



# The State Hospitals Board for Scotland

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

Year ended 31 March 2011

24 June 2011



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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 development of a 'new' hospital facilities continues to be a key priority as progress is made towards completion of the project in 2011-12. The re-development is an extensive capital project with a cost in the region of £70 million; management have therefore had to ensure effective processes are in place for monitoring the build and regularly provide updates to members. The Board has received capital funding from the Scottish Government for the project.

The board maintains a robust governance framework to provide an appropriate structure for decision-making, accountability and control. There have been no changes to the governance structure in 2010-11 and four sub-committees of the board continue to provide scrutiny and challenge across all areas of activity.

The Board met its financial targets for the year ended 31 March 2011, with an outturn surplus against the revenue resource limit of £326,000. Approval has been received from the Scottish Government to carry forward this surplus. Similarly, a £581,000 saving against the capital resource limit, arising from slippage in the hospital development programme, will be carried over to 2011-12.

Management have robust process in place for financial monitoring and control and members are provided with regular updates throughout the year regarding financial performance. The 2010-11 financial plan had forecast a breakeven position, but savings have been made in year, in particular staff costs have been lower than forecast due to a number of unfilled vacancies.

Management continues to focus on identifying and achieving cash savings through its efficiency savings plan. Following identification and implementation of a number of schemes, the Board achieved cumulative savings of £1.9 million (of which £1.5 million are recurring savings) in 2010-11, in line with the local delivery plan target. The financial plan for 2011-16 forecasts continuing to achieve and build upon recurring efficiencies; a target of 3% has been used in the plan.

Financial plans forecast a breakeven position for the financial year 2011-12. Management has identified a number of financial risk areas facing the Board and have put processes in place to mitigate these risks in order to achieve the targets outlined in the five year financial plan and local delivery plan.

Management has made clear improvements in relation to purchasing and have well defined schemes of delegation and authority in this area.

We have issued unqualified audit opinions on the financial statements and regularity of transactions.



## Executive summary

### 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 staff during the course of our work.

#### Priorities and risks

Management has made significant progress to enhance arrangements around significant risk areas. Significant risks continue to exist, but internal processes reduce the likelihood and potential impact on the Board.

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#### Financial statements

We have issued unqualified audit opinions on the 2010-11 financial statements and the regularity of transactions reflected in those financial statements.

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No technical accounting matters were considered during the audit process; management provided good quality analysis and identified only one adjustment to be processed in the financial statements. No audit adjustments were required.

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#### Use of resources

The Board met its financial targets. Having initially forecast a breakeven position, a surplus of £326,000 against the revenue resource limit was reported for the year.

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We reviewed management's completion of the Best Value sustainability toolkit which demonstrated some improvement since the topic was last considered.

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We have carried out a targeted following up of the 2009 Audit Scotland report 'improving public sector purchasing' overall, management were able to demonstrate clear improvements in processes.

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#### 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.

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Internal audit completed their plan and did not report any significant risk recommendations.

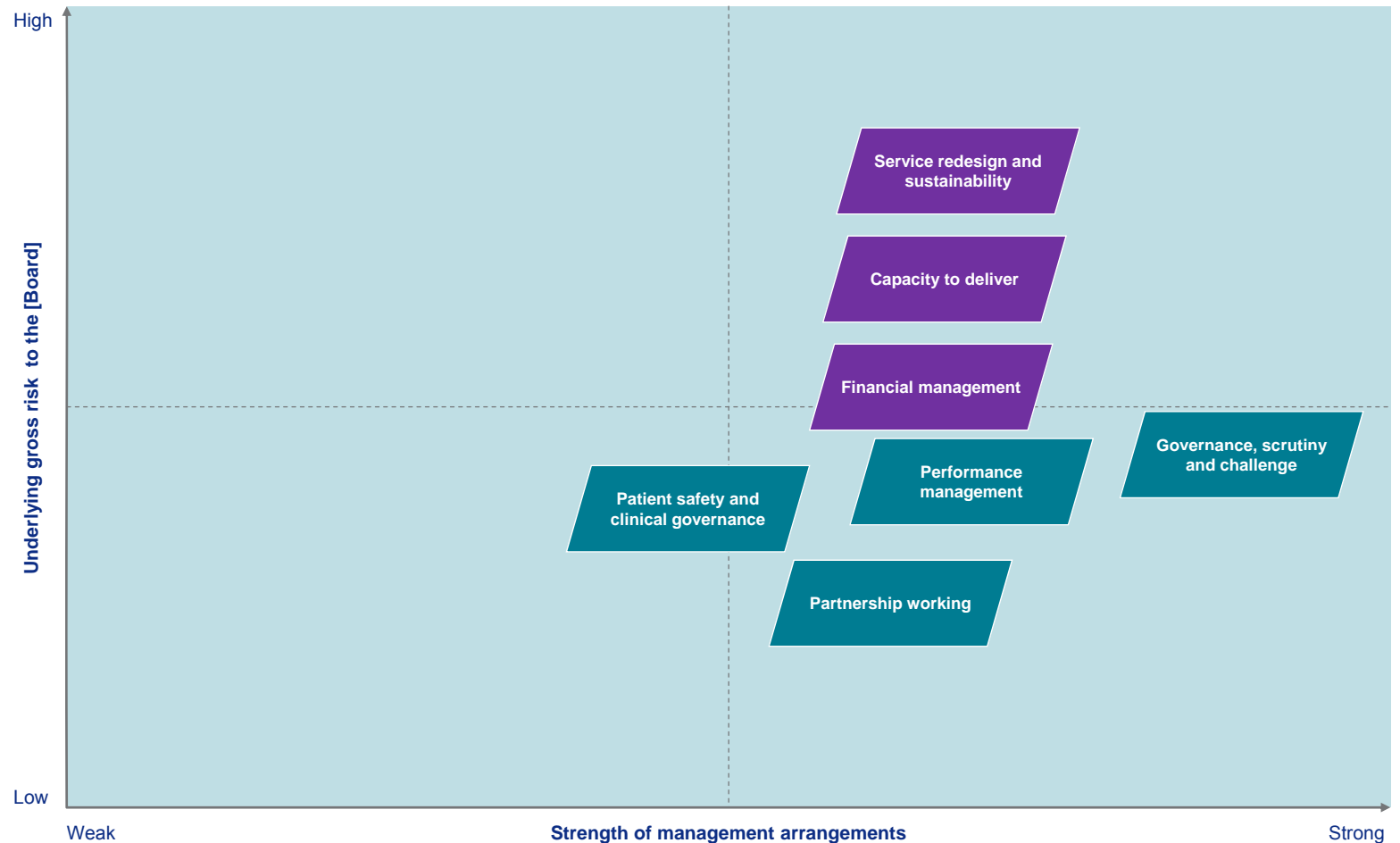
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Arrangements to prevent and detect fraud are embedded in internal controls, including processes to comply with requirements in respect of the National Fraud Initiative.

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**Competing risks and pressures continue to present new and recurring challenges. Overall, the impact of sector priorities present a moderate risk.**

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.



Arrangements in respect of significant risk areas are likely to mitigate the impact of those risks.

<b>Service redesign and sustainability</b>	<p>The Board continues its significant capital re-development. The aim of the development is to ensure that patients are treated in accommodation appropriate to their needs and in an environment that supports rehabilitation.</p> <p>The capital project was around three to four weeks behind schedule as at 31 March 2011. This was an improvement from a position six weeks behind schedule during the severe winter weather.</p> <p>There may be some additional costs associated with the opening which is delayed until September 2011, such as project team costs.</p>	<p>The design and implementation of actions to mitigate the risks are effective.</p> <p>The hospital redevelopment project board oversees the hospital redevelopment and reports to alternative board meetings.</p>
<b>Capacity to Deliver</b>	<p>As part of the hospital redevelopment, a 'hub and cluster' way of working is anticipated. The workforce plan assumes a particular way of staffing this new arrangement, however ,changes to the proposed nurse staffing arrangements mean there are risks around delivery of the efficiency savings forecast in the workforce plan.</p> <p>The four year workforce plan is likely to be achieved in terms of the overall number of staff, but the skills mix of the staff is not anticipated to be as expected. As a result, the savings forecast to be delivered from the workforce plan may under pressure.</p>	<p>The design and implementation of actions to mitigate the risks are effective. The management team and board continue to consider risks associated with the new hub and cluster arrangements.</p> <p>Savings from vacancy management are expected to cover the additional costs associated with the failure to fully achieve the workforce plan by 2011-12.</p>
<p>■ In our view, risks exist but actions have been identified and processes implemented to address these risks.</p> <p>■ In our view risks exist, but actions have been identified to address these risks.</p> <p>■ The Board currently has a higher number of nurses than anticipated in the workforce plan. In two years, the Board expects a number of nurses to be due to retire and taking significant action to reduce staffing levels now in order to achieve the workforce plan will require careful consideration.</p>		

<b>Financial management and affordability</b>	<p>The local delivery plan for 2011-12 has been prepared following a review of relevant assumptions and supporting documents, including the workforce plan, risk register and financial plans.</p> <p>There are expected to be some double running costs associated with the new hospital development, but management monitors these frequently.</p> <p>Unidentified savings are included in the local delivery plan and management intend to hold workshops to identify how the 3% efficient government savings target will be met.</p> <ul style="list-style-type: none"> <li>■ In our view risks exist, but actions have been identified to address these risks.</li> <li>■ The Board should continue to closely monitor double running costs and take action to identify the necessary savings to ensure achievement of the 3% efficient government target for 2011-12.</li> </ul>	<p>The design and implementation of actions to mitigate the risks are effective.</p>
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Management anticipated risks around fixed assets and capital funding; no audit adjustments were required and matters were concluded in a timely manner.

Areas of HIGH audit risk			
Area	Value (£'000)		KPMG comment
	2010	2011	
Fixed asset useful lives - depreciation	2,128	2,323	<p>The Board received a “dear colleague” letter from the Scottish Government on ‘IFRS transition in NHS Scotland – meeting the requirements of IAS 16 (property, plant and equipment)’. This advised a proposed amendment to existing methodologies for assessing the useful lives of buildings held at depreciated replacement cost. The revised methodology was intended to ensure that assigned useful lives took into account the wear and tear of all elements, but also recognised the maintenance spend to preserve the less significant elements and align them to the overall life of the building.</p> <ul style="list-style-type: none"> <li>Management identified those buildings and components impacted by the proposed change with the assistance of their internal auditors and valuer. The useful life of relevant components was amended to the highest individual component life of each building, ie its total estimated useful life, in line with the advised methodology.</li> <li>The revised depreciation charge was then calculated for each building based on this revision. This resulted in overall reduction of £135,000 in depreciation for 2010-11, adjusted for by management in the fixed asset register and financial ledger.</li> <li>We have concluded that management’s approach to calculation of depreciation appears reasonable.</li> </ul>
Capital development - impairment	11,236	7,046	<p>The Board’s re-development programme continues to progress. There have been significant additions to the cost of the assets under construction in year.</p> <p>The Board’s external valuer has provided a projected valuation of the completed project of £59 million. This is below the expected total cost, primarily as a result of a fall in the Building Cost Information Service Tender Price Index (“BCIS TPI”). There has been a 15% reduction in the BCIS TPI between 2007 when the project commenced and quarter one of 2011.</p> <p>The Board’s valuers have also completed research in respect of the pre- and post recession costs of building hospitals, prisons and secure accommodation when arriving at their valuation.</p> <p>As a result of the reduction in values, an impairment charge of £7 million was incurred in 2010-11. This impairment has been correctly recognised in the statement of comprehensive net expenditure. The Board has received Annually Managed Expenditure (‘AME’) funding from the Scottish Government Health Directorates to meet this cost.</p> <ul style="list-style-type: none"> <li>Financial statement disclosures in this respect are complete and accurate.</li> </ul>





## Accounting Financial statement level risks (continued)

Management anticipated risks equal pay; no audit adjustments were required and matters were concluded in a timely manner.

Areas of HIGH audit risk			
Area	Value (£'000)		KPMG comment
	2010	2011	
Equal pay – contingent liabilities	-	-	<p>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 NHS Scotland Central Legal Office ('CLO') to co-ordinate the legal response to this issue.</p> <p>Developments over the past year have led to a reduction in the number of 'live' claims going forward. The CLO has stated that claims still do not provide sufficient detail about 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. Furthermore, it is not possible to determine the number of live cases which may be valid due to the identification of a number of duplicate claims, and claims that might be invalid for a number of other reasons. 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.</p> <p>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 2010-11. 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 2010-11 financial statements.</p> <p>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.</p> <p>■ Financial statement disclosures in this respect are complete and accurate.</p>



**Draft financial statements and requested working papers were received in line with agreed timescales. Management provided additional information and explanations requested in a timely manner ensure the audit progressed to the agreed timetable.**

### Systems and controls

#### Preparation of the financial statements

- Draft financial statements and supporting documentation were provided on 3 May 2011, in line with the agreed timetable.
- Good quality working papers were provided and management dealt with all audit queries in an efficient manner.

#### Control environment

- Overall, management's approach to preparing the financial statements is efficient.

**The Board met its three financial targets – revenue resource limit, capital resource limit, and cash requirement.**

**The 2011-12 financial plan forecasts a breakeven position.**

**The plan requires the Board to achieve efficiency saving of 3% in year which will create challenges for the Board if they are to achieve their plan for the year.**

#### Financial position

The Board achieved all three of its financial targets for 2010-11. The Board has agreed with SGHD that both the revenue and capital surplus will be carried forward to 2011-12.

Management maintained its continuing commitment to the financial plan and this was evidenced by regular review of financial results, as well as routine monitoring of the progress of the capital plan. Monthly reports consider significant movements and enable management to manage their financial position with the aim of achieving their targets at the end of the financial year.

Performance against financial targets for 2010-11 was as follows:

	Final Allocation (£'000)	Outturn (£'000)	Variance (£'000)
Revenue resource limit	41,325	40,999	326
Capital resource limit	39,650	38,638	12
Cash requirement	69,200	69,180	20

A breakeven position was forecast for the financial year 2010-11. This position was monitored throughout the year. No revisions were deemed necessary and the Board continued to forecast a breakeven outturn position against their revenue resource limit ("RRL").

The financial statements show a final outturn surplus of £326,000 against the RRL. Performance savings, arising mainly from unfilled vacancies during the year, contributed to the outturn surplus against the core revenue resource limit. The revisions to the useful lives of fixed assets also contributed to the surplus position as at 31 March 2011.

The Board received confirmation of AME funding in respect of impairment charges of £7 million and provisions of £342,000 arising in 2010-11.

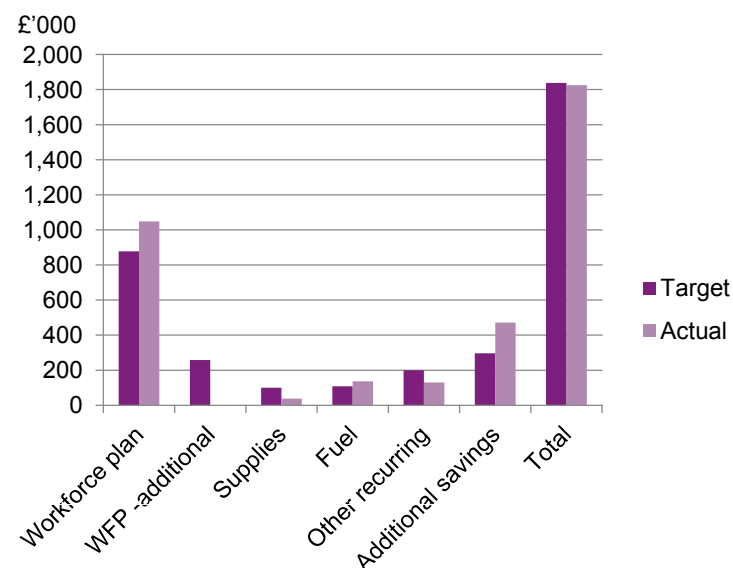
#### Efficient government programme

The Board had an efficiency target of 2% for 2010-11 and forecast total savings of £1.934 million were included in the 2010-11 local delivery plan, of which £1.838 million related to efficient government savings.

The Board has met its total savings target for the year, but fell slightly short of the efficient government target with savings of £1.825 million (short fall £13,000).

£472,000 of the savings achieved were non-recurring (against a target of £99,000) which will therefore pose further challenges if the Board is to continue to meet efficiency savings targets going forward.

The key area of savings relates to workforce planning. The table below highlights the actual savings made in each of the efficient government programme areas against the targets set in 2010-11.



#### Financial planning

The five year financial plan for the period 2011-16 was presented to board for approval in May 2011. This plan, alongside the local delivery plan, has been submitted to SGHD.

The plan shows that the Board is forecasting a breakeven position in 2011-12 and the following four years. The underlying assumptions of the plan will present challenges for management if they are to achieve a breakeven position over the next five years. In particular, the plan incorporates annual net savings of £1.5 million per year to be returned to the Scottish Government from 2012-13 (2011-12, £500,000) and the efficiency savings target under the efficient government programme has been increased from 2% to 3%.

The plan is also set against a degree of uncertainty in relation to NHS funding and management will need to ensure that the plan is flexible and can adapt to satisfy any changes which may arise.

The plan identifies four key financial risk areas:

#### Financial risk area

- Revenue – unavoidable costs
- Capital – unavoidable costs
- Revenue – service planning
- Financial management and controls

The 2011-12 financial plan includes measures to mitigate these risks however these will require close monitoring and actions to ensure the required savings are achieved.

#### Capital programme

The redevelopment project continues to progress and the Board incurred capital expenditure of approximately £38 million on the project during 2010-11.

The Board underspent against the original capital resource limit by £581,000. This was largely due to delays incurred following the adverse weather conditions in December 2010.

Management closely monitor the progress of the development and have regular update meetings with the contractor. Despite the slippage in 2010-11, completion is still expected during 2011-12, with phase three being completed by April 2012.

In our 2009-10 annual report we identified a key risk in respect of the potential for unfunded impairments to be incurred on the development. In 2010-11 there has been an impairment to the development of £7.046 million, however, this has been fully funded through AME funding. Management will continue to work with the SGHD where further impairments are identified.

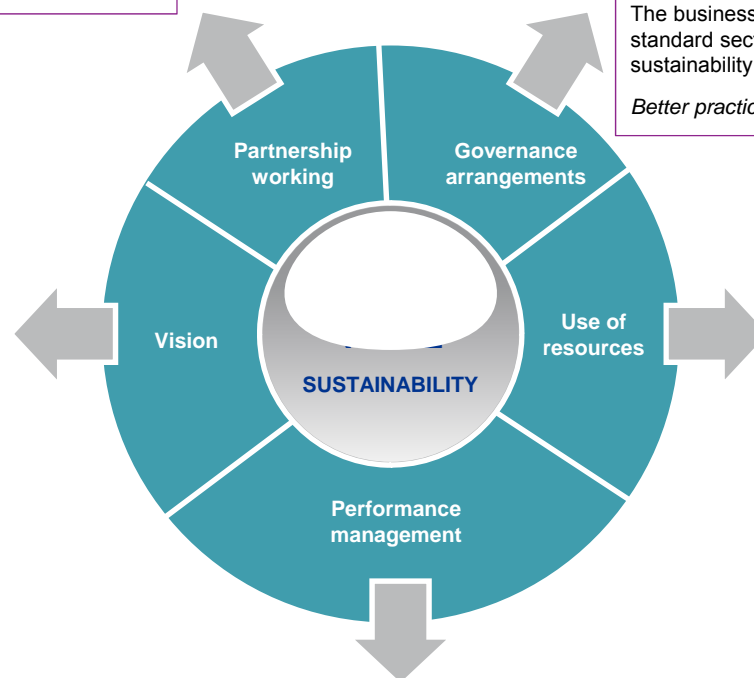
**We have completed a Best Value review of the Board's arrangements around sustainability. This pagesummarises our key findings.**

**Due to unforeseen circumstances, the Board was not able to provide us with the completed toolkit until late in the audit cycle and then only with limited supporting evidence. As a result, we have discussed management's self assessment with them, but have not reviewed supporting evidence in detail.**

The Board has not completed this section of the Best Value toolkit as it does not typically work with a number of partners and its arrangements in respect of ensuring sustainability is considered through partnership working are not well developed.

The Board has appointed a sustainability champion. There is an environmental policy statement in place. The Board actively monitors HEAT targets. A sustainability risk assessment has been completed.

*Basic practice*



There is a sustainability champion who chairs the sustainability group meetings. The group includes members from estates, facilities, procurement, nursing, risk and security teams.

Energy certificates are being obtained in respect of the new hospital development.

The business case process at the Board includes a standard section to document consideration of sustainability factors.

*Better practice*

The Board has developed an asset management system which includes a strategy in respect of each category of fixed asset. Sustainability has been considered as part of the hospital redevelopment, procurement of vehicles and in respect of use of commodities such as water / gas.

*Advanced practice*

Through monitoring of HEAT targets, the Board benchmarks itself against other boards. The procurement team has developed indicators to measure performance. Board reporting has been increased from six-monthly, to a standing agenda item.

*Better practice*

**Management has established procedures to consider and respond, where applicable, to individual national reports issued by Audit Scotland.**

#### **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.

Management has established procedures to consider individual reports. A responsible officer is assigned for each report and has responsibility for reporting to the Board and the audit committee on this area.

The studies published during 2010-11 were not relevant to the Board, therefore no reviews were required on these reports.

#### **Improving public sector purchasing**

Audit Scotland's corporate plan 2009-12 reinforces a commitment to maximising the impact of their work and to providing more evidence of impact. As part of this process auditors are required to provide information on how bodies respond to national performance audit reports.

In 2010-11 a more targeted follow-up was required in respect of the Board's actions following publication of the joint Accounts Commission / Auditor General for Scotland report, *Improving Public Sector Purchasing* published in July 2009.

Our work centred around the answers to three questions to facilitate analysis of the Board's arrangements. Overall, taking into account the size and nature of the Board, we found that processes are appropriate and mitigate the issues highlighted by the report.

The Board has demonstrated improvement between the 2009 and 2010 procurement capability assessments, moving from a 'conformant' rating (38%) to 'improved performance' (53%). This represents an above average position compared with other boards in Scotland.

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

<b>Corporate governance framework</b>	<p>The Board has a sound corporate governance structure in place which aims to ensure that accountability is taken for the efficient use of the Board's resources. No changes have been made to the governance structure from prior years.</p> <p>The Board has three sub-committees which each have terms of reference to outline their roles and responsibilities. These committees provide appropriate challenge to management in order to determine the effective running of the Board and use of resources.</p>
<b>Statement on internal control</b>	<p>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.</p>
<b>Internal controls</b>	<p>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.</p>
<b>Internal audit</b>	<p>We have considered the audit work performed and reports completed by internal audit and placed reliance on this work where possible. The reports issued in year do not make any 'critical' recommendations, but have raised a number of recommendations for management to implement to strengthen the system of internal control.</p> <p>Internal audit's 2010-11 annual opinion on internal controls notes that no critical control weaknesses have been identified and that no matters were identified which required to be brought to the attention of the audit committee.</p>
<b>Fraud and irregularity</b>	<p>We reviewed the procedures and controls related to fraud and are satisfied these controls are effective in mitigating the associated risks. The Board has a designated fraud liaison officer who maintains detail of any actual or alleged instances of fraud and provides updates to the audit committee for consideration where appropriate. No losses arising from fraud have been identified during 2010-11.</p> <p>The Board has participated in the NFI exercise and a total of six matches were recommended for follow up. The Board has investigated all matches and to date no issues have been identified .</p>



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