



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 2009

30 June 2009

AUDIT

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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 only 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.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

The Board has experienced significant change in recent years – culturally, strategically and operationally – and this will continue in the future. Implementing change during a period of increased pressure from tightening financial targets and increasing focus on performance targets will be a challenge.

The re-focusing exercise initiated in 2008 aimed to align corporate structures with the patient pathway, eliminating barriers that originated in the former trust structure, prior to unification in 2004. Management did not accept our recommendation to perform a post-implementation review to ensure that objectives had been met and to identify benefits realised, both financially and operationally.

Service provision in the acute and mental health sectors is subject to ongoing review; the six year capital plan outlines how the results of these reviews will be implemented in the short and medium term. Awareness of the requirement for change and the culture of service redesign continues to develop across the Board, but there is a risk that the lack of robust arrangements to demonstrate achievement of efficiency savings, has a detrimental impact on the Board's ability to implement change and demonstrate the benefits realised as a result, particular in light of management's decision to increase the target from 2% to 4%.

The Board continues to pursue partnerships with other bodies to improve delivery of local services in Ayrshire and Arran. A strategic alliance between the Board and North, East and South Ayrshire Councils was approved during 2008-09. The structure of community health partnerships was revised to include a CHP committee, CHP forum and CHP officer locality group, which aim to improve delivery of local services. Operational partnerships with councils continue to develop, for example, completion of the Largs resource centre.

Participation in a number of Scottish Government patient safety initiatives enhances governance arrangements. The recently created department of policy, planning and performance is planning to implement a local system – NHS Ayrshire and Arran performs – to measure and report performance. Performance against targets is routinely reported to the health and performance governance committee, but only by exception to the board. HEAT targets associated with workforce management, including sickness absence, were not achieved.

Our audit of the financial statements identified two significant areas of management judgement – interpretation of the valuation of land and buildings and the potential cost of *Agenda for Change* accruals. Further consideration of the former resulted in an adjustment to the financial statements of £1.3 million, the impact of which was mitigated by additional funding secured from the Scottish Government Health Directorate in June 2009, and a potential error in the latter of around £0.6 million was not considered material and not amended in the financial statements.

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, some of these have been reported in more than one year. In previous years, management accepted most of our recommendations to enhance controls, but instances where controls do not operate on a consistent basis continue to arise.

Management has and continues to recognise risks to the achievement of its plans and has plans in place to mitigate these risks and lower the Board's exposure, but a number of these will take time to implement.

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 third 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 on 10 December 2008.

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 2009 and financial plans for 2009-10 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 Executive'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 2008-09 we completed work on arrangements to achieve Best Value through information management, efficiencies and financial management. Plans are being developed for the application of a series of toolkits on the use of resources in future years based on an assessment of the Board's priorities and risks during the audit planning process.

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 also included the seven 'grade one' recommendations reported earlier in the year. 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.

Background – service overview

Service overview

The Board continues to progress service redesign initiatives in both the acute and mental health sectors. The re-focusing exercise initiated in 2008 aimed to align corporate structures with the patient pathway, eliminating barriers that originated in the former trust structure, prior to unification in 2004. Awareness of the requirement for change and the culture of service redesign continues to develop across the Board. Service provision in the acute and mental health sectors is subject to ongoing review; the six year capital plan outlines how the results of these reviews will be implemented in the short and medium term.

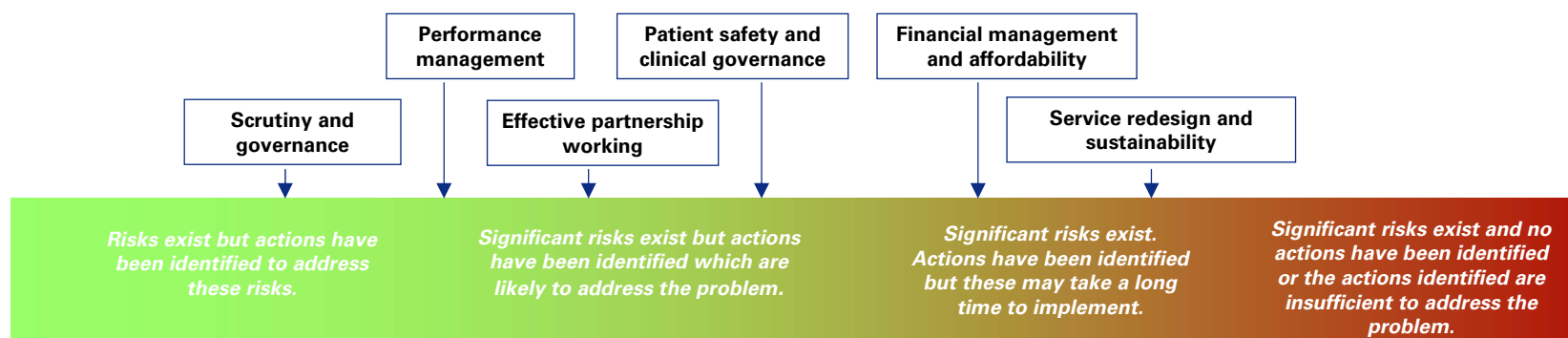
A strategic review of mental health services, *Mind your health*, was launched in 2006. During 2008-09 the Board undertook a detailed programme of consultation from the wider community over the location of the acute mental health inpatients services. This included community focus groups, targets focus groups, consultation with local MSPs and open public consultation. Following this exercise a new adult mental health inpatient facility is to be developed on the Ayrshire Central Hospital site at an estimated capital cost of £50 million.

The Board continues to pursue partnerships with other bodies to improve delivery of local services in Ayrshire and Arran. A strategic alliance between the Board and North, East and South Ayrshire Councils was approved during 2008-09. The structure of community health partnerships was revised to include a CHP committee, CHP forum and CHP officer locality group, which aim to improve delivery of local services.

The Board continues to modernise facilities and construction of the new Girvan community hospital commenced in 2008-09. Total anticipated spend is £20 million, with £6.8 million (34%) incurred during the year. Other major capital projects to improve the delivery of local services include a total of £5.5 million (2008-09: £1.8 million) on redevelopment of the Largs resource centre.

The Board has experienced significant change in recent years – culturally, strategically and operationally – and this will continue in the future. Implementing change during a period of increased pressure from tightening financial targets and increasing focus on performance targets will be a challenge. Management has and continues to recognise risks to the achievement of its plans and has plans in place to mitigate these risks and lower the Board’s exposure, but a number of these will take time to implement.

We have characterised the Board’s arrangements to achieve national priorities and mitigate against key risks as follows:



Financial statements

We have issued unqualified opinions on the financial statements and the regularity of transactions reflected in those financial statements and have drawn attention to the Board's contingent liability in relation to equal pay claims.

There were two key issues arising from our audit of the financial statements:

- Valuation of land and buildings – late consideration of the detailed results of the external valuation at 31 March 2009 in relation to three health centres, that had previously been reduced in value, resulted in an increase to net operating costs to reflect £1.3 million of permanent impairment. Confirmation of additional funding from the Scottish Government Health Directorate on 4 June 2009 mitigated any impact on the financial outturn.
- *Agenda for Change* – a difference in opinion over the applicability of assumptions used by management led us to conclude that the accrual could be overstated by £0.6 million, which was not considered material and not amended in the financial statements.

Recommendations

The action plan includes recommendations for improvement in the following areas:

Area for development	Action plan reference
There was insufficient evidence of detailed consideration of the valuation of land and buildings at 31 March 2009 provided by the external valuer. Late consideration of the impact of the valuation of land and buildings introduced unnecessary volatility in the financial outturn. While additional funding was obtained from the Scottish Government Health Directorate to mitigate the impact on the financial outturn in 2008-09, management should ensure full consideration of such matters at an earlier stage in future years.	One
Management should continue to work with the Scottish Government Health Directorate to resolve equal pay claims.	Two

Audit opinions and key issues

Reporting arrangements and timetable

The draft financial statements were available for audit on 18 May 2009 in line with previous years, but this was later than the agreed date of 14 May 2009 and there was insufficient documentation and analysis to support key management judgements over the valuation of fixed assets and the accrual for *Agenda for Change* reviews. However, the audit was completed in a timely manner and the board considered and approved the financial statements on 24 June 2009 as planned.

Audit opinion

Following board approval we issued an audit report expressing unqualified opinions on the financial statements for the year ended 31 March 2009 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 one key risk area. We have concluded our work in this area and summarise the results below.

Key risk area	Conclusions
Financial position	<p>Throughout 2008-09 the Board has forecast a revenue surplus of £10 million. This in line with the financial plan approved by the Scottish Government Health Directorate. The final outturn against revenue is £10.012 million</p> <p>The Board continues to incur significant capital expenditure during the last quarter of the financial year; a trend similar to previous years. £12.5 million (41%) of the £30.3 million annual capital allocation was spent during the first nine months of the financial year. This demonstrates a marginal improvement on 2007-08, during which 38.7% of capital spend was incurred during the first three quarters.</p>

We identified three additional key risk areas during our audit of the financial statements.

Agenda for Change

The financial statements include a provision of £6.6 million (2008: £14.4 million) to reflect the remaining 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 2009, increasing the accuracy of the population of potential reviews. £4 million (2008: £8.7 million) of the total accrual reflects management's assessment of the cost of successful reviews.

Information provided to support the *Agenda for Change* review accrual was based on staff numbers at 31 December 2008 (2,764), rather than at the year end on 31 March 2009 (2,867). In addition, there were delays in receiving evidence of appeals settled during the year. Sufficient and appropriate audit evidence was not obtained until after the clearance meeting on 4 June 2009. Similar to previous years, management used a combination of local and national assumptions as the basis for the accrual for successful reviews. The accrual in the financial statements is based on the average national review success rate. Management believes this is a prudent assumption, despite their view in 2007-08 that the national rate was appropriate for the Board's circumstances. We re-calculated the accrual using the actual success rate for the Board's employees to date, which indicates that the accrual could be overstated by £0.6 million. This is recorded as an unadjusted audit difference and is not considered to be material in the context of the financial statements.

Audit opinions and key issues (continued)

Fixed assets

In line with accounting standards and the NHS board manual for accounts, management obtained an external valuation of all land and buildings at 31 March 2009. There was little evidence that management had considered, at a sufficiently detailed level, the impact of the valuation of land and buildings at 31 March 2009 on the financial statements. We requested additional information during the audit fieldwork to facilitate consideration of valuation movements on a building by building basis; a requirement of accounting standards. This information was subsequently provided by management in response to our requests during the audit fieldwork.

As a direct result of the additional analysis, management identified that the 2009 valuation confirmed that the previous reductions in value of three health centres was a permanent reduction, and unlikely to recover within a short to medium timeframe, and should therefore be recognised as a charge in the operating cost statement. The financial statements were amended, to increase net operating costs by £1.3 million, following agreement from the Scottish Government Health Directorate on 4 June 2009 that additional funding would be available to mitigate the impact on the financial outturn.

Recommendation one

Equal pay

Article 141 of the Treaty of Rome requires member states to ensure and maintain “the application of the principle that men and women should receive equal pay for equal work”. This was expanded on in the Equal Pay Directive, which made it clear that all such discrimination should be eliminated from all aspects of remuneration. As at 31 March 2009, NHS bodies in Scotland had received some 12,500 claims for backdated pay increases arising from this requirement and referred them to the NHS Central Legal Office. It is possible that these claims represent a current liability for NHS boards. The NHS Central Legal Office has recorded 1,926 claims against the Board.

The NHS Central Legal Office has co-ordinated the response to all claims and advises that, until named comparators are identified, a view cannot be taken either about the likely success, or otherwise, of the claims or the value of them. Further information is, therefore, required about the claims and there are fundamental legal issues that require to be tested to allow any assessment of financial risk to be included in the financial statements. On the basis of this position, and following discussions with the Scottish Government Health Directorate and the NHS Central Legal Office, the Board has recognised its potential financial exposure by way of a contingent liability in its financial statements.

In the light of the potential significance of this matter to the Board individually, we have included an “emphasis of matter” paragraph in our audit opinion. We strongly encourage management, working with the Scottish Government Health Directorate and other NHS boards, to progress resolution of this matter so that there is clarity over the Board’s financial position.

Recommendation two

Regularity

Regularity of transactions

In order to gain assurance over the regularity of expenditure we updated our understanding over the processes to receive Scottish Government Health Directorate circulars, register, allocate and distribute responsibility for action points and monitor and follow up these action points. Management maintain a register of circulars, which is reviewed on a weekly basis. We noted in our interim report to management that no formal process was in place to monitor the receipt and action of circulars by responsible officers.

We have considered the specific requirements of a number of financial circulars, particularly those in relation to remuneration, and did not identify any instances of non-compliance.

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 – quarterly meetings with NHS NSS are held to review and consider payment verification reports. A summary of the quarterly reports is presented to the audit committee on an annual basis.
- Qualities and outcomes framework – in line with national guidance, the Board visited 15% of practices during 2008-09 to review the prior year outturn and gain assurance for 2008-09. Two practices were randomly selected for verification of quality outcomes and high quality results were reported.

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, 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 systems.

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 2008 was £1.2 million (2007-08: £0.9 million). We concur with management's view that the potential fraud / error is not significant and has not been reflected in the financial statements.

Implementation of International Financial Reporting Standards

The NHS will prepare full IFRS compliant financial statements for the year ending 31 March 2010. This is preceded by a shadow conversion process.

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 ("IFReM"), from 2008-09. Following consultation with Government departments and the Financial Reporting Advisory Board on the technical work needed to implement this change, the Government now intends to move to IFRS from 2009-10 as announced in the 2008 Budget.

Health bodies will be required to prepare their financial statements on the basis of the IFReM from 2009-10. Shadow IFReM financial statements, including an opening balance sheet, will be required for 2008-09. The shadow IFReM financial statements were subject to a 'dry run' audit in accordance with timescales prescribed by the Scottish Government. The timescales are set out in the table below. NHS Scotland has contracted with a third party for support to individual health boards on the application of IFRS.

	Presented for audit	Completion of dry-run audit
Opening 2008 IFRS based balance sheet	28 November 2008	28 February 2009
2008-09 shadow IFRS based financial statements	30 September 2009	30 November 2009

As a result of the audit of opening balances a report was issued to management highlighting the work done, our findings and areas for further work by management. Our work was undertaken in accordance with guidance included in Audit Scotland's note for guidance 2008/6: *Auditors' role in the implementation of international financial reporting standards*. The key points to note from our audit were that management must give further consideration to the accounting treatment of leases held, assets held under the private finance initiative, assets held for sale and investments in joint ventures.

Our work on the 2008-09 shadow IFReM based financial statements will be performed as part of our 2009-10 audit.

The Board met its financial targets – revenue resource limit, capital resource limit and cash requirement. The outturn against the revenue resource limit is consistent with the financial plan, but includes some individually significant movements, including a late funding allocation from the Scottish Government Health Directorate. Similarly, capital spend was in line with plans, but reflected only marginal improvement in the timing of capital expenditure. 59% of capital spend was incurred in the final quarter (2007-08: 61%).

Our follow-up of recommendations to enhance financial management arrangements recognised that some progress had been made in the four months since our initial report. However, significant progress is required in 2009-10 to develop robust arrangements that will mitigate the risk of non-achievement of financial targets and support implementation and monitoring of benefits realised from service redesign proposals.

The Board is participating in a national Audit Scotland study on efficiencies. While the need for efficiencies is clear, limited progress has been made in establishing appropriate processes to identify, monitor and report efficiency savings.

Achievement of the 2009-10 revenue and capital plans will be challenging. Management has identified risks in utilising surpluses brought forward, the impact of pay modernisation and workforce management. We have identified additional risks linked to the lack of formal consideration and linking of finance and activity.

HEAT targets associated with workforce management, including sickness absence, were not achieved.

Arrangements to monitor compliance with staff governance standards and report to the Scottish Government each year could be enhanced through increased use of SMART (specific, measurable, achievable, realistic and timely) criteria and implementation of a clear project timetable.

Management approved the decision not to require competitive tender for 12% of relevant contracts, in line with the Board standing financial instructions and procurement guidelines, due to reasons including sole supplier or suppliers' experience with the Board. Our sample testing did not identify any significant instances where this did not appear to be appropriate.

Recommendations

We did not identify any significant recommendations for development of arrangements to manage the use of resources during our audit of the financial statements, but a number of 'grade one' recommendations were raised during the year and are included in appendix two.

Financial management

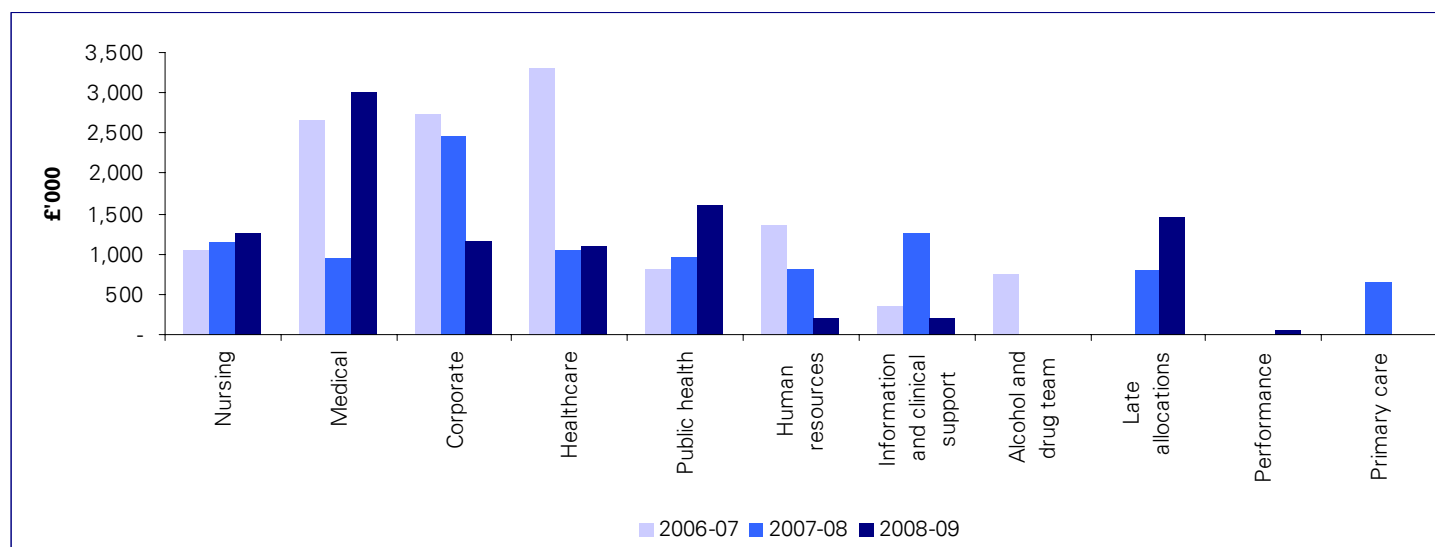
Financial position

Performance against the three financial targets was as follows:

£'000	Original forecast	Final Allocation	Outturn	Variance
Revenue resource limit	617,753	618,987	608,975	10,012
Capital resource limit	37,205	30,492	30,490	2
Cash requirement	658,914	660,500	660,439	61

The 2008-09 outturn is not materially different from the financial plan or routine re-forecasting during the year, but there are a number of individually significant movements, including those identified as a result of the audit process. Achievement of the financial plan was secured on 4 June 2009 following confirmation of an additional 'annually managed expenditure' funding allocation from the Scottish Government Health Directorate to mitigate the impact of late recognition of impairment charges of £1.3 million.

The Board continues to carry forward significant levels of funding into the next financial year, although this is in line with the financial plan. Similar to previous years, the majority of funding carried forward is for specific purposes. The graph below summarises the areas of carry forward into 2009-10.



Financial management (continued)

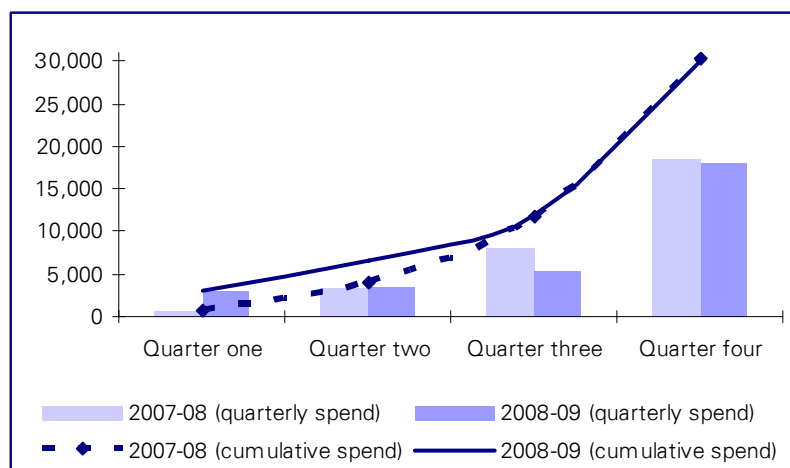
Reconciliation of the financial plan and outturn reported in the financial statements

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
Financial plan forecast outturn against RRL	10,000	Draft financial statements	10,012
Release of unutilised <i>Agenda for Change</i> accrual	3,200	Impairment of land and buildings	(1,300)
Release of bridge financing brought forward	2,600	Additional 'annually management expenditure' allocation	1,300
Other increases in funding and income	2,585		-
Increased expenditure	(8,261)		-
31 March 2009 SGHD return	10,124		-
Immaterial adjustments to provisions	(112)		-
Draft financial statements	10,012	Final financial statements	10,012

Increased expenditure included non-value adding capital expenditure, which is treated as revenue costs, bank and agency nursing overspends and other non-recurring projects. Similar to previous years, management continues to report that all efficiency savings (2008-09: £10.9 million) were achieved on a recurring basis and that non-recurring funding is used solely to meet non-recurring expenditure. Management believe that, for 2008-09, £1.4 million of the £10 million surplus was recurring. In 2009-10, forecasts indicate that the recurring surplus will be eliminated and that the planned £7 million cumulative outturn to be carried forward into 2010-11 will be non-recurring.

Capital expenditure



The outturn against the capital resource limit was similarly in line with plan, but significant capital spend continues to be incurred in the final quarter, and indeed month, of the financial year, as shown below. We reported in February 2009 that management continued to anticipate significant capital expenditure during the last quarter of the financial year. £12.5 million (41%) of the £30.3 million annual capital allocation was spent during the first nine months of the financial year. This demonstrates a marginal improvement on 2007-08, during which 39% of capital spend was incurred during the first three quarters. For 2009-10 the assistant director of finance (planning and efficiency) has requested monthly spend profiles from all managers responsible for capital projects. This aims to allow timely monitoring and reporting of spend against specific targets and to enable management to take corrective action earlier in the financial year.

Financial management and budgetary control

In 2007-08, the Board participated in the pilot of Audit Scotland's toolkit on achieving Best Value through financial management. Our report, issued in December 2008, identified a number of significant weaknesses in existing processes. We reviewed management's progress in responding to our recommendations during the last quarter of 2008. We acknowledge that our follow-up was completed only four months after the initial report. We concluded that, while a number of the implementation timescales proposed by management are not in the immediate future, work needed to commence at an early stage and at the same time as service redesign, rather than retrospectively at a later date. In some areas, significant progress is still required to enhance arrangements in a robust and timely manner. Management needs to commit appropriate and adequate resources to developing and implementing robust systems and reporting mechanisms to fully mitigate the risk of non-achievement of financial targets. The audit committee requested routine follow-up of management's progress, the next stage of which will be reported in late 2009.

Internal processes

The board approves the annual budget setting process, which includes input by clinicians and managers outwith the finance department. Previously, this process focused on allocation of funding uplifts and new monies available, rather than consideration of base budgets. In June 2008 the finance committee received a paper on progress towards re-basing budgets. The paper acknowledged the time required to change the budget setting and operational focus from a geographical one towards a revised focus on integrated pathways. This aim is consistent with the aims of the recent management re-focusing exercise.

The financial management report for the 10 months to 31 January 2009 included, for the first time, a small amount of activity data. The report states that, in the majority of overspending directorates, activity had increased compared to the previous year. We challenged this statement in a number of ways because it assumed that budgets are based on actual activity in the previous year and did not make any reference to potential changes in the complexity of cases or staff mix. Including some activity data is a first step, but we would encourage inclusion of sufficient and robust comparisons to demonstrate the link between activity and cost. This would provide robust explanations of past performance and inform future decisions.

Efficiency savings

In December 2006 Audit Scotland published a progress report of achievements made under the 2004 efficient government initiative. The report reviewed the progress of implementation of the initiative and the extent to which reported efficiency gains were based on robust processes and information. Audit Scotland's current programme of performance audits sets out the intention to undertake a review of the delivery of efficiencies within the public sector. This study will provide an overview of the 2005-08 programme and reported savings. It will also consider how well prepared public bodies are to deliver the 2% efficiency target set in the Scottish Government's 2007 spending review and highlight good practice and areas for improvement. Audit Scotland approached us in February 2009 and requested assistance in completing the fieldwork for the study in relation to a sample of our clients, including the Board, selected for inclusion in the study.

The need for efficiency savings is clear, but there are differences in perception as to how these will be delivered and over the robustness of current arrangements to identify, monitor and report progress. 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 impact of the recent UK Government budget. Consequently, the Board is required to release both cash and time savings through increased efficiency and, from 2010-11 onwards, achieve an internal target of 4%, which exceeds the (current) Scottish Government target of 2%.

Financial management (continued)

The 2009-10 financial process included, for the first time, identification of efficiency savings prior to the start of the next financial year. This process identified a number of specific schemes together with some high level initiatives, such as savings to be achieved through supplies costs and vacancy management. In line with good practice, projected efficiency savings are removed from budgets at the start of the year.

There are no arrangements for reporting progress against targets during the year. Projected efficiency savings are removed from budgets at the start of the year and progress is monitored, indirectly, by considering variances against budget as part of the routine monthly financial reporting process. There is currently no analysis of the reasons for overspends between efficiency savings not delivered and higher / more complex activity, or vice versa, i.e. that an underspend does not automatically mean that there have been higher efficiency savings.

Arrangements to identify, monitor and report efficiency savings are primarily 'basic' and there is a significant risk that the Board will be unable to demonstrate achievement of efficiency savings, albeit that financial plans may be achieved.

Financial planning

The 2009-10 financial plan forecasts a cumulative outturn against the revenue resource limit of £7 million, requiring an in-year deficit of £3 million. The capital resource limit for 2009-10 is £42.8 million; an increase of £12.8 million (43%) from 2008-09. Significant capital projects will include the new Girvan community hospital and the Ayrshire Central community hospital. The increased projected spend, combined with several years' history of disproportionate spend during the last quarter of the financial year, increases the risk of slippage and an underspend against the target, for which the Board may not receive permission to carry forward into 2010-11.

Key risks

Achievement of the 2009-10 financial plan will be challenging due to the need to reduce the carry forward of budgets at the year end. The diagram below summarises the key risks identified by management, together with two additional risks identified during our audit work.

Key risks identified by management

- Reduction in cumulative surplus – the requirement to reduce the cumulative surplus by £3 million.
- Budget reduction – the impact of the recent UK Government budget on NHS Scotland is unknown.
- Reduction of junior doctor hours – work solutions have yet to be agreed to compliance with European Working Time Regulations. Management estimates the likely impact to be at least £2 million.
- Equal pay – the potential impact of claims is not included as management assumes that the Scottish Government would fund these costs.
- International Financial Reporting Standards – the implementation of IFRS will result in the PFI assets being accounted for 'on balance sheet' at an estimated cost of £0.6 million.

Key risks identified by KPMG

- Performance data – limited use of performance data in preparing the financial plans increases the risk that financial planning does not reflect actual activities and therefore is not achievable.
- Efficiency savings – the lack of routine consideration of efficiency savings achieved during the financial year increases the risk that, while budgets may be met, this is due to one-off items. Consequently, additional recurring efficiency savings will need to be identified and delivered in subsequent years (in addition to increasing in-year targets).

Financial management (continued)

Long-term financial planning

The majority of medium and long term change and service redesign proposals within Ayrshire and Arran are based on capital developments. In November 2008, the capital planning group and capital planning steering group agreed the content of the six year capital plan. The plan forecasts gross capital expenditure of £218 million over a six year period. Implementation of the plan will be managed through revised capital programme management and governance arrangements. Since November 2008, the six year capital plan has been developed in detail and included within the local delivery plan. Importantly, the plan clearly allocates 56% of the total planned spend to the three major service re-design projects: review of services (£38 million), mental health (£53 million), and North Ayrshire Community Hospital (£31 million).

The medium term revenue financial plan forecasts a cumulative surplus of £5 million in 2010-11; a reduction of £2 million from 2009-10. Thereafter management anticipate maintaining this level of cumulative surplus, which represents 0.9% of the 2009-10 revenue resource limit of £557 million.

Workforce management

The annual workforce plan identifies current and future staff requirements and links to the objectives of the local delivery plan. HEAT targets included reducing staff absence to 4% by 31 March 2009. However, the annual rate was 5.47% (2008: 5.6%), which is significantly higher than the national average of 4.95% (2008: 5.24%). The high level of staff absence is a key driver of continued use of bank and agency nurses, with a cost of £6.9 million in 2008-09 (2007-08: £5.6 million). Management has taken steps to address staff absence, including 'promoting attendance' training. Similar initiatives contributed to a reduction in staff absence in the month of March 2009 to 4.47%, which is in line with the national average of 4.48%.

Agenda for Change

Assimilation of staff under *Agenda for Change* is nearing completion, with 98% staff assimilated. The review process commenced during the year and 627 posts had been reviewed by May 2009. In addition to the routine review process, recruitment problems in laboratories and psychology led management to identify that staff working in these areas in Ayrshire and Arran are paid at the lowest band for their job. Management believes that these staff should be upgraded, which will assist recruitment, and accrued £1 million at 31 March 2009 to reflect the back pay required to 1 October 2004 for those staff currently in post.

The knowledge skills framework has been designed to ensure there are appropriate training and development arrangements for all staff under *Agenda for Change*. The HEAT target for 2008-09 was that all relevant staff had a personal development plan by 31 March 2009, but this was subsequently extended, by the Scottish Government Health Directorate, to 31 May 2009. Management has reported that 95% of staff across the Board had a personal development plan at 31 May 2009.

Staff governance

Staff governance is the third component of governance, combining with financial and clinical governance to complete the governance framework within which Scottish NHS boards are required to operate. The performance and accountability framework for NHS Scotland will ensure that boards are equally accountable for how they behave as employers as well as their existing accountability for finance and clinical matters. Boards are expected to demonstrate that they are exemplar employers. The staff governance standard sets out the minimum standard that each NHS Scotland employer must continuously achieve in their management of staff. Implicit in the standard is that all legal obligations are met and that all policies and agreements are fully implemented.

In April 2009 we reviewed arrangements to manage the 2009 staff survey, update the 2008-09 action plan and complete the self-assessment audit tool. We made a number of recommendations, including the need to ensure that action plans incorporate outstanding action points from prior years and that SMART (specific, measurable, achievable, reasonable and timely) objectives should be established, which will allow the Board to measure progress against their key objectives.

Asset management

Asset management

Effective asset management can be a key role in improving service delivery and is a key factor in service redesign proposals impacting on acute and community healthcare services. The *Mind your health* consultation process was completed during the year and the chosen option is to rationalise mental healthcare services on the Ayrshire Central Hospital site. In addition, the Board demonstrates best practice through a number of joint initiatives with each of the three Ayrshire councils, including joint premises at the north west Kilmarnock and Largs resource centres.

Procurement

The Board's standing financial instructions outline the procurement process. However, we identified that 12% of contracts (by volume) which, in line with the Board's procedures, should have been subject to a tender process, were awarded without this process being completed. The value of these contracts was £1.2 million. Management reports all such instances of when decisions have been taken not to require competitive tender to the audit committee. These decisions are based on a number of reasons, the most frequent of which include single suppliers of a particular product or service, or a supplier's previous experience with the Board and ability to act quickly. Our testing of a sample of these contracts did not identify any significant errors or indications that the decision not to tender the contract was inappropriate. However, in light of the chief executive's responsibilities as accountable officer, management should keep this area under review to mitigate the risk of any reputational damage that may arise in the event that a contract was inappropriately awarded.

National distribution centre

The centre was established to provide NHS Scotland with an efficient logistics infrastructure and simplify the physical supply chain at both local and national level. The Board was one of the first to use the centre and management identified savings to date of £2.4 million as a result of changes in supplier and the procurement process.

Information management

The information management framework is supported by the information governance steering group, knowledge management and eHealth steering group, and health records steering group; all with senior management representation. These groups consider all areas of information management, from high level strategy and governance, to specific areas such as data confidentiality and information security. Key performance indicators are used to monitor information technology performance on a detailed level and the results are widely communicated. A policy on appropriate use of the internet was recently implemented. All new staff are also required to sign a code of connectivity and data confidentiality. All non-NHS staff who require access to the systems are required to complete a request and have this approved before access will be granted.

The communications strategy is under review and aims to raise awareness and explain decision-making policies and strategies and ensure that staff have access to high quality, accessible and accurate information. An information strategy is currently under development and will include specific information security policies such as data stick encryption. A new programme management office is being established to deal with standardisation of information methodologies and documentation. Freedom of information data releases are tracked by the communications department and data protection queries are the responsibility of the information governance department.

The Board participates in the Ayrshire information sharing protocol; a pilot project for accessing national data. The main objective of the project is to set parameters for sharing information, define justified purposes for sharing data, and discuss security and access measures.

The diagram below summarises key strengths and weaknesses identified during our work on information management arrangements.

Strengths	Weaknesses
<ul style="list-style-type: none"> • The programme management office aims to ensure that new projects are appropriately established, including standardisation of information and use of standard project management methodology. • The Ayrshire information sharing protocol should assist management in improving arrangements through sharing best practice. • Recently implemented security policies and protocols demonstrates the Board's commitment to data security and patient confidentiality. 	<ul style="list-style-type: none"> • There are no formal plans to address workforce and skills gaps and little evidence of consideration of staff training requirements. • Members of the information management team do not routinely hold information governance qualifications. • There is no formal methodology for sharing and communicating information, although an information strategy is being developed.

We plan to issue a report summarising our findings, highlighting good practice and areas for development, in July 2009.

The statement on internal control highlights weaknesses in controls over the use of bank nursing and difficulties in achieving sickness absence targets.

The Board received internal audit's annual report in June 2009, which concluded that "*we did not identify any critical control weaknesses that we consider to be pervasive in their effects on the system of internal control ... however, we did identify a number of areas of higher risk*". Overall, internal audit concluded that they could provide "*moderate assurance on the adequacy and effectiveness of the system of internal control*."

The majority of key financial controls are designed appropriately and operating effectively, but there are recurring instances where controls do not operate on a consistent basis.

Arrangements to participate in NFI have been improved and are operating effectively, but activity is relatively low compared to that of other NHS boards.

Participation in a number of Scottish Government patient safety initiatives enhances clinical governance arrangements. The local continuous clinical improvement board has reviewed operational arrangements and identified areas for development in 2009-10.

CHP structures were revised during the year, as planned, and changes are being implemented in line with an operational development programme. Operational partnerships with councils continue to develop including, for example, completion of the Largs resource centre.

The CHP committees agreed the 2009-10 single outcome agreements and action plans are being developed to underpin these agreements. The same committees are also responsible for monitoring delivery of outcomes during the year.

Recommendations

We did not identify any significant recommendations to improve governance arrangements during our audit of the financial statements, but appendix two includes on recommendation arising from our work on the priorities and risks framework.

Corporate governance arrangements

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. 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.

The board consists of eight executive directors and 15 non-executive directors, including the chair. None of the members of the audit committee have a formal accountancy qualification.

Management re-focusing

In 2007 the chief executive initiated a re-focusing exercise to amend senior management and department structures to reflect a 21st century healthcare organisation. A consultation process followed and in March 2008 the revised structure was approved by the board. The fundamental change was the creation of three health care directorates. The primary aims were to allow healthcare directors to report directly to the chief executive, secure re-alignment of departments with patient pathways, and to increase opportunities for identification and achievement of efficiently targets. Management recognised that the changes led to significant upheaval and that the level of change may result in a loss in momentum in implementing service change and progressing strategic objectives and planned changes.

Management did not agree with our recommendation in April 2009 that a post implementation review of the re-focusing exercise should be performed to ensure that the objectives of the exercise have been met and to identify and analyse direct and indirect benefits realised, both financially and operationally.

Internal audit

Internal audit completed their plan for the year. We relied on a number of reports, including the consultants' contract, risk management, financial systems, financial ledger data migration, the general ledger, payroll, treasury management and fixed assets.

The Board received internal audit's annual report in June 2009, which concluded that *"we did not identify any critical control weaknesses that we consider to be pervasive in their effects on the system of internal control ... however, we did identify a number of areas of higher risk"*. The areas of 'higher risk' highlighted by internal audit are the consultants' contract, workforce futures, facilities / contracting, catering / value for money arrangements, and health records. Overall, internal audit concluded that they could provide *"moderate assurance on the adequacy and effectiveness of the system of internal control."*

Corporate governance arrangements

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, some of these have been reported in more than one year. In previous years, management accepted 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, with the exception of some weaknesses noted, controls are designed appropriately and operating effectively.

Internal audit reported weaknesses in sickness absence rates and controls over the use of bank and agency nursing, both of which are reflected in the statement on internal control.

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 Department's guidance.

Equality and diversity

The Board has not been subject to a review by the Equality Commission. There are clear policies on race, gender and disability equality which are up-to-date and available on the website.

Prevention and detection of fraud and irregularity

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.

National Fraud Initiative (“NFI”)

Health bodies took part in the NFI exercise for the second time. Payroll information remains the main dataset for health bodies. Creditors’ payment history and standing data have been added to the 2008-09 exercise for health bodies as a ‘risk-based’ dataset.

During the first year of participation (2006-07) we concluded that the Board had inadequate arrangements for managing its obligations. Weaknesses were rectified in 2007-08 and management was making progress in implementing a framework for considering data matches in line with an agreed timetable. During 2008-09, management assigned responsibility to the assistant director of finance (corporate and shared services). The data handling exercise was performed securely and management complied with guidance about layered fair processing through notices on staff payslips and the Board’s ‘stop press’ staff updates. Following our recommendations in previous years’, a NFI working group was established in 2008 to manage the NFI process and oversee the approach to resolving data matches. A similar process has been followed in 2008-09 and progress is reported to the audit committee.

We tested a sample of resolved matches and concluded that satisfactory evidence was available to support all matches noted 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	1,334	8	-	-

¹ As at 9 June 2009

There has been limited activity by Board staff on the NFI website during the period 20 April to 9 June 2009 and the number of matches investigated in both years is relatively low compared to the number of matches and the work performed by other NHS boards.

Patient safety and clinical governance

The safety of patients is at the heart of clinical governance and risk management. The Board participates in a number of Scottish Government pilots in relation to improved clinical governance and patient safety, such as MRSA screening. Therefore, the Board is entering the new Scottish arrangements with considerable experience. NHS Quality Improvement Scotland ("NHS QIS") co-ordinated the Scottish patient safety alliance, which launched in January 2008. The aim of the alliance is to use evidence based tools and techniques to reduce healthcare associated infections, adverse surgical incidents, and adverse drug events and improve critical care outcomes; general ward care; organisational and leadership culture on safety.

An NHS QIS visit in November 2008 and subsequent report was positive and noted that there was a willingness and commitment across frontline teams and senior management for the programme and that lessons are being used to ensure continuous improvement and development.

The health and performance governance committee reviews HEAT targets during the year to identify areas of concern and ways in which management can address these issues. Areas of concern highlighted during the year include targets around breastfeeding, sickness absence and the subsequent impact on the standard of care provided, and cancer waiting times.

Management established a local continuous clinical improvement board in January 2009. In May 2009 the board considered the results of an internal review of arrangements to deliver continuous clinical improvement. That review identified areas for improvement, including the need to consider the cumulative and simultaneous burden of initiatives on clinical staff, increase clinical staff and senior management interaction, and improve consistency of processes, information and decisions across the Board. In response, the medical and nurse directors have committed to ensuring that clinical governance and clinical improvement functions are appropriately aligned with each other and across all service areas.

Management continues to develop partnership working arrangements, particularly with the three Ayrshire councils. In line with the community health partnerships' ("CHP") schemes of establishment, approved in 2004, management commenced a review of operational and strategic effectiveness in 2006. Following a review of current arrangements, the board agreed to develop revised structures and endorsed a stakeholder engagement plan in April 2008.

Similar to the approach to the *Mind your health* consultation, management established clear aims and objectives and identified relevant stakeholders to progress these towards implementation of a revised CHP structure. Consequently, management demonstrated to the board in June 2008 that the proposed structure addressed those issues identified during the initial review. As well as benefits, the stakeholder engagement process also identified a number of risks, including the requirement for culture change to ensure the success of the innovative approach and centralisation of power at committee level. Management has reviewed risks identified to ensure that adequate arrangements exist to mitigate these to acceptable levels.

Board approval of the revised structure required changes in the governance and accountability arrangements which, in line with good practice, were approved in a timely manner as follows:

- July 2008 – high level changes, together with those required to reflect the re-focusing exercise, to the standing orders and scheme of delegation; and
- September 2008 – proposed changes to the CHPs' schemes of establishment and delegated authority limits.

Management continued to ensure that the change programme was implemented successfully through preparation and approval of an operational development programme. Phase one of this programme covered the period October 2008 to March 2009 and clearly outlined individual planned activities and associated development outcomes.

Clinical partnerships continue to have a significant role in healthcare provision, including the cochlear implant facilities at Crosshouse Hospital and centralised emergency care for some cardiac patients at National Waiting Times Centre Board and NHS Lanarkshire's Hairmyres Hospital. Where specialist services are provided or received by the Board, recurring funding agreements are in place with partner boards. The Board has partnership arrangements with East Ayrshire Council for completion of the Crosshouse resource centre. A capital grant of £2.1 million was made to the Council during the year towards the costs of completing the centre.

The introduction of single outcome agreements in local authorities formally expands into the NHS for 2009-10 onwards. Single outcome agreements are part of the performance management framework and agreements are between individual local authorities and the Scottish Government. A report to the board meeting on 25 March 2009 confirmed that:

- agreement of single outcome agreements is delegated to CHP committees and has been completed for the 2009-10 agreements;
- action plans are being developed to underpin the agreements; and
- CHP committees will monitor delivery of outcomes under the revised CHP structure.

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. The reports are considered by the audit committee who assigned responsibility and reports are forwarded to the appropriate person or committee.

We submitted a short return to Audit Scotland in February 2009 on the Board's responses and have summarised these below. A second return is due in July 2009.

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
New general medical services contract (July 2008)	✓	n/a	✓	✓ ¹	✗	n/a
Palliative care (August 2008)	✓	n/a	✓	✓ ¹	✓	✗
Diagnostic services (November 2008)	✓	n/a	✓	✓	✓	Every six weeks
Day surgery (September 2008)	✗	✗	✓	✓	✗	n/a
Major capital projects (June 2008)	✗	✓	✓	✗ ²	✗	n/a
Asset management in the NHS (January 2009)	✓	n/a	✓	✗ ³	✗	n/a
Drugs and alcohol services in Scotland (March 2009)	✓	n/a	✓	✗ ⁴	✓	✗
Managing the use of medicines in hospital (April 2009)	✗	✓	✗	✗	✗	✗

1 Actions identified are included within a board strategy.

2 There is no formal action plan, but the report was used to inform changes to internal procedures for approving and developing capital projects.

3 Action plan to be completed following attendance at Scottish Government health facilities Scotland asset management group in June 2009.

4 Action plan to be completed following consideration by the health and performance committee in June 2009.

The recently created department of policy, planning and performance is planning to implement a local system – NHS Ayrshire and Arran performs – to measure and report performance. Performance against targets is routinely reported to the health and performance governance committee, but only by exception to the board.

The Board leads one of the five shared service consortia in NHS Scotland. The service auditor report concludes positively on controls operating in the first year.

Recommendations

We did not identify any significant recommendations for development of performance management arrangements.

Performance management

The 2008 re-focusing exercise created a policy, planning and performance department, led by the new director of policy, planning and performance and a new performance management system has been established. The system – NHS Ayrshire and Arran performs – has been designed to measure and report on local and national targets and objectives. Management's current priorities include the need to ensure that base data to support strategic reporting is available and can facilitate detailed investigation of performance. Only when robust data is available will the new system be rolled out across the organisation. Procedures have been developed to provide a framework in which issues can be quickly escalated and resolved when priorities change. Management has made increasing use of dashboard reporting in year and is changing focus of reporting towards local performance indicators rather than solely HEAT targets. The performance management team provides regular performance information on service provision, HEAT targets and other objectives to the health and performance governance committee.

Management report that 51% of HEAT targets were achieved or on target in 2008-09. Of the HEAT targets not achieved, 25% were more than 5% outside the target. The following table highlights a selection of targets achieved and not achieved.

Indicator	Target	Target date	Actual	Actual date	Achieved / not achieved
All cancer waiting times (65 days)	95%	March 2011	95.01%	September 2008	✓
Ambulance response times	75%	March 2009	76.7%	March 2009	✓
Outpatients waiting over 15 weeks	0	March 2009	0	March 2009	✓
Inpatients / day cases waiting over 15 weeks	0	March 2009	0	March 2009	✓
Child healthy weight intervention	1,419	March 2011	17	March 2009	✗
Alcohol brief interventions	10,697	March 2011	603	March 2009	✗
Smoking cessations	6201	March 2010	1,223	February 2009	✗
Online triage	90%	March 2011	14.02%	March 2009	✗

Public performance reporting

All board meeting agendas, minutes and papers are available to the general public on the website. However, information on performance against HEAT targets is not easily accessible to the general public because performance reporting to the board is on an exception, rather than a routine, basis and therefore only the minutes of the health and performance governance committee are publicly available.

Stakeholder engagement and consultation

Management has used stakeholder engagement consultation to inform the decision-making process throughout the review of acute services and *Mind your health*.

National shared support services

In 2007-08, the Board implemented a proposal to establish and lead a consortium, consisting of Lanarkshire, Dumfries and Galloway, Shetland, and Orkney NHS Boards, NHS Health Scotland and NHS Education for Scotland. The financial services consortium management team oversees the project and includes representatives from all member boards. This team meets on a monthly basis to consider issues, project status, updates on the national shared services programme and risk management. A risk register and action plan exist at consortium and local NHS board level.

The Board appointed a service auditor to provide an opinion on management's controls assurance report. An opinion was provided in line with Statement of Auditing Standards 70 ("SAS 70"), issued by the American Institute of Certified Public Accountants ("AICPA"). We have placed reliance on the SAS 70 service audit findings.

The service auditor concluded that:

"In our opinion, the description of the aforementioned controls as set out in Section 4 of the attached Report presents fairly, in all material aspects, the relevant aspects of NHS Ayrshire & Arran eFinancial controls that had been placed in operation as at 31 March 2009. Also in our opinion, the controls, as described, are designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls were complied with satisfactorily."

Management plan to increase the service offered to members of the consortium, particularly the smaller bodies, through a variety of developments, including:

- full disaster recovery testing across all member boards;
- in-house operational contingency plan;
- implementation of auto bank reconciliations; and
- testing of invoice / purchase order automatching.

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	Late consideration of the impact of the valuation of land and buildings introduced unnecessary volatility in the financial outturn. While additional funding was obtained from the Scottish Government Health Directorate to mitigate the impact on the financial outturn in 2008-09, management should ensure full consideration of such matters at an earlier stage in future years. <i>(Grade one)</i>	Annual valuations will be done by independent valuers and considered for any impact on the financial statements.	Assistant director of finance 31 October 2009
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. <i>(Grade one)</i>	We will work with the equal pay unit which has been established nationally.	Director of finance Ongoing

Appendix two – audit recommendations in 2008-09

Our audit plan overview identified a number of individual areas of work to be performed during 2008-09, following which we issued reports to management and the audit committee. We have summarised the number of recommendations in each report, followed by details of the ten 'grade one' recommendations and management's responses (which were provided at the date of each report and have not been updated at the time of this report).

Report title	Issue date	Total recommendations	Recommendations accepted by management	Grade one	Grade two	Grade three
Best Value: financial management	2 December 2008	11	11	4	6	1
Interim management report	7 April 2009	9	9	-	7	2
Priorities and risks framework report	12 April 2009	8	6	1	7	-
Financial management – status update	15 April 2009	4	4	1	2	1
Staff governance arrangements	30 April 2009	5	4	1	4	-
Total		37	34	7	26	4
			92%	16%	73%	11%

No.	Report, issue and recommendation	Management response	Officer and due date
Best Value: financial management (2 December 2008)			
1	The way in which change will be implemented is not always clear and consistent across the organisation. Clear commitment and direction from senior management is required to ensure the achievement of strategic and financial objectives in coming years.	In November 2008 the board agreed the "stakes in the ground" for capital schemes to take forward over the next seven years.	Director of finance 30 November 2008
2	The previous budgeting process focused on new monies, rather than existing budgets and, although there are plans to address this in 2008-09, they do not include zero-based budgeting and seek only to confirm the accuracy of existing budgets rather than considering service requirements. Management should continue to enhance the budget setting process, preferably through implementation of a zero-based approach, which could be performed on a cyclical and risk based timetable.	In 2008-09 reviews of maternity, orthopaedics and geriatric psychiatry services (with a combined value of over £50 million per annum) were performed in detail as they are relatively high cost compared to Scotland. Other specialties will be reviewed over the next five years on a cyclical basis.	Director of finance Ongoing until 2014

Appendix two – audit recommendations in 2008-09 (continued)

No.	Report, issue and recommendation	Management response	Officer and due date
3	<p>Management reduced operational budgets by £11 million in 2008-09 to reflect the savings to be achieved: service departments had only identified high level schemes prior to the commencement of the financial year, but specific schemes were agreed later in the financial year and detailed reports have now been provided to the board.</p> <p>The ongoing commitment to achieving efficiency savings would be enhanced through identification and agreement of specific programmes in advance of 1 April each year. The budget setting process should be revised to include this key step in the timetable.</p>	<p>The identification of efficiency savings will be made explicit in the budget-setting process.</p>	<p>Director of finance 31 March 2009</p>
4	<p>Financial and performance information is well linked at the planning stage, but these links are not so evident during and after the project, particularly in relation to revenue projects.</p> <p>Benefits realisation is complex and the Board's ability to demonstrate benefits in a timely and accurate manner is mixed. Improved performance in this area will depend on co-ordination between senior finance and operational staff as the benefits obtained are primarily the responsibility of clinical teams.</p> <p>The planned increased use and reporting of key performance indicators and activity levels to the finance committee should be used as the first step in demonstrating the link between financial investment and subsequent performance.</p>	<p>Agreed.</p>	<p>Director of finance 31 December 2009</p>
Priorities and risks framework report (7 April 2009)			
5	<p>Changes from the re-focusing exercise may lead to upheaval and a loss of momentum in implementing service change and progressing strategic objectives and planned changes.</p> <p>Management should plan and perform a post implementation review of the re-focusing exercise to ensure that the objectives of the exercise have been met and to identify, where appropriate, areas for improvement. This should include identification and analysis of direct and indirect benefits realised, both financially and operationally.</p>	<p>The success of the refocused organisation is seen in our achievement of local delivery plan targets and in individual directors achieving their objectives.</p>	<p>-</p>
Financial management – status update (15 April 2009)			
6	<p>Management included some base activity data in the financial report for the ten months to 31 January 2009, but this is an area for further development during 2009-10.</p> <p>The nature and extent of information to be provided should be considered to ensure that it can be used to provide robust explanations of past performance and inform future decisions.</p>	<p>Agreed.</p>	<p>Director of finance Ongoing</p>

Appendix two – audit recommendations in 2008-09 (continued)

No.	Report, issue and recommendation	Management response	Officer and due date
Staff governance arrangements (30 April 2009)			
7	<p>Three of 30 actions in the 2008-09 action plan are noted as complete, but supporting evidence indicates that these have only been partially implemented.</p> <p>Management should implement a robust process of reviewing action in response to previous recommendations to ensure that the 2009-10 action plan is complete and accurate. The 2009-10 action plan should be updated to include these three actions.</p>	<p>The three areas identified within the audit were also identified by the area partnership forum, who requested that the report be amended to reflect that they were 'in progress'. The workforce transport policy and computer access survey actions are being undertaken and are in the final stages of reporting / ratification. The roll-out of the e-Manager system is ongoing and is an integral element of the department of organisation and human resource development workplan for 2009-10. It was not deemed necessary to reflect these actions within the 2009-10 staff governance action plan as progress in completion will be via the relevant committees.</p>	<p>Workforce modernisation manager 15 May 2009</p>