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Ayrshire and Arran NHS Board

Annual audit report to Ayrshire and Arran NHS Board

and the Auditor General for Scotland

Year ended 31 March 2011

29 June 2011

Contents

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

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

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

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Executive summary

Progress continues to be evident in service redesign and sustainability plans, but the extent to which these are affordable, on a short and long term basis, depends heavily on availability of funding. Conversely, the ability to achieve performance targets may be impacted if redesign proposals are postponed.

The Board has a clear vision for the future, which is underpinned by three key strategy documents covering acute, mental health and primary care. Outline business cases for the redevelopment of primary care and mental health facilities on the Ayrshire central site and enhancement of accident and emergency services at Crosshouse and Ayr hospitals were submitted to the Scottish Government in early 2011, but the outcome of ongoing discussions on capital funding is likely to be a key feature in decisions to proceed with these service redesign plans.

The Board continues to achieve its financial targets, but the potential impact of risks presented by recurring overspends, uncertainty around funding allocations, and continued pressure to achieve financial targets, increases each year. Financial management arrangements should be enhanced to ensure that they contribute to achievement of ongoing financial and operational sustainability, rather than report historical figures and statistics.

Financial plans and reports to the board and finance committee continue to improve, but focus primarily on reporting historical and factual information. In addition, finance reports concentrate heavily on the in-month / year to date position, with limited consideration of the ongoing impact in the next financial year. The Board is a complex organisation and the cause and effect of decisions are likely to impact more than one feature of the financial position, and ultimately the outturn in the current or future financial years.

Reporting during the financial year could be enhanced to clarify the link between movements, for example the reduction in private sector expenditure to meet orthopaedic waiting times had the inevitable result of increasing internal supplies and staffing costs. The lack of linked reporting of the cause and effect negates the positive outcome of the decision to limit private sector spend in favour of increasing board activity.

Finance reports to the board should clarify the recurring or non-recurring nature of significant movements; financial plans should reflect the extent to which recurring overspends, particularly in respect of the nurse bank and supplies, may impact achievement of these plans.

The 2011-12 financial plan does not attempt to include potential overspends, which have been prevalent in recent years; £14.6 million, of the £18 million total, of efficiency savings had been identified and secured at 23 March 2011, but progress in identifying further efficiency savings schemes has been made in the first quarter of the 2011-12 financial year. Financial balance also depends on identifying funding to meet £5.3 million of non-recurring cost pressures, which management intends to fund by advancing 2012-13 efficiency savings and deferring development expenditure; an approach that we consider to be high risk.

Performance management arrangements are strong and continue to develop, but work is required to define performance measures, and associated monitoring frameworks, required by ongoing service redesign workstreams.

Headlines

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.

This report summarises our work for the year ended 31 March 2011.

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

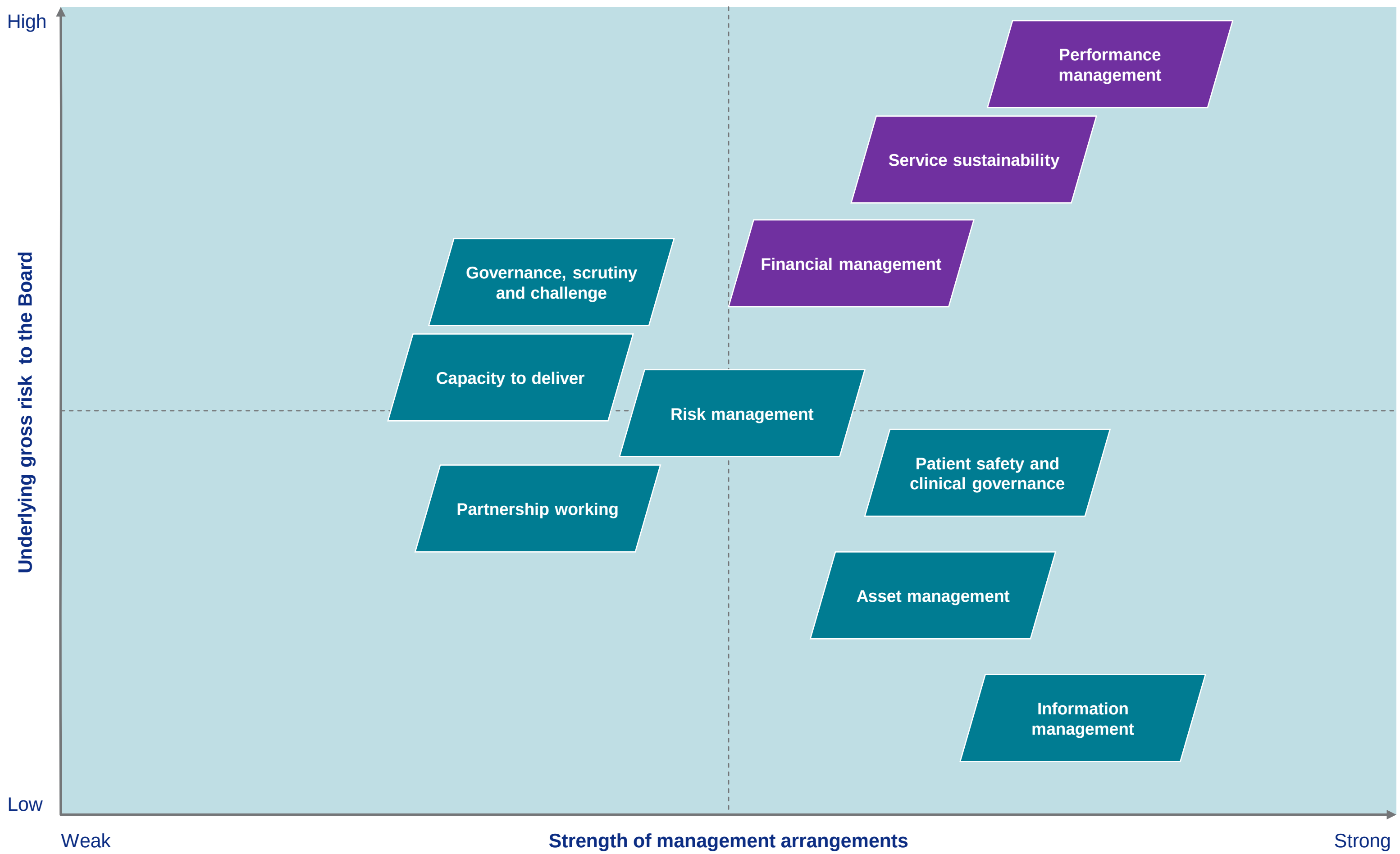
The action plan in appendix one includes two recommendations.

Priorities and risks	
Management continues to enhance performance management arrangements and plans to ensure service sustainability. Risks continue to exist, but, subject to funding constraints, internal processes reduce the likelihood and potential impact on the Board.	Pages 5 and 6
We continue to report significant risks in respect of financial management and reporting. Despite improvements during the year, in our view, significant risks and ongoing challenges remain in respect of recurring financial sustainability.	Pages 6 and 8
Financial statements	
We have issued unqualified audit opinions on the 2010-11 financial statements and the regularity of transactions reflected in those financial statements.	-
Two technical accounting matters were considered during the audit process; management provided good quality analysis to support the £2.3 million reduction in depreciation, but voluntary redundancy costs in 2010-11 are overstated by £0.9 million because approval of applications occurred on 8 April 2011. This error is not considered significant and the financial statements were not adjusted in this respect.	Page 7
Use of resources	
The Board met its financial targets, but there were a number of significant recurring and non-recurring movements during the year.	Page 8
We validated management's completion of the people management Best Value toolkit, which concluded that the majority of arrangements were 'basic', with plans established to improve practices in the majority of areas.	Page 11
We assessed management's response to Audit Scotland's national report on procurement; in the majority of areas, management has taken some action to mitigate risks and improve processes at a local level , but further action is required in respect of risk assessment and reporting.	Page 12
Governance	
There have been no significant changes and the statement on internal control continues to confirm the existence of a comprehensive framework of internal control. Internal audit completed their plan and did not report any 'critical' risk recommendations. Arrangements to prevent and detect fraud are embedded in internal controls, including processes to comply with requirements in respect of the National Fraud Initiative.	Page 13

Summary of arrangements

Competing risks and pressures continue to present new and recurring challenges. Overall, the climate in which the Board operates continues to present significant risks, challenges and opportunities in respect of competing priorities to achieve performance and financial targets.

The diagram summarises the potential underlying risks to achievement of strategic objectives, compared to the strength of management arrangements to mitigate these risks. The following pages summarises those areas where we believe that significant risks are inadequately managed, together with those where management arrangements are likely to mitigate or eliminate these risks to a greater or lesser extent.



Assessment of significant risks

Progress continues to be evident in service redesign and sustainability plans, but the extent to which these are affordable, on a short and long term basis, depends heavily on availability of funding. Conversely, the ability to achieve performance targets may be impacted if redesign proposals are postponed.

<table>
<tr>
<td rowspan="2">Service sustainability</td>
<td>The Board has a clear vision for the future which has been determined through consultation with partners and other stakeholders and is underpinned by three key strategies covering acute, mental health and primary care. Governance and responsibility arrangements supporting delivery of sustainable service redesign include:
■ integrated care and modernisation board – responsible for ensuring that decisions taken on potential redesign options are aligned with strategic objectives; and
■ strategic alliance board – leads an integrated approach to planning with local authority partners, including identifying challenges in the macro-financial environment and how joint redesign can assist all parties in addressing these challenges.
Outline business cases for the redevelopment of primary care and mental health facilities on the Ayrshire central site and enhancement of accident and emergency services at Crosshouse and Ayr hospitals were submitted to the Scottish Government in early 2011.</td>
<td>Similar to previous years, the Board's ability to maintain momentum across a variety of ongoing and emerging projects continues to present significant risks. Management and non-executives continue to identify risks to timely implementation of service redesign proposals and, importantly, assessment of benefits realised, including lateness and inaccuracies in data, and the lack of ability to track 'referral to treatment' times.
While no approval has been given in respect of the outline business cases, discussions are ongoing between the Board and the Scottish Government in respect of funding options for both projects. The extent to which public or other funding is available is likely to be a key feature in decisions to proceed, or otherwise, and, consequently, in management's ability to redesign services.</td>
</tr>
<tr>
<td colspan="2">■ In our view significant risks continue to exist; actions have been identified but these may take a long time to implement due to uncertainty and constraints around funding and ongoing challenges associated with achieving performance targets.</td>
</tr>
</table>

Assessment of significant risks

Management's approach to financial management reporting, which is largely historical, is unlikely to address recurring risks to financial sustainability.

Arrangements in respect of performance management are likely to mitigate the impact of significant risks.

Financial management	The Board continues to achieve its financial targets. However, the potential impact of risks presented by recurring overspends, uncertainty around funding allocations, and continued pressure to achieve financial targets, increases each year. Management commissioned a CIPFA review of financial management arrangements in 2010 and progress is ongoing to implement recommendations. Financial plans and reports to the board and finance committee continue to improve, but focus primarily on reporting historical and factual information. In addition, finance reports concentrate heavily on the in-month / year to date position, with limited consideration of the ongoing impact in the next financial year. The Board is a complex organisation and the cause and effect of decisions are likely to impact more than one feature of the financial position, and ultimately outturn in the current or future financial years.	Reporting during the financial year could be enhanced to clarify the link between movements, for example the reduction in private sector expenditure to meet orthopaedic waiting times had the inevitable result of increasing internal supplies and staffing costs. The lack of linked reporting of the cause and effect negates the positive outcome of the decision to limit private sector spend in favour of increasing board activity. In addition, finance reports to the board should clarify the recurring or non-recurring nature of significant movements; for example, it is unclear the extent to which support services underspends and elements of supplies and nurse bank overspends are likely to recur in future years. While management continues to report the impact of action taken in respect of areas such as nurse bank and supplies, overspends are common factors underlying the financial performance each year.
	■ In our view significant risks continue to exist; but these could be mitigated, to some extent, by enhanced financial management reporting and analysis. ***Recommendation one***	
Performance management	The health and performance governance committee receives balanced scorecards, reports and action plans for improvement. In our view, the committee minutes demonstrate increased challenge, compared to previous years, of management and the information presented for consideration. Work is now ongoing to define performance measures, and associated monitoring frameworks, required by ongoing service redesign workstreams.	Performance management arrangements are strong and continue to develop, particularly in light of the inter-relationship in respect of achievement of both performance and financial targets.
	■ In our view risks exist but actions have been identified to address these risks.	

Financial statements preparation and audit process

Management anticipated risks around fixed assets useful lives; no audit adjustments were required and matters were concluded in a timely manner.

The voluntary redundancy framework omitted to allocate responsibility for considering governance and accounting implications.

Areas of HIGH audit risk			
	Value (£'000)		
Area	2010	2011	KPMG comment
Building useful lives – depreciation	18,117	15,313	Extending the useful live of buildings and their components is subjective and based on management judgement. The revised depreciation charge reflected a reduction of £2 million, which was appropriately reflected in the financial statements. Management considered these changes in a timely manner and no adjustments to the financial statements were required. Internal processes and discussions reflect the changes in the way in which the estate will be managed. We have reviewed the maintenance plans, in which the type of projects and expenditure appears consistent with that expected to maintain buildings for a longer period of time.
Voluntary redundancy	-	1,227	The voluntary redundancy policy does not consider the approval process for director applications or the accounting implications arising from the timing of decisions. The lack of advanced planning and subsequent timing of approval meant that funding and expenditure were misaligned. Management accepted our recommendation[1] to revise the policy to clarify approval processes for director and senior manager packages and consideration of accounting implications. ■ £0.9 million of voluntary redundancy costs charged in 2010-11 were not approved until 8 April 2011 and do not meet the requirements of accounting standards for inclusion in 2010-11. This error remains unadjusted; we agree with management that this amount is not material to the financial statements. Had it been correct to charge this expenditure in 2010-11, the additional costs (£77,000) associated with pay in lieu of notice should also have been recognised as an obligation at 31 March.

Systems and controls

Preparation of the financial statements

- Draft financial statements and supporting documentation were provided on 16 May 2011, which was in line with the revised agreed timetable.
- The quality of information provided to support the financial statements improved, particularly in respect of property, plant and equipment.

Control environment

- Overall, management's approach to preparing the financial statements is acceptable, but improvements could be made to advance the preparation timetable and availability of draft financial statements at an earlier date, and ensure that all documentation requested is provided at the start of audit fieldwork.

1 Report to those charged with governance (7 June 2011)

Financial position

The Board continues to achieve its revenue target, despite significant recurring and non-recurring operational and accounting movements during the year.

The Board achieved its revenue target, reporting a cumulative surplus of £5 million compared to £7 million at 31 March 2010. Inevitably, and similar to previous years, this required in-year management of a combination of overspends and other significant movements, which are summarised in the chart below.

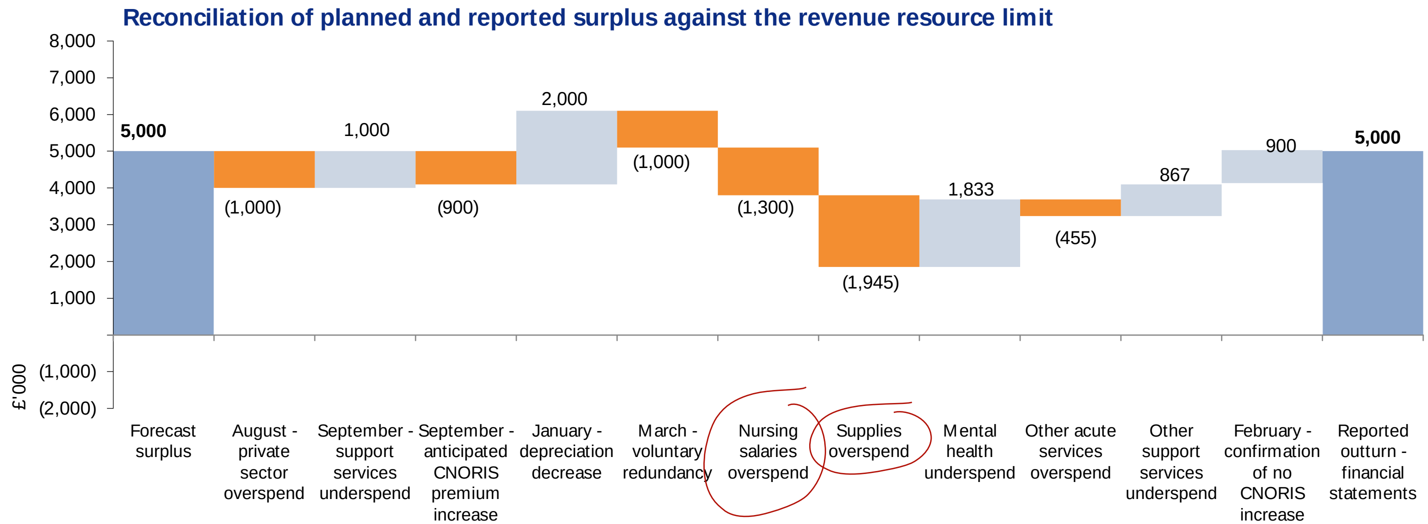
Supplies and bank nurse costs were, again, key features of overspends reported by acute health directorates, with overspends totalling £1.3 million and £1.9 million, respectively. Supplies budgets had included £0.9 million of planned efficiency savings, but the budget reduction had been applied without specific schemes being identified. However, action was taken during the year and is summarised opposite.

Supplies costs

- Increased use of the national distribution centre, rather than national contracts
- Identifying, and funding, activity driven increases
- Use of the LEAN process in theatres

Nurse bank costs

- Revised absence policy (December 2010), enhancing requirements for 'return to work' interviews and staff reviews after multiple periods of absence
- Introducing a hierarchy for additional staffing: part-time staff, paid overtime, followed by bank resource as a 'last resort'.



Financial position (continued)

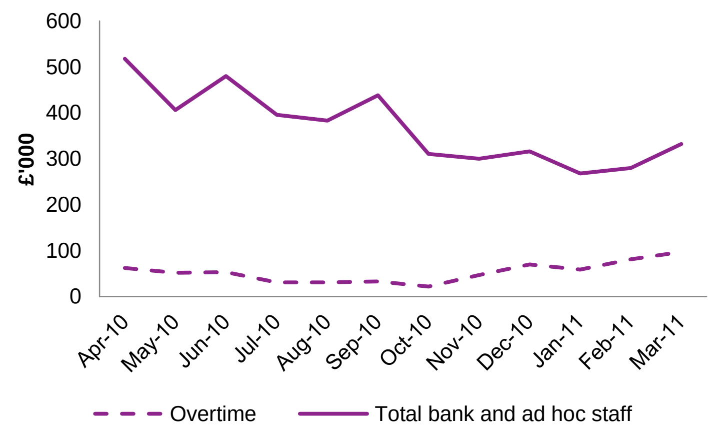
Action taken in response to increasing nurse bank costs had a positive impact on the financial position in the second six months of the financial year.

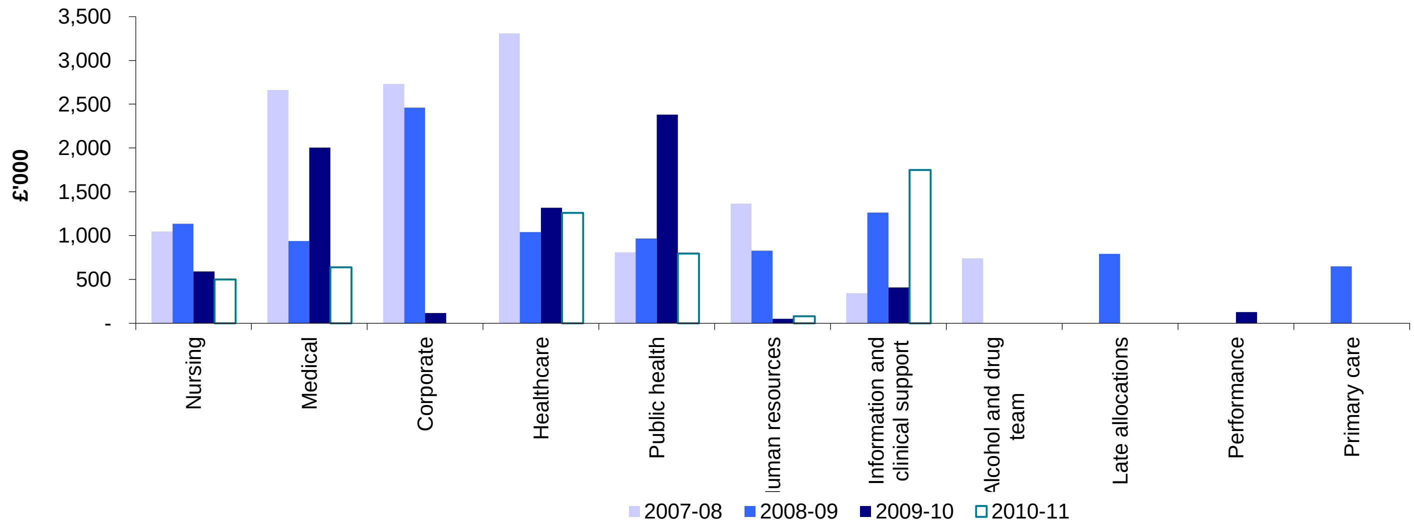
Action taken in response to continually increasing nurse bank costs commenced in October 2010 and the graph opposite demonstrates the positive impact on costs. It is important that the culture change is maintained in future years.

Changes to the way in which supplies budgets are compiled, and orders are placed, will take effect in 2011-12. These changes acknowledge the inherent difficulties in realising efficiency savings from generic budget reductions that are unsupported by specific plans, and fail to recognise activity based increases.

Management reports that the £5 million carry forward, reduced from £13 million at 31 March 2008, consists solely of non-recurring funding received by directorates across the Board, as shown in the chart below. There is one individually significant balance of £1.6 million, which is held by the director of information and clinical support in respect of implementation of the new patient management system.

Nurse bank and overtime spend by month (2010-11)





Financial position (continued)

Efficiency savings continued to be required, but at a lower level than had been anticipated, but challenges remain in securing savings in healthcare directorates.

The capital spend profile is repeatedly weighted to the final quarter of the financial year.

The availability of capital funding is a key driver of service redesign.

Efficiency savings

Management reported achievement of 2% efficiency savings - in line with the revised target – but, following a higher than expected Scottish Government funding uplift, less than the 4% initially anticipated.

Savings targets in 2010-11, and plans for 3% savings in 2011-12, are set on a directorate basis. Healthcare directorates are planning savings of less than 2%, requiring support functions to realise savings of up to 10% to reflect the considerably lower proportion of expenditure incurred in comparison to healthcare services. While this supports the desire to maintain front-line services, management should consider the extent to which support functions can, year on year, deliver sufficient savings to ensure financial and service sustainability. In our view, while opportunities for efficiency exist equally in support functions, this approach presents significant and recurring challenges to achievement of annual savings targets of £18 million.

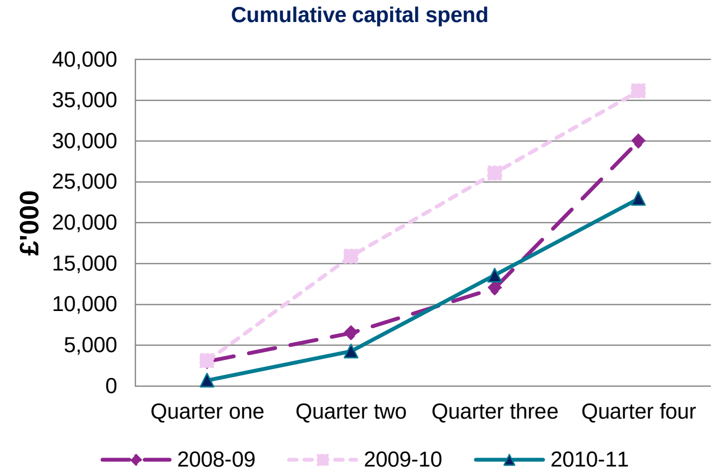
The 2010-11 voluntary severance scheme will generate annual savings of £0.5 million.

Capital expenditure

The Board met its 2010-11 capital resource limit of £23 million; a reduction of £13 million (36%) compared to the previous year. The graph opposite highlights that the monthly spend profile is not inconsistent with the previous year, but spend continues to occur late in the financial year.

The way capital spend is reflected in the financial statements, and should therefore be considered in the financial planning process, requires to change to reflect the useful lives assigned to buildings in 2010-11.

Extending the useful live of buildings and their components is subjective and based on management judgement. In addition, there is an inherent assumption that robust maintenance plans exist, and are affordable.



Management's report to the capital programme board on the 2011-12 capital programme reflected this assumption and increases annual maintenance budgets to £2.8 million. Internal processes and discussions reflect the changes in the way in which the estate will be managed. We have reviewed the maintenance plans, in which the type of projects and expenditure appears consistent with that expected to maintain buildings for a longer period of time.

The reduction in available capital funding, at Scottish Government level, and changes in allocation models (an increased proportion of funding will be available on a 'bid' rather than 'allocation' basis') presents ongoing challenges in implementation of large and small scale service redesign plans.

Financial position (continued)

Financial planning, including efficiency saving arrangements have improved, particularly in respect of the timing of preparation and approval, but the value of known cost pressures (combined with unanticipated pressures and overspends) presents a significant risk to achievement of financial plans.

Financial planning

> ***"… a budget for 2011/12 recognising there are £25 million of identified cost pressures but a general allocation uplift available of less than £6 million."***

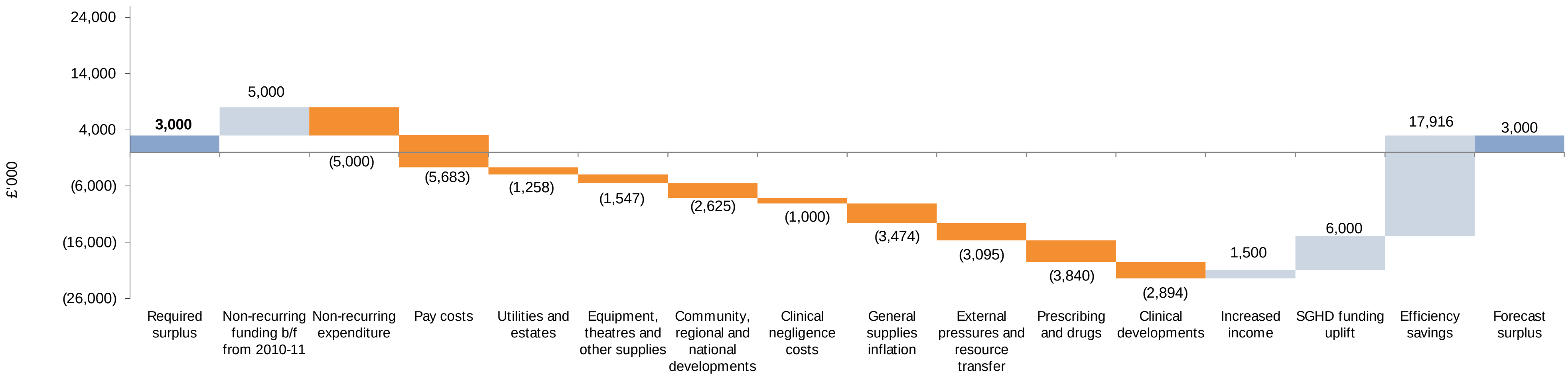
Ayrshire and Arran NHS Board, 23 March 2011

The purpose of management's 2011-12 budget paper, presented to the board in March 2011, summarises the challenge facing the board in the current financial year.

Similar to previous years, 'expert groups' considered and prioritised spend in specific areas, such as clinical priorities, medicines and prescribing, pay, and supplies. The chart below summarises the identified pay pressures, together with the level of efficiency savings required to offset these costs and achieve the planned cumulative surplus of £3 million at 31 March 2012.

The combination of the value and volume of cost pressures goes some way to highlighting the pressures and challenges facing the Board. The financial plan presented to the board addresses some recurring overspends, such as supplies, but does not include the potential for overspends in staff costs and other areas, which have been prevalent in recent years, and, inevitably, unknown movements, accounting adjustments and risks that may arise during the year. £14.6 million, of the £18 million total, of efficiency savings had been identified and secured at 23 March 2011, but progress in identifying further efficiency savings schemes has been made in the first quarter of the 2011-12 financial year. There are additional, non-recurring, cost pressures of £5.2 million, which management intends to fund by advancing 2012-13 efficient savings and deferring development investment; an approach that we consider to be high risk. In addition, an element of non-recurring funding may be available. £2 million of the £5.2 million total will be used to fund a voluntary severance scheme, but only if funding is available.

Reconciliation of planned and reported surplus against the revenue resource limit



Best Value

Arrangements to achieve Best Value through people management are generally 'basic' and focus primarily on reactive reporting mechanisms and national compliance processes, rather than proactive leadership and development.

Management should use the toolkit self-assessment to enhance arrangements and the role of people management in service sustainability.

The staff governance committee is responsible for all systems and process to monitor, manage and improve performance. Guidance is collated and made available through the intranet, newsletter and *ad hoc* communications. The human resources and organisational development structure was realigned following the Board-wide restructuring in 2004-05 and individual departments continue to be subject to review. Management self-assessed policies, procedures and structures as 'basic'; improvements could increase proactivity and flexibility in the human resources and function, leading to enhanced capabilities in front line managers and seamless joint working with partners.

Performance management follows the national knowledge and skills framework and performance development review process. Arrangements exist to identify and monitor core training requirements.

The staff governance committee recently considered a revised learning strategy, in which the action plan includes:

- developing career pathways;
- prioritising investment in learning and development which supports organisational objectives; and
- establishing training and development partnerships with other agencies.

Establishing a methodology, including enhanced reporting arrangements, to evaluate the value for money, impact and effectiveness of the costs of human resources activity in supporting achievement of corporate objectives would enhance current arrangements.

The annual workforce plan submitted to the Scottish Government Health Directorate reflects service redesign and the training and skills mix the Board wishes to attain. This 'basic' practice primarily reacts to service redesign and changing priorities and is not fully integrated with service and financial planning.

Management and leadership training programmes are available; talent management and development is limited to that required by the performance appraisal process. Management is developing a number of programmes to deliver enhanced leadership capability.

Management reporting includes staff costs and numbers, but these focus on quantifying, rather than analysing, resources. Management quantified the costs of pay modernisation, totalling £25 million over five years. However, there is no formal evidence that management has quantified the benefits of this additional investment.

Two thirds of staff completing the 2010 staff survey felt 'well informed' by the Board; an improvement on the 2008 survey and above the national average. Staff engagement groups, such as the area partnership forum, are active and play an important and valued role in operational and strategic decision-making. Staff recognition schemes promote reward and recognition through nominations by colleagues or members of the public.

Sickness absence continues to present challenges in workforce and financial planning; a number of 'managing attendance' and wellbeing initiatives have been implemented.

Audit Scotland national reports

Audit Scotland national reports

Audit Scotland periodically undertakes national studies on topics relevant to the performance of NHS Scotland. While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at board level, as appropriate.

Procedures exist to consider individual reports at board and committee levels. In addition, where appropriate, management self-assess local arrangements against national recommendations and implement local action plans as required

We considered two studies published during 2010-11, ‘using locum doctors in hospitals’ and ‘emergency departments’, and submitted a short return to Audit Scotland in February 2011 on the Board’s response. In both cases we reported that study had been considered by at least one committee, self-assessments against the published findings had been performed, and local action plans prepared.

Improving public sector purchasing

Audit Scotland required specific follow-up work in respect of the joint Accounts Commission / Auditor General for Scotland report, “Improving Public Sector Purchasing” (July 2009). The aim of this work is to assess actions taken by public bodies to ensure that they can demonstrate value for money when purchasing goods and services.

The Scottish Government’s procurement capability assessment consistently grades the Board’s arrangements as ‘conformant’, the third of four ratings. While improvements were noted in 2010, these were offset by declining performance in other areas.

The procurement steering group is responsible for improving processes and making progress towards the procurement strategy action plan.

The procurement department influences 45 to 50% of spending on goods and services. However, best practice would suggest that, for an organisation of the Board’s size, this level of influence should be around 80%.

Areas for continued improvement include:

- incorporating a risk assessment and related action plans within the purchasing strategy; and
- providing the appropriate governance committee with details of the results of, and subsequent responses to, procurement capability assessments.

Corporate governance framework and supporting arrangements

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a framework for organisational decision-making.

Corporate governance framework	Corporate governance arrangements are designed and implemented appropriately. In line with previous practice, bi-monthly board development days allow executive and non-executive directors the opportunity to discuss strategy and emerging issues in more detail than during alternate public board meetings. The health and performance governance committee demonstrates a commitment to best practice through explicit consideration of corporate risks for which responsibility has been allocated to this committee. The board continues to delegate responsibility for managing the corporate risk register to its governance committees; we continue to highlight the risks associated with this approach, which is increasingly out of line with good practice across the public sector.
Statement on internal control	The statement on internal control provides details of the purpose of the framework of internal control, along with an analysis of its effectiveness. This statement is in compliance with guidance issued by the Scottish Government Health Directorates.
Internal controls	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively.
Internal audit	Internal audit have submitted all but one of their planned reports for the year. We have relied on a number of reports, including those in respect of procurement and payroll. Internal audit's 2010-11 annual report confirms that their work "*did not identify any critical control weaknesses that we consider to be pervasive in their effects on the organisation's overall system of internal control*".
Fraud and irregularity	Processes and procedures exist to promote fraud prevention and detection, and to report matters arising to the audit committee. Health bodies continued to participate in the National Fraud Initiative. The 2011 data contacted 689 matches (*2009 NFI, 1,334 matches*) and have investigated 569 of these, to date, which is in line with our expectation at this stage of the process.

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Appendix

Appendix one – action plan

The action plan summarises specific recommendations, together with related risks and management's responses.

- **High risk** issues are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.
- **Moderate risk** issues have an important effect on internal controls, but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately, but the weakness remains in the system.
- **Low risk** issues would, if corrected, improve the internal control in general, but are not vital to the overall system. These are generally issues of best practice that we feel would be of benefit to you if introduced.

Ref	Issue and risk	Recommendation and risk	Management response
1	Financial plans and reports to the board and finance committee focus primarily on reporting historical and factual information and concentrate on the in-month / year to date position, with limited consideration of the ongoing impact in the next financial year. The Board is a complex organisation and the cause and effect of decisions are likely to impact more than one feature of the financial position, and ultimately outturn in the current or future financial years.	Reporting during the financial year could be enhanced to clarify: ▪ the link between movements and the impact of service decisions; and ▪ the recurring or non-recurring nature of significant movements. **High risk**	Finance committee receives reports on emergent and future cost pressures which aid future financial planning. Reports to the board will reflect the link between service decisions and financial position. **Responsible officer**: director of finance **Implementation deadline**: 30 September 2011
2	People management arrangements focus primarily on reactive reporting mechanisms and national compliance processes. Talent management and development is limited to that required by national performance appraisal processes.	Establishing a methodology , including enhanced reporting arrangements, to evaluate the value for money, impact and effectiveness of the costs of human resources activity in supporting achievement of corporate objectives would enhance current arrangements. Development of a more formal talent pool, and talent management process, would minimise the risk of loss of key personnel and ensure effective succession planning in light of future challenges. **Moderate risk**	Agreed. Management will take this forward and include in regular reporting. **Responsible officer**: director of people and organisational development **Implementation deadline**: 31 August 2011

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