INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

Ayrshire and Arran NHS Board

Annual audit report to Ayrshire and Arran NHS Board
and the Auditor General for Scotland

Year ended 31 March 2010

25 June 2010

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

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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 Ayrshire and Arran NHS Board 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

Competing pressures to meet performance and financial targets underpin the Board's performance in 2009-10. Significant fluctuations in waiting times activity cumulated in a public decision, in late 2009, that achievement of waiting times would take precedence over the agreed £7 million cumulative position. Additional funding, from a combination of internal and external sources, and a total spend of £8.9 million on waiting list initiatives, prevented the need to implement this decision, but the opposing challenges continue to present risks in 2010-11. Conversely, other significant pressures and new HEAT targets do not appear to be weighted equally; such as child and adolescent mental health services (new HEAT target in 2010-11), in respect of which only £0.25 million additional funding has been allocated in 2010-11.

Service redesign plans are based on 'stakes in the ground' agreed in 2008-09 and management continues to review funding available to deliver service redesign priorities. There is increased evidence of board level commitment to improvement, but the awareness and need to change should be defined with greater clarity, rather than the more general aim of improvement and increased effectiveness. One of the most important components of a change programme is the ability to measure and demonstrate benefits. While work is ongoing to develop a benefits realisation framework, this is later than would have been expected given the nature and level of change required.

The 2009-10 outturn of a £7 million cumulative surplus is not materially different from the financial plan or routine re-forecasting during the year, despite individual fluctuations of up to £3.5 million during the year. Financial plans for 2010-11 anticipate a further reduction in the cumulative surplus to £5 million and subsequently to £3 million from 2011-12 onwards. Key risks to achieving the 2010-11 financial plan include, first and foremost, the availability of sufficient waiting times funding to meet targets, but also achievement of efficiency savings and management of existing and emerging cost pressures.

The need for robust financial management arrangements, including those around efficiency savings, increases significantly in the current and anticipated economic climate. Management reported £22 million of efficiency savings in 2009-10. While a number of high value savings are accepted by the Scottish Government as 'efficiency' savings, such as reducing bank and agency spend and lower employer pension contributions, they do not arise from more efficient use of existing resources or increased efficiency in service provision. In 2008-09 management set an internal efficiency savings target of 4% for 2010-11, which exceeded the extant Scottish Government target of 2%. Following a higher than anticipated Scottish Government funding allocation (2.15%) for 2010-11, regardless of a need for continued investment in service redesign, improved performance against HEAT and other targets, and increasing efficiency, the savings target set for 2010-11 has reduced to 2%.

The Board met its capital resource limit in 2009-10, but the 2010-11 limit decreases by £13.6 million to £22.5 million. Capital plans are an important component of service redesign proposals and, in the period to 2014, are dependent on £10 million proceeds from the sale of existing assets, in a difficult property market, together with £10 million of unspent capital allocations in previous years. There is a significant risk that this funding may not be returned to the Board in future years as planned.

Service sustainability and financial management continue to present significant risks and plans to mitigate these risks are unlikely to be fully developed and implemented within a short timeframe. Strategic challenge is largely contained within board sub-committee meetings and, in our view, there is a risk that the board meetings could be perceived as fora for disseminating decisions and information rather than constructive and transparent challenge. Implementation of ambitious service redesign and efficiency plans will require increased scrutiny and challenge in a transparent and open manner.

Scope

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("The *Code*"). This specifies a number of objectives for our audit.

Audit framework

This year was the fourth of our five-year appointment by the Auditor General for Scotland as external auditors of Ayrshire and Arran NHS Board ("the Board"). This report to the Board and Auditor General provides our opinion and conclusions and highlights significant issues arising from our work. We outlined the framework under which we operate, under appointment by Audit Scotland, in the audit plan overview discussed with the audit committee earlier in the year.

The purpose of this report is to report our findings as they relate to:

- the **financial statements** and our audit opinions on net operating costs and the regularity of transactions;
- **use of resources**, including financial outturn for the year ended 31 March 2010 and financial plans for 2010-11 and beyond;
- arrangements around **governance and accountability**, including risk management, patient safety, partnership working and our consideration of the work of internal audit; and
- **performance management** and the Board's arrangements to achieve efficiency savings.

Best Value

Audit Scotland and the Scottish Government have 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 Government's nine best value principles as the basis for audit activity, Audit Scotland selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). In 2009-10 we completed work on arrangements to achieve Best Value through performance management and challenge and improvement.

International financial reporting standards

The 2007 Budget had announced that central government and health bodies would report under international financial reporting standards ("IFRS"), as adapted by HM Treasury through the financial reporting manual ("FReM"). The financial statements for the year ended 31 March 2010, including comparative figures for 2008-09, were prepared on the basis of the FReM.

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 the 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 the accountable officer, to make arrangements to secure Best Value.

Action plan

This report includes an action plan containing areas for development or improvement identified during our financial statements audit fieldwork. We have not repeated recommendations raised in reports issued during our earlier work in respect of our 2009-10 audit. Responsibility for taking action and monitoring progress in response to all our recommendations lies with management.

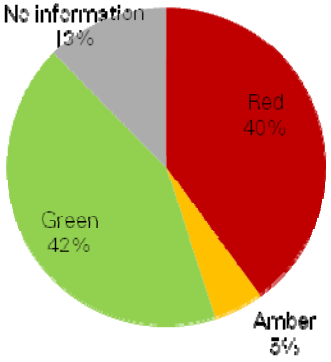
Acknowledgement

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

Service overview

The Board faced a number of key challenges in 2009-10, which have resulted in competing pressures to meet performance and financial targets. The primary challenge was achieving waiting times targets, despite cost pressures and funding shortfalls, and this will continue to result in financial pressure in 2010-11 and future years. The board and its governance committees publicly decided, in late 2009, that meeting the waiting times performance targets through delivery of the required service levels would take precedence over achievement of the agreed financial position. A combination of Scottish Government waiting times funding and internal funding allocations from the Board's routine budgets resulted in £9 million being spent on waiting times initiatives during 2009-10. However, significant pressures exist outside HEAT targets, such as child and adolescent mental health services ("CAMHS"). While management recognises clinical risks associated with breaching the new 26 week 'access to treatment' target, only £0.25 million additional funding has been allocated to CAMHS in 2010-11.

In 2009-10, in light of the competing pressures and the requirement for a robust performance management framework, management self-assessed arrangements to achieve Best Value in this area. Our validation of management's assessment and the underlying evidence concluded that the Board demonstrates 'better practice' in all areas assessed and ongoing developments are likely to demonstrate 'advanced practice' in some areas, such as finalisation of the sustainable futures plan to review organisational objectives. While the adequacy of performance management arrangements is separate from the achievement of performance targets themselves, the Board's position at 31 March 2010 has deteriorated since the previous year. The chart below summarises the position against HEAT targets.



The 2009-10 HEAT performance has been reported by the Board as follows:

- 17 'green' - ahead of trajectory
- Two 'amber' - within 5% of trajectory
- 16 'red' - outwith the acceptable control limit (5% from plan)
- Five where no information is recorded

This represents a relative reduction in performance compared with 2008-09, as 42.5% of targets are recorded 'green' this year compared with 51% in the prior year.

A new 'real-time' performance management framework was developed and approved in 2009-10; which has been agreed with partner organisations. National benchmarking is undertaken against HEAT targets following the introduction of *Scotland Performs* in January 2010.

The impact of this information in identifying and realising efficiencies has yet to be seen given its relatively recent introduction. The Board does not routinely meet targets year on year, but does not believe that this is indicative of poor performance management. When targets are identified as poorly performing, remedial actions are put in place in advance of reporting against indicators in an attempt to monitor and improve the ratio. Management continues to actively monitor sickness absence levels (although this is no longer a HEAT target); reporting an improvement in absence rates from 5.5% in 2008-09 to 4.9% in 2009-10. Efforts to meet the 4% target are ongoing and achievement of this target is becoming increasingly important with the need to continually increase efficiencies in response to budgetary constraints and other pressures on staff costs arising from European Working Time Regulations and the cost of bank nursing and locum medical staff. Compliance with the former increased medical staff costs by £0.7 million for the post implementation period since August 2009, funded by deferring investment in other areas, particularly non-essential mental health developments.

Service overview

The challenge and improvement Best Value toolkit was also completed by management. While we did not disagree with management's assessment that, in all areas, arrangements demonstrate 'better', or above, practice, there are a number of significant risks to achievement of the change agenda. The commitment at board level has become more visibly evident and this is now driving the change agenda forward, but the awareness and need to change should be defined with greater clarity, rather than the more general aim of improvement and increased effectiveness. It would appear, from discussions during our validation work, that the extent to which this culture is embedded at senior and middle management is unclear. There is a risk that inconsistent leadership or engagement at senior manager level results in insufficient empowerment of front line delivery staff to identify and implement improvements and service changes. There are a number of new and ongoing initiatives across all functions of the Board, focussing predominately on clinical services. At an organisation-wide level, the sustainable futures plan aims to bring these initiatives together and ensure that they complement each other and that each one contributes to a sustainable future. It is too early to determine the extent to which challenge has delivered improvement and, while work is ongoing to develop a benefits realisation framework, this is later than would have been expected given the nature and level of change required.

There is a clearly defined framework for scrutiny and governance across the Board. The Board has a new risk management strategy and has reviewed the risk register during the year. This was subject to review by NHS Quality Improvement Scotland in January 2010, but the results have not been finalised at the time of our report. Our review of the risk register identified that a high level snap shot is presented to governance committees. This high level overview does not include an assessment of the likelihood or impact of risk, although this is considered elsewhere.

The Board remains committed to improving local partnership working through existing community health partnerships ("CHPs") and the involvement of local council representatives at board level. Each CHP strives to improve service delivery in the local area by removing duplicated efforts to improve the overall quality of service delivery. The Board is also entering a data sharing arrangement with local authority, criminal justice, social care committees and police partners to further streamline services by eliminating duplication and improve performance monitoring. To facilitate effective partnership working, performance data sharing is underway with North Ayrshire Council, where each party can enter data directly into the other party's systems. South Ayrshire Council is making plans to procure the same performance management system as the Board. East Ayrshire Council operates on a different performance management system, but management is trying to identify ways in which information is comparable and can be shared. The single outcome agreement is used to measure performance, i.e. measurement against the original agreement and the achieve outcomes.

The Board has a clear vision for the future, which was subject to consultation with key stakeholders. The Board has a track record of consultation on major service redesign projects, including the *Review of Services* and *Mind Your Health*, but has 'learned lessons' and enhanced arrangements with the aim of presenting options for consideration rather than seeking buy-in to the board's preferred option.

Service redesign plans are based on 'stakes in the ground' agreed in 2008-09 and management continues to review capital and revenue funding and the ability to deliver service redesign priorities. The Board is considering ways in which it can make efficiencies by redesigning the provision of services using efficiency saving targets and the 'LEAN' methodology, which is being introduced across eight clinical areas; starting in orthopaedics. The ability to implement service redesign plans depends on securing funding, but none of the Board's capital projects are on the Scottish Government's priority list. The Board continues to modernise facilities and the new Girvan Community Hospital, costing £19 million, became operational in May 2010. Other major capital projects to improve the delivery of local services include £5.4 million spent on kitchen and outpatient facilities at Ayrshire Central Hospital.

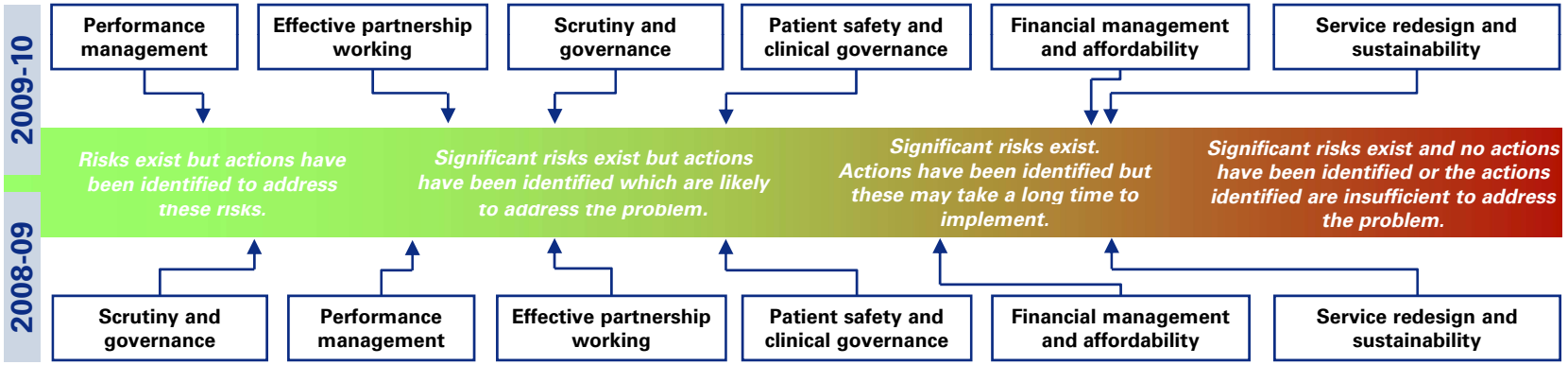
Service overview (continued)

Financial management procedures remain largely unchanged from previous years. This continues to present key challenges in achievement of the change and efficiency agenda, particularly when combined with the competing pressures presented by performance targets. Achievement of future financial plans and service redesign proposals are contingent on the achievement of significant savings.

Arrangements to ensure patient safety and clinical governance remain a key priority. In preparation for the Healthcare Environment Inspectorate ("HEI") inspection in February 2010, mock inspections increased the level of awareness surrounding clinical standards. A new post was created to oversee the streamlining of various sets of clinical guidance used across activities and different sites. HEI issued a report, following their inspection at Ayr Hospital, which sets out a number of requirements and recommendations in light of their findings. An action plan has been developed to address these findings. The clinical governance committee has enhanced arrangements to hold clinicians responsible for performance and clinical incidents.

Key challenges which may impact the Board's capacity to deliver include workforce planning, potential infection outbreaks, asset management and information management. Levels of sickness absence and compliance with the provisions of European Working Time Regulations are closely monitored as both can have a significant impact on staff resource availability and cost management

The Board's arrangements to achieve national priorities and mitigate against key risks in 2008-09 and 2009-10 are characterised by us as follows:



Service sustainability and financial management continue to present significant risks and plans to mitigate these risks are unlikely to be fully developed and implemented within a short timeframe. Implementation of ambitious service redesign and efficiency plans will require increased scrutiny and challenge in a transparent and open manner.

Financial statements

We have issued unqualified opinions on the financial statements and the regularity of transactions reflected in those financial statements.

While there were delays in the preparation of the financial statements and supporting evidence for fixed assets disclosures, the audit work was completed on schedule. The level of the *Agenda for Change* accrual has reduced significantly during 2009-10 through a combination of progressing appeals and a re-assessment of assumptions used to calculate potential liabilities. There is no substantial change in the situation regarding equal pay claims, which remain a risk in 2010-11.

Reporting arrangements and timetable

The draft financial statements were available for audit on 19 May, but outstanding capital notes were not provided until 25 May 2010. This is later than in previous years and one week beyond the agreed date. The initial information and documentation to support key management judgements over capital accounting was insufficient. However, the audit was completed in a timely manner and the board considered and approved the financial statements at the board meeting as planned. Our report to those charged with governance highlights some concerns in respect of the time taken to prepare the financial statements, reliance on key individuals, and risks arising from the need for increased challenge and understanding of financial reports and performance, rather than a focus on preparing and reporting numbers and movements.

Audit opinion

Following board approval we issued an audit report expressing unqualified opinions on the financial statements for the year ended 31 March 2010 and on the regularity of transactions reflected in those financial statements.

Key issues arising during our audit of the financial statements

Our audit plan overview and interim management report narrated potential key risk area and we identified additional risk areas during our audit of the financial statements.

The Scottish Government announced on 25 April 2008 that all Scottish Government departments, executive agencies, non-departmental public bodies and health boards would report under IFRS, as interpreted by the financial reporting manual issued by HM Treasury, from 2009-10, necessitating the restatement of comparative information under new accounting policies. As part of the process of transition to IFRS, the Board prepared 'shadow financial statements' which we reviewed and reported on in Autumn 2009. Our review identified a number of issues which required further consideration by management. Each of these has subsequently been actioned.

The transition to reporting under IFRS has resulted in the following key changes in the financial statements:

- the Ayrshire maternity unit PFI arrangement has now been recognised 'on balance sheet' with both an asset value and related liability appropriately reflected;
- an accrual has been made for untaken holiday pay at the balance sheet dates; and
- accounting policies have been updated in line with the FReM.

There have also been significant changes to the overall presentation of the financial statements.

Financial statements (continued)

We have concluded our work in respect of other key issues and summarise the results below.

Agenda for Change

The financial statements include a provision of £1.4 million (2009: £6.6 million) to reflect the remaining estimated cost of assimilation and subsequent reviews (appeals) and any potential claims from former staff. The Board had assimilated the majority of staff by 31 March 2010, increasing the accuracy of the population for potential reviews. £0.5 million (2009: £4 million) of the total accrual reflects management's assessment of the cost of successful reviews.

At 31 March 2010, only 60 posts were subject to review; significantly reducing the level of uncertainty attached to the accrual. As the review process progressed during the year a total of £3.5 million was released 'unutilised' from the accrual, albeit in three tranches. These amounts had been accrued in the prior year when the potential liability was based on the assumption that 35% of appeals would be successful. During the year it became evident that the actual level of appeal success was much lower (reaching 14% by the year end) and it was clear that the full balance of the accrual would not be required to cover the actual liabilities.

Capital accounting

An independent valuation of land and property was performed at 31 March 2010, which required a large number of adjustments to reflect various upward and downward movements in capital values. All movements had been cumulatively reflected in the revaluation reserve and there had been little advance consideration, by management, of individual movements on an asset by asset basis. In particular, consideration should have been given to assets that had increased in value during the year following decreases in previous years. The net effect of the revaluation was a downward adjustment in value of £25 million, of which approximately £2.7 million related to the Ayrshire maternity unit which had been brought onto the balance sheet under IFRS. The independent valuer has confirmed that the downward valuations are specific to changes in the market conditions in 2009-10.

Given the level of fluctuation in property values seen in recent times, it is important that timely consideration is given to the impact of upward and downward valuations in terms of the specific assets in order to determine the correct accounting treatment. Capital reconciliations and input of the results of the valuation exercise were not finalised until late May 2010. Similar to 2008-09, this resulted in late changes to the operating cost statement to ensure the correct treatment of increases in valuation of some buildings. While the net impact of £0.3 million of these changes was offset by Scottish Government funding allocations this may not always be the case in future years.

Whilst some delay had been caused by the IFRS transition, this could have been mitigated by a review of the position much closer to the year end, which would have identified the problem and allowed time for resolution prior to completion of the financial statements and commencement of the audit fieldwork. The transition to IFRS required a change in the capital accounting software and the implications of this were not considered until shortly before the audit fieldwork when it became apparent that the software based register did not reconcile with the financial ledger. This was compounded by the fact that one individual was largely responsible for the processing of the required adjustments and a lack of timely communication with the central finance team.

Recommendation one

Financial statements (continued)

Equal pay

The National Health Service in Scotland has received in excess of 11,000 claims for equal pay and the Board has received 1,920 claims. These have been referred for the attention of the NHSScotland Central Legal Office ("CLO") to co-ordinate the legal response to this issue

Developments over the past year have slowed the progress of claims and led to a reduction in the number of claims going forward. The CLO has stated that claims still do not provide sufficient detail about the comparator jobs to allow an estimate to be made of the likelihood of the success of the claims or of any financial impact that they may have. The CLO and Equal Pay Unit are monitoring the progress of claims as well as developments relating to NHS equal pay claims elsewhere that may further inform the position.

Discussions have been held between Audit Scotland, their partner firms, the Scottish Government, the CLO and board representatives to ascertain the appropriate accounting treatment of equal pay claims in 2009-10. Given the CLO's advice, it is not possible to estimate the impact of the claims and it has been agreed that disclosure as an unquantified contingent liability remains appropriate for the 2009-10 financial statements.

We continue to strongly encourage management, working with the Scottish Government Health Directorate, the CLO and other NHS boards to progress resolution of equal pay so that there is clarity over the Board's financial position.

Recommendation two

Regularity

Regularity of transactions

Management has processes to receive Scottish Government Health Directorate circulars, register, allocate and distribute responsibility for action points and monitor and follow up these action points.

Family health services

NHS National Services Scotland ("NHS NSS") processes family health services ("FHS") income and payments on the Board's behalf. Transactions are completed on the basis of self-certification by FHS contractors. Payment verification processes continue to be reviewed on a quarterly basis and management provided a summary of activity to the audit committee at the end of the year. The Board complied with the requirements of the qualities and outcomes framework.

Patient exemption checking

The patient fraud protocol requires NHS Counter Fraud Services to provide an annual estimated level of fraud and error to each NHS board for the 12 months to December. Total estimated fraud represents income lost through patients fraudulently or mistakenly claiming exemptions against dental, pharmaceutical and ophthalmic treatment charges. Total estimated fraud within Ayrshire and Arran in 2009 was £1.4 million (*2009: £1.2 million*). The estimated level of fraud is based on the extrapolation of findings from a small sample and does not necessarily represent the actual level of lost income. We concur with management's view that the potential fraud / error is not significant and has not been reflected in the financial statements.

Service organisations

NHS NSS operates a number of systems and initiatives on behalf of NHS organisations in Scotland. Service auditors are appointed to provide assurance over control objectives agreed between NHS NSS and NHS boards in relation to the operation of these national systems. Service audits were conducted in accordance with Statement on Auditing Standard 70 ("SAS 70"), issued by the American Institute of Certified Public Accountants, in order to provide positive assurance over controls and to identify areas of control weakness.

Audit Scotland, as external auditor of NHS NSS, reviews the work of service auditors on behalf of auditors of other NHS bodies. This has enabled us to place reliance upon the work of service auditors of the practitioner services division of NHS NSS, the national logistics programme, national information and management technology system.

The Board entered into agreement for the provision of managed technical services and application support services, which took effect from 1 April 2008. The Board was subject to a SAS 70 service auditor report prepared by the auditors for the purposes of the other boards to which services are provided under the financial ledger shared service arrangement. This report did not raise any significant concerns.

Use of resources

The 2009-10 outturn is not materially different from the financial plan or routine re-forecasting during the year, but there have been a number of individually significant movements. The plan required utilisation of £3 million carried forward from 2008-09 which had been earmarked for specific areas of spend in 2009-10. A number of adjustments were made as a result of the audit process, which were not significant, but management chose to reflect these in the financial statements due to the proximity of the outturn compared to the forecast financial position agreed with the Scottish Government Health Directorate.

The financial plan for 2010-11 anticipates reducing the cumulative surplus to £5 million through planned use of earmarked funding carried forward from 2009-10. Key risks to achieving the 2010-11 financial plan include, first and foremost, the availability of sufficient waiting times funding required to meet targets, but also achievement of efficiency savings, managing the cost implications of complying with European Working Time Regulations, together with staff, pharmacy and supply cost pressures.

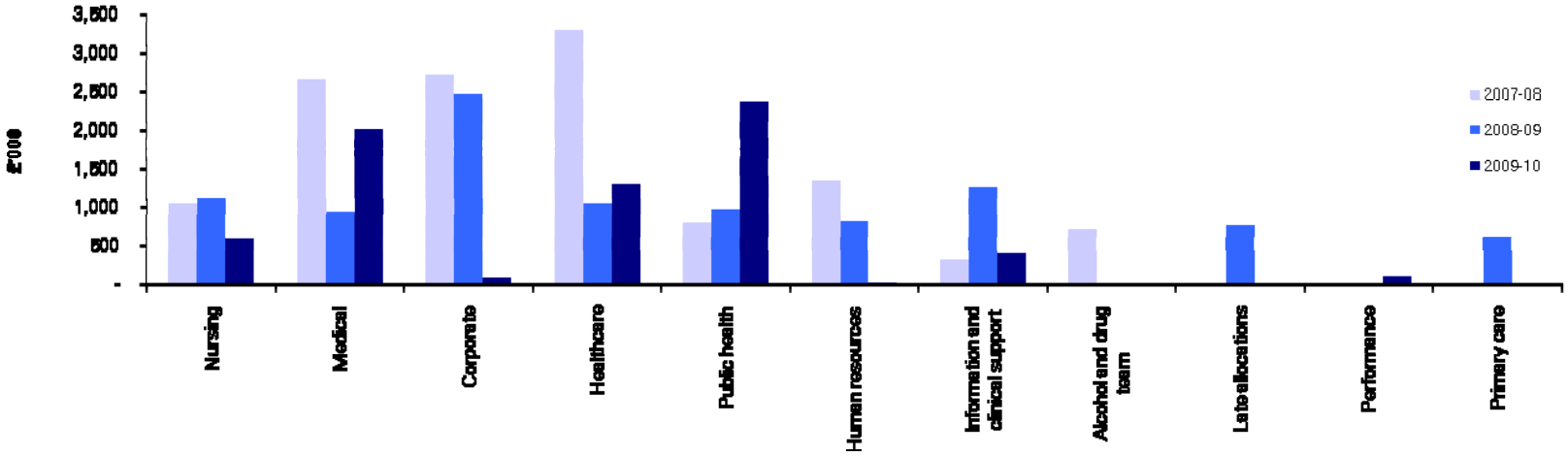
The need for robust financial management arrangements, including those around efficiency savings, increases significantly in the current and anticipated economic climate. It is important the report commissioned, by management, from CIPFA on financial management arrangements is used as a basis on which to ensure that arrangements continue to develop.

Financial position

The table summarises the outturn against the three financial targets set by the Scottish Government Health Directorate for 2009-10:

£'000	Allocation	Outturn	Variance
Revenue resource limit	635,043	627,948	**7,095**
Capital resource limit	36,148	36,147	**1**
Cash requirement	692,000	691,065	**935**

The final outturn for the year is consistent with the 2009-10 financial plan and the majority of financial reports to the board and Scottish Government Health Directorate during the year. The Board continues to carry forward significant levels of funding into the next financial year, although this is in line with financial plans. Similar to previous years, the majority of funding carried forward is for specific purposes. The graph below summarises the areas of carry forward into 2010-11.



Financial management

The table below summarises key movements during the year, after the year end, and during the preparation of the financial statements.

Movement	£'000	Movement	£'000
Surplus brought forward from 2008-09	**10,012**	**Forecast outturn at 31 August 2009**	**3,000**
Utilisation of non-recurring brought forward surplus:		Release of Agenda for Change accrual (November 2009)	3,500
- staff and human resources projects	(784)	Additional SGHD waiting times funding (January 2010)	1,050
- facilities improvement projects	(916)	Additional waiting times spend (March 2010)	(475)
- service improvement projects	(1,312)	**Forecast outturn - 31 March 2010 SGHD return**	**7,075**
Forecast outturn (maintained to 31 July 2009)	**7,000**	Financial statement adjustments (mainly capital related)	265
Shortfall in SGHD waiting times funding	(2,000)	**Draft financial statements at 25 May 2010**	**7,340**
Increased spend to achieve orthopaedics waiting times	(1,700)	Late accrual	(245)
Pandemic flu costs	(300)	Capital and FHS adjustments (matched by funding changes)	-
Forecast outturn at 31 August 2009	**3,000**	**Final financial statements**	**7,095**

During the year there have been a number of significant fluctuations in the projected outturn caused primarily by the impact of funding and expenditure in respect of achieving waiting times targets. Achievement of these targets, particularly in orthopaedics, presented significant challenges in the year and cost £8.9 million, incurring £2.3 million spent in the private sector, an increase of £0.4 million on the prior year. Additional funding secured and the release £3.5 million of the *Agenda for Change* accrual mitigated the impact on the final outturn, but this was not clear until the fourth quarter of the financial year.

Waiting times funding allocations received in August 2009 were £2 million lower than anticipated; expectations were based on amounts received in 2008-09. This shortfall, together with increased spend to meet the required reduction in orthopaedic waiting times, led to a revision in the projected surplus to £3 million in August 2009. In the second half of the year, two additional allocations totalled £1.1 million, which partially offset the funding gap. Following a revision of the assumptions underlying the *Agenda for Change* accrual, particularly those relating to the quantity and success of appeals, £3.5 million was released from the accrual. This was used to fund non-recurring expenditure relating to cost pressures and funding shortfalls on waiting times.

Both the £1.1 million funding received and £3.5 million accrual release were non-recurring transactions and management has reported that these additional amounts were used to fund non-recurring elements of waiting times pressures. In 2010-11 £6.6 million of recurring waiting times funding has been allocated, but further non-recurring funding may be required in order to achieve HEAT targets. Achievement of waiting times targets in future years is a recurring pressure, particularly in time of potentially reduced funding allocations, and timely consideration should be given to other sources of funding, internal or external, that could be made available to mitigate the risk of non-achievement of the agreed financial outturn or performance targets.

Financial management (continued)

Efficiency savings

The Board reported achievement of recurring efficiency savings of £22.2 million in 2009-10, of which £10.9 million were identified and realised in 2008-09. Significant savings reported in the year include a £2 million reduction in pension contributions and a £1 million reduction in the cost of agency and bank staff. The latter reflects decreasing sickness absence levels, which are expected to be maintained or improved in the future through ongoing cultural change and increased awareness. Whilst these recurring cost savings, which are accepted by the Scottish Government Health Directorate as 'efficiency' savings, they do not arise from more efficient use of existing resources or increased efficiency in service provision.

In addition to continuing to deliver £22 million of savings realised prior to 31 March 2010, the savings target was 2010-11 is set at £11.6 million. Management has informed us that, as at 4 June 2010:

- detailed savings schemes exist to deliver £10 million of the annual target;
- £0.7 million has been allocated to specific spend areas, where provisional schemes have been identified; and
- £0.9 million of recurring savings will be achieved through managing vacancies as they arise.

Internal audit made two 'high' risk recommendations relating to the proportion of 2010-11 efficiency savings not earmarked by April 2010 and a lack of visibility of efficiency targets in the budgetary review process. We have not audited reported efficiency savings in 2009-10 or plans for 2010-11.

The requirement to achieve efficiency savings has a number of sources, including reduced financial allocations from the Scottish Government Health Directorate, implementation of service redesign proposals, Scottish Government efficiency savings targets, and the potential impact of the UK Government budget. In 2008-09 we reported[1] that management had decided that the Board, in order to maintain financial balance, was required to release both cash and time savings through increased efficiency and, from 2010-11 onwards, secure an internal target of 4%, which exceeded the extant Scottish Government target of 2%. At that time, we reported[2] that the Board's processes and overall framework for identifying, monitoring and reporting efficiency savings would be insufficient to secure a 4% recurring savings targets. Following a higher than anticipated Scottish Government funding allocation (2.15%) for 2010-11, regardless of a need for continued investment in service redesign, improved performance against HEAT and other targets, and increasing efficiency, the savings target set for 2010-11 has reduced to 2%.

We highlighted in our interim management report that management had commissioned CIPFA to review financial management arrangements using their established financial management model. Management agreed the content of CIPFA's report and is preparing management responses to the action plan. The recommendations require enhancement of arrangements across the Board, outside the finance department, and it is important that this report is considered, at an appropriate level within the Board, in a timely manner and that action plans seek to introduce robust and enduring solutions, rather than short-term and high level actions.

1 *Annual audit report 2008-09 (30 June 2009)*

2 *Best Value: use of resources – efficiency savings (14 September 2009)*

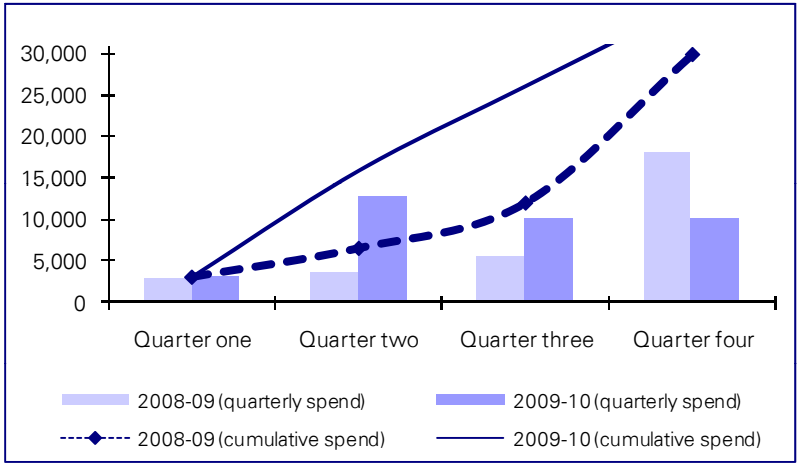
Financial management (continued)

Capital expenditure

The capital outturn for the year is £36.14 million which is within £1,000 of the allocation for the year. Similar to previous years, around £4 million of expenditure on capital projects was assessed, by an independent valuer, as not adding value to existing buildings and was therefore charged to revenue expenditure. The largest single element of 'non-value adding expenditure' was in respect of the new Girvan hospital. Of the total spend of £19 million, the independent valuer reported that the depreciated replacement cost of the building was £17.7 million; requiring £1.3 million of the capital spend to be charged against the revenue resource limit rather than the capital resource limit.

The outturn against the capital resource limit was in line with the original plan and the spend profile in the current year demonstrates improvement in spending patterns throughout the year.

We previously reported that a disproportionately high level of capital expenditure (60%) was incurred during the last quarter of the 2008-09 financial year. In 2009-10 the assistant director of finance (planning and efficiency) requested monthly spend profiles from all managers responsible for capital projects. This aimed to allow timely monitoring and reporting of spend against specific targets and to enable management to take corrective action earlier in the financial year. In 2009-10, 44% of spend was incurred in the first half of the year (2008-09: 22%) and 72% (2008-09: 40%)by the end of the third quarter.



The transition to IFRS during the year has had the effect of bringing a number of assets on to the balance sheet, most notably the Ayrshire Maternity Unit at a year end value, following impairment of £2.7 million during the year, of £17 million. The impact of this change in accounting treatment was an increase of £0.4 million in the charge to the operating cost statement. This was matched by additional funding from the Scottish Government Health Directorate, there are may be risks with all elements of additional funding in the current and future economic climate.

The Board has reviewed surplus vacant property assets with a view to potential disposals and has classified land and buildings worth £1.2 million as held for sale at 31 March 2010, which means, in accounting terms, that management fully expects to sell these assets within a 12 month period. There are a number of other properties which are also surplus to requirements and no longer used operationally, but, due to market conditions it is inappropriate to classify these as held for sale. The disposal programme anticipates capital receipts of £10 million over the period to 2013-14.

Financial management (continued)

2010-11 capital plan

The 2010-11 capital resource limit is £22.5 million, which represents a decrease of £13.6 million (38%) compared to 2009-10. The two individually largest projects in 2010-11 are a new theatre sterile supplies unit (£4.5 million) and development of North Ayrshire Community Hospital (£2.7 million).

Total planned capital spend of £23.3 million depends on timely receipt of £1.2 million of expected sale proceeds. This represents a relatively small portion of the overall capital plan and management will identify lower priority areas of expenditure which could be deferred if a funding gap arises due to a lack of property sales or proceeds being lower than anticipated. Nevertheless, capital plans in the period to 2014 are dependent on £10 million proceeds from the sale of existing assets together with £10 million of unspent capital allocations in previous years. The latter is being held by the Scottish Government Health Directorate and, at the time the underspends were reported, with a commitment to increase capital allocations in future years to match service redesign plans. However, the current political and economic environment, together with ambitious capital plans across the public sector in Scotland, significantly increases the risk that this funding may not be returned to the Board in future years as planned.

Financial planning

The 2010-11 local delivery plan was drafted in February 2010 and approved by the Scottish Government Health Directorate in March 2010. The plan reflects a planned reduction in cumulative surplus to £5 million in 2010-11, which requires a reduction in earmarked funding that can be carried forward into 2011-12. The current financial plan also covers 2012-13, during which the cumulative surplus is expected to be maintained at £3 million.

Management has identified a number of key cost pressures in 2010-11, including workforce, prescribing, and supplies. Full compliance with European Working Time Regulations is forecast to cost £1 million in 2010-11 (2009-10 part year costs: £0.7 million) and requires changes to working patterns and staffing levels. Requirements to give patients greater rights of access to certain proprietary drugs will bring further cost pressures, although savings through the pharmaceutical price regulation scheme will offset these to some extent. Whilst net pharmaceutical costs have increased during 2009-10, primarily due to the volume and price increases on proprietary medicines, the impact would have been greater without these savings. The Board already uses a high proportion of generic drugs which limits savings potential as there will always be an element of proprietary products required. The additional costs of prescribing in 2010-11 are estimated at £6.9 million.

The Scottish Government Health Directorate funding allocation increased by 2.15% compared to 2009-10. In addition to an £11 million efficiency savings plans, management has also set a £0.7 million income generation target. The latter is likely to represent securing inflationary and activity increases under local and national service level agreements – these have not yet been agreed and, in our view, will present a significant challenge given the similar financial pressures facing the organisations with whom the Board negotiates service level agreements.

Financial management (continued)

Key risks

Achievement of the 2010-11 financial plan will be challenging due to the need to reduce the cumulative surplus, combined with achievement of performance targets , including waiting times, and delivery of an increasingly ambitious savings programme. The table below summarises the key risks identified by management, which are included in the corporate risk register. The number of unquantified risks increases the inherent risk of non-achievement of financial plans, albeit that some of the risks are outwith management's control.

Key risks identified
• **Reduction in cumulative surplus** by £2 million. • **Budget reduction** – the unknown impact of the forthcoming UK Government budget on NHSScotland. • Reduction of junior doctor hours – management reported full compliance with **European Working Time Regulations** in 2009-10, but work solutions have yet to be agreed to ensure continued compliance, with which additional costs of £0.3 million are associated. • Achievement of the 2010-11 **capital plan** depends, to some extent, on timely disposal of properties held for sale (£1.2 million) in difficult market conditions. • Maintaining **performance against waiting times targets** will be challenging due to continued constraints on the availability of recurring and non-recurring funding. • Expansion of facilities as part of the **modernisation programme** could lead to increased running costs in certain cases which need to be justified by utilisation levels in new facilities. • Reducing **non recurring funding** is an unquantifiable risk. • **Equal pay** – the potential impact of claims is not included as management assumes that the Scottish Government would fund these costs.

Corporate governance arrangements

We considered the corporate governance arrangements and conclude that the framework is designed and implemented appropriately for the organisational structure, although the degree to which decisions are made in a transparent manner and challenged at board level could be enhanced.

Key financial controls are generally designed and implemented adequately and operating effectively, with some exceptions. Progress in implementing recommendations made in current and previous years continues to be slower than expected.

The statement on internal control provides details of the purpose of the framework of internal control, along with an analysis of its effectiveness. This statement is in compliance with guidance issued by the Scottish Government Health Directorate.

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 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; and
- standards of conduct and arrangements for the prevention and detection of corruption.

Governance framework

The integrated governance framework includes four governance sub-committees of the board: audit, staff governance, health and performance, and clinical. There is also a finance committee chaired by the board chairman. The terms of reference for each committee detail decision-making powers and delegated responsibility. The integrated structure is based on regular and open communication, which is enhanced by quarterly meetings of the committee chairs.

Non-executive remuneration is set by the Scottish Government on an annual basis. Remuneration is based on the expectation that a non-executive role requires, on average, eight hours per week. Five non-executive directors are remunerated in excess of the standard remuneration band, with Scottish Government permission, due to commitments in excess of eight hours per week. In some cases, the time commitments of individuals can be up to three days per week. The total additional cost in 2009-10 was £36,041.

Strategic challenge is largely contained within board sub-committee meetings. These committees have an important role to play in considering more of the detail in respect of their individual areas and advising on strategic decisions, but board papers, minutes and discussions should reflect the board's status as the strategic decision-making body. There is a risk that the board meetings could be perceived as a forum for disseminating decisions and information rather than constructive and transparent challenge. There is also a risk that committees consider the outputs of management consideration without full knowledge of the process followed to arrive at these outputs. This is particularly evident given the emphasis on challenge at committee level, which inevitably means that only a small number of non-executive directors (and sometimes executive directors) are fully appraised on individual methodologies and approaches.

Corporate governance arrangements (internal audit)

Internal audit

Internal audit have submitted all but one of their planned reports for the year. We have relied on a number of reports, including those in respect of health records, value for money (catering), property transaction monitoring, health and safety, and efficiency savings and budgetary control. These reports do not make any 'critical' recommendations, but the catering review highlighted some 'high' risk control weaknesses over value for money and made recommendations to address these. Four 'high' grade risks were identified in the health records review and management has action plans to address these.

Internal audit's 2009-10 annual report provides "*moderate assurance on the adequacy and effectiveness of the system of internal control ... we have identified mostly low and medium rated risks ... but there have been some isolated high risks recommendations and/or the number of medium rated risks is significant in aggregate*".

Internal audit highlight 'high' risks reported in the following areas in 2009-10:

- efficiency savings and budgetary control;
- attention-deficit hyperactivity disorder and autistic spectrum disorder services;
- NHS Ayrshire Doctors on Call; and
- Fullarton community health house.

Internal controls

Since our appointment as the Board's external auditors in 2006 we have reported opportunities for improvement in the operation of some key financial controls and some of these have been reported in more than one year. Management accepts most of our recommendations to enhance controls, but instances where controls do not operate on a consistent basis continue to arise.

Our testing, combined with that of internal audit, of the design and operation of controls over significant risk points confirms that controls are designed appropriately and operating effectively. However, we note that weaknesses exist over the purchase to pay process, including authorised signatory limits and compliance with purchase order procedures.

The statement on internal control provides details of the purpose of the system of internal control, the risk and control framework and the effectiveness of this framework. The statement complies with the Scottish Government Health Directorate's guidance.

Prevention and detection of fraud and irregularity; Audit Scotland national reports

The review of fraud arrangements performed by internal audit during 2008-09 found procedures and controls in relation to fraud arrangements to be "*generally designed appropriately and operate effectively in practice*". The Board has undertaken activities to raise awareness of fraud during the year, including a series of presentations made to staff and a poster campaign within hospitals to raise awareness of the fraud liaison officer and NHS Counter Fraud Services. At present fraud training has been directed mainly at finance staff. We noted that fraud training is being included in the inductions carried out for new members of staff, but no further roll out of training is planned for existing operational staff at the present time.

Recommendation three

National Fraud Initiative ("NFI")

In 2009 the Board participated in the NFI for the second time. We tested a sample of resolved matches and concluded that satisfactory evidence was available to support these matches being reported as resolved on the NFI system. A summary of the Board's activity is shown below.

	Total matches	Number investigated	Volume of fraud identified	Value of fraud identified
2007	1,009	6	-	-
2009	1,306	54[1]	-	-

1. *A number of these matches remain under investigation at the date of this report*

Audit Scotland national reports

Audit Scotland national reports

Audit Scotland periodically undertakes national studies on topics relevant to the performance of NHS Scotland. While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at board level, as appropriate.

Management has established procedures to consider individual reports; reports are considered by the audit committee who assign responsibility and reports are forwarded to the appropriate person or committee.

In 2009-10 we have reported action taken by management in response to a number of reports and those not previously reported on are summarised below. We will report the Board's response to all these reports in July 2010.

Report topic (issue date)	Discussed by a committee	Noted by a committee	Self-assessment performed	Local action plan prepared	Plans to feed back to a committee	Frequency of feedback
Scotland's public finances (November 2009)	✓	n/a	×	×[1]	×	n/a
Overview of NHS in Scotland performance 08/09 (December 2009)	✓	n/a	✓	×	×	n/a
Improving public sector efficiency (February 2010)	✓	n/a	n/a	n/a	×	n/a
Managing NHS waiting lists (March 2010)	✓	n/a	tbc	tbc	✓[2]	Quarterly
Review of orthopaedic services (March 2010)	✓	n/a	tbc	tbc	✓[3]	n/a

Some actions are noted 'tbc' due to the short time that has elapsed between the report being issued and the date of this report.

1. *Local delivery plan and annual financial plan for the three years commencing 2010-11*
2. *Feedback to be submitted to the audit committee on 16 June 2010*
3. *Feedback to be submitted to the health and performance governance committee during 2010-11*

Appendix one – action plan

Priority rating for recommendations		
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.	**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.	**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.

No.	Issue and recommendation	Management response	Officer and due date
1	Similar to 2008-09, late consideration of the impact of the valuation of land and buildings introduced unnecessary volatility in the financial outturn. While the Scottish Government Health Directorate adjusted funding allocations to mitigate the impact on the financial outturn in 2008-09 and 2009-10, this may not always be possible and management should ensure full consideration of such matters at an earlier stage in future years. (*Grade one)*	The impact of the independent valuation of assets at 31 March each year will be considered on an individual asset basis under IFRS prior to the financial statements being submitted for audit.	Assistant director of finance (planning and efficiency) 30 April 2011
2	We strongly encourage management, working with the Scottish Government Health Directorate and other NHS boards, to progress resolution of equal pay so that there is clarity over the Board's financial position. (*Grade one*)	This is not within local control and is being taken forward on a national basis.	Director of finance 31 May 2011
3	All existing staff should be given the opportunity to complete fraud awareness training. *(Grade three)*	We will email all staff who have an email account some on-line training material about fraud awareness.	Assistant director of finance (corporate and shared services) 30 September 2010