Government and Public Sector

23 June 2010

NHS Lanarkshire
Annual Report to Members and the Auditor General for Scotland 2009/10

Contents

1. Executive Commentary

Introduction – Section 2

Our overall responsibility as external auditor of NHS Lanarkshire ("the Board") is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice ("the Code"), revised and published in March 2007. We have a dual reporting responsibility for the audit: to the Board Members of NHS Lanarkshire and to the Auditor General for Scotland.

Financial Statements and Audit Opinions – Section 3

The financial statements of the Board for the year ended 31 March 2010 have been prepared to comply with accounting requirements contained in the NHS Board Accounts Manual for Directors' Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers. We are pleased to report that our opinion on the financial statements for the year ended 31 March 2010 is **unqualified.**

In order to prepare financial statements which are compliant with International Financial Reporting Standards (IFRS), the Board has been required to change the format of its financial statements and include a considerable number of additional disclosures. Significant work has been undertaken (in consultation with the PricewaterhouseCoopers' technical support team) to achieve this objective particularly in relation to the accounting treatment of the three PFI contracts. Over the last 18 months this has required a significant time commitment by the Director of Finance and her team and it is to their credit that this first full audit under IFRS has been completed smoothly.

The financial statements and supporting schedules were presented to us for audit within the agreed timetable and the quality of working papers provided by management was of a high standard. The only exception to this was in relation to the revaluation of land and buildings, which was not finalised until later in the audit. Overall an efficient audit process was achieved through an effective working relationship with your staff.

As a result of our work, we proposed a number of audit adjustments and all but one of these have been processed by management in the finalised version of the 2009/10 financial statements. We have reported the details of the unadjusted item in Appendix B to this report. Due to the immaterial nature of this item, it has not impacted upon our opinion on the financial statements.

2009/10 Performance – Section 4

The Board budgeted for a deficit position of £2.8 million for the year ended 31 March 2010. It was planned that this would be financed by utilising an element of the funds carried forward from 2008/09. The final outturn was in line with the budgeted deficit of £2.8 million meaning that the Board's cumulative savings against the RRL have now been reduced to £12.069 million as agreed in the Board's Financial Plan.

-In terms of non-financial performance, the Board has performed well in working towards achieving two high profile national performance targets for sickness absence and the implementation of the electronic recording of staff members' annual Knowledge and Skills Framework development reviews on a system known as e-KSF.

The 2009/10 sickness absence results represent a 35.4% improvement on the prior year figures and the Board has moved significantly closer to the national target of 4%, which reflects the measures that have been put in place by the Board to manage sickness absence. With regard to the implementation of e-KSF the Board has reported that it is currently ahead of the trajectory required to meet the target by March 2011.

Governance and Control – Section 5

We have assessed the Board's overall governance arrangements including a review of Board and key Committee structures and minutes, financial reporting to the Board, and risk management. We consider that appropriate arrangements and reporting are in place. We have also considered key areas of risk to the Board including partnership working; service sustainability; performance management; and people management. Appropriate arrangements and reporting were evidenced.

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

Managing in Uncertain Times – Section 6

Despite entering the downturn from a relatively strong financial position the NHS in Scotland currently faces a period of uncertainty. Impending tightening of public expenditure will impact the sector at a time when the cost base of many NHS bodies will rise.

While some NHS bodies will be more vulnerable than others, all will be impacted. Regardless of whether an NHS body is in a comparatively stronger or weaker financial position, difficult decisions will have to be made. From our experience in other sectors, we recommend that the Board consider the following key areas in addressing the challenges ahead:

- Honesty and awareness of the size of the challenge
- Strong leadership
- The need to engage with the whole organisation and external stakeholders

- Realistic and detailed plans to resolve the situation
- Rigorous implementation (programme management arrangements)
- Financial control and discipline

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The Board has recognised the need to secure savings of approximately £17.1 million in 2010/11 and has identified projects to do so. However, there is a recognition that in future years even deeper savings may be required and it is important that these are tackled at the earliest possible opportunity in order to allow the Board the maximum possible time to develop saving programmes and deliver upon them.

2. Introduction

Purpose of this report

Our Annual Audit Report which follows is designed to set out the scope, nature and extent of our audit, and to summarise our opinion and conclusions on issues arising. Specifically this will direct your attention to matters of significance that have arisen out of the 2009/10 audit process and to confirm what action is planned by management to address the more significant matters identified for improvement.

Scope, nature and extent of our audit

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

Acknowledgment

We would like to formally extend our thanks to the Board's managers and staff for the assistance they have given us during the audit process.

PricewaterhouseCoopers LLP
Glasgow

23 June 2010

3. Financial Statements and Audit Opinion

Audit opinion

Our audit opinion concerns the true and fair statement of the Board's financial results for the year ended 31 March 2010 and the regularity of its income and expenditure for the year.

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

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

Audit Process

The financial statements and supporting schedules were presented to us for audit within the agreed timetable and the quality of working papers provided by management was of a high standard. The only exception to this was in relation to the revaluation of land and buildings, which was not finalised until later in the audit. Overall an efficient audit process was achieved through an effective working relationship with your staff.

Basis of Preparation

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

Government bodies, including NHS Boards, have been required to adopt International Financial Reporting Standards (IFRS) from 2009/10 onwards. This included a restatement of 2008/09 comparatives. The objective is to bring the public sector into line with the private sector, and to introduce greater comparability and consistency across public sector accounting.

In order to prepare financial statements which are IFRS compliant, the Board has been required to change the format of its financial statements and include a considerable number of additional disclosures. Significant work has been undertaken (in consultation with the PricewaterhouseCoopers' technical support team) to achieve this objective particularly in relation to the three PFI contracts. Over the last 18 months this has required a significant time commitment by the Director of Finance and her team and it is to their credit that this first full audit under IFRS has been completed smoothly.

Approval

The Financial Statements will be submitted to the Board's Audit Committee on the 23 June 2010 and are to be approved and adopted at the Board meeting which follows the Audit Committee meeting.

Unadjusted misstatements

Under ISA 260 - "Communication of audit matters to those charged with governance", we are required to report to you all unadjusted misstatements which we have identified during the course of our audit, other than those which we deem to be of a trivial nature.

As a result of our work, we proposed a number of audit adjustments and all but one of these have been processed by management in the finalised version of the 2009/10 financial statements. We have reported the details of the unadjusted item in Appendix B to this report. Due to the immaterial nature of this item, it has not impacted upon our opinion on the financial statements.

Accounting Issues

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

Maintenance of a Leases and Contracts Register

The Board does not have a comprehensive register of leases and contracts in place at present to capture all of the agreements that it has entered into. The adoption of IFRS accounting in the NHS has meant that the criteria for classifying leases between operating and finance has changed, with the effect being that more leases are likely to be classified as finance leases. This then requires any such leases to be capitalised on the balance sheet. Whilst it is likely that not all finance leases held by NHS Lanarkshire have been recognised on the balance sheet, we consider that the impact on the financial statements would not be material. However, going forward, it is important that the Board puts in place a control mechanism to ensure that all leases and contracts entered into are recorded with a leases/contracts register in order that they can be assessed against the new accounting criteria and categorised appropriately.

The IFRS accounting regime also requires an organisation to assess all contracts against IFRIC 4 criteria in order to determine whether arrangements that do not take the legal form of a lease (for example, outsourcing arrangements) should be accounted for in accordance with IAS 17.Such arrangements are often found where an asset is used in the delivery of a contract, and in effect the provision of the asset constitutes a lease. The lease must then be assessed to determine whether it is finance or operating in nature and thereafter accounted for appropriately. At present, the Board does not have a comprehensive contracts register and is therefore unable to fully address this IFRS requirement. However, on the basis of our work in this area, we consider that the impact on the financial statements would not be material.

ACTION 1

Change in Discount Rate for Provisions for Pensions and Similar obligations

A new discount rate was issued by HM Treasury in February 2010 to apply to pension provisions, and those provisions which result in enhanced pension contributions (including injury benefit provisions). This has resulted in a change of discount rate from 2.2% to 1.8% increasing the level of the provision by £0.587 million. This resulted in a corresponding charge to the Operating Cost Statement. We are pleased to note that the Board had applied the correct discount rate within the draft financial statements.

Valuations of Property, Plant & Equipment

The Board occupies a number of properties where there are medium term plans to dispose of these sites. As operational properties they should be valued on a Depreciated Replacement Cost (DRC) basis, whereby the majority of the value of the site lies within the building, which reflects the fact that the cost of replacing the asset would largely lie in the creation of a new building. However, when assets are declared surplus, and available for sale, they are required to be valued on an open market basis, with the practical effect that the majority of the value is reflected by the land element. In the first set of financial statements these properties were valued on an open market basis as though no longer in operational use. We agreed with Management that these assets should continue to be held at DRC and the financial statements were adjusted accordingly.

The Scottish Government provides funding for impairments on the value of these sites when they are declared surplus, but only the overall difference between DRC and open market value in total terms, and does not differentiate between land and buildings. Going forward this could result in the Board incurring a significant impairment charge in relation to a building. This would impact on the Operating Cost Statement when an asset is reclassified in such a way, as the building would be likely to be deemed to have little value, but any increase in the land valuation would offset the overall impairment on the asset as a whole. This has had no impact in 2009/10 as management agreed to reclassify four assets from surplus to operational, as they are still currently in use. However, going forward, management should agree an approach with the Scottish Government to minimise any financial loss to the Board when these assets do become surplus.

ACTION 2

Unidentifiable Locations of Plant and Equipment

The Board's fixed asset register includes £3.2 million of equipment which cannot be traced back to individual asset locations across the Board. Approximately £1.5 million of this total relates to equipment added to the fixed asset register between 1997/98 and 2008/09 and the remaining £1.7 million was added to the register during 2009/10. These assets cannot be located as the current additions process for plant and equipment does not require asset locations to be notified to the capital team, responsible for updating the register, upon purchase. Therefore once an asset is coded as capital to the ledger, a follow up procedure must be undertaken to identify its location.

The Board perform an annual exercise of plant and equipment verification to confirm that the asset is still in use. These assets were excluded from this audit since their location was unknown. This resulted in delays in updating the fixed asset register as, on a number of occasions, staff in various hospital sites identified assets not on the audit listing, which appeared to be additions. NHS Lanarkshire believes that some of these additions notified during the asset audit, make up part of the £3.2 million of plant and equipment that have no identified location. This could potentially expose the Board to fraud, if assets are not traceable to a location or asset keeper.

ACTION 3

Provisions and Accruals

The Board has disclosed an "Other Provisions" balance of £23.5 million in the 2009/10 financial statements. Provisions remain an area of particular audit focus as a significant element of judgement is required to determine whether the criteria of IAS 37 have been met. IAS 37 defines a provision simply as "*a liability of uncertain timing or amount*" going on to say that a liability is "*a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits*". In addition, for the first time in the 2009/10 financial statements, NHS Scotland Boards are required to separate out deferred income from accruals within the trade and other payables note to the financial statements. For our audit work in this area, a number of reclassification between these lines were required to ensure compliance with the definitions in the NHS Boards' Accounts Manual for 2009/10.

We identified a number of items classified as provisions that failed to meet the criteria of IAS 37 and these were adjusted by management. The key issues in this regard were in relation to:

- Labs Information Management System – A provision of £0.9 million was included in the draft financial statements for the implementation of one common Labs Information System across the three hospital sites in Lanarkshire. However, since the Board was not tied into a contract at the year end this provision did not represent a current obligation arising from a past event and was subsequently removed from the finalised financial statements.

- A number of provisions totalling £1.5 million relating to unutilised ring-fenced allocations were reclassified from provisions to deferred income in the final financial statements. This resulted in a corresponding credit to the Operating Cost Statement.

Equal Pay

The National Health Service in Scotland has received a number of claims for equal pay including related back pay. The NHS Central Legal Office (CLO) has been instructed by the Management Steering Group of NHS Scotland in this regard and is co-ordinating the legal response of NHS Scotland to this issue and has attended tribunal hearings at which discussion about procedural matters has taken place.

At the end of May 2010 there were 983 grievance and employment tribunal claims registered against NHS Lanarkshire out of an NHS Scotland total of 11,397.

The CLO has confirmed that the cases in Scotland are not sufficiently progressed to allow any assessment of the potential financial exposure to be included in the financial statements. The Board has therefore included a Contingent Liability Note in its financial statements, setting out this matter.

4. 2009/10 Performance

Financial Results 2009/10

	£m	£m
Recurring income	838.0	
Recurring expenditure (before savings)	(841.5)	
Recurring savings	3.9	
Underlying recurring surplus / (deficit)		**0.4**
Non-recurring income	140.2	
Non-recurring expenditure (before savings)	(143.3)	
Non-recurring savings/(cost pressures)	(0.1)	
Non-recurring surplus/(deficit)		**(3.2)**
Financial surplus/(deficit) for the year		**(2.8)**
Underlying recurring surplus as a percentage of recurring income		**0.05%**

Confirmed by NHS Lanarkshire Director of Finance: Laura Ace

The Board budgeted for a deficit of £2.8 million for the year ended 31 March 2010 which was to be financed by utilising an element of the funds carried forward from 2008/09. The final outturn was in line with the budgeted deficit of £2.8 million meaning that the Board's cumulative savings against the RRL have now been reduced to £12.069 million as agreed in the Board's Financial Plan.

In achieving this planned position, the Board encountered a number of variations from budget as follows:

Pay Costs – £4.7 million under spend

Pay costs came in below budget in each of the three operating divisions and corporately. The main reason for the overall under spend has been a higher level of vacancies than anticipated, which have remained vacant for an extended period of time.

GP Prescribing – £5.7 million over spend

Prescribing remains a significant cost pressure for the Board due to the upward trend in the volume of drugs dispensed. The Board had budgeted for a 2.1% increase in the items dispensed but the actual increase amounts to 4.83% resulting in the £5.7 million overspend.

Out of Area Treatments and Unplanned Activity - £1.0 million over spend

The Board encountered an over spend in this area as a result of higher than anticipated activity, in part relating to additional high cost low volume activity within North Glasgow (£0.4 million).

Performance against Key Financial Targets

The Board has achieved all three of its financial targets in the year, as follows:

	Limit set by SGHD £m	Actual Outturn £m	Variance (over)/under £m
Revenue Resource Limit	844.802	832.743	12.059
Capital Resource Limit	49.068	49.067	0.001
Cash Requirement	965.089	964.891	0.198

The Board also reported that it had met the 2% Scottish Government target for efficiency savings in 2009/10.

Managing Financial Performance

Management receives detailed financial information each month to help manage performance against budgets and control expenditure. Detailed management accounts are prepared on a monthly basis. Management accountants liaise with budget holders to analyse the management reports and understand key variances against budgets. The outcomes of the monthly reviews are consolidated into monthly financial management reports that are considered by the Board and senior management. The extent of information produced and frequency of reporting ensures decision makers have appropriate information on which to base decisions. The reporting arrangements were considered during the year and reported in our Interim Management Letter reported to the Audit Committee on 9 March 2010.

Trade & Other Payables – Better Payment Policy

The 2009/10 Financial Statements report a reduction in creditor payment days to 16 days, down from 25 days in 2008/09. Government guidance, issued in 2008/09 as a result of the economic downturn, states that suppliers should be paid within 10 days and at present 85.6% of invoices by value are paid by the Board within this timescale. Management has invested resources to improve the payables process, but challenges still remain with respect to the invoice query register and ensuring the accuracy of purchase orders. A recent National Procurement report on the Board's procurement arrangements highlighted the potential for improvement and management is in the process of developing an action plan to take this forward.

Managing Performance and Non Financial Performance Targets

The Board undertook a full review of the Performance Management arrangements across the Board approximately 18 months ago with a view to developing a coherent and streamlined structure that avoided duplication but ensured that any performance issues could be appropriately escalated through the management and governance structures. As a result of this review, there has been a minimisation of duplication with clear distinctions between the performance information that is monitored by the localities, the Operating Management Committees and the Board, and clear arrangements for escalating issues.

Quarterly detailed Performance Management reports are presented to the Board following approval by the Corporate Management team. The 29 HEAT targets, and the 40 associated measures applicable to NHS Lanarkshire in 2009/10, are reported quarterly to the Board with the focus on amber and red targets. At the end of 2009/10 the Board was meeting 34 of the 40 associated measures and compares positively against other NHS Scotland Boards in several areas

Pay Modernisation

NHS Boards are required to ensure that at least 80% of staff covered by Agenda for Change have their annual Knowledge and Skills Framework development reviews completed and recorded on the e-KSF system by March 2011.

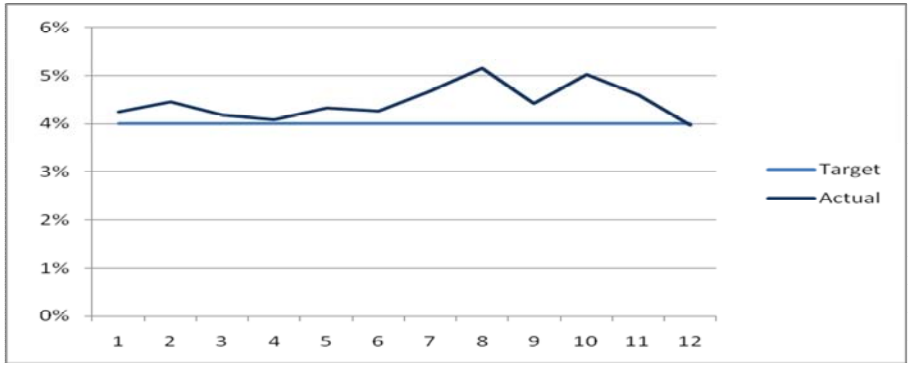
The Board has arrangements in place to achieve this HEAT target and has developed a trajectory for monthly monitoring purposes. In order to meet this two year target the Board estimated that by March 2010, 30% of staff should have had their reviews completed and recorded on e-KSF. The actual percentage achieved was 37% meaning that the organisation is well on course to deliver this target. This has been achieved through a mixture of training and communication and the process has been supported by a network of 70 local e-KSF experts who are dispersed throughout the organisation.

Sickness Absence

The Board continues to find it challenging to drive sickness absence below the 4% national target. The average sickness absence rate for the 12 months to March 2010 was 4.5% meaning that the Board did not achieve the target.

However, the 2009/10 results represent a 35.4% improvement on the prior year's results and the Board has moved closer to the national target, reflecting the measures that have been put in place by the Board to manage sickness absence.

The table below shows how the Board performed against the sickness absence target in each of the 12 months of the 2009/10 financial year:



Best Value

Best Value audits are being carried out across the public sector to help protect taxpayers interests by examining the use of resources and to report on the delivery of outcomes for people who use services. The Best Value audits are being carried out in a cycle focusing on distinct areas each year. In 2008/09 the Use of Resources Best Value audit focused on Information Management. In 2009/10 Audit Scotland issued 18 toolkits with instructions that one was to be performed and validated by the auditors of each NHS Board.

In agreement with management, we selected the Efficiencies toolkit for completion in 2009/10 in order to best address the risks of the organisation. The evaluation for each module within a toolkit is classed as: does not meet basic requirements; basic practices; better practices; and advanced practices. The results are summarised below.

The Efficiency Best Value Toolkit covered five key themes of efficiency focusing on the culture within NHS Lanarkshire, the organisation's vision, planning, information gathering and monitoring procedures. The evaluation of the Board in each of these areas was as follows:

Efficiencies Toolkit Module	Evaluation
Does the organisational culture support improved efficiency?	Better Practices
Is improved efficiency incorporated into the organisation’s vision?	Better Practices
Does the organisation have realistic plans which allow the scale of efficiencies achieved to be measured?	Better Practices
Does the organisation gather the right information about efficiency plans to monitor progress?	Better Practices
Does the organisation use information on progress to ensure planned efficiencies are attained or adjusted appropriately?	Better Practices

The Board leads the efficiency agenda within NHS Lanarkshire and individual Board members have been assigned responsibility for specific initiatives. The Board has identified 120 efficiency programmes since September 2009. An infrastructure to support the efficiency agenda has been created, including the establishment of Programme Boards and a Financial Savings Partnership Group, and its remit is to take the 120 programmes forward and translate these into tangible savings. Progress is monitored regularly and communicated throughout the organisation to reinforce the need for efficiency at every level.

The findings and recommendations from this work will be reported to the Audit Committee in a separate Best Value Report.

5. Governance and Control

Overall Governance Arrangements

There have not been any significant changes to the governance arrangements in operating during 2009/10 with the key committee structures remaining the same. However the Board remains committed to continuous improvement in this area and undertook an exercise to compare NHS Lanarkshire's arrangements with the Good Governance Standard. In addition, the Board Effectiveness tool which was introduced in October 2009 will be used to evaluate the activities of the Board going forward.

Following NHS QIS' Corporate Governance and Risk Management assessment at the Board, work has been undertaken to strengthen the effectiveness of the committees. A number of the Board's committees have extended their remit to include the "areas of responsibility" that were set out in the draft Best Value Matrix, including the Clinical Governance Committee and both CHPs' Operating Management Committees.

Partnership Working

The Board devotes time and resources to the achievement of effective partnership working and has good working relationships with the two local authorities in the NHS Lanarkshire area. The Joint Service Management Group Workplan is the overarching annual plan between the Board and North and South Lanarkshire Councils which drives the Single Outcome Agreements.

There have been significant changes within the CHPs during 2009/10 including a management restructuring exercise transforming the ten current localities into a structure of five units; four geographical (two North and two South) and one Mental Health Unit for the whole of Lanarkshire. This change was designed to increase efficiency and effectiveness. In additional, although the area of pooled or aligned budgets is one where integration is currently limited, there are some areas where this is working well, such as Integrated Substance Misuse and Integrated Services are expected to become a focus for further integration going forward.

Statement on Internal Control

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

Systems of Internal Control

The results of our work on systems of internal control were communicated to the Audit Committee in our Interim Management Letter on 9 March 2010. The report contained 10 recommendations to improve controls, none of which were graded as higher risk or business critical in nature. Management has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion. We will follow up this action plan during our 2010/11 audit process.

Follow up of outstanding recommendations

We followed up the Board's progress in implementing recommendations made in the prior year. Our Follow Up of Prior Year Recommendations Report was considered at the Audit Committee meeting on 8 June 2010. At the time of reporting, of the 50 agreed actions, progress was as follows:

Status	Interim Management Letter 2008/09	Final Management Letter 2008/09	Annual Report to Board Members 2008/09	Follow up of 2007/08 Audit Recommendations	Total
Action Implemented	13	3	5	10	31
Action in Progress	2	-	-	5	7
Little Action to Date	-	2	-	-	2
No Longer Applicable	1	1	1	7	10
Total	**16**	**6**	**6**	**22**	**50**

We are pleased to report that 62% of the recommendations made have been implemented in full which demonstrates a significant commitment by management to improve the overall control environment within the Board.

Information Technology General Controls

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

During our 2009/10 interim visit, we performed ITGC procedures and identified 3 medium risks and 1 low risk in relation to IT and these were reported to the Audit Committee in our Interim Management Letter 2009/10.

National Fraud Initiative

The National Fraud Initiative (NFI) brings together data from health bodies, councils, police and fire rescue bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud.

As reported in our Interim Management letter (March 2010), the Board has investigated all recommended matches as well as an additional sample of 25 further matches that were chosen at random. One match was referred to the Counter Fraud Services for further investigation.

6. Managing in Uncertain Times

The UK economy went into recession in mid-2008 for the first time since 1991. By summer 2009, UK economic output had fallen for five consecutive quarters. Significant financial pressures remain and the future economic position is uncertain and difficult to predict.

In response to the recession the UK Government almost doubled its level of borrowing to £175 billion in 2009/10 to allow it to increase public spending to support the economy. This level of borrowing means that the UK Government will need to pay higher debt interest payments, which in turn reduces the amount left for spending on the public sector. The recent Westminster General Election has resulted in a change of Government and this has led to a change in the plans for the repayment of national debt with the new coalition government planning to halve the deficit by 2013/14. In order to achieve this ambitious target, significant reductions in public sector spending will be required. A recent paper by the Scottish Government Chief Economist predicts that public sector spending in Scotland may fall in real terms by 3% every year to 2014/15 and will take a total of 12 to 15 years to get back to 2009/10 levels.

Further details of this challenge may become clearer after the 22 June 2010 UK emergency budget, although the impact this will have on the NHS in Scotland may take some time to become apparent.

In April 2009, the UK Government also announced that Public Sector **capital budgets would fall**.

Taken together, these factors will have **serious consequences** for the Scottish budget. As a result of the current financial position, Audit Scotland has issued a number of reports on the matter. Key reporting themes from two of these reports are highlighted below.

Audit Scotland - Scotland's Public Finances: Preparing for the Future

In November 2009 Audit Scotland published its report: 'Scotland's Public Finances: Preparing for the Future'. This report highlighted the fact that the Scottish Government budget is likely to have peaked in 2009/10 for the foreseeable future. This means that individual public bodies will have **smaller budgets** in future years. It highlighted that, in addition, **other public sector income is likely to be less than previously forecast** – in particular, NHS capital funding, which may affect the Board's ability to deliver its capital programme.

The report concluded that we are at a real **historical breakpoint** in public finances.

Audit Scotland - Improving Public Sector Efficiencies

Following on from the Scotland's Public Finances report, Audit Scotland published a further report in February 2010: 'Improving public sector efficiency'. It provided a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in a 2006 Audit Scotland report about the previous efficiency programme.

The report noted that Scottish public bodies had reported more efficiency savings than the Government's two per cent target. However, there are serious financial challenges ahead – the biggest since devolution – and making the required savings simply through efficiency will become increasingly difficult.

The report recommends that in order to deal with reduced future funding, public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and to improving collaboration and joint working.

To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office have drawn on their combined experience to develop a detailed good practice checklist. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement. We recommend that those responsible for leading efficiency and improvement work at NHS Lanarkshire should formally assess themselves against each question.

These Audit Scotland reports have been presented previously to the Board for consideration. The reports were provided in the Board papers along with financial performance information and details of the 2010/11 budget including key cost pressures and significant challenges facing NHS Lanarkshire.

The NHS Lanarkshire Perspective

Due to the challenging economic outlook facing the public sector in Scotland, the Board will have to increase the level of direct cash releasing efficiency savings from the £4.5 million originally envisaged for 2010/11 to £17.1 million, and rising to £18.8 million in 2011/12. This challenging target has prompted a critical examination of spending across the Board resulting in, amongst other changes, the reorganisation of Community Health Partnerships (CHPs) and review of current Allied Health Professionals (AHPs) structures. Management has identified projects to deliver the required £17.1 million savings target for 2010/11.

As highlighted in the Best Value section, the Board has put a framework in to place in order to identify and deliver the necessary savings.

Figures confirmed by Laura Ace – Director of Finance

2010/11 Projected Outturn	£m	£m
Recurring income	867.6	
Recurring expenditure (before savings)	(881.3)	
Recurring savings	14.2	
Underlying recurring surplus		**0.5**
Non-recurring income	156.5	
Non-recurring expenditure (before savings)	(162.9)	
Non-recurring savings	1.4	
Non-recurring deficit		**(5.0)**
Projected financial deficit for the year		**(4.5)**
Underlying recurring surplus as a percentage of recurring income		**0.06 %**

Financial Plan

The Board approved the 2010/11 to 2014/15 Five Year Financial Plan in March 2010. The Plan includes detailed budgets for revenue and capital in 2010/11 as well projections for a further four years.

Cost Pressures: The Board has identified a number of financial risks, which have been incorporated into its forecast financial position. The single largest increase in the forecast reported to the January 2010 Board is the pay uplift. The three year deal for Agenda for Change pay award sets the 2010/11 cost of living rise at 2.25%. In addition staff on Agenda for Change pay scales are entitled to an additional annual incremental pay rise of 3.3% on average until they reach the top of the scale.

In addition, the 2010/11 budget anticipates a rise in GP Prescribing costs resulting from an increase in the number of items dispensed as well as a significant overspend in 2009/10. In addition to this, it is expected that the Scottish Medical Consortium will approve a number of high cost drugs for use in the NHS in Scotland in 2010/11, which will result in higher costs for the organisation.

Capital Investment: A key challenge for the Board in the near future is the level of investment required in Monklands Hospital. In addition, a number of proposals within the Picture of Health document remain on hold with further work required to assess the priority of these investments given the significant drop in the capital budget from 2010/11 onwards. This issue has been communicated to the Scottish Government for their consideration.

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Appendices

Appendix A – Action Plan

Ref	Issue and Recommendation	Management Response
1	The Board does not have a comprehensive register of leases and contracts in place at present to capture all of the agreements that it has entered into. The adoption of IFRS accounting in the NHS has meant that the criteria for classifying leases between operating and finance has changed, with the effect being that more leases fall in to the finance lease category. This then requires any such leases to be capitalised on the balance sheet. Whilst it is likely that not all finance leases held by NHS Lanarkshire have been recognised on the balance sheet, we consider that the impact of the financial statements would not be material. However, going forward, it is important that the Board puts in place a control mechanism to ensure that all leases and contracts entered into are recorded with a leases/contracts register in order that they can be assessed against the new accounting criteria and categorised appropriately. Management should develop a comprehensive leases and contracts register so that the finance department can use this as the basis for ensuring that its financial accounting treatment is in compliance with IFRS. **Risk Rating: Medium**	**Management Response:** Agreed **Responsible Officer:** General Manager Procurement (Contracts Register) General Manager Procurement & Head of Financial Services (Lease Register) **Due Date:** December 2010

Ref	Issue and Recommendation	Management Response
2	The Board operates in a number of properties where there are medium term plans to dispose of these sites. As operation properties they are valued on a Depreciated Replacement Cost (DRC) basis, whereby the majority of the value of the site lies within the building, which reflects the fact that the cost of replacing the asset would largely lie in the creation of a new building. However, when these assets are declared surplus, and available for sale, they are required to be valued on an open market basis, whereby the effective value of the site is the land element. The Scottish Government provide funding for impairments on the value of these sites when they are declared surplus, but only the overall difference between DRC and open market value in absolute terms, and does not differentiate between land and buildings. This could result in the Board incurring a significant impairment charge on a building. This would impact on the Operating Cost Statement when an asset is reclassified in such a way, as the building would be deemed to have little value, but the increase in the land valuation would offset the overall impairment on the asset as a whole. This has had no impact in 2009/10 as management agreed to reclassify four assets from surplus to operational, as they are still currently in use. Management should agree an approach with the Scottish Government to minimise any financial loss to the Board when land and building assets are reclassified from operational to surplus. **Risk Rating: High**	**Management Response:** Management agree with the audit recommendation and will contact SGHD to agree an approach. **Responsible Officer:** Head of Financial Services **Due Date:** 31 July 2010

Ref	Issue and Recommendation	Management Response
3	The Board's fixed asset register includes £3.2 million of equipment which cannot be traced back to individual asset locations across the Board. Approximately £1.5 million of this total relates to equipment added to the fixed asset register between 1997/98 and 2008/09 and the further £1.7 million was added to the register during 2009/10. These assets cannot be located as the current additions process for plant and equipment does not require asset locations to be notified to the capital team (responsible for updating the register) upon purchase. Therefore once an asset is coded as capital to the ledger, a follow up procedure must be performed to identify its location. The Board perform an annual audit of plant and equipment verification to identify that the asset is still in use. This £3.2m were excluded from this audit since their location was unknown. This caused delays in updating the fixed asset register as on a number of occasions staff in various hospital sites identified assets not on the audit listing, which appeared to be additions. NHS Lanarkshire believe that some of these additions notified during the asset audit, make up part of the £3.2m of plant and equipment that have no identified location. This could potentially expose the Board to fraud, if assets are not traceable to a location or asset keeper. Management should confirm the location of £3.2m of assets and update the fixed asset register accordingly. A more robust additions process for plant and equipment should be put in place that requires the verification of the location of plant and equipment prior to its addition to the fixed asset register. **Risk Rating: Medium**	**Management Response:** We have reviewed the list of assets in question and located the £1.7m relating to 2009-10. Details have been passed to PwC. Work is ongoing with Medical Physics and asset owners to identify the remaining assets. **Responsible Officer:** Head of Financial Services **Due Date:** 30 September 2010

Appendix B – Unadjusted Items

Description	OCS		Balance Sheet	
	Dr	Cr	Dr	Cr
Dental expenditure information for March is not available to the Board by Practitioner Services Division until the following month and therefore management creates an accrual in the accounts to estimate the expenditure. However, during the time of the external audit visit the actual expenditure information was available and it showed that management had underestimated the expenditure by £322,477.	Expenditure £322,477			Accruals £322,477
Dental services expenditure is a non cash limited item which means that it is fully funded by the Scottish Government Health Directorate. Therefore the additional expenditure incurred through the adjustment above would also result in an equal amount of additional income in order to ensure that there was no overall impact on the RRL position.		Income £322,477	Accrued Income £322,477	

Appendix C – Communications to Management

International Standards on Auditing ("ISA") (UK&I) 260 – Reporting to those charged with Governance, requires that the External Auditor communicates certain matters to those charged with Governance. Those charged with Governance is taken to be the Members of the Audit Committee with responsibility discharged through the regular meetings of the Audit Committee during the year. Summarised below are the requirements set out within ISA 260 together with reference to the relevant communication with you during 2009/10 or comments as appropriate.

Communication Required under ISA 260	Reference/Comment
Engagement Letters	Signed Engagements Letter with Audit Scotland at the start of our 5 year appointment and updated annually.
Independence	Audit Planning document report to 8 December 2009 Audit Committee and confirmed no member of audit team has any direct interest, financial or otherwise, in NHS Lanarkshire.
Audit Approach and Scope	Audit Planning document (reported to Audit Committee 8 December 2009)
Accounting Policies/Practices with a Material Effect on the Financial Statements	Sections 3 and 4 of our Annual Report to Board Members and the Auditor General for Scotland.
Potential Effects of Material Risks and Exposures	Audit Planning document (8 December 2009).
Audit Adjustments	Section 4 of our Annual Report to Board Members and the Auditor General for Scotland.
Material Uncertainties relating to Going Concern	None identified.
Disagreement with Management about Matters that could be Significant to the Financial Statements	Not applicable.
Expected Modifications to the Auditor's Report	No modifications identified. An unqualified audit opinion provided.
Letter of Representation	Signed by Management 23 June 2010.
Material Weaknesses in Internal Control	Internal Controls findings reported separately in our Interim Management Letter (9 March 2010), Section 7 of our Annual Report to Board Members and the Auditor General for Scotland.
Fraud	Discussed fraud arrangements with the Chair of the Audit Committee (8 December 2009) and Management throughout audit process.

Communication Required under ISA 260	Reference/Comment
Laws and Regulations	We have not identified any material breaches of laws and regulations in the period which impact on the 2009/10 Financial Statements.
Audit Materiality	Our Audit Planning document was presented to Audit Committee in 8 December 2009.
Fair Value Measurement and Disclosure	Included in representation letter, signed by Management dated 23 June 2010.
Related Parties	Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.

Formal Reporting to Management during 2009/10

During the year we have presented a number of formal reports to Management and the Audit Committee and produced certain outputs. Our principal outputs during 2009/10 are summarised below:

Formal Output	Timing
Letter outlining work undertaken in relation to our review of the Board's 2008/09 shadow IFRS based financial statements	8 December 2009
Audit Plan	8 December 2009
Interim Management Letter	9 March 2010
Follow-up of 2008/09 Recommendations	8 June 2010
Annual Report to Board Members and the Auditor General for Scotland	23 June 2010
Audit Opinions 1. True and fair and regulatory value on the financial statements and income and expenditure ✓ 2. Remuneration Report (parts only) ✓ Unqualified Audit Opinions	23 June 2010 Board Meeting

Freedom of Information Act (Scotland) 2002

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