

Lothian Health Board

Report on the 2006/07 Audit

 AUDIT SCOTLAND

31 July 2007



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Executive Summary

Introduction

Based on our analysis of the risks facing NHS Lothian in 2006/07 our audit work included: a review of governance arrangements, including the adequacy of Internal Audit and a Computer Services Review; a review of the Board's financial position and financial management arrangements; a review of internal control systems and a review of arrangements for Community Health Partnerships. We audited the financial statements, including a review of the Statement on Internal Control. This report sets out our key findings.

Financial statements

We have given an unqualified opinion on the financial statements of Lothian Health Board for 2006/07. The Board carried forward a £179,000 surplus from 2005/06. This, together with the in-year surplus of £4.5 million, has resulted in a cumulative saving of £4.6 million against the Revenue Resource Limit (RRL) in 2006/07.

*Table 1
Financial Performance*

	2006/07	2005/06
	£ Million	£ Million
Net operating costs	1,105.8	1,061.8
Less capital grants to other bodies	(18.2)	(6.8)
Less FHS non-discretionary income	(59.3)	(49.5)
Net resource outturn	1,028.3	1,005.5
RRL (incl surplus carried forward)	1,032.9	1,005.6
Saving against Revenue Resource Limit	4.6	0.1
Capital grants	18.2	6.8
Capital expenditure	29.4	20.9
Capital disposals (@ NBV)	(5.6)	(0.3)
Net capital expenditure	42.0	27.4
CRL	42.6	33.1



Saving against Capital Resource Limit	0.6	5.7
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Financial balance has been achieved in part this year by managing the position using the sale of assets and slippage on projects, realisation of a gain on the re-financing of the Royal Infirmary of Edinburgh, retention of SEHD brokerage and recognition of certain expenditure items as capital grant schemes, as appropriate, thus scoring against the Capital Resource Limit (CRL) and not the RRL. The Board is therefore using non-recurring funding, albeit at a significantly reduced level, to meet both recurring and non-recurring expenditure. While at times this is necessary, the Board should aim to be in recurring balance, and use non-recurring funding only for one-off items of expenditure or specific projects.

A savings target of £15 million has been set for 2007/08. In addition, £13.7 million of unachieved Cash Releasing Efficiency Savings (CRES) in 2006/07 has been carried forward, giving a CRES target of £28.7 million for 2007/08. Whilst acknowledging that £26m was achieved in 2006/07, this remains a challenging target. In respect of 2007/08, however, detailed CRES plans have been submitted by budget holders which compares favourably with 2006/07 when options to meet savings targets were not fully identified nor fully built into the budgets.

Performance management

During the year we carried out a review of arrangements for the management of Community Health Partnerships (CHPs) and related organisations. Our review was primarily focussed on the use of resources, although it also included work on performance management and data sharing. Our draft report is currently being finalised but we note that significant progress has been made during 2006/07 in relation to setting up the partnerships with all relevant services being devolved to the CHPs and CHCP from the Primary Care Organisation which was dissolved on 31 March 2007. We also identified that while the CHPs have the ability to spend and commit expenditure within their budget allocations to ensure they achieve their objectives and those of the Board and Council, the budgets from the Board and Council are not yet pooled, although we are aware that the Board is pursuing this with Council colleagues.

Performance management reporting continues to be developed through the use of CitiStat software and the MIDAS system. In addition, due to early successes, Kaizen lean management techniques are being rolled out to more programme areas.

Governance

NHS Lothian continues to make progress in incorporating strategic objectives in the national report '*Delivering for Health*' in its strategies and objectives: the NHS Lothian Primary Care Modernisation



Strategy (PCMS), together with the overarching framework for mental health, elderly people and learning disabilities, was approved by the Board in March 2007.

During the year we carried out a review of the Board's Financial Position and Financial Management arrangements. This review, which was carried out across all NHS bodies audited directly by Audit Scotland staff, considered whether: financial planning is integrated with the overall strategic aims of the Board, the budget setting processes are robust; and there is adequate scrutiny of financial plans and budget monitoring undertaken across the Board. We noted a number of areas of good practice against a landscape of continuous challenge. In particular good progress was made in the second part of the year to address recurrent overspend in the University Hospitals Division, and a robust Mid Year Review identified areas of non-recurrent income, which assisted in the achievement of financial balance in 2006/07. However, there are clearly ongoing challenges and NHS Lothian has instigated monthly monitoring of financial outturn from Month 1 hereon in 2007/08, and not just after the first quarter.

We reviewed a number of key financial systems and identified weaknesses in internal controls, a number of which related to inconsistencies in either the design or application of internal controls. We were aware that 2006/07 continued to be a period of transition for NHS Lothian as three, and at times four, former departments came together to form a single system.

The Board reviewed its governance structures during 2006/07. Changes to the audit committee structure are being introduced in early 2007/08 to better reflect the new single system organisation.

Audit Scotland
July 2007



Introduction

1. This report summarises findings from the 2006/07 audit of NHS Lothian. The scope of the audit was set out in our Audit Risk Analysis & Plan, which was presented to the Audit Committee on 12 February 2007. This plan set out our views on the key business risks facing the Board and described the work we planned to carry out on financial statements, performance and governance.
2. As at this date we have issued a number of draft reports and a brief Pathfinder Diagnostic Review on the eFinancials system, and we briefly touch herein on some of the key findings. Each draft report set out our detailed findings and recommendations. Appendix A of this report sets out the key risks highlighted in *this* report and the action planned by management to address them.
3. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Board during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk.



Organisational Risks

Introduction

4. At the planning stage we identified a number of risk areas for NHS Lothian. Having now completed the audit, in this section, we describe the risks and our views on their current status.
5. NHS Lothian implemented its second phase of restructuring in April 2005 with the creation of: the University Hospitals operating division; the Primary Care Organisation; four Community Health Partnerships (CHPs) and one Community Health and Care Partnership (CHCP). Since then, NHS Lothian has been moving progressively towards single system working across the whole organisation to ensure that services are planned and delivered on a pan-Lothian basis and that efficiencies are realised where appropriate. A Strategic Change Management Group has overseen this process. For example, during 2006/07, the Board implemented a single financial ledger system and has moved towards a shared financial services structure. In addition, an overarching governance framework which reflects the new single system and the CHPs/CHCP was developed and approved by the Board. We are pleased to note that single system working, particularly at an operational level, continues to develop across NHS Lothian. However, this ongoing development may continue to present challenges in 2007/08.

Risk Area 1

Service sustainability

6. In our 2006/07 audit plan, we commented on the risks relating to the Board's ability to provide appropriate, safe, sustainable services in an environment of changing clinical demands. Those risks included:
 - there may be slippage in the *ICIC* projects if the Board does not have sufficient management capacity to deliver projects in line with plans and achieve the desired redesign of services; and
 - organisational change and costs associated with service redesign projects may affect the Board's ability to meet its key operational targets such as waiting times and delayed discharges as well as its ability to achieve financial balance.
7. *Delivering for Health* sets out a programme of action for the NHS in Scotland to shift the balance of care from episodic acute care, particularly through emergency admissions, to a more proactive approach in the form of preventive care services. *ICIC* was developed by NHS Lothian in response to the issues raised in *Delivering for Health* and the Board continues to develop different elements of it,

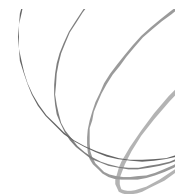


for example at the March 2007 meeting the Board approved its Primary Care Modernisation Strategy (PCMS) together with the overarching framework for mental health, elderly people and learning disabilities.

8. The Board's PCMS is a five year strategy with a wide ranging remit and focus on long-term conditions. It aims to reduce reliance on acute hospitals by shifting care from traditional hospital settings to the community, where safe and appropriate to do so. As a consequence of this move in activity, the Board is progressively shifting financial resources from acute to the primary care sector: in 2006/07 33% of growth monies was identified for Primary Care, and in 2007/08 the percentage is 40%. We are pleased to note that costed action plans are currently being developed for the implementation of the PCMS.
9. NHS Lothian has continued to explore options for service redesign and process improvement during 2006/07. A pilot project of process improvement activities has recently been the subject of evaluation. In partnership with GE Healthcare, the programme was established to enhance the organisation's capacity to deal with significant service redesign. Through the use of Kaizen lean management techniques, 6 specific projects within 2 programmes were selected for detailed review. These included cancer waiting times (CT scanning, urgent colorectal referrals and new patient breast clinics) and delayed discharges (medicine of elderly length of stay, bed management and alternatives to acute admission).
10. The evaluation report (presented to the Board in May 2007), stated that 'the pilot has delivered the objectives originally set and has led to transformational change in those clinical services involved... The organisational experience has been overwhelmingly positive and...has generated almost universal interest and enthusiasm.' The process has now been approved to move into the second phase with two further streams of change projects being identified for review.
11. The objective of providing safe and sustainable services that are in line with the requirements of *Delivering for Health* must be balanced with the need to achieve financial balance. In 2006/07, non-recurrent funding has been crucial to achieving financial balance in-year, rather than investing in service developments. There is therefore a need to ensure recurrent financial balance across the organisation in future years. This matter is discussed further at paragraphs 38 to 44.

Financial management

12. In our audit plan, we commented that there were considerable risks to the achievement of the financial targets in 2006/07. The financial recovery plan and mid-year review prepared by the Board detailed specific solutions to achieve financial balance at 31 March 2007. NHS Lothian achieved the identified solutions. This resulted in remaining within the Revenue Resource Limit (RRL) by £4.6 million. Table



2 below outlines the financial actions taken to achieve the year end outturn of a £4.6 million surplus when compared to the mid-year review position which identified financial pressures of £23.9 million.

*Table 2
Comparison of mid-year review to final outturn position*

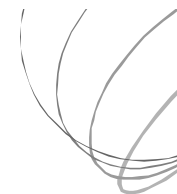
Risk Exposure	£m	£m
Midyear forecast outturn		(23.9)
Brokerage from SEHD	6.0	
Accelerated funding for IT and health improvement schemes from SEHD	3.4	
Finance department efficiencies	3.6	
Expenditure now classified against CRL	4.8	
Gain on sale of Fixed Assets	10.0	
Sub-total		27.8
Revised forecast year end outturn		3.9
Actual year end outturn		4.6

13. As indicated above, NHS Lothian identified a number of actions as part of their financial recovery plan and mid-year review to manage the identified revenue cost pressures.
14. We carried out a specific review of the Board's financial position and financial management arrangements. This area is addressed in the Governance and Financial Statements sections of this report.

People management

15. We highlighted the need for workforce information to be robust and accurate in order to allow management to make informed decisions. We noted in our ARAP that the Board was planning to introduce a new HR system during 2006/07 and all staff were expected to transfer to this system by the end of March 2007. This new system would be a single system across the whole of NHS Lothian and would standardise all HR administration processes.
16. We are aware of some slippage with the introduction of the new Northgate Empower system. It is anticipated that the core modules (recruitment, training and eManager) will be fully operational by November 2007 with the next phase being to establish a number of electronic interfaces and linkages.

Risk Area 2



17. Our plan identified that as NHS Lothian implemented its *Improving Care, Investing in Change (ICIC)* strategy and other modernisation strategies, the Board may be exposed to risks in relation to the retention and recruitment of key staff and the morale of staff generally. We are aware from our ongoing review that the Board recognises these risks and in its 2007 Workforce Plan seeks to address a number of key issues including supply and demand within the workforce and recruitment and retention of staff. The Plan was prepared in accordance with the framework outlined by the Scottish Executive in the *National Workforce Planning Framework 2005 – Guidance*. It takes account of the 'key drivers' of change such as the impact of the Primary Care Modernisation Strategy and *ICIC*. To manage staff concerns about the potential impact of those strategies and plans, the Board seeks to keep staff fully informed on a timely basis in a number of forms of communication.
18. It is anticipated that implementation of this plan will help the Board utilise the workforce effectively in delivering sustainable services in line with *Delivering for Health*.
19. All qualifying staff were due to be assimilated to their new job description and pay bands under Agenda for Change by 31 December 2006. However due to national delays, this deadline has not been met and approximately 11,000 staff (including leavers) have not been assimilated by the year-end. Additional checks are also being performed on the pay arrears calculations for staff who have already been assimilated. Risks therefore remain that the current cost estimates are exceeded when payments are made. There is a year-end accrual of some £31 million and it is essential that all estimates are robust and supported by evidence.

Equal pay claims

20. There have been significant recent developments in the area of equal pay claims. Article 141 of the Treaty of Rome requires member states to ensure and maintain "the application of the principle that men and women should receive equal pay for equal work". This was expanded on in the Equal Pay Directive which made it clear that all such discrimination should be eliminated from all aspects of remuneration. The National Health Service in Scotland has received a number of claims for backdated pay increases, arising from this requirement.
21. As at 31 March 2007 NHS Lothian had received some 2,500 grievances and 1,550 employment tribunal claims and these had been referred for attention to the Central Legal Office. Even taking account of the work which has been undertaken in relation to Agenda for Change, it is still possible that these claims represent a current liability for NHS Lothian; although it is worth noting that we have not been able to obtain from the Central Legal Office any estimate of the potential liability.
22. For 2006/07 we have accepted this position because of its stage of development and as a result of NHS Lothian including within its annual accounts a contingent liability note setting out relevant details on the matter. Nevertheless, we would have expected further details to have been available to



management from the Equal Pay Unit, beyond those currently received from the Central Legal Office, including a reasonable estimate of the Board's liabilities determined in accordance with financial reporting standards. We would strongly encourage NHS Lothian management, working with the Scottish Executive Health Department, to resolve this matter in advance of compilation of next year's financial statements.

Risk Area 3

Information management

23. We noted in our audit plan that a single eHealth/IM&T department has now been created which brings together the eHealth and IM&T staff from the four former NHS Lothian organisations. As with all NHS bodies the increased use of ICT systems presents NHS Lothian with a range of information security challenges. At the planning stage we identified the following risks, all of which the Board is aware of and managing:

- that the eHealth Strategy may not be completed, nor adopted by the Board, nor adequately funded;
- the effective delivery of large eHealth projects is dependent on strong strategic leadership;
- staff at NHS Lothian and partner organisations may not be aware of the security implications of their use of IT equipment; and
- appropriate ICT operational and system maintenance controls may not have been fully applied when the Board implemented the eFinancials system.

24. From our audit work we note that the production of the eHealth Strategy is nearing conclusion. NHS Lothian's eHealth Vision, which described the vision in terms of the infrastructure, software applications, customer service and health records requirements, has been used as the basis for the development of the eHealth strategic direction for the next three years and takes account of a range of NHSScotland national eHealth programmes that NHSL must use. It is expected that this strategy will be complete and formally adopted during the course of 2007. Formal adoption and implementation of this strategy will be key to NHS Lothian's ability to deliver the modern ICT systems envisaged by the Kerr report. Funding implementation of this Strategy will also be a significant challenge to the Board.

Risk Area 4

25. We undertook three specific areas of work to consider the response of the Board to the areas of risk identified above and these are discussed further in paragraphs 109 to 111 below.



Longer term planning issues

26. Longer term planning issues which we have identified will have an impact on the Board in future years are as follows:
- development of medium and low secure facilities to accommodate the transfer of patients from the State Hospital;
 - Modernising Medical Careers; and
 - national shared support services.

Development of Secure Forensic Learning Disabilities Facility

27. Boards throughout Scotland are expected to provide appropriately secure accommodation for patients with learning disabilities living within its boundaries. The development of a South East of Scotland Learning Disabilities Forensic Unit is being progressed with South East and Tayside (SEAT) Regional Planning Group. The unit will be located at Lynebank Hospital in Fife and will provide a facility for those few individuals with learning disabilities who require support within an appropriately secure setting. NHS Lothian is providing approximately £900,000 for the initial revenue funding associated with this Forensic Unit and the Board is currently pursuing a release of revenue from Carstairs State Hospital to mitigate the revenue consequence of the new unit and to ensure that money follows the patient.
28. Under the Mental Health (Care and Treatment) (Scotland) Act 2003, patients have the right to appeal against excessive levels of security, if they have not been transferred from the State Hospital to medium secure accommodation as planned. At present, there are a limited number of these beds in Scotland and NHS Lothian has had to find beds outwith Scotland to accommodate its patients. The unit at Lynebank will therefore enable NHS Lothian as well as its regional partners to provide care that meets patients' needs in the most appropriate environment.

Modernising Medical Careers

29. Work is ongoing regarding the implementation of modernising medical careers (MMC). MMC is included within the NHS Lothian workforce plan which is discussed above. There have been significant challenges in terms of the recruitment process, and changes in the structure of medical training are ongoing, based on decisions made at UK level.



Shared Services

30. During the period from December 2004 to January 2007, NHS Scotland has been developing proposals for shared support services across the sector. It had been envisaged that this would take the form of a 'hub and spoke' system which delivered financial and related services for all NHS Scotland bodies from two central hubs with feeder activities at local Board level. A Draft Full Business Case (FBC) had been developed for this model and was made available for consultation at the end of 2006. The response to the FBC from NHS Scotland organisations, whilst supportive of the overall principle of shared services, was characterised by reservations over the risks inherent in the proposed scheme, the impact on staff and the deliverability of savings.
31. The Shared Support Services Project Board met in February 2007 to consider responses received and concluded that it would not proceed with its Draft Full Business Case in its current form. The project has now been re-launched as the Shared Support Services Programme. This involves a two-tier approach which seeks to build confidence in new ways of working, using common processes and systems, eventually leading to a single services model based on a common finance system. The approaches comprise: a Foundation level of involvement, for all Boards, centring around developing common ledger arrangements; and a Pathfinder approach, which seeks to develop the more advanced elements of the proposed development. Expressions of interest are being sought from Boards for Pathfinder status and a number of workshops have been held to begin the development of potential service solutions.
32. This is a highly significant development for the NHS in Scotland and the process so far has been protracted, with the major recent change in emphasis to a more evolutionary development. It is estimated that a revised business case will not be available until mid- to late-2008. Full system migration is presently estimated at March 2009. There remain significant risks for the service in securing the delivery of the project, particularly in engaging and involving Boards and their staff and in developing systems which deliver clear benefits for the NHS in Scotland. Auditors will continue to monitor the development of these arrangements and the management of related risks.



Financial Statements

Our responsibilities

33. We audit the financial statements and give an opinion on:
- whether they give a true and fair view of the financial position of the Board and its expenditure and income for the period in question;
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements; and
 - the regularity of the expenditure and receipts.
34. We also review the Statement on Internal Control by:
- considering the adequacy of the process put in place by the Chief Executive as Accountable Officer to obtain assurances on systems of internal control; and
 - assessing whether disclosures in the Statement are consistent with our knowledge of the Board.

Overall conclusion

35. We have given an unqualified opinion on the financial statements of Lothian Health Board for 2006/07.

The Board's financial position

36. The Board is required to work within the resource limits and cash requirement set by the Scottish Executive Health Department. NHS Lothian's performance against these targets is shown in Table 3 below.

*Table 3
2006/07 Financial Targets Performance £ million*

Financial Target	Target	Actual	Variance
Revenue Resource Limit	1,032.9	1,028.3	4.6
Capital Resource Limit	42.6	42.0	0.6
Cash Requirement	1,115.0	1,115.0	-

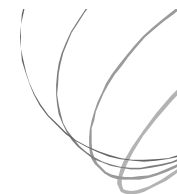
37. The Board has achieved a cumulative surplus of £4.6 million. The Board carried forward a surplus of £179k from the previous year and there was an in-year surplus of £4.5 million.



38. NHS Lothian met these financial targets against the backdrop of a number of financial pressures in-year. These financial pressures were recognised early in the financial year 2006/07, with management implementing corrective action from August 2006. A financial recovery plan was agreed with the SEHD in October 2006. NHS Lothian also formed a Financial Recovery Group to assist Clinical Management Teams (CMTs) in meeting savings targets. Through the challenge of the Financial Recovery Group, CMTs were able to turn around UHD overspending which was transformed from a £1.1m deficit per month for the first six months of the financial year, to month on month financial balance by December 2006.
39. Remaining within the revenue resource limit (RRL) target has largely been achieved through the sale of assets, phasing of developments, realisation of a gain on the re-financing of the Royal Infirmary of Edinburgh (RIE) PFI scheme, retention of SEHD brokerage (£6m) and recognition of certain expenditure items as capital grant schemes, as appropriate, thus scoring against the Capital Resource Limit (CRL) and not the RRL. Where this has been used to support recurring expenditure it will have to be re-provided in future years. Stripping the application of this non-recurring funding out allows us to reflect the underlying recurring funding gap in NHS Lothian for 2006/07, as illustrated below.

Table 4
Funding Position 2006/07

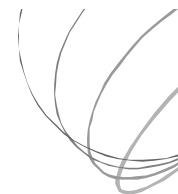
	2006/07 £ Million	2006/07 £ Million
Recurring income	944	
Recurring expenditure	(1,027)	
Recurring corporate savings	15	
Underlying recurring surplus/(deficit)		(18)
Non-recurring income	64	
Non-recurring expenditure	(53)	
Balance of non-recurring		11
Difference		(7)
Non-recurrent savings		11
Financial surplus/(deficit)		4



40. NHS Lothian's 2006/07 financial plan included a £37.7 million savings target to achieve financial balance. At the financial year end the Board reported Cash Releasing Efficiency Savings (CRES savings) of £25.8 million, of which £10.5 million was non-recurring, and the remainder of the balance met through other means.
41. Looking ahead to 2007/08 the Board's original financial plan for 2007/8 includes a savings target of £15 million, which equates to 1.6% of the total RRL allocation, and that part of the 2006/07 CRES target which was not achieved, will also be rolled forward to 2007/08. The total CRES target for 2007/08 is a challenging £28.7 million. Detailed plans have been submitted by budget holders to demonstrate how they will achieve that part of the CRES target for which they are responsible and the plans were approved by the Finance and Performance Review Committee in April 2007.
42. Pay modernisation in the health service has been driven at a UK level. NHS Lothian is active in monitoring the cost and benefits realised from pay modernisation. It estimates that it has spent £70 million on pay modernisation, which has realised benefits to date in the order of £12.5 million. NHS Lothian will be looking for a greater return on their pay modernisation investments going forward and has produced a plan to achieve this. Other areas of financial pressure include: the on-going impact of Agenda for Change, amounting to £6.5 million in 2007/08; £2.3 million being set aside to fund 2007/08 pressure from the GMS contract; and £17.2 million on general developments, including long term conditions expenditure of £2 million and waiting times expenditure of £6.2 million. The increasing cost of fuel resulted in a £5 million uplift in the 2006/07 budget and, similarly, increasing water rates costs will require a £2 million uplift in 2007/08.
43. As already mentioned, financial balance has been achieved in part this year by managing the position using the sale of assets and slippage on projects. The Board is, therefore, using non-recurring income, albeit at a reducing level, to help meet recurring and non-recurring expenditure. While at times this is necessary, the Board should aim to be in recurring balance, and use non-recurring income only for one-off items of expenditure.

Risk Area 5

44. Considerable senior executive time, primarily that of the Director of Finance and Chief Operating Officer of the University Hospitals Division, was consumed during 2006/07 in the renegotiation of the Project Agreement for the Royal Infirmary of Edinburgh, a first generation Private Finance Initiative contract. External advice was sought from financial advisors and lawyers throughout negotiations and the Project Agreement Amendment was signed on 30 March 2007. Further detail is given in paragraph 58 onwards, but in the context of the Board's financial position this agreement secured a refinancing gain in excess of £18 million, £5.2 million of which was recognised in the 2006/07 accounts.



The issues arising from the audit

45. We reported the following main issues to the audit committee on 25 June 2007:

- **Agenda for change accrual:** We drew specific attention to the accrual for increased payroll costs arising from the Agenda for Change programme for the period October 2004 to March 2007. The accrual is necessary to reflect the costs attributable to the thirty month period ended 31 March 2007, but as yet not fully determined by the Board and consequently not yet paid to those staff affected. A national methodology was developed to provide a basis for calculating these costs. The figure included within NHS Lothian's financial statements (£30.1 million) has been arrived at through the use of a detailed financial model. We asked the Board for formal assurance, in a letter of representation, that the accrual, in their judgement, represented a prudent estimate of anticipated cost.

Resolution: Appropriate assurance was provided in the Letter of Representation.

- **Royal Infirmary of Edinburgh (RIE) – PFI: Prior year payments in relation to additional works orders:** Additional work was undertaken on the RIE following completion of the main contract. An appropriate payment was therefore included within the annual unitary charge to cover the costs of these additional works (AWOs). During 2006/07 was agreed that NHSL would buy out these additional works by making a lump sum payment of £4.2 million to the provider, Consort. The effect of this 'buy out' is to reduce future revenue charges while increasing capital expenditure in 2006/07. As noted above, the unitary charge had been adjusted to reflect this work/additional cost. It was also decided by NHSL to treat *prior year* expenditure in respect of these AWOs, as a capital grant in 2006/07. As this expenditure had not actually been incurred during 2006/07 we considered that the prior year elements may fall to be treated as a prior year adjustment. However, such adjustments should only be made where there is a fundamental error or a change in accounting principle, and this reflects neither instance. Following discussion between NHSL and SEHD, we requested that the Director of Finance, who had already raised this issue with the SEHD prior to requesting Board approval, seek formal clarification from the Scottish Executive Health Department (SEHD).

Resolution: The Board have obtained specific written approval from the Scottish Executive Health Department to treat the £1.2 million prior year expenditure as a capital grant in 2006/07.

- **Equal pay claims.** NHS Trusts in England have settled equal pay claims for female employees and similar claims have now been received by Boards in Scotland. NHS Lothian should evaluate the financial impact of any potential equal pay claims and make appropriate disclosure in its financial statements. As a minimum there should be disclosure within the Contingent Liabilities note to the accounts. We have also requested written assurance on this matter in the letter of representation.



Resolution: The known number of claims and an unquantified contingent liability has been included in the accounts and appropriate assurance has been provided in the Letter of Representation.

- **Waste Electronic and Electrical Equipment.** Boards may have an obligation resulting from the Waste Electronic and Electrical Equipment Regulations 2006 which came into force on 1 July 2007. In accordance with the regulations, where waste arises from assets obtained prior to 13 August 2005, Boards will be responsible for the costs of collection, treatment, recovery and environmentally sound disposal of them after 1 July 2007, unless they are purchasing a direct replacement. NHS Lothian is to demonstrate that they have considered the implications of these regulations and do not require a contingent liability or provision for the potential cost of disposal within the 2006/07 accounts. We have also asked for written assurance on this point in a letter of representation.

Resolution: An unquantified contingent liability has been included in the accounts and appropriate reference made in the Letter of Representation.

- **Provisions for pensions and injury benefits:** The Board have used a discount rate of 2.8% in the calculation of the provision. The rate used was based on information originally advised by the SEHD. However, this information was later found to be incorrect as a rate of 2.2% should have been used. All NHS Boards, except two, have now adopted the lower rate of 2.2%. Management have advised that the effect of using the correct rate would be to reduce the surplus against the revenue resource limit by c£900,000. As the incorrect guidance was originally provided by the SEHD, we have asked the Department to clarify whether it remains valid to apply the 2.8% when this is at odds with the guidance applied elsewhere in the SE. NHSL have again confirmed with the SEHD the advice originally provided.

Resolution: Clarification has been received from the SE Accounting Services Unit and in their view it is acceptable to use the 2.8% discount rate in this instance.

Risk Area 6

- **Revaluation reserve:** The revaluation reserve records a balance of some £139.5 million. This reserve should be capable of allocation against individual assets and represents the element of revaluation attributed to the individual asset. Management were unable to attribute some £28.4 million of this reserve to individual assets due to difficulties in identifying supporting documentation relating to the systems in place in prior years. It was agreed that the unidentifiable balance would be pro-rated in order to allow NHSL to move forward. However, this has resulted in a number of negative balances (£0.568 million). Negative balances should only be carried forward when there is no permanent diminution in the value of asset. Management have been asked to provide us with assurance that the negative balance is temporary in nature.



Resolution: Appropriate assurance has been provided in the Letter of Representation.

Risk Area 7

- **Capital grants:** Boards have powers to make capital grants to other bodies who create or develop assets for their own use for the benefit of the Board's residents. The use of capital grants has been discussed for several months between management and ourselves. The figure originally identified was some £18.7 million which was later adjusted to £18.2 million following audit review. We raised a number of matters with management including the need to ensure the availability of the appropriate supporting documentation, ensuring that a clear audit trail is maintained, that agreement has been reached with the third party regarding the use of the capital grant and that expenditure should meet the definition of capital expenditure as used by the Board. We have asked management to provide appropriate assurance that the disclosure and accounting of capital grants to other bodies are in accordance with the Capital Accounting Manual (CAM).

Resolution: Appropriate assurance has been provided in the Letter of Representation.

Risk Area 8

- **Weaknesses in internal controls:** We have issued two management letters detailing instances of potential weaknesses in internal controls on key financial systems. We tailored our final accounts audit work in light of these findings. The nature of these findings, e.g. in procurement, payroll etc, were indicative of a finance function still going through a period of transition over the twelve months to 31 March 2007 as three finance functions became one. We do, however, recognise the enhancement in internal controls as reported by the Chief Internal Auditor in his annual report. We have been advised that the final versions of these management letters will be discussed at the operational audit committee.
- **Resolution:** Final versions of the management letters to be presented to the operational audit committee.

Other matters

46. We reported in our ISA 260 report that although our audit was due to commence on 7 May 2007 draft accounts were not received until 8 May, and that they were subject to completion and amendment on an ongoing basis. As a result of review by both finance staff and audit, and due to the late receipt of information from third parties, 19 significant adjustments were posted to the accounts in the course of the final audit process. This created inefficiencies for both accounts' preparers and the audit team. Of particular concern was the delay in providing the final figures and matching back-up to the fixed assets notes which were not received until the middle of June 2007. As a consequence, two matters



which should have been reported in our ISA 260 were not included. These are discussed further below (see paras 48 and 49).

47. Working papers to support the draft financial statements were not presented to the audit team unless specifically requested. It would prove beneficial to both NHS Lothian staff and the audit team if prime documentation which support the figures in each note were produced at the same time as drawing together the final accounts. This would then allow external audit to more readily conduct straightforward audit procedures and limit interaction with the Finance team to discussions on audit findings. We also encountered difficulties in receiving specific supporting documentation to our sample testing. We look forward to working with management and Finance staff, as proposed by NHS Lothian, to discuss the challenges faced by both parties in the accounts preparation and audit process so as to improve communications, streamline processes and make more efficient use of time in future years.

Risk Area 9

48. As discussed above, our work on reviewing fixed assets was delayed. This was as a result of difficulties experienced with the new capital accounting system which amalgamated the previous systems into one. In particular, we noted that depreciation was not being properly calculated by the system. As a consequence some £300k was incorrectly charged to the operating cost statement. Adjustment of this error would have led to a decrease in expenditure and an increase in the surplus against the RRL.
49. The balance sheet discloses a balance of £139m in the revaluation reserve. However, back up provided by officers totalled some £136m. We are aware that management have reviewed the figures and have advised that any required amendment will be processed in the 2007/08 opening balances by mid-August.

Risk Area 10

50. We noted in our ISA 260 report that Boards have powers to make capital grants to other bodies. We were involved in early discussions with management where we discussed the efficacy of awarding such grants. Guidance requires that:
- Boards must be able to demonstrate that the recipient body has agreed to use the funding for specific capital purposes;
 - expenditure should meet the definition of capital expenditure as applied by the board; and
 - grants should only be used by external bodies for the benefit of the Board's residents.



51. Revised capital grants guidance was issued formally in March 2007 which clarified, to a limited degree, the use of capital grants. (Draft guidance had been made available some months earlier). However, we noted that appropriate back up was not made available at the start of the audit but was provided on an ongoing basis which was dependant upon audit requesting the information.

Risk Areas 8 and 9

52. Our work on capital grants identified some £5.5m being transferred to NHS Lothian's local authority partners through the resource transfer process. We note that while the transfer complied with the requirements of the guidance, the payment represented an agreed change in the use of funding which was previously spent on care packages. As a consequence, the local authorities will have to commit their own revenue funds for care packages. We shall continue to review this area as part of our ongoing audit responsibilities.
53. Due to the amalgamation of the previous financial systems, there were a number of instances where staff were unable to provide valid reasons for changes in the pattern of expenditure between 2005/06 and 2006/07. At the request of the Audit Committee this matter has been disclosed by management in the Operating and Financial Review within the accounts.

Statement on internal control

54. The Statement on Internal Control (SIC) provided by the NHS Lothian Accountable Officer provides a summary of the framework of governance committees and processes which are in place to ensure effective systems of internal control.
55. The 2006/07 Statement provides an update on how matters reflected in the 2005/06 Statement have been progressed, in the areas of, for example, Procurement arrangements, the Records Management Strategy, Junior Doctors' pay, and the roll-out of a redesigned 'hospital at night' workforce initiative. A significant development in 2006/07 has been the integration of three capital accounting records onto one asset register as from 31 January 2007. In respect of other audit areas, documentation presented to the Audit Committee demonstrated that significant progress had been made in addressing outstanding audit recommendations.
56. Whilst the SIC states that no 'unsatisfactory' opinions have been issued by Internal Audit during 2006/07, there were a number of reports which concluded that improvements were required.
57. The areas highlighted in the SIC in need of improvement relates to the role of primary care and the need for it to become a more integral part of the comprehensive emergency plan for Lothian and the continuing development of finance procedure notes.



PFI/PPP schemes

58. NHS Lothian has a number of PFI commitments which are disclosed in Note 25 in the accounts. Five contracts are off balance sheet while the sixth, and largest, the Royal Infirmary of Edinburgh, on-balance sheet. Four of the five off-balance sheet projects are 30/60 bedded units for frail elderly and dementia patients while the fifth is a primary care centre which accommodates 3 GP practices and CHP community activities. The capital values of the off-balance sheets schemes range from £2.1 million to £3 million and the associated annual revenue cost is £4.1 million.
59. There are a number of capital projects at an early stage of development where no decision has been reached as to their method of funding i.e. PPP or traditional methods.
60. The Midlothian Community Hospital outline business case (estimated capital value of £17.6 million) has been approved by the Scottish Executive as a PPP project and the board are currently at the stage of inviting the preferred bidder to negotiate. We shall continue to review progress on this scheme.
61. In the course of 2006/07 NHS Lothian concluded the re-negotiation and refinancing of the Private Finance Initiative (PFI) contract with Consort in respect of the new Royal Infirmary of Edinburgh. Some ten years on from striking the original contract the construction phase is, largely, history, PFI schemes have become more commonplace and have evolved, and senior debt terms have become more competitive than was the case 10 years ago. Consequently Consort has borrowed more, and on more competitive terms, thus releasing a cash gain. No provisions governing refinancing were included in the original contract and Consort have agreed to follow the voluntary HM Treasury Code of Conduct such that the public sector should receive 30% of the overall gain.
62. In March 2007 external financial advisors to the Board confirmed that the transaction, with increased termination liabilities, complied with the Code of Conduct and represented value for money. The Board approved formal sign off of the negotiations such that there was a refinancing gain of £18.3m and assuming maximum increase in termination liabilities.
63. We did not review in detail the sensitivity analysis provided by the Board's financial advisers. However, I note their conclusion that "break even analysis shows that only in the unlikely events of termination as a result of force majeure, corrupt gifts and uninsurable risks would the increased termination liabilities outweigh the refinancing gain received. Further these events would need a 38%-63% probability of occurrence over the life of the contract, as compared to the 1% used for this analysis, for the expected costs to outweigh the expected benefits. The conclusion, therefore, is that it would offer value for money to NHS Lothian to proceed with the refinancing and increase termination liabilities."



64. In the absence of specific guidance from the Scottish Executive, I am satisfied that NHS Lothian made a robust assessment of the benefits of refinancing, based on specialist advice, and that it was appropriate for the Board to agree to the "combined" timing of these gains, ie to accept part of the gain as a lump sum in 2006/07 and part as a deduction on the unitary charge for the remainder of the contract, accepting that a slightly lower quantitative value for money position was obtained in consideration of other quantitative and qualitative benefits arising from the selected solution.



Performance Management

Introduction

65. This section covers our assessment of the way in which NHS Lothian secures value for money in the use of its resources. This year we focused primarily on the management arrangements for Community Health Partnerships (CHPs) and related organisations.

Community health partnerships

66. As part of our risk based assessment carried out during the initial planning stage of NHS Lothian we identified partnership working, specifically through Community Health Partnerships (CHPs), as an area for review in 2006/07. Our draft report, which will shortly be provided to management, focuses on the arrangements put in place by NHS Lothian to develop partnership working in relation to health care services. CHPs are new organisations that were set up in April 2006 to develop community based health services in the Board area. The main objectives of our Partnership Working Review were to:

- examine the clarity of accountability and financial decision making arrangements;
- identify any barriers to effective partnership working;
- assess whether information management arrangements are appropriate and sufficient to support effective decision making;
- consider the adequacy of performance management arrangements;
- ascertain and comment on the governance framework for CHCPs; and
- identify examples of good practice that facilitate effective partnership working.

67. Our review of partnership working focussed on the two Edinburgh CHPs: North and South Edinburgh. East and Mid-lothian CHPs and the West Lothian Community Health and Care Partnership (CHCP), which are also within the NHS Lothian catchment area, were outwith the scope of this review.

68. Within NHS Lothian, significant progress has been made during 2006/07 in relation to setting up the partnerships, with all relevant services being devolved to the CHPs and CHCP from the Primary Care Organisation, which was dissolved on 31 March 2007.

69. The Audit Scotland 'Governance in Community Health Partnerships Self Assessment Tool' (issued May 2006) was used by the Corporate Governance and VFM Manager to review the position of the



CHPs and CHCP against good practice and statutory guidance. A number of recommendations have been made which will be carried forward and addressed by the CHPs and CHCP. We noted that while the CHPs have the ability to spend and commit expenditure within their budget allocations to ensure they achieve their objectives and those of the Board and Council, the budgets from the Board and Council are not yet pooled. However, there is a desire to have integrated or 'pooled budgets' at the appropriate time in the future.

Performance management

70. The Scottish Executive Health Department introduced new delivery and performance arrangements for NHS Scotland during 2005/06. One of the key building blocks of these new arrangements is the introduction of local delivery plans (LDP). The LDP focuses on a core set of objectives, targets and measures that reflect Ministers' key priorities for the Health portfolio. Following agreement of the Board's LDP by the Chief Executive of NHS Scotland and approval by the Board in May 2006, monthly monitoring of progress against targets has been monitored through the Finance & Performance Review Committee.
71. The review and reporting of performance continues to be developed through the use of the MIDAS reporting tool (management information dissemination and action system) and the CitiStat monitoring system. MIDAS is a locally developed system as part of NHS Lothian's commitment to further enhance effective performance management. CitiStat is a performance management and improvement methodology developed specifically for the public sector which involves high level scrutiny meetings which focus on identifying main areas of concern. The MIDAS system comprises three modules: Finance, Activity and Key Performance Indicators (KPIs). Two modules, Finance and Activity, were rolled out in April 2007 while the third, the KPI module, is under development. The Board anticipates full roll out towards the end of 2007.
72. NHS Lothian has also placed great emphasis on using Kaizen lean management techniques to drive efficiencies through the system. A good example of how this is having a positive impact on patient care has been highlighted by the progress made in streamlining the process for patients receiving breast cancer test results. The trial has resulted in patients receiving tests and results on the same day as opposed to having to wait for a week for test results.
73. We are pleased to note that delayed discharge is an area where NHS Lothian has shown improvement at the April 2007 annual census. The Lothian Delayed Discharge Partnership reported a total of 89 patients delayed, compared to 142 patients delayed at the April 2006 census date. This represents a decrease of 37% at the census date.
74. However while the year on year comparison indicates an overall improvement in the position, further analysis identifies an increase in the number of delayed discharges up to September 2006 (250



cases) rising to a peak of 258 cases in February 2007. The number of delayed discharges then falls to 89 in April 2007. NHS Lothian should continue to work closely with its partners to ensure delayed discharges are kept to a minimum throughout the year.

Risk Area 11

75. As part of the 2007/08 audit we will be reviewing the progress that NHS Lothian has made in strengthening their arrangements for securing Best Value since our baseline review in 2005/06. Over the next year we will also be developing and refining our approach to the audit of public bodies' arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.

NHS tariffs

76. During 2005/06 the NHS in Scotland introduced an NHS tariff scheme to standardise the cost of cross-boundary activity. At that point tariffs were set for two specialties and during 2006/07 these have been extended to a further eight specialties.
77. NHS Lothian implemented the eight new tariffs in March 2007. The financial impact of the introduction of these tariffs has led to increased income recovery of some £1.1 million when compared to the original pricing strategy.

Quality and Outcomes Framework

78. The Quality Outcomes Framework (QOF) is part of the General Medical Services contract for general practices and provides financial rewards to general practices for the provision of high quality care. It measures achievement against 146 indicators plus three measures of depth of care.
79. General Practitioners (GPs) assess their own performance against these criteria. However, to ensure that only genuine, high quality care provision is rewarded, NHS boards are required to verify the validity of the performance declared. NHS Lothian uses a two-stage approach to verify the data. GPs submit current and estimated year end QOF information and a comprehensive review of these submissions is undertaken by a group which includes representatives from the Finance Department and Internal Audit. The results of this review are then used to identify practices to visit.
80. During 2006/07, NHS Lothian undertook both random and targeted visits to GPs to verify achievement against the QOF indicators. These visits allow for the verification and inspection of practice data



collected and also provide support to the practice to improve information obtained from clinical systems. Through this review process, NHS Lothian are able to gain assurance that only valid performance has been declared.

National studies

81. In 2006/07, Audit Scotland published three national studies:

- Informed to Care: Managing IT to deliver information in the NHS in Scotland (November 2006);
- Catering for Patients: A follow-up report (November 2006); and
- Planning ward nursing – legacy or design? (January 2007).

In December 2006 an overview report was published: Overview of the financial performance of the NHS in Scotland, and two publications to assist NHS Boards and their members were published:

- Health and community care bulletin (May 2006), a summary of the key findings from the 2005/06 national studies; and
- How the NHS works: Governance in Community Health Partnerships; a self-assessment tool (May 2006).

82. We are pleased to note that NHS Lothian review all national reports produced by Audit Scotland and prepare a position statement for the audit committee which compares where the organisation sits in relation to the matters identified in each report.

Informed to Care: managing IT to deliver information in the NHS in Scotland

83. This national study sought to provide a high-level overview of the national picture at a time when new structures were being put in place across the NHS (unified boards and community health partnerships), new staff contracts are being implemented, there is increasing joint working with other parties, such as local authorities, and there is increasing opportunity for innovation in service delivery and data management with developments in Information Management and Technology (IM&T).

84. The report concluded that 'Delivering for Health', published by the SEHD, signalled a more corporate approach for IM&T, with a shift away from local autonomy for strategic planning and associated decision-making, and that the SEHD recognised the need to review governance and management arrangements for IM&T throughout the NHS and was taking steps to improve them. Nevertheless there is still the need to develop an overarching information framework or strategy to inform the development of integrated IT solutions for the NHS in Scotland, taking account of all information needs and recent policy initiatives.



85. The report highlighted that the NHS does not know how much it spends on IM&T overall, but recognises that it falls short of the Wanless target of 3-4% of total health spend and should it seek to do so the SEHD will have to consider the future funding of IM&T developments. It was felt that greater stakeholder engagement is required to ensure all information needs are effectively addressed, and, finally, best practice in identifying, monitoring and reporting expected benefits from IM&T projects has to be adopted consistently across the service.

Catering for patients – a follow up report

86. This follow-up study assessed progress in implementing recommendations made in a baseline report, published November 2003, in the areas of nutrition, quality, patient satisfaction, costs and management of the catering service.
87. The key findings were that: catering services are offering an improved level of choice; there are improvements in collating the views of patients; there are improvements in associated management information systems; and Boards have reduced the level of wastage.
88. However more work has yet to be done in the areas of: nutritional care of patients; conducting patient satisfaction surveys; and closer management of the level of subsidy for non-patient catering services.

Planning ward nursing – legacy or design? – a follow up report

89. This follow-up study assessed progress made in implementing recommendations made in a baseline report, published 2002, in the areas of: workload and workforce planning, recruitment and retention, the use of bank and agency nurses, information on the quality of nursing care, and information to inform workforce planning and management of resources at ward level.
90. The key finding was that the SEHD has made progress in addressing the recommendations, thus laying the foundations for better ward nursing workload and workforce planning in the future. A wide range of recruitment and retention programmes have been implemented, and dependency on agency nurses (i.e. external to the NHS) has reduced, whilst use of bank nurses (i.e. internal to the NHS) has increased. NHS Lothian's 'candidate-focused strategy' was highlighted as an example of best practice where a solution has been developed locally to overcome recruitment challenges specific to the Edinburgh area.
91. Areas for further improvement were identified in respect of: management information on workload and workforce; planning establishment to take account of annual leave, average sickness cover, study time, protected time for senior nursing staff, etc; closer management on the use of bank nurses and the development of quality indicators.



Governance

92. This section sets out our main findings arising from our review of NHS Lothian's governance arrangements as they relate to:
- clinical governance; and
 - corporate governance.
93. NHS Lothian has been moving progressively towards single system working across the whole organisation to ensure that services are planned and delivered on a pan Lothian basis and that all possible efficiencies are realised. Strategic change management groups have overseen this process, for example: the move towards a shared financial services structure, the implementation of a single financial ledger in 2006/07 and a single complaints group. An overarching governance framework to reflect the new single system and the CHPs/CHCP has also been developed and approved by the Board. Single system working, particularly at an operational level, continues to develop across NHS Lothian and we will continue to review developments during 2007/08.

Clinical governance

94. We noted in our audit plans that a key challenge for NHS Lothian would be to consolidate progress made in moving towards single system working by harmonising clinical governance arrangements across the organisation particularly at an operational level. NHS Lothian's healthcare governance and risk management arrangements have continued to develop during 2006/07. These arrangements are overseen by the Healthcare Governance and Risk Management Committee and supported by the newly established Clinical Governance and Risk Management Support Team which ensures that sufficient resources are available to enable policies to be implemented and monitored. There has been a further strengthening of single system working with the dissolution of the acute division sub committee and replacement by an operational group. In addition, there has been progress in developing single system policies and procedures for guidelines implementation, clinical audit, critical incident reporting, and analysis and informed consent.
95. The Committee has also dealt with updates and action plans relating to NHS QIS service specific reviews including the NHS QIS review of breast screening and maternity services and overseeing the establishment of new quality improvement teams in every directorate and CHP.



Corporate governance

96. Our work on corporate governance focused on our Code of Audit Practice responsibilities as they relate to: systems of internal control; prevention and detection of fraud and irregularity; standards of conduct and the Board's financial position. We have made comment on the financial position at paragraphs 101 to 107.
97. As stated above, the Board's corporate governance structures continued to evolve with further development of single system working over the course of 2006/07. As well as the amalgamation of the two Edinburgh CHPs to become the largest CHP in Scotland, there has been extensive work around the dissolution of the Primary Care Organisation on 31 March 2007 and the transfer of services to the CHPs.
98. Even though a shadow period was in operation between January and March 2007, there remain risks which have to be managed by the Board. These include: the transfer of relevant budgets, the handover of CRES programmes; and the embedding of risk management into the governance arrangements for each CHP. Furthermore, the Primary Care and Partnership Committee has a critical role in monitoring best value and effective and efficient delivery of services provided by the CHPs.
99. We are also aware of proposed changes to the audit committee structure. The UHD and PCO audit committees are to be disbanded and replaced by a single audit committee which will deal with all operational issues. The over-arching NHS Board audit committee will remain and will be able to concentrate on matters of a more strategic nature.
100. We placed reliance on the work of Internal Audit to give us assurance in terms of: systems of internal control; prevention and detection of fraud and irregularity; standards of conduct; and the Board's financial position. We considered three other specific areas of risk to see what governance arrangements were in place to manage them:
- financial position and financial management arrangements;
 - review of key financial systems; and
 - computer services review.

Financial position and financial management arrangements

101. During the year we carried out a review of the Board's financial position and financial management arrangements. This review, which was carried out across all NHS bodies audited directly by Audit Scotland staff, considered whether:
- financial planning is integrated with the overall strategic aims of the Board;



- the budget setting processes are robust; and
- there is adequate scrutiny of financial plans and budget monitoring undertaken across the Board.

102. To address these objectives we conducted interviews with senior finance staff and a small sample of budget holders, and reviewed minutes and documentation in respect of budget planning, budget setting and monitoring, reporting and scrutiny, and, finally, forward planning.

103. In common with other NHS Boards there is continual pressure to deliver high quality services within budget, and in a *demand-led* environment. Consequently financial management in NHS Lothian has a high profile throughout the year and at all levels of management throughout the organisation.

104. Historically, despite achieving significant CRES savings in absolute terms, NHS Lothian does not fully achieve the CRES target that has been set. Each annual shortfall is rolled forward into the next year's CRES target compounding the challenge that faces the organisation. In the context of 2006/07, financial pressures were identified in reviews at the end of Quarter One and Quarter Two. Remedial action was taken to control recurrent expenditure and by December 2006 the University Hospital Division was achieving month on month balance. The Board must ensure timely identification and implementation of specific efficiency saving schemes to be on track to achieve CRES targets earlier in the financial year.

105. The injection of flexibility in the last quarter relating to: gains on sales of fixed assets, a refinancing gain arising from the renegotiation of the PFI contract and finalisation of capital grants, assisted significantly in the achievement of the 2006/07 outturn. Continued close monitoring of financial performance against budget is essential in 2007/08. We welcome the introduction of a high level period one monitoring report by the Board, for April 2007, to identify and address promptly any areas of variance from budget.

Risk Area 12

106. Our review noted the following areas of good practice:

- the mid-year review process which reviews the financial position and identifies areas of risk;
- the use of zero based budgeting within certain specialties;
- the role of the UHD financial recovery team in challenging budget holders to address adverse variances in 2006/07; and
- the Prescribing Forum which reviews prescribing activity.

107. We also highlight the following areas exposed to risk:



- the challenge faced by budget holders to identify and implement appropriate corrective action in addressing adverse budget variances;
- there is one example of where, for a period of time, a budget holder considered the management accounting information for their area to be incomplete, but by working together with finance colleagues the information became increasingly robust and reliable. There is continual challenge to ensure all budget and actual financial information is fully reported per cost centre area, especially at periods of re-organisation;
- pay budgets are, in some areas, set at the mid point of the scale, even when, in certain areas, a large proportion of staff are at the top of the scale; and
- the challenge to achieve *recurrent* CRES, with the knock on effect of any under achievement being rolled forward.

Systems of internal control

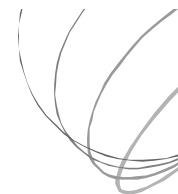
108. As part of our interim audit work, we undertook a review of a number of key financial systems. The systems reviewed included payroll, accounts payable, accounts receivable, procurement and stores. Two reports were issued in draft form to management in June 2007 and are currently being finalised. The issues arising included:

- instances of excessive overtime, which may be in contravention of the EU Working Time Directive;
- an absence of evidence of checks undertaken on some staff engagement/notification forms;
- supplier statement reconciliations were not undertaken during the first 8 months of the financial year;
- credit balances within the debtors ledger were only reviewed once during 2006/07 and not more regularly as intended;
- different stock systems are in place across NHS Lothian; and
- stock write-offs may not be properly recorded.

Risk Area 13

Computer Services Review

109. As part of a risk based assessment carried out during the initial planning stage of the NHS Lothian audit, we identified Information Management and Technology (IM&T) as a priority area for review in 2006/07. We undertook a Computer Service Review (CSR) which provides a high-level risk based



assessment of IM&T services. The report, which is currently in draft form with management, identified that:

- significant organisational change is ongoing within the organisation to introduce single system working. The challenge following the introduction of a single reporting structure for eHealth is to ensure that the good practice that existed in the former organisations is recognised and harnessed in the consolidated procedures and working practices;
- the introduction of a programme office within the eHealth Department has provided the platform to ensure that clinical systems are introduced in a consistent way to all areas within NHSL. A further challenge facing the eHealth Department is how to make use of the project management skills available within this programme office to provide consistent project management rigour to infrastructure developments; and
- prior to the introduction of a single IM&T system the infrastructure deployed in each of the four former organisations was different. Converging these into a single consistent IM&T infrastructure, capable of supporting the vision set out in the *eHealth Strategic Direction*, presents a significant challenge.

Risk Area 13

Pathfinder Diagnostic Review

110. We also undertook a Pathfinder Diagnostic Review of eFinancials to provide assurance that appropriate ICT operational and system maintenance controls were in place. The issues were reported to management in June 2007 and highlighted a number of good practices and potential risk areas. The risk areas included:

- the need for a finance business continuity plan to be prepared; and
- the absence of formal performance monitoring and management of the contractual relationship between the partners providing the eFinancials service may present the risk that NHS Lothian is not receiving the required level of service. Management have since responded to this issue and advised that formal monitoring meetings have been set up but that the documentation which will support these meetings is still being discussed.

Your Business @ Risk

111. All NHS Lothian staff were given the opportunity to complete the Your Business @ Risk web-based survey. Examining how well information policies and procedures are embedded is necessary to gain assurance that they are effective. The results of this survey can help an organisation to identify areas where there is a need to improve information security and governance arrangements. Details of the survey results have been provided to the eHealth Department and a summary of the key messages will be reported to management in due course.



National Fraud Initiative

112. In 2006/07 NHS Lothian took part in the National Fraud Initiative (NFI) in Scotland. The Health Department and NHS Counter Fraud Services have strongly supported the involvement of health bodies in the exercise, which is undertaken as part of the audits of the participating bodies. NFI brings together data from health bodies, councils, police, fire and rescue boards, and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. Health bodies provided payroll data for the exercise. The NFI has generated significant savings for Scottish public bodies (£27 million to 2005) but, even if fraud or overpayments are not identified, assurances may be taken about internal arrangements for preventing and detecting fraud.
113. The NFI 2006/07 results (data matches) were made available to health bodies on 29 January 2007 via a new secure web-based application. Participating bodies follow up the matches, as appropriate, and record the outcomes of their investigations in the application. I monitored the Board's involvement in NFI 2006/07 during the course of the audit.
114. I am pleased to note that the Board established key contacts and nominated other contacts in personnel and payroll at an early stage and that following receipt of the data matches, an action plan was created for each type of match i.e. payroll to payroll within and between bodies, payroll to payroll pensions etc. The findings have been prioritised and work is ongoing to review all high and medium quality matches. The process identified some 1090 potential high quality and 893 medium quality data matches.
115. In accordance with the agreed timetable a progress report has been provided as at 30 May 2007 and it is anticipated that the investigative work will be completed within the required timescales. We will continue to monitor the Board's progress in this area.



Looking Forward

116. NHS Lothian faces significant challenges in 2007/08 which include:

- The national shared support services timetable has been further delayed. There is a risk that the Board develops its systems in an individual manner, separate to any future shared service and the uncertainty for staff will continue for the foreseeable future. The Board should ensure any system improvements or changes are aligned with the national project development.
- While a surplus of £4.6 million was achieved in 2006/07, this represented a significant challenge to the Board. The financial position has been achieved this year through the use of non-recurring sources of funding. These challenges will continue in 2007/08 due to the tighter regulatory environment with the removal of Board's ability to retain gains on the sale of capital assets.
- The Board's Primary Care Modernisation Strategy was approved in March 2007. Detailed and costed action plans are currently being developed and require to be implemented. In 2007/08, it is important that NHS Lothian can demonstrate that the balance of care is continuing to shift from secondary care to primary care within a community setting.
- Single system working should continue to develop and deliver efficiencies in working practices and financial resources.
- The redesign of services as part of *IC/C* brings risks with the implementation of new ways of working, associated financial implications, and potentially, double-running costs for at least some of the introductory period.
- Equal Pay claims were not calculated in 2006/07 and will be running into 2007/08. This issue, together with Agenda for Change may have implications for the financial position and have associated staff morale issues.

117. The Board recognises these challenges and is taking steps through its planning processes to address them. We will continue to monitor the progress that the Board is making on these key issues.



Appendix A: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para. No	Risk Identified	Planned Action	Responsible Officer	Target Date
1	5	Single system working continues to present challenges to the Board as it moves forward. There is a risk that the planned efficiencies are not achieved.	Move to Single System working is progressing well. Delivery of efficiencies is led by identified individuals to agreed timescales to minimise risk	Director of Acute Services & Workforce	Ongoing
2	16	There has been slippage in the introduction of the new HR system. There is a risk that legacy systems continue to be used which are sub-optimal.	The Empower HR system implementation plan continues to be project managed by NHS Lothian eHealth department, with a delivery date of November 2007. The HR department provide resource to support this implementation across NHS Lothian and establish the requisite interfaces to other corporate and National systems. The Project Board is chaired by Ruth Kelly, an Associate Director of HR	Director of Acute Services & Workforce	Nov 07
3	22	NHS Lothian should work with the SEHD to clarify issues and potential costs relating to equal pay claims in the NHS in Scotland. There is a risk that the potential liability is not disclosed appropriately in the financial statements.	NHS Lothian in common with all other Boards has regular discussions with the SEHD and the CLO on this issue. The Equal Pay Unit within the SEHD has specific responsibility for taking forward this issue	Director of Acute Services & Workforce	Dec 2007
4	24	The eHealth strategy requires to be finalised and adopted by the Board. Without a strategy driving the organisation forward, there is a risk that NHS Lothian will be unable to deliver the appropriate level of service.	The NHS Lothian eHealth Strategy was completed in June 2007, and was approved by the NHS Lothian Informatics Management Group (IMG) on 26 th July 2007.	Director of eHealth	Jul 07
5	43	The Board is using non-recurring income to meet both recurring and non-recurring expenditure. Where possible, the Board should aim to be in financial balance using non-recurring income to meet non-recurring expenditure.	There has been a significant reduction in the level of non-recurrent income used to meet recurrent expenditure over the past 4 years from a level of 5% to the current level of 1%. This will continue to be assessed as part of the financial planning for NHS Lothian	Director of Finance	Mar 2008



Action Point	Refer Para. No	Risk Identified	Planned Action	Responsible Officer	Target Date
6	45	The discount rate for pension and injury benefits provision, as notified in the accounts manual, should be used in 2007/08. There is a risk of the accounts being incorrectly stated.	NHS Lothian will continue to action advice from the Scottish Executive to the discount rate to be used	Director of Finance	Mar 2008
7	45	Negative balances being carried in the revaluation reserve should be reviewed to ensure that there is no permanent diminution in the value of the associated assets.	NHS Lothian will review the negative balances to assess whether the diminution is permanent and take action as appropriate	Director of Finance	Mar 2008
8	45	In order to ensure compliance with the relevant guidance, management should ensure that appropriate documentary evidence for capital grants is maintained.	NHS Lothian will continue to ensure compliance with the relevant guidance	Director of Finance CHCP/CHP General Managers	Mar 2008
9	46, 47	The processes for the production of the annual accounts should be standardised, ensuring at all times that there is an accessible documented audit trail between the financial statements and the financial ledger. By anticipating the supporting documentation external audit are required to examine, this will make the audit process more efficient for both accounts preparation staff and auditors.	2006/07 was the first year of new external auditors. Issues arose during the audit both with NHS Lothian and Audit Scotland which reflected the fact that this was the first year. A review meeting will take place shortly to consider how the audit went and identify issues to be addressed for future years.	Director of Finance	Sep 2007
10	49	The revaluation reserve as disclosed in the balance sheet did not originally agree to back up. Management should ensure these two figures are reconciled to fulfil their intention of commencing 2007/08 with the revaluation reserve clearly allocated across the NHS Lothian estate.	Actions are in hand to address this issue	Director of Finance	Sep 2007



Action Point	Refer Para. No	Risk Identified	Planned Action	Responsible Officer	Target Date
11	74	The number of delayed discharges fluctuates during the year. There is a risk that patient care is affected and that care is not provided in the most appropriate location.	NHS Lothian is proud of the progress made in reducing the level of delayed discharge and a plan is being put in place to ensure that agreed targets are met in a managed way in future.	Director of Strategic Planning & Modernisation + Lead Director	Mar 2008
12	104,105	In order to achieve financial balance, realistic and achievable savings plans should underpin the CRES target and performance against budget must be closely monitored.	NHS Lothian has achieved the highest level of efficiency savings in Scotland in each of the last 2 years. CRES plans are in place for 2007/08 and are being monitored on a monthly basis with corrective action being taken where required		
13	108,109	Control weaknesses identified through reviews of systems of internal control should be prioritised by management and appropriate action taken.	Significant progress has been made in 2006/07 as recognised by Internal Audit and evidenced through progressing Audit recommendations. A significant number of the issues identified have already been implemented and timescales with identified lead individuals have been agreed for all others		