

NHS Borders

Annual Report to Members and the Auditor General for Scotland

2009/10



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The principal objective of our audit procedures is to enable us to express our opinion, in line with the requirements of the Audit Scotland Code of Audit Practice, on the financial statements as a whole. Our audit opinion does not guarantee that the financial statements are free from misstatement. Our audit responsibilities, and their limitations are explained in our letter of appointment.

Any oral comments made in discussions with you relating to this report are not intended to have any greater significance than explanations of matters contained in the report. Any oral comments that we make do not constitute oral advice unless we confirm any such advice formally in writing.

The matters raised in this and other reports that will flow from the audit are only those which have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks at the Board or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared for, and is not intended for, any other purpose.

1. Executive Commentary

Introduction – Section 2

Our overall responsibility as external auditor of NHS Borders ('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 Borders and to the Auditor General for Scotland.

Financial Statements and Audit Opinions – Section 3

The financial statements of NHS Borders 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 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.

Over the last 18 months this has required a significant time commitment by the Finance team and it is to their credit that this first full audit under IFRS has been completed smoothly.

No unadjusted misstatements or significant financial issues were noted in the period, with targeted audit work around the Service Level Agreement with NHS Lothian, a change in the discount rate for pension provisions and the re-categorising of certain short-life medical equipment assets not giving rise to any such matters.

2009/10 Performance – Section 4

The Board budgeted for a surplus of £1.000 million for the year to 31 March 2010. The final outturn was a surplus of £1.039 million. Given the significant impact of unbudgeted cost pressures encountered in the period, arising principally in the form of additional GP prescribing and commissioning expenditure, there were concerns that it may not be possible to achieve the target surplus by year end. Recognising this, the Board identified and implemented a number of discretionary spend measures while later in the financial year the Board secured an allocation of £0.500 million, primarily to focus on commissioning, which also had a positive

impact.

We have also considered the Board's performance and people management arrangements. Whilst appropriate arrangements and reporting mechanisms were noted in respect of performance management, areas of improvement were identified in respect of the levels of reported sickness absence and the Board's progress towards eKSF implementation.

Recommendation 1

Governance and Control – Section 5

We have reviewed 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. Appropriate arrangements and reporting were found to be in place.

We have also considered other aspects of the internal control environment, including partnership working, fraud and the Board's response to outstanding audit recommendations. Appropriate arrangements and reporting were noted.

Additionally, we have reported on the Best Value self-assessment exercise undertaken by the Board in the period and subsequently validated by PwC. From a selection of 18 Best Value toolkits, Board management agreed that 'Planning and Resource Alignment' would be useful area in which to carry out a Best Value assessment. The outcome of the Board's self-assessment noted arrangements in respect of 'Planning and Resource Alignment' as indicative of 'better practices'. PwC validated these findings and concurred with Board's self-assessment.

Managing in Uncertain Times – Section 6

Audit Scotland developed a good practice checklist following the issue of its report: *Improving Public Sector Efficiencies*, in February 2010. 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 the Board should formally assess themselves against each question.

Recommendation 2

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 NHS bodies, including NHS Borders, will be impacted. Regardless of whether an NHS body is in a relatively stronger or weaker financial position, difficult decisions are going to have to be made. We recommend looking at six key areas that our experience in other sectors has shown may be relevant to addressing the challenges ahead:

- Honesty and awareness of the size of the challenge
- Strong leadership

- 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

Recommendation 3

Careful consideration and achievement in respect of each of these areas will go a considerable way to ensuring that NHS Borders will emerge from this unprecedented period of financial challenge on a strong and stable footing.

2. Introduction

Purpose of this report

The 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 from 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 NHS Borders ('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 all Board managers and staff for the assistance they have given us during the audit process.

PricewaterhouseCoopers LLP
Glasgow

21 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. The quality of working papers provided by management was of a high standard. 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 to include a considerable number of additional disclosures. Significant work has been undertaken (in consultation with the PricewaterhouseCoopers' technical support team) to achieve this objective:

Over the last 18 months, this has required a significant time commitment by the Board's Finance team and it is to their credit that this first full audit under IFRS has been completed smoothly.

Approval

The Financial Statements were submitted to the Board's Audit Committee on 21 June 2010 and are to be approved and adopted at the Board meeting on 21 June 2010.

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 of these have been processed by management in the finalised version of the 2009/10 financial statements. We therefore have no unadjusted misstatements to report.

Accounting Issues

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

Service Level Agreement (SLA) – NHS Lothian

The Board forms part of SEAT (South East and Tayside Regional Planning group) and operates SLAs with several of the group's constituent members. By far the most significant of these is with NHS Lothian.

NHS Lothian utilises a costing model, the East Coast Costing Model (ECCM), to calculate the amount which it is due to recover from each SEAT Board member for which it delivers healthcare services. However, in recent years, NHS Lothian has not recovered the estimated costs of delivering the activity levels referred by NHS Borders. This issue is not just specific to the Board, with NHS Lothian noting a shortfall in 'activity reimbursement' against 'activity cost' for several NHS Boards. This under-recovery has been attributed to factors such as uncertainties in the quality of data reflected in the ECCM and the agreement of locally-calculated costs.

This situation gave rise to the Board reaching a negotiated settlement position with NHS Lothian for 2009/10 SLA activity, following a revision to the ECCM model, as approved by SEAT, NHS Lanarkshire and NHS Dumfries and Galloway. The aim of the revised ECCM model is to ensure that future activity with NHS Lothian is reflected in timely reimbursement payments.

The Board is in the process of agreeing a phased uplift in charges over the 3 year period 2009/10 to 2011/12 such that the cost to the Board will reflect the costs

incurred by NHS Lothian at that time. The Board has recently appointed a new commissioning manager to exert further control over SLA expenditure and will aim to manage the increased settlement through repatriating a greater volume of Lothian patients and investing in new facilities where commissioning expenditure is high. This can be evidenced in projects such the development of the Borders General Hospital renal wards.

We have noted the uncertainty around SLA expenditure with NHS Lothian as a concern in prior year Annual Reports, first raising the issue during the 2007/08 Interim Management Letter. However, significant progress has been made in this area and in reaching a formal agreement with NHS Lothian it should be possible to ensure that this expenditure stream will be more tightly managed going forward.

Discounted Liabilities - Provisions

The Board is responsible for meeting additional pension costs arising from early retirement, as well as servicing the cost of awards have been made to current or former employees under the NHS Injury Benefits Scheme. The Board has provided for these liabilities within its financial statements. HM Treasury guidance for 2009/10, which the Board received after the end of the financial year, dictated that the amounts provided should be discounted at a rate of 1.8% in order to accurately reflect the present value of these future obligations. However, in preparing the first draft of the statutory accounts, the Board applied a 2.2% discount rate to each pension provision element, reflecting the rate that HM Treasury required in 2008/09. The difference between the incorrectly applied discount rate and that prescribed by HM Treasury gave rise to an increase in the provision of £65,000. The adjusting entry to reflect this change has been incorporated in the final version of the statutory accounts.

Short Life Medical Equipment – Reclassification Exercise

During the prior reporting period, we identified several assets which were held at a nil book value, but still in use by the Board. In response to this, the Board reassessed the depreciation policy for all assets within the short life medical equipment category.

This exercise identified several assets in this category which were subsequently reclassified as medium-life, as opposed to short-life, medical equipment.

As a consequence, these assets will now be depreciated over a longer useful life, with a lower depreciation charge being taken through the Operating Cost Statement on an annual basis. Depreciation is a non-cash item and as such no cash benefit was realised from this change. However, £376,000 of prior year depreciation charges were credited to the 2009/10 Operating Cost Statement.

Creditors – Creditors Payment Days

The Financial Statements at 31 March 2010 report a decrease in creditor payment days from 16 days in 2008/09, to 13 days in 2009/10.

Government guidance was issued in 2008/09, as a result of the economic downturn stating that suppliers should be paid within 10 days. The Board processes invoices and releases them for payment as soon as they are matched to purchase orders and receipts on the ledger meaning that in the absence of unforeseen issues, this target is expected to be achieved.

Equal Pay

The National Health Service in Scotland has received a number of claims for equal pay including related back pay. By the end of May 2010 there was 34 grievance and employment tribunal claims registered against the Board, with over 11,000 registered across the country. 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.

The CLO has co-ordinated the legal response to all claims and has attended tribunal hearings at which discussion about procedural matters has taken place. The CLO has confirmed that the cases in Scotland are at too early a stage to allow any assessment of the potential financial exposure to be included in the financial statements.

The Board has included a Contingent Liability Note in its financial statements, setting out this matter. The wording used within this note reflects guidance issued by Audit Scotland.

4. 2009/10 Performance

Financial Results 2009/10

| | £m | £m |
|---|-----------|----------------|
| Recurring income | 195.299 | |
| Recurring expenditure (before savings) | (199.219) | |
| Recurring savings | 2.976 | |
| Underlying recurring surplus/(deficit) | | (0.944) |
| Non-recurring income | 7.769 | |
| Non-recurring expenditure (before savings) | (7.614) | |
| Non-recurring savings | 1.828 | 1.983 |
| Non-recurring surplus/(deficit) | | 1.039 |
| Financial surplus/(deficit) for the year | | 1.039 |
| Underlying recurring deficit as a percentage of recurring income | | 0.48% |

Figures confirmed by NHS Borders Director of Finance, Jane Davidson.

The Board budgeted for a £1.000 million surplus for the year to 31 March 2010. The final outturn was £1.039 million. In achieving this surplus, the Board encountered a number of variations from budget, as detailed opposite:

Efficiency Savings

Non-recurring efficiency savings were generated in excess of those budgeted. Much of these savings can be attributed to vacancy control procedures (£1.184m) and control of discretionary spends (£0.429m). Savings were also beginning to be realised from the Board's LEAN programme, through the efficient redesign of organisational processes.

Income

Additional income was recognised in the period as a result of an increase in the budgeted recovery of amounts of £0.200 million from the NHS Injury Cost Recovery Scheme (compensation income reclaimed from Road Traffic Accidents). Further unbudgeted income of £0.200m was received from Scottish Borders Council in respect of funding the region's Rapid Response Team.

GP Prescribing

This increase was attributable for a budgetary over spend of £1.035m, driven by a marked increase in prescribing volumes in the period. Prescribing volumes remain a significant risk to the Board and indeed across the NHS in Scotland and have been recognised as a significant 2010/11 cost pressure.

Medical and Nursing Staffing

A budgetary over spend of £1.187m was incurred in respect of medical and nursing salaries. The majority of this, £1.000m, can be attributed to bank and agency nursing costs, with the remainder being attributable to medical staff.

Services out with Borders (Commissioning)

This overspend in commissioning expenditure totalled £1.928m and can principally be attributed to the NHS Lothian SLA, with both activities and tariffs in excess of budget. Unbudgeted increases in Young Person Unit referrals,

UNPACS (Unplanned Activities provided by a SLA partner that is not covered by the service agreement) and renal referrals were noted as key drivers of this overspend.

Overall Position

Given the significant impact of unbudgeted cost pressures encountered in the period, arising principally in the form of additional GP prescribing and commissioning expenditure, there were concerns during the year that it may not be possible to achieve the target surplus by year end.

In this regard, later in the financial year, the Board secured an allocation of £0.500 million from SGHD primarily to focus on commissioning, while a change to the useful lives of certain medical equipment items had the effect of reducing the total depreciation charge in-year by £0.376 million.

Taken together, these contributed significantly to the achievement of the reported surplus for the year.

Performance against Key Financial Targets

The Board is required to meet three targets each year as set by the SGHD. The performance of the Board against these targets is as follows:

| | Limit set by SGHD £m | Actual Outturn £m | Variance (over)/under £m |
|------------------------|----------------------------|-------------------------|--------------------------------|
| Revenue Resource Limit | 186.659 | 185.636 | 1.039 |
| Capital Resource Limit | 5.690 | 5.679 | 0.011 |
| Cash Requirement | 196.149 | 195.954 | 0.195 |

The Board has achieved all three of its financial targets in the year.

The Board also achieved efficiency savings in the year above the 2% Scottish Government target. Cash releasing revenue efficiencies of £4.804 million were released in the year, against the Scottish Government target of £3.290 million and the Board LDP target, of £5.129 million. Achieving target efficiency savings will become ever more critical over the next few years, as discussed in more depth within Section 6: 'Managing in Uncertain Times'.

Managing Financial Performance

Management receives detailed financial information to help manage performance against budgets and control expenditure. Detailed management accounts are prepared on a monthly basis, while 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 financial management reports for consideration by the Board and senior management. The 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 summarised in the Interim Management Letter, as reported to the Audit Committee on 29 March 2010.

As detailed in Section 3, the revision and subsequent agreement of the ECCM should help the Board in managing its financial performance in respect of commissioning expenditure with NHS Lothian and other SEAT Boards.

The Board has an updated Financial Plan covering the period to 2011/12. This is included within the Local Delivery Plan 2009/10 to 2011/12 which has been approved by the Board.

Managing Performance and Non-Financial Performance Targets

An assessment of the Board's performance management arrangements is detailed in full within the Interim Management Letter. However, the key points and a year-end update is summarised below:

- Performance was reported to the Board and the Strategy and Performance Committee on a monthly basis during 2009/10.
- The information reported and monitored focuses on the achievement of LDP national HEAT targets and local KPIs, as well as a range of other measures including CHCP performance.
- Summarised KPI reports are prepared for every Board meeting, while full KPI reports are prepared for the Board on a 6 monthly basis.
- Strategic Change Programme performance management is monitored through the arrangements detailed above, as well as through formalised quarterly reviews and corporate objective updates.

At March 2010, two HEAT targets – 'Online triage of referrals' and 'eKSF annual reviews complete' - were noted as 'tracking red'. This reflects underperformance against the trajectory level set. We note that through the current performance management arrangements, the Board is aware of underperformance in these areas.

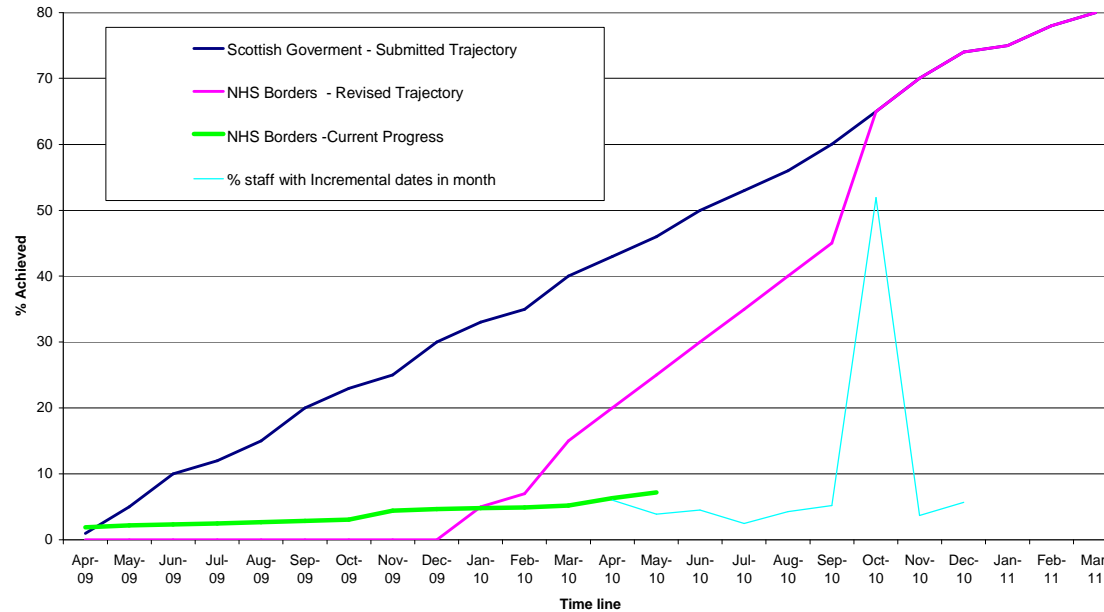
People Management - Sickness Absence

NHS Borders improved its levels of recorded sickness absence in the period, with the rate recorded being 4.48%. This was noted as both a reduction against prior year (0.17%) and against the NHS Scotland Health Board average (0.27%). However, this performance is set against a targeted sickness absence rate of 4% for the Board. Therefore while improvement has been noted, further work is required to achieve the Board's target level.

People Management – Pay Modernisation

NHS Boards are to ensure at least 80% of staff covered by Agenda for Change have their annual Knowledge and Skills Framework development reviews completed and recorded on eKSF by March 2011. This target has been formalised by way of a statutory KPI and the Board's progress (at May 2010) in meeting this KPI is reflected in the following graph:

HEAT - E10 : NHS Boards to ensure that at least 80% of Agenda for Change Staff have their annual Knowledge and Skills Framework Review completed and recorded on e-KSF by March 2011



The gap between the Board’s current progress and the March 2011 target was highlighted in a recent internal audit review. The challenge involved in meeting the target has been acknowledged by management who have recognised that progress is behind initial plans as operational targets have been prioritised. The Board is still working towards meeting previous targets and management should give further consideration as to how efforts can be intensified to achieve the March 2011 targets.

Recommendation 1

5. Governance, Control and BV toolkits

Overall Governance Arrangements

The established Committee framework at the Board remains in place, incorporating Audit, Staff Governance, Risk Management, Clinical Governance, Community Health & Care Partnership (CHCP) and Strategy & Performance Committees, as well as the Board Executive Team (BET). Each of these Committees meets on a regular basis and is chaired by a non-executive member, with the exception of the Risk Management Board which is chaired by a member of the BET.

As reported in our Interim Management Letter (March 2010), the senior management team has undergone significant change in the period, with a new Chief Executive, Director of Finance and Director of Nursing being appointed in the period. Each of these individuals took up post in January 2010. The Non-Executive membership also experienced change in the period, with two members demitting office and one appointment being made. The new appointment was made following a robust recruitment process, with the individual possessing the necessary experience to provide an appropriate level of challenge and scrutiny to the executive team.

The NHS Quality Improvement Scotland (QIS) Standards for Clinical Governance, Patient Safety and Risk Management covers all aspects of clinical governance and risk management from the perspective of patient outcomes. A QIS Clinical Governance and Risk Management monitoring visit was carried out in November 2009, with the Board assessed as mitigating the majority of risks in respect of clinical governance. However, the Board's risk management arrangements were noted as being at the 'implementation' stage, with risk management and mitigating activities requiring dissemination through the organisation. Further comment on this was included in our Interim Management Letter.

Partnership Working

The Board's partnership working arrangements are characterised by SLAs with other NHS bodies, membership of the NHS Tayside Consortium for shared payroll and Cedar e-financials systems and the CHCP with Scottish Borders Council (SBC). Governed by a Single Outcome Agreement, the responsibilities of each partner in the CHCP are refreshed through an annual work plan, the work plan in turn being supported by joint delivery boards. A joint learning and disability service and the integration of mental health services were noted as two areas where partnership working has led to the generation of efficiencies. The CHCP is still developing, with the alignment and integration of monitoring and reporting arrangements continuing to develop. However, further projects of this nature can help both the Board and SBC meet the challenging financial targets ahead.

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 order to add value and address one of the key risk areas identified by management, the Board agreed to undertake the 'Planning and Resource Alignment' toolkit. The evaluation for each module is classified in one of four categories: **does not meet basic requirements; basic practices; better practices; and advanced practices.**

A summary of the Board's assessment against the key areas of the toolkit is detailed below:

| Planning and Resource Alignment Toolkit Module | Evaluation |
|--|------------------|
| Does the organisation demonstrate effective strategic planning and resourcing of its activities to deliver its vision? | Better Practices |
| Does the organisation have a well developed planning framework that ensures effective integration of strategy and resources? | Better Practices |
| Does the organisation's approach help deliver improved outcomes? | Better Practices |

Our detailed findings and assessment of the Board's self-evaluation ratings will be reported to management and the Audit Committee on 21 June 2010.

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 29 March 2010. The report contained 6 recommendations to improve controls, none of which was graded as higher risk. There were also no risks identified that could be considered business critical in nature. The Board 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 the 2010/11 audit process.

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.

Follow up of outstanding recommendations

We followed up on the Board's progress in implementing recommendations made in the prior year, with our Follow Up Report considered at the Audit Committee meeting on 29 March 2010. At the time of reporting, of the 33 agreed actions, progress was as follows:

| Status | Follow Up of 2007/08 Reports | Interim Management Report 2008/09 | Annual Report to Members 2008/09 | Total |
|---------------------------------|---------------------------------|---|--|-----------|
| Action Implemented | 11 | 8 | 0 | 19 |
| Action in Progress | 7 | 2 | 1 | 10 |
| Limited/Little Progress to Date | 0 | 0 | 0 | 0 |
| Not Yet Due | 0 | 1 | 1 | 2 |
| No Longer Applicable | 2 | 0 | 0 | 2 |
| Total | 20 | 11 | 2 | 33 |

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". IT 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.

Several of the Board's IT operations are outsourced to service organisations such as NSS and the Tayside Consortium. As a result, we are able to gain assurance over the Family Health Service, Payroll and General Ledger systems through the receipt and review of service organisation auditor reports, such as a SAS 70. Our review of these reports did not uncover any instances whereby we were unable to place reliance upon the outsourced key financial systems. In other areas, we perform our own ITGC procedures.

From our own ITGC work, two control weaknesses were noted in respect of the Board's IT control environment. These related to 'organisational leaver network access' and 'Board employees' adherence to IT Policy'. While both of these issues were reported in the Interim Management Letter, neither was noted as high risk or impacting the level of reliance placed on the key financial system outputs.

Internal Audit

The role of Internal Audit is set in accordance with Government Internal Audit Standards and therefore its objectives differ from ours. Part of our overall audit approach involves gaining an understanding of the Internal Audit function to determine if it would be effective and efficient to use their work.

During 2009/10, the Lothian and Borders Internal Audit Service continued to deliver the Board's Internal Audit function. We have reviewed the work of Internal Audit and have, where appropriate, placed reliance on their work.

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.

The 2008/09 NFI project is a two year initiative which has just been completed, with the report issued by Audit Scotland in May 2010. The Board met its mandatory requirements in 2008/09 with regard to the submission of payroll data sets and subsequent investigation of matches. As reported in our Interim Management letter (March 2010), no exceptions were noted in our review of this area during the interim audit process. The report issued by Audit Scotland (National Fraud Initiative in Scotland – Making an Impact), detailing the results of the 2008/09 NFI exercise, made no specific reference to NHS Borders.

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 repaying the national debt with the new coalition government planning to halve the debt 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 were serious financial challenges ahead – the biggest since devolution – and making the required savings simply through efficiency will become increasingly difficult.

The report recommends that 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 the Board should formally assess themselves against each question.

These Audit Scotland reports have been presented previously to the Board for consideration. Initially reviewed by the Risk Management Committee, the reports are disseminated through the organisation, helping to inform the scale of the challenge that faces the Board's principal service sustainability mechanism: the Strategic Change Programme. We recommend that those responsible for leading efficiency and improvement work at the Board should formally assess themselves against each question of the 'Improving Public Sector Efficiencies' good practice checklist.

Recommendation 2

NHS Borders Perspective

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.

The Board is already considering how best to respond to the existing drive for efficiencies. We suspect that much of the relatively easier savings will already have been achieved so that the ability of the Board to respond to a prolonged wave of revenue reduction arising from the re-assessment of public spending levels and priorities is likely to be more difficult. Forecasts for the next four years should include "downside" scenarios and challenge from zero and priority-based budgeting. In addition, there are lessons to be learned from other organisations that have already weathered financial challenge and crisis.

While some NHS bodies will be more vulnerable than others, all NHS bodies, including NHS Borders, will be impacted. Regardless of whether an NHS body is in a relatively stronger or weaker financial position, difficult decisions are going to have to be made. We recommend looking at six key areas that our experience in other sectors has shown may be relevant to addressing the challenges ahead:

- Honesty and awareness of the size of the challenge
- Strong leadership
- 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

Recommendation 3

The 2010/11 budget was set against the backdrop of significant economic uncertainty. 2010/11 was within the current three year spending review period with allocations from the Scottish Government linked to the corresponding three year pay award. The severity of the economic conditions has already impacted on future resource availability however with a revised allocation being given by the Scottish Government in 2010/11. This actual allocation to be received represents an uplift of 2.15%, against a pay award for employees covered by the Agenda for Change agreement, of 2.25%.

The Board is required to achieve efficiency savings of 2%, as outlined in the NHS Scotland Efficiency and Productivity Programme: Delivery Framework, published in June 2009. Cash and productivity efficiency savings are required to enable the Board to produce a break-even budget. The Board has identified the savings for 2010/11 to achieve and exceed the targeted 2%, generating £7.927 million towards the annual budget.

Projected Outturn 2010/11

| | £m | £m |
|---|--------------|-----------------------|
| Recurring income | 198.081 | |
| Recurring expenditure (before savings) | (205.402) | |
| Recurring savings | <u>6.398</u> | |
| Underlying recurring surplus/(deficit) | | <u>(0.923)</u> |
| Non-recurring income | 0.500 | |
| Non-recurring expenditure (before savings) | (1.106) | |
| Non-recurring savings | <u>1.529</u> | |
| Non-recurring surplus/(deficit) | | <u>0.923</u> |
| Financial surplus/(deficit) for the year | | <u>0.000</u> |
| Underlying recurring surplus/(deficit) as a percentage of recurring income | | <u>0.00%</u> |

Figures confirmed by NHS Borders Director of Finance, Jane Davidson

Some of the key cost pressures which will impact the achievability of the budgeted savings are detailed in the analysis opposite. Management has undertaken an exercise whereby all cost pressures were identified, allocating funding to those pressures deemed to be the most significant:

CNORIS

Whilst participating in the CNORIS scheme transfers and mitigates significant financial risk, the continued volume increase in claims against NHS Scotland bodies is expected to lead to an increase in the cost of this risk transfer. This is expected to crystallise in the form of an upward revision to the Board's maximum liability in respect of each claim, as well as increase in the volume of claims made.

Rates

From 1 April 2010, Non-Domestic Rates will increase across all of Scotland, following the most recent five yearly adjustment of rateable values. The NHS is not exempt, with management quantifying the monetary impact of this change to be in the region of £0.200 million.

Commissioning

The increased activity and cost of treating NHS Borders residents out with the Board is expected to remain a significant issue throughout 2010/11. Management has agreed that around £0.400 million be allocated to meet this recurring cost pressure.

Prescribing Costs

A 9% increase on 2009/10 prescribing costs has been submitted as part of the 2010/11 LDP. This increase reflects the increased unit cost for the provision of prescriptions, rather the continued upward trend in the volume of scripts. This trend represents a significant risk both to the Board and across the NHS in Scotland.

Financial Plan

The Board has completed its revised three year financial plan, incorporating the impact of the cost pressures detailed above. The financial plan is included within the Local Delivery Plan 2009/10 to 2011/12 submitted to the SGHD for approval.

Service Sustainability

As reported in the Interim Management Letter, the Board's strategic framework for service redesign and sustainability remains the Strategic Change Programme (SCP). We have noted a change since FY09, in that the programme is no longer limited to a three year timeframe and is simply regarded as the organisational redesign mechanism. Timeframes will be implemented once targets are more clearly defined and will be delivered through the 6 SCP workstreams and the Local Delivery Plan. The 6 Strategic Change Programme workstreams are as follows:

- Improving Efficiency, Reducing Waste
- Productivity and Benchmarking
- Operational Budget Savings
- Integrated Health Strategy
- Continuous Improvement
- Sustainable Workforce

An executive member heads each of these workstreams with formal progress updates being reported to the Board on a quarterly basis. SCP updates are also noted as being included as a standing item on the meeting agendas of the Clinical Boards and main committees within the Board, demonstrating that the SCP is the core driver of organisational change.

Service redesign plans are still being formulated and will principally be effected through the Integrated Health Strategy workstream. Current timescales estimate a period of public consultation on planned change towards the end of 2010/11, with the implementation of these changes taking place through 2011/12. Depending upon the period of consultation this would suggest that **any savings and efficiencies achieved by the SCP may not be realised until FY12.**

Thus, while a process is in place for service redesign and sustainability, it may fail to address the full scale of future funding pressures in a timely manner. This matter was raised initially during 2008/09 and as such has been reported upon through the 2009/10 Follow Up of Prior Year Audit Recommendations report. As part of wider efficiency drives, LEAN processes have been embraced by the Board. Through a combination of redirecting existing resources and the addition of an externally appointed LEAN Programme Manager, the Board has substantially increased its resource dedicated to undertaking LEAN projects. These projects have been tasked with contributing £1.900 million of the total savings being targeted during 2010/11.

Appendices

Appendix A – Action Plan

| Ref | Issue and Recommendation | Management Response |
|-----|--|---|
| 1 | <p>NHS Boards must ensure that at least 80% of staff covered by Agenda for Change have annual Knowledge and Skills Framework development reviews completed and recorded on e-KSF by March 2011.</p> <p>A recent Internal Audit review highlighted that the gap between the Board's current progress and the March 2011 target is significant. Management should give further consideration as to how they can intensify efforts to achieve the March 2011 targets.</p> | <p>Management Response:</p> <p>To improve progress with the KSF HEAT target by March 2011 the Board has designated senior management sponsors to lead and a KSF champion to support and facilitate the process within each Clinical Board and Support Services. With the support of KSF Champions, Action Plans are being developed within each department for progressing KSF outline, PDP and review compliance. The Clinical Boards and Executive Directors will receive an update report on their current position on a regular basis so performance and need for corrective action can be identified throughout their scope of responsibility. Progress with KSF action plans within Clinical Boards are a commitment within the Staff Governance Action Plan.</p> <p>Responsible Officer: Director of Workforce</p> <p>Due Date: 31 March 2011</p> |
| 2 | <p>Following the publication by Audit Scotland in February 2010 of their report: <i>Improving Public Sector Efficiencies</i>, a detailed good practice checklist was developed. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement.</p> <p>Those responsible for leading efficiency and improvement work at the Board should formally assess themselves against each question.</p> | <p>Management Response:</p> <p>The report will be considered at the next meeting of the Risk Management Board where an action plan will be devised to ensure that key individuals assess themselves against the good practice checklist.</p> <p>Responsible Officer: Director of Finance</p> <p>Due Date: 31 August 2010</p> |

| Ref | Issue and Recommendation | Management Response |
|-----|---|---|
| 3 | <p>As part of initiatives to generate efficiency savings, management should consider six key areas that our experience in other sectors has shown may be relevant in addressing the financial challenges ahead:</p> <ul style="list-style-type: none"> • Honesty and awareness of the size of the challenge • Strong leadership • 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 | <p>Management Response: Management support the principles outlined.</p> <p>Responsible Officer: Chief Executive</p> <p>Due Date: N/A</p> |

Appendix B – 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 Engagement Letter with Audit Scotland at the start of our 5 year appointment and updated annually. |
| Independence | Audit Planning document ¹ report to 29 March 2010 Audit Committee, confirming no member of audit team has any direct interest, financial or otherwise, in the Board. |
| Audit Approach and Scope | Audit Planning document (reported to Audit Committee 29 March 2010). |
| 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 | Identified in our Audit Planning document (29 March 2010) and addressed satisfactorily through our audit approach over the course of the year. |
| 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. A true and fair opinion provided. |
| Letter of Representation | Signed by Management 21 June 2010. |
| Material Weaknesses in Internal Control | Internal Controls findings reported separately in our Interim Management Letter (29 March 2010), Section 5 of our Annual Report to Board Members and the Auditor General for Scotland. |

¹ The Audit Planning document was agreed in principle with the Acting Deputy Director of Finance prior to the Audit Committee meeting held on 18 December 2009. However, it was not formally presented to the Audit Committee until agreement was reached with the incoming Director of Finance, Jane Davidson, who took up post in January 2010.

| Communication Required under ISA 260 | Reference/Comment |
|---------------------------------------|---|
| Fraud | Discussed fraud arrangements with the Chair of the Audit Committee (29 March 2010) and Management throughout the audit process. |
| Laws and Regulations | We have not identified any material braches of laws and regulations in the period which impact on the 2009/10 Financial Statements. |
| Audit Materiality | Audit Planning document – presented to Audit Committee on 29 March 2010. |
| Fair Value Measurement and Disclosure | Included in representation letter signed by Management, dated 21 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 | 18 December 2009 |
| Audit Planning document | 29 March 2010 |
| Detailed Timetable for 2009/10 Financial Audit | 29 March 2010 |
| Follow-up of 2008/09 Recommendations | 29 March 2010 |
| Interim Management Letter | 29 March 2010 |
| Annual Report to Board Members and the Auditor General for Scotland | 21 June 2010 |
| Audit Opinions 1. True and fair value on the financial statements ✓ 2. Regularity of income and expenditure ✓ 3. Remuneration Report (sections) ✓ | } Unqualified } Audit } Opinions 21 June 2010 |

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"), the Board 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. The Board 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, the Board 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.

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