www.pwc.co.uk

NHS Lanarkshire

Annual Report to Members and the Auditor General for Scotland

2010/11

June 2011

pwc

Contents

Section 1. Executive Commentary

Introduction - Section 2

Our overall responsibility as external auditor of NHS Lanarkshire ("the Board") is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice ("the Code"), revised and published in March 2007. We have a dual reporting responsibility for the audit: to the Board Members of NHS Lanarkshire and to the Auditor General for Scotland.

Financial Statements and Audit Opinions - Section 3

The financial statements of the Board for the year ended 31 March 2011 have been prepared to comply with accounting requirements contained in the NHS Board Accounts Manual for Directors' Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers.

We are pleased to report that our opinion on the financial statements for the year ended 31 March 2011 is **unqualified**.

The financial statements and supporting schedules were presented to us for audit in accordance with the agreed timetable and the quality of working papers provided by management was of a high standard. Overall an efficient audit process was achieved through an effective working relationship with your staff.

As a result of our work, we proposed a number of audit adjustments. With one exception, all of these adjustments have been processed by management in the final version of the 2010/11 financial statements. Details of the unadjusted item are provided in Appendix 1.

2010/11 Financial Management and Performance - Section 4

The Board budgeted for a deficit of £4.448m for the year ended 31 March 2011.

The Board has reported a year end recurring surplus of £0.552m and a non recurring overspend of £5.0m, resulting in a net deficit of £4.448m. The final outturn for 2010/11 was therefore in line with budget and the financial plan. The Board had a carried forward surplus of £12.069m from the previous financial year resulting in a cumulative surplus of £7.621m as at 31 March 2011.

The Board has achieved its revenue, capital and efficiency targets, including achievement of a £17.1m savings programme.

2011/12 Financial Management and Performance - Section 5

The Local Delivery Plan for 2011/12 was presented to the Board in March 2011. The Board has budgeted for a deficit of £5.6m which will be financed by the cumulative surplus carried forward from 2010/11.

The Board is required to achieve savings of £24m to achieve its Local Delivery Plan (LDP) for 2011/12.

Governance and Control - Section 6

We have assessed the Board's overall governance arrangements including a review of Board and key Committee structures and minutes, financial reporting to the Board, and risk management. We consider that appropriate arrangements and reporting are in place. We have also considered key areas of risk to the Board including partnership working; service sustainability; performance management; and people management. Appropriate arrangements and reporting were evidenced.

The Code of Audit Practice requires us to review and report on the Board's Statement on Internal Control. The Board has used the correct format for its Statement and has outlined the processes it had employed to identify and evaluate risks. In addition, key elements of the Board's control framework have been highlighted. Based on our normal audit procedures, **we do not disagree** with the disclosures contained in the Statement.

Section 2. Introduction

Purpose of this report

Our Annual Audit Report is designed to set out the scope, nature and extent of our audit, and to summarise our opinion and conclusions on issues arising. Specifically this will direct the Board's attention to matters of significance that have arisen out of the 2010/11 audit process and to confirm what action is planned by management to address the more significant matters identified for improvement.

Scope, nature and extent of our audit

Our overall responsibility as external auditor of the Board is to undertake our audit in accordance with the principles contained in the Code of Audit Practice issued by Audit Scotland in March 2007. In this regard, the Code sets out the need for public sector audits to be planned and undertaken from a wider perspective than in the private sector involving not only assurance on the financial statements but also consideration of areas such as regularity, propriety, performance and the use of resources. It also sets out the need to recognise that the overall audit process is a co-ordinated approach involving the "appointed auditor", the Auditor General for Scotland and other auditors such as Audit Scotland's Health Performance and Public Reporting Group. Our audit has been planned and conducted to take account of these wider perspectives.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260: "Communication of audit matters to those charged with governance", we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This Annual Audit Report to Members, together with previous reports to the Audit Committee throughout the year, discharges the requirements of ISA 260.

Acknowledgement

We would like to formally extend our thanks to the Board's managers and staff for the assistance they have given us during the audit process.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Glasgow
29 June 2011

Section 3. Financial Statements and Audit Opinion

Audit Opinion

Our audit opinion concerns the true and fair statement of the Board's financial results for the year ended 31 March 2011 and the regularity of its income and expenditure for the year.

We are pleased to report that our opinion on the true and fair view on the financial statements and on the regularity of income and expenditure is **unqualified**.

We also provide a view as to whether those parts of the Remuneration Report subject to audit have been properly prepared. Our opinion on the Remuneration Report is **unqualified**. Our audit opinion does not extend to any other part of the Directors' Report.

Audit Approach

Our audit approach was set out in our Annual Audit Plan as presented to the Audit Committee Members in December 2010. There have been no changes to our audit plan and we set out below our response to the significant risks highlighted in that plan.

Audit Process

The financial statements and supporting schedules were presented to us for audit in accordance with the agreed timetable and the quality of working papers provided by management was of a high standard.

Basis of Preparation

The financial statements were prepared in accordance with the accounting requirements contained in the NHS Board Accounts Manual for Directors' Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers.

Approval

The Financial Statements will be submitted to the Board's Audit Committee on the 29 June 2011 and are to be approved and adopted at the Board meeting which follows the Audit Committee meeting.

Unadjusted Misstatements

Under ISA 260 - "Communication of audit matters to those charged with governance", we are required to report to you all unadjusted misstatements which we have identified during the course of our audit, other than those which we deem to be of a trivial nature.

As a result of our work, we proposed a number of audit adjustments. With one exception, these have been processed by management in the final version of the 2010/11 financial statements. We have reported the details of the unadjusted item in Appendix 1 to this report. From discussions with management we understand that they believe the unadjusted amount is not material to the financial statements. Within the letter of representation we request that the Audit Committee members confirm that they are in agreement with that view.

Significant matters

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

Exit Packages

All NHS Boards in Scotland are required to disclose the number of exit packages agreed with employees during the year and the associated severance costs. A targeted approach to voluntary severance was undertaken by the Board following expressions of interest from staff. The Board agreed 168 voluntary severance packages in 2010/11 with an associated severance cost of £6.527 million. Our testing identified that a severance amount of £140,000 was accrued by management in respect of one employee. However, the severance agreement was not finalised and signed by the employee of the Board before the year end. The £140,000 should therefore have been accounted for as a provision at the year end date, rather than being treated as an accrual, since an agreement was not in place and the expenditure had not been committed. This has not been adjusted for by management and the unadjusted difference has been included within Appendix 1.

Enhanced Payroll Disclosure

The Scottish Government is committed to providing greater transparency on the remuneration of senior staff in the public sector and as such there is a greater emphasis on the disclosures within the remuneration report. Boards are now required to disclose performance related pay and bonuses separately. The remuneration report was tested during our audit to confirm that the Board had complied with the required disclosures. No exceptions were noted from our testing.

Long term receivable

The long term receivable in respect of the sale of land at the Law Hospital site has not been recovered during the year. To reflect market circumstances, the Board has increased the bad debt provision in respect of the sale to reflect the deterioration in the market conditions since the agreement of missives in prior years. To reflect the long term nature of the debtor, the balance has also been discounted as required by the NHS Manual of Accounts. We consider that the Board's accounting treatment of the remaining balance is appropriate.

Accruals and Provisions

New guidance was issued during 2010 regarding the accounting treatment, disclosure and funding for provisions by the Scottish Government Health Directorate. New provisions and increases to existing provisions must now be provided against Annual Managed Expenditure; this was previously charged against the Revenue Resource Limit. We tested the treatment of accruals and provisions to ensure that the expenditure has appropriately been accounted for in line with the revised funding requirement. As identified in Exit Packages above, we identified one exception to this.

Revenue and Expenditure Recognition

As reported in our audit plan, there is a rebuttable presumption that there is a risk of material misstatement in the financial statements due to fraud relating to revenue recognition. For the purposes of NHS Scotland this risk is more sensibly inverted to reflect the risk around overstatement of expenditure. Testing was performed on higher risk areas such as accruals to ensure the treatment of income and expenditure complied with accounting standards. No adjusting errors were identified from our testing.

Accounting Policies - Depreciation

Following the introduction of IFRS during 2009/10 in the NHS, Boards are required to comply with International Accounting Standard (IAS) 16 – Property, Plant and Equipment. One of the key elements of IAS 16 is the requirement to separately identify and depreciate asset (building) elements that have different expected lives. This would include for example, roof, lifts, electrics and so on.

To comply with this standard, a revision to the estimations in respect of depreciating assets has been introduced by the Scottish Government Health Directorate. The adoption of the revised methodology has resulted in reduced recurring annual depreciation charges. The reduction in the depreciation charge for the year ended 31 March 2011 for NHS Lanarkshire was £1.044m. This reduction in depreciation has been largely offset by increases in maintenance expenditure during the year.

We understand that management has already engaged with the Scottish Government Health Department (SGHD) to ensure that this revision does not negatively impact future capital plans for Monklands Hospital.

Equal Pay

As reported in the prior year, the National Health Service in Scotland has received a number of claims for equal pay including related back pay. The Central Legal Office (CLO) is co-ordinating the legal process and at the end of May 2011, there were 818 grievance and employment tribunal claims registered against NHS Lanarkshire.

The Board has included a Contingent Liability Note in its financial statements, consistent with the prior year, as the potential financial impact cannot yet be assessed, in accordance with advice from the Central Legal Office.

Section 4. 2010/11 Financial Management and Performance

The table below summaries the Board's 2010/11 financial performance:

NHS Lanarkshire	£m
Recurring income	860.8
Recurring expenditure	(874.5)
Recurring savings	14.2
Underlying recurring surplus	**0.5**
Non-recurring income	194.5
Non-recurring expenditure	(200.9)
Non-recurring savings	1.4
Non-recurring deficit	**(5)**
Financial deficit	**(4.5)**
Underlying recurring surplus as a percentage of recurring income	**0.1%**

Confirmed by the Director of Finance on 23 June 2011.

The Board reported a deficit of £4.448m for 2010/11 in line with the financial plan. This deficit was financed by past of the available carry forward surplus from 2009/10. This leaves the Board with a carry forward surplus of £7.621m remaining as at 31 March 2011 of which £5.6m will be used to support the 2011/12 financial plan and the remainder utilised is expected to be utilised in 2012/13.

Performance against Key Financial Targets

The Board has achieved all three of its financial targets in the year, as follows:

	Limit set by SGHD £m	Actual Outturn £m	Variance (over)/under £m
Core Revenue Resource Limit	840.017	832.396	7.621
Capital Resource Limit	30.546	30.545	0.001
Cash Requirement	982.044	982.044	-

The Board also reported that it had met the 2% Scottish Government target for efficiency savings in 2010/11.

The Board reported a number of variances from the 2010/11 budget as follows:

Primary Care – North Community Health Partnership (CHP)

The North CHP reported an underspend of £1.343m against budget. Of this, £0.845m relates to an underspend against pay budgets as a result of delays in filling posts in areas such as the North Addictions services and Childrens' Services. The Old Age Psychiatry and Complex Needs Services reported an overspend position due to staffing pressures and incremental drift within nursing pay costs. This was offset by underspends in Medical and Psychological Therapies.

Primary Care Other Services

Primary Care Other Services reported an over spend of £2.707m against budget. Prescribing costs were higher than anticipated for the second consecutive year resulting in an overspend of £3.6m against budget. This overspend was partially offset by lower than anticipated cost increases and over achieving against savings targets in other areas. The Board has acknowledged that prescribing costs remain a risk area and intends to review the 2010/11 financial planning assumptions when developing the 2011/12 prescribing savings schemes.

Service Level Agreements/Other Healthcare Providers

Service Level Agreements and Other Health Care Providers reported a net underspend of £0.650m. This included an underspend of £0.998m due to the cost of services provided by other NHS Boards for the treatment of Lanarkshire patients being lower than budget. This was partially offset by an overspend of £1.263m against the out of area and unplanned activity budget. The overspend was due to a number of factors including high cost drugs, bone marrow transplants, Stem Cell Plasma Exchange and increased oncologist costs.

Capital Expenditure

The Board has reported actual capital expenditure of £33.545m, an under spend of £0.001m for the year against the Capital Resource Limit.

Capital expenditure of £9.5m was initially planned for the Airdrie Community Health Centre project. The plan was revised to £2.760m with actual spend reported of £2.753m. The Board has identified a higher than anticipated level of 2011/12 expenditure for this project which has been reported to the Scottish Government Health Department within the five year capital plan.

The new Coatbridge Health and Dental Centre, a joint venture with North Lanarkshire Council, was completed during 2010/11. The development which provides two dental practices, a dental outreach centre, two GP surgeries and a community health department had a total capital investment of £13.7m.

Capital investment on Monklands Hospital during 2010/11 was £5.0m, with further investment planned for future years.

Other significant capital expenditure during the year includes IM&T (£6m) and dental decontamination and refurbishment (£3.2m).

Capital Grants

The Board issued £3.261m of capital grants during 2010/11 to dental practices to fund set up costs and alterations during the year. In line with the Manual of Accounts, capital grants now score against the Board's non-core annually managed expenditure and not against the Board's Capital Resource Limit.

Severance Costs

The Board has agreed 168 severance packages with employees during 2010/11, compared to 60 packages at a cost of £3.06m that were agreed in 2009/10. The associated severance cost for 2010/11 is £6.527 million.

Savings

The Board was set a 2% target for efficiency savings in 2010/11 by the Scottish Government. The Board achieved savings of £17.1 million. Efficiencies were made across 122 schemes with some of the largest savings achieved through more cost effective primary care prescribing (£2,876,000) and a restructure of the Community Health Partnership (CHP) management structure (£800,000).

Section 5. 2011/12 Financial Management and Performance

The following table identifies the Board's 201/12 financial plans:

NHS Lanarkshire	£m
Recurring income	882.8
Recurring expenditure	(900.8)
Recurring savings	18
Underlying recurring surplus	-
Non-recurring income	164.4
Non-recurring expenditure	(170.0)
Non-recurring savings	-
Non-recurring deficit	**(5.6)**
Financial deficit	**(5.6)**
Underlying recurring surplus as a percentage of recurring income	**0%**

Confirmed by the Director of Finance on 23 June 2011.

Financial Challenges

The Board is budgeting for a deficit of £5.6m in 2011/12. This will be financed by the overall carried forward surplus from 2010/11.

The 2011/12 budget includes a number of financial assumptions and is dependent on a range of efficiencies and savings targets being met. The budget has been based on a SGHD uplift of 1% with a number of assumptions made on those areas of key financial challenge.

2011/12 Cost Pressures

The Board expects pay costs to rise by £7 million as a result of a number of factors including the living wage commitment, pay rises for individuals earning less than £21,000, increase in employer National Insurance contribution rates and incremental drift following implementation of Agenda for Change.

Non pay expenditure is expected to rise by £8.3m. This includes £2.2m for the full year effect of the increase in VAT to 20% and an anticipated 12.9% rise in energy costs. Hospital drug expenditure is also budgeted to rise by £3.2m to £36.3m, representing an increase of 9.6%. The increased cost of drugs continues to be a concern for the Board and as a result, NHS Lanarkshire is involved in developing a prescribing action plan with a view to delivering savings and reducing the net increase to 7%.

Planned Savings

The Board has identified £17.4m of savings for 2011/12. A further £6.7m of savings have yet to be identified to deliver the Board's efficient government target of £24.1m. The Board continues to progress work in this area through its CRES schemes. However, the Board also has received authority to utilise £5.6m of the carried forward surplus from previous years, which may help to relieve pressure in 2011/12.

A number of the efficiency plans have workforce implications resulting in a reduction in staff numbers which will be achieved through natural turnover and targeted voluntary severance for around 100 whole time equivalents.

Capital Investment

The 2011/12 Capital Plan will be presented to the Board in June 2011 for approval. Capital budgets have been greatly affected by the challenging economic conditions facing the public sector. The Board has been awarded an initial capital allocation of £18.5m. The Board has the challenge of using this allocation to cover work on the Airdrie Health Centre project (budgeted at £10.7m) and further investment in Monklands District General Hospital to improve the infrastructure of the hospital, in addition to other projects and essential estates work and equipment replacement across the Board's estate.

A prioritised workplan to deliver work at Monklands Hospital has been approved by the Monklands Investment Programme Board. £1.4m of work has been approved to date for 2011/12 with further plans being progressed.

Section 6. Governance and Control

Overall Governance Arrangements

There have been no significant changes to the governance arrangements operating at the Board during 2010/11.

As reported in our Interim Management Letter, the Board has an established committee framework in place. All committees now have appropriate Terms of Reference governing their activities. Following recommendations from the Board's Internal Auditors, some changes were made to the structure during the year with, for example, the abolition of the property sub-committee and changes to the staff governance committee.

Two Non Executive Directors are also coming to the end of their term and the Board has taken the decision not to fill these vacancies as part of a streamlined governance function. Continuing the exercise to comply with the Good Governance Standard, the Board has developed a governance section on the public website.

Statement on Internal Control

The Code of Audit Practice requires us to review and report on the Board's Statement on Internal Control. The Board has used the correct format for its Statement and has outlined the processes it has employed to identify and evaluate risks. In addition, key elements of the Board's control framework have been highlighted. Based on our normal audit procedures, we **do not disagree** with the disclosures contained in the Statement.

Systems of Internal Control

The results of our work on systems of internal control were communicated to the Audit Committee in our Interim Management Letter dated February 2011. The report contained six recommendations to improve controls, one of which was graded as higher risk. Management has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion.

Follow up of outstanding recommendations

We followed up the Board's progress in implementing recommendations made in the prior year. Our Follow Up of Prior Year Recommendations Report was considered at the Audit Committee meeting in February 2011. At the time of reporting, of the 24 agreed actions, progress was as follows:

Status	Total
Fully implemented	11
Partially implemented	2
Not yet implemented	3
Not yet due for implementation	3
No longer applicable	5
Total Recommendations	**24**

We are pleased to report that, of the recommendations due to be implemented, 69% are fully implemented and 12% are partially implemented. This demonstrates a significant commitment by management to improve the overall control environment within the Board.

Year End Findings

During our audit work two further control weaknesses were identified relating to the incorrect coding of expenditure and the information provided on the contracts register as follows:

- During testing on lease expenditure we identified that unrelated expenditure had incorrectly been coded to the land and building leases account code. There is a risk that staff may be using this account code to disguise unauthorised expenditure which may not identified by management on a timely basis. While we are satisfied that the amounts have now been treated appropriately within the annual accounts, the use of this account code should be improved throughout the year.

- The Board has made good steps towards compiling a contracts register. However, we noted that the register currently does not include contract values thereby reducing its effectiveness. The actual, estimate or range of the contract value should be added to the register.

These weaknesses, including management's agreed action plan, will be reported within our 2011 final management letter.

National Fraud Initiative

The National Fraud Initiative (NFI) brings together data from health bodies, councils, police and fire rescue bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud.

The Board has 53 'recommended' matches from the 2010/11 exercise which it is required to investigate. The Head of Internal Audit is responsible for investigating matches. At the time of our audit visit, work was underway and 20 of the recommended matches had been cleared. The Board has until February 2012 to follow up and resolve the issues these matches. We are required to report to Audit Scotland on the Board's NFI arrangements by the same date. We are satisfied that the Board's arrangements appear reasonable.

National Performance Audits

At the request of Audit Scotland, we were required to perform targeted follow up work on one of their National Performance Reports: *Improving public sector purchasing* (published July 2009). The full findings of our work will be reported to the Board in a separate letter.

The recent Procurement Capability Assessment (PCA) undertaken shows a marked improvement in scores. The Board has increased its score from 19% overall in 2009 to 58% in 2010 and moved from 'non-conformant' to 'improved performance'. This improvement is as a result of a number of actions including establishing a Procurement Steering Group to lead progress in this area. However, further improvement is required in areas such as people; performance management; and contract and supplier management where scores remain below 50%.

Best Value

As reported in our Interim Management Letter, we were instructed by Audit Scotland to follow up on the Board's progress in implementing recommendations made in the Information Management (2008/09) and Efficiencies (2009/10) Best Value toolkits. The results of this work have been reported in our final management letter, which reports that good progress has been made on these action plans.

High Earnings

The Cabinet Secretary for Health and Wellbeing issued a letter to all health board Chairs on 12 November 2010 asking them to undertake a detailed review of their boards' pay policies for all staff earning over £100,000 to ensure they have been properly applied. The letter also requested that external auditors provide 'specific reassurance' that boards had complied with national policies and guidance.

We reviewed the work undertaken by the Board. The findings of our work reported separately to the Board in March 2011 highlighted two exceptions as follows:

- There were no records for one higher paid earner as they had left the organisation to join another Health Board. Therefore, we were unable to verify payment in accordance with national pay policies and guidance; and

- One employee was paid for Extra Programmed Activities (EPA) throughout 2009/10 when authorisation had been given for one month only (April 2009). This resulted in an overpayment of £7,978 in 2009/10.

Appendices

Summary of Uncorrected Misstatements

No	Description of misstatement (factual, judgemental, projected)		Income statement		Balance sheet		Cash flow	
			Dr	Cr	Dr	Cr	Inflow	Outflow
1	Dr Accruals Cr Provisions Being an adjustment to reclassify a severance payment from accruals to provisions as the severance agreement had not been signed before the year end.	F			140,000	140,000		
Total uncorrected misstatements					140,000	140,000		

Communications to Management

International Standards on Auditing ("ISA") (UK&I) 260 – Reporting to those charged with Governance, requires that the External Auditor communicates certain matters to those charged with governance. Those charged with Governance is taken to be the Members of the Audit Committee with responsibility discharged through the regular meetings of the Audit Committee during the year. Summarised below are the requirements set out within ISA 260 together with reference to the relevant communication with you during 2010/11 or comments as appropriate.

Communication Required under ISA 260	**Reference/Comment**
Engagement Letters	Signed Engagements Letter with Audit Scotland at the start of our 5 year appointment and updated annually.
Independence	Audit Planning document report to December 2010 Audit Committee and confirmed no member of audit team has any direct interest, financial or otherwise, in NHS Lanarkshire.
Audit Approach and Scope	Audit Planning document (reported to Audit Committee 7 December 2010)
Materiality	Audit Planning document (reported to Audit Committee 7 December 2010)
Form and Timing of Communications	Audit Planning document (reported to Audit Committee 7 December 2010)
Accounting Policies/Estimates/Disclosures	Sections 3 and 4 of our Annual Report to Board Members and the Auditor General for Scotland.
Correspondence with management on significant matters	Discussed and resolved matters arising with management throughout audit process.
Letter of Representation	To be signed by the Board on 29 June 2011.
Other matters significant to the oversight of financial reporting process	None identified.
Material Uncertainties relating to Going Concern	None identified.
Related Parties	Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.
Fraud	Discussed fraud arrangements with the Chair of the Audit Committee and management throughout audit process.
Material Weaknesses in Internal Controls	Internal Controls findings reported separately in our Interim Management Letter (February 2011)