

INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

# **The State Hospitals Board for Scotland**

Annual audit report to The State Hospitals Board for Scotland  
and the Auditor General for Scotland

Year ended 31 March 2010

28 June 2010

AUDIT

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**About this report**

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of The State Hospitals Board for Scotland and is made available to Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

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The hospital redevelopment continues to progress in line with the strategic aim of the Board to “ensure patients are treated in accommodation appropriate to their needs, and in an environment that supports rehabilitation”. The full business case for this was agreed by the Scottish Government Health Directorate in 2007 and construction work commenced in March 2008. The development has progressed significantly during 2009-10 with the closure of wards in the south of the site in November 2009. The activity centre and essential services were completed in December 2009, but due to the extreme weather conditions there was water damage to phase 1 buildings. Therefore, the activity centre had to undergo remedial works before being opened to patients in January 2010.

At 31 March 2010, bed occupancy was 136 reduced from 153 in the prior year. As well as meeting strategic aims over patient treatment and care, the hospital redevelopment will help the Board to meet sustainability targets. This will be achieved through the use of renewable fuel for heating and hot water and the overall energy-efficient design of the redeveloped hospital. These features of the design will also help the Board reduce costs and meet ongoing efficiency targets. It was also noted that the hospital has approximately 36 acres of non-operational land that could be used to further contribute to sustainability targets in the future.

The Board continues to develop a detailed local delivery plan setting out their agreement with Scottish Government Health Directorate. In 2009-10 an area of good performance was the significant effort to improve the physical health of patients, monitored through several different key performance indicators. The Board has reported improvements in a number of these areas, including patient obesity and levels of patients accepting the offer of fresh air.

The Board met its financial targets for the year; the outturn was ahead of forecasts.

The local delivery plan for 2010-14 was submitted to Scottish Government Health Directorate and approved on 31 March 2010. This is supported by the financial plan and workforce plan. The 2010-11 financial plan forecasts a breakeven cumulative outturn against the revenue resource limit reflecting financial balance for the year. Management continues to use the financial plans to monitor progress of the redevelopment and has noted this area as a key risk to achieving budgeted results going forward. Achievement of the plan will be challenging due to the financial risk that workforce plan assumptions may not be delivered. There are also a number of risks around the redevelopment which could have a financial impact.

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

### Audit framework

This year was the fourth of our five-year appointment by the Auditor General for Scotland as external auditors of The State Hospitals Board for Scotland ("the Board"). This report to the Board and Auditor General provides our opinion and conclusions and highlights significant issues arising from our work. We outlined the framework under which we operate, under appointment by Audit Scotland, in the audit plan overview discussed with the audit committee on 27 January 2010.

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

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

### Best Value

Audit Scotland and the Scottish Government have been committed to extending the Best Value audit regime across the whole public sector for some time now, with significant amounts of development work having taken place during the last year. Using the Scottish Executive's nine best value principles as the basis for audit activity, Audit Scotland selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). In 2009-10 we completed work on arrangements to achieve Best Value through financial management.

### International financial reporting standards

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

### Responsibilities of the Board and its auditors

External auditors do not act as a substitute for the Board's own responsibilities for putting in place proper arrangements to account for the stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through the accountable officer, to make arrangements to secure Best Value.

### Acknowledgement

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

### **Service redesign and sustainability**

Service redesign and sustainability at the core of Board activities through the hospital redevelopment. The board has a vision of where the organisation will be in the future, outlined in the local delivery plan. The 2009-13 local delivery plan (issue: 09/10 V3) is applicable to the current year. The local delivery plan ("LDP") is normally underpinned by a financial plan for the same period, but due to the scale of the hospital redevelopment, the Scottish Government has requested a five year financial plan in support of the LDP. In previous years, the LDP would have been made available for wide consultation through the annual review event, but there was no event planned for 2010. This is due to the main issues within the LDP, being the implementation of the clinical model which was approved during 2009-10 after wide consultation. It was noted at the board meeting in August 2009 that the clinical model would 'provide a clear platform on which the new State Hospital would base new ways of working and ensure best value'.

The chief executive leads NHS regional planning links with other professional relationships in place to support best practice. In order to share best practice, directors and heads of service have links and regular liaison with English special hospitals. The Board works in close partnership with the Forensic Mental Health Services Managed Care Network.

### **Scrutiny and governance**

The Board has good scrutiny and governance arrangements in place. The QIS peer review on risk management arrangements took place in November 2009 with the Board maintaining 'level three'. It is the intention of the board to review the clinical governance and risk management evaluation plan to ensure continuous improvement. With regard to staff governance, it is the opinion of the board that all staff have the right to be consulted on matters which affect them and their work environment. Therefore, staff are consulted through various channels such as circulars, intranet, staff bulletins, strategy days etc. There are five communication strands; patients, carers, development of new State Hospital, public/media, and hospital staff. A number of communications strategies have been developed to support both internal and external communication including the internal communications strategy. The communications framework for the whole hospital, 2010-13, was updated and approved by the staff governance committee in March 2010. The board also considered the need to submit a new freedom of information publication scheme for the Scottish Information Commissioner's approval. The Board has information security policies in place in relation to data protection and freedom of information. Information governance training modules are available to staff to improve their understanding over high risk areas of confidentiality and data protection. The focus for 2010-11 is to launch the remaining training modules as, due to the nature of the patient group, the risk of a breach of confidentiality is considered to be high.

### **Patient safety and clinical governance**

Due to the patient group, a key focus is the need for patient safety and clinical governance. The Scottish Patient Safety Alliance (SPSA) was launched in 2007 and pilot sites were identified across the country. Although the Board is not a pilot site, it was keen to make best use of the initiative and devised a strategy and action plan 2009-11. The second phase of the national programme will include mental health safety issues. A relevancy exercise was undertaken in April 2008 to consider whether all of the national initiatives would be appropriate in a mental health setting. The following aims were considered as the key areas for the Board: a) deliver evidence-based care to prevent deaths from heart attack, b) prevent adverse drug events, c) reduce the likelihood of the transmission of blood borne viruses, d) hand hygiene, e) drive a change in the safety culture in NHS organisations. The launch of the patient safety programme took place in August 2009.

### Financial management and affordability

The board has established an appropriate framework for the monitoring and control of financial management, including over the hospital redevelopment. Annually, the board approves a financial plan covering one year in detail and five years at a high level. The five year plan is under review throughout the year and any changes are agreed at mid year and annual reviews. Performance against the financial plan is regularly reviewed at board meetings. The plan for 2010-11 was considered by the board on 22 April 2010 with an appendix of comments from Scottish Government Health Directorate produced when signing off the LDP.

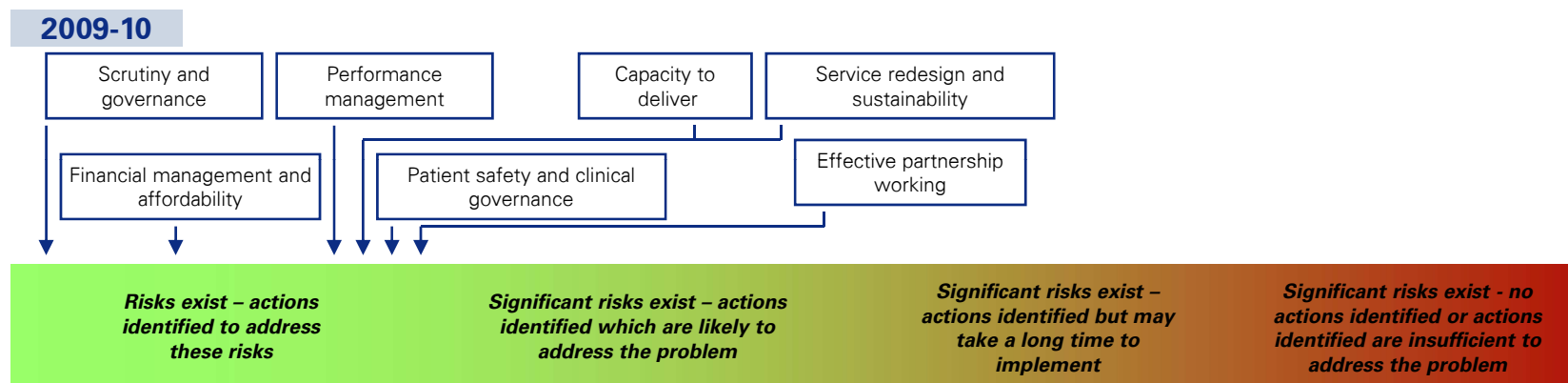
### Performance management

The finance and performance director is responsible for financial planning and performance management on behalf of the board. The finance and performance director monitors financial performance against budget and strategic plan which is then reported at board meetings. As in previous years, the performance management system uses financial and non financial systems to report on the budget and LDP objectives. Management has made sufficient arrangements for the monitoring of key projects through the establishment of individual groups charged with performing regular appraisal and control over project activities.

### Capacity to deliver

The key project of redevelopment requires accurate estimates and plans for workforce requirements in order to maintain appropriate capacity to deliver. The workforce plan is updated annually and is centred on the level of services required as part of the full business case for the redevelopment. It is supported by a development plan, corporate training plan and directorate training plan. From the 2010-11 financial plan it is evident that the higher financial risks relate to savings required from workforce changes. In relation to the workforce, it was noted that the Board has not met the national sickness absence target of 4% for 2009-10. The performance for the year ended 31 March 2010 was 5.61%. The target for 2010-11 has been amended to 5%, in agreement with the Scottish Government.

The Board continues to perform well under the various priorities and risk framework headings and consistently with the previous year, as demonstrated below:



### Best Value

In April 2010 management completed one of Audit Scotland's toolkits for monitoring Best Value arrangements. An internal assessment was carried out over arrangements for maintaining financial management within the Board. The assessment considered factors including: the role of senior management in fulfilling financial management responsibilities; distribution of financial management skills within the organisation; processes for monitoring and challenging financial matters; linkage of financial management strategies with strategic planning; and arrangements for investment appraisal.

We evaluated management's responses and wider evidence and concluded that the Board demonstrated at least 'basic' practice in all areas, with a considerable number showing 'better practice' or 'advanced practice'.

Examples of advanced practices included: bi monthly preparation of financial information subject to active challenge by senior management; regular communication between budget holders and the Board's finance team to monitor in-year progress against financial targets; linkage between financial and service/workforce planning to allow effective allocation of the organisation's resources; and established procedures for undertaking and monitoring risk assessments over capital projects.

Identified opportunities for improvement include: completion of training programmes under development for non finance managers to allow for informed input into budget setting processes; further work to ensure consideration of efficiency and productivity is embedded as part of service reviews, including the various service plans associated with the redevelopment; and consideration of sensitivity analysis during budget monitoring processes.

Management is considering these findings and working towards embedding advanced practices, where appropriate given the specific nature of the Board's services, in all areas.

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

### Reporting arrangements and timetable

The draft financial statements were available for audit on 28 April 2010 in line with previous years. The audit was completed in a timely manner and the board considered and approved the financial statements as planned.

### Audit opinion

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

### Key issues arising during our audit of the financial statements

Our audit plan overview and interim management report narrated potential key risk areas identified in relation to our audit of the financial statements. We have concluded our work in each area and summarise the results below.

- Application of International Financial Reporting Standards ('IFRS'): The Scottish Government announced on 25 April 2008 that all Scottish Government departments, executive agencies, non-departmental public bodies and health boards would report under IFRS from 2009-10, necessitating the restatement of comparative information under new accounting policies. As part of the transition to IFRS, the Board prepared 'shadow accounts' which we reviewed and reported on in Autumn 2009. Our review identified a number of issues which required further consideration by management. These have subsequently been actioned. The transition to reporting under IFRS has resulted in a number of key changes in the financial statements:
  - Opening balances for property, plant and equipment have been adjusted to reflect the impairment of the hospital estate as opposed to the treatment under UK GAAP of accelerated depreciation;
  - An accrual has been made for untaken holiday pay at the balance sheet dates;
  - Accounting policies have been updated in line with the Government financial reporting manual.

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

- Impairment of property: The financial statements reflect an impairment of £11,236,000 on the completion of the first phase of the hospital redevelopment against the costs of construction incurred of £26,489,000. This is based on advice from the Board's independent valuer and is significantly above the level anticipated in the project business plan. While the impairment in 2009-10 has been covered by additional resource from the Scottish Government, there remain financial risks in relation to remaining phases of the project.
- Pay modernisation: The process for measuring the expected liability under *Agenda for Change* has continued on the same basis as prior years. At 31 March 2010, employees had still to be assimilated. The accrual at that date has been calculated as £662,000, slightly higher than £631,000 in the prior year due to equal pay cases 'being pursued that also comprise a challenge to the Agenda for Change pay evaluation system on the basis that it perpetuates discrimination.' The year end accrual also includes an amount in respect of the estimated levels of appeals which, similar to the main accrual, has been calculated on a detailed basis.



## Financial statements (continued); Regularity

### Equal pay

The National Health Service in Scotland has received in excess of 11,000 claims for equal pay and the Board has received 34 claims. These have been referred for the attention of the NHSScotland Central Legal Office ("CLO") to co-ordinate the legal response to this issue

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

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

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

### Regularity of transactions

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

All circulars are received by either the chief executive or her assistant and allocated to the relevant director for action. A record is kept of all circulars received and the individual responsible for actioning each.

### Service organisations

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

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

The Board received a SAS 70 service auditor report in respect of the financial services, which concludes that:

"In our opinion, the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the specified control objectives were achieved during the period from 1 April 2009 to 31 March 2010".

It was also noted that "the 2009-10 service audit identified two areas of control weaknesses, compared with eight last year. None of the areas identified this year were considered to be significant in nature, compared with two significant exceptions noted last year."

The Board met its financial targets for the year – revenue resource limit, capital resource limit, and cash requirement. The actual outturn against the revenue resource limit reported in the financial statements was lower than the annual plan therefore it has been agreed with the Scottish Government Health Directorate that £300,000 will be accommodated as carry forward into 2010-11.

The 2010-11 financial plan forecasts a breakeven cumulative outturn against the revenue resource limit reflecting financial balance for the year. Achievement of the plan will be challenging due to the financial risk that workforce plan assumptions may not be delivered. There are also a number of risks around the hospital redevelopment which could have a financial impact.

The Board continues to operate to the five year plan and has updated this to reflect current conditions. Management continues to use the financial plans to monitor progress of the redevelopment and has noted this area as a key risk to achieving budgeted results going forward.

The redevelopment of the hospital includes a number of sustainability features to drive efficiencies and cost savings going forward.

### Financial position

Performance against the three financial targets was as follows:

£'000	Final Allocation	Outturn	Variance
Revenue resource limit	35,317	35,017	300
Capital resource limit	18,793	18,743	50
Cash requirement	50,775	50,556	219

During 2009-10, the Board was within all three of its financial targets. The Board is reporting a carry forward of £300,000 surplus into 2010-11, as £14,000 of the allocation will be treated as deferred income. This carry forward will be used to support the continuing hospital redesign process.

The final revenue resource outturn was above initial plans of a breakeven situation as management was successful in closely controlling costs, leading to particular underspends against plan in relation to nursing enhancements and overtime, capital charges and utility costs. The difference between the revenue outturn anticipated in management accounts, returns to the Scottish Government and the finalised financial statements is minimal.

The Board achieved overall savings of £1.7 million against an internal target of £1.7 million. Efficient government savings totalled £1.4 million for the full year (4% of recurring revenue resource limit and therefore, in excess of the national target of 2%). Going forward there is the significant risk that there will be a surplus of staff that may compromise the expected savings. In 2010-11, £0.879 million of savings arise from implementation of the workforce plan. Therefore, the risk that staff turnover will not be sufficient to meet the required workforce changes is classed as high.

## Financial management (continued)

### Financial planning

The 2010-11 financial plan forecasts a cumulative outturn of £33.6 million; being in balance with the revenue resource limit for the year. Management have calculated the recurring uplift of £0.748 million, which is confirmed as 2.15% of baseline funding, and took unavoidable costs of £0.675 million into consideration. In order to calculate the unavoidable costs, such as pay awards, management have made assumptions on inflation etc. Workforce levels are also incorporated into the assumptions and remain one of the highest risks of the financial plan.

Management has considered the impact of the financial risks and mitigated most of the risks to a medium or low level by considering the impact cost and accepting it or putting funds aside. Two risks remain at a high level for 2010-11. These risks have also been given an impact cost and are due to be closely monitored.

The 2% efficiency target from the efficient government initiative is anticipated to be met in the next financial year by the service changes driven by the hospital redevelopment. In 2010-11, overall savings are estimated to be £1.677 million with £0.878 million of the total derived from the realisation of the workforce plan for the full business case.

The Scottish Government Health Directorate has commented on the ambitious nature of the savings plan for 2010-11 and requested regular reports on progress to gain more assurance over the delivery of these savings on a recurrent basis.

### Key risks

Achievement of the 2010-11 financial plan will be challenging due to the key risks identified below. The diagram below summarises the key risks identified by management, together with additional risks identified during our audit work.

Key risks identified by management	Key risks identified by KPMG
<ul style="list-style-type: none"> <li>Cost implications for <i>Agenda for Change</i> higher than anticipated (low risk- £300k)</li> <li>Assessed value of redevelopment is less than capitalised value leading to unfunded impairment (very high risk- not quantifiable)</li> <li>Inflation on utilities is greater than funded and consumption greater than anticipated (medium risk- not quantifiable)</li> <li>Service and workforce changes do not deliver required savings (medium risk- £200k)</li> <li>Excess cost arising from nursing enhancements and overtime (medium risk- £100k)</li> </ul>	<ul style="list-style-type: none"> <li>Strategy to monitor equal pay claims is not considered (low risk- not quantifiable)</li> <li>Electronic patients records may have higher than anticipated cost implications (low risk)</li> <li>High sickness absence may hinder the delivery of service changes however this is mitigated by new sickness absence policy</li> </ul>

## Corporate governance arrangements

The statement of internal control does not disclose any significant weaknesses in the systems of internal control. The content of the statement is consistent with our understanding of the Board. The majority of key financial controls are designed appropriately and operating as intended.

NHS Quality Improvement Scotland undertook a peer review of clinical governance and risk management and confirmed that the Board improved in six out of 10 core areas.

The Board recognises the importance of effective partnership working with geographical NHS Boards and external agencies.

The Board notes all Audit Scotland reports and management self-assess local arrangements where applicable to services and healthcare activities.

### Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through its chief executive, the board is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The *Code* requires auditors to review and report on corporate governance arrangements as they relate to:

- the board's reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity; and
- standards of conduct and arrangements for the prevention and detection of corruption.

### Governance framework

The integrated governance framework includes four governance sub-committees of the board: audit, clinical governance, staff governance and remuneration (sub-committee of staff governance). The terms of reference for each committee detail decision-making powers and delegated responsibility. The integrated structure is based on regular and open communication. There is also an operational risk and governance committee in place composed of the senior management team and members of staff. This committee is responsible for incident review, actioning points from the risk register and reporting to the audit committee.

The Board's internal auditors concluded that their work "*did not identify any critical control weaknesses that we consider to be pervasive in their effects on the system of internal control*". We note that internal audit raised 25 'findings' in their report on 'the system of internal control'. Six of those were identified as high priority with the remainder being medium or low priority. The areas of higher priority highlighted by internal audit are in relation to the pay arrangements (SSTS) and Agenda for Change (PDP).

Our testing, combined with that of internal audit, of the design and operation of controls over significant risk points confirms that, with the exception of some isolated findings in the operation of controls over payroll and BACS transactions, controls are designed appropriately and operating effectively.

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

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### **National Fraud Initiative ("NFI")**

Health bodies took part in the NFI exercise again this year. From the 2009 data, the Board had 12 matches (*2007 NFI, 35 matches*) and satisfactorily investigated each of these. We tested a sample of resolved matches and concluded that satisfactory evidence was available to support all matches noted as resolved on the NFI system.

### **Audit Scotland national reports**

Audit Scotland periodically undertakes national studies on topics relevant to the performance of NHS Scotland. While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at local level, as appropriate, although the nature of the Board's activities inevitably restricts the applicability of some.

Management has established procedures to consider reports. These are then assigned responsibility and are forwarded to the appropriate person or committee. During 2009-10 the reports *Scotland's public finances* (November 2009), *Overview of NHS in Scotland performance 2008-09* (December 2009) and *Improving public sector efficiency* (February 2010) were discussed and noted by board committees. Management has been requested to submit a report on the local application of the latter to an audit committee meeting in September 2010.