



The State Hospitals Board for Scotland

**External Audit Annual Report
2012/13 to the Board and the
Auditor General for Scotland**

June 2013



Scott-Moncrieff
business advisers and accountants



The State Hospitals Board for Scotland

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Executive Summary

Financial Statements

The State Hospitals Board for Scotland annual accounts are due to be approved by the Board on 27 June 2013. We have included within our independent auditor's report an unqualified opinion on the financial statements for the year ended 31 March 2013. We have also issued an unqualified opinion on the regularity of transactions.

We received draft annual accounts and supporting papers of a high standard, in line with our agreed audit timetable. We are pleased to report that the audit process ran smoothly and our thanks go to the finance team for their assistance with our work. Arrangements are in place to enable the annual accounts to be submitted to the Scottish Government Health and Social Care Directorates (SGHSCD) and the Auditor General for Scotland prior to the 30 June 2013 deadline.

Use of resources and performance

The Board reported an underspend of £4,000 against its Revenue Resource Limit (RRL). In achieving this underspend, the Board exceeded its efficiency savings target for the year by £9,000, although a proportion of savings are non-recurring. Significant savings have been reported in estates and facilities and support services as well as non-recurring savings of £0.373m through vacancy management.

The Board broke even against its capital target, with total capital expenditure of £1.581m. The majority of capital expenditure related to phase 3 of the hospital redevelopment, which was completed in June 2012.

The Board has submitted its Local Delivery Plan to the Scottish Government forecasting a breakeven position for the next three years. This however is dependent on realisation of a challenging savings plan. In addition, in 2013/14, the Board has yet to identify £0.226m of savings.

The Board has developed a performance management framework and receives reports on organisational performance and finance at every meeting. Finance and performance reports are based around the Local Delivery Plan and its associated targets and measures.

Governance

Our work on corporate governance focussed on reviewing the Board's arrangements to ensure effective systems are in place for internal control, prevention and detection of fraud and irregularity and standards of conduct. We are pleased to report that, in our opinion, the governance arrangements at the Board are sufficient and appropriate.

During the year, the Chair of the Board received three letters, each raising a number of concerns over certain aspects of the organisation's operations. The Chair has taken personal responsibility for addressing these concerns and, where appropriate, has commissioned the Board's internal auditors or external advisors to carry out investigatory work. Investigatory work continues to be carried out by an external advisor. We intend to continue to monitor the outcome and response by the Chair to these concerns. Reference has been made in

the governance statement to the letters that the Chair received during the year and the work on going in response to these.

Conclusion

This report concludes our audit of the State Hospitals Board for Scotland for 2012/13. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards. This report has been discussed and agreed with the Finance and Performance Director and we would like to thank all management and staff for their co-operation and assistance during the audit.

Scott Moncrieff
June 2013

Introduction

1. This report summarises the findings from our 2012/13 audit of the State Hospitals Board for Scotland (the Board). The scope of our audit was set out in our External Audit Plan, which was presented to the Audit Committee at the outset of our audit.
2. The main elements of our audit work in 2012/13 have been:
 - An audit of the financial statements, including a review of the Governance Statement;
 - A review of governance arrangements, internal controls and financial systems; and
 - A targeted follow-up review of Audit Scotland's national report on 'Scotland's Public Finances: Addressing the Challenges'.
3. In addition to this annual report, we have issued the following reports during 2012/13:
 - External audit plan;
 - Interim management report; and
 - Targeted follow up of Audit Scotland's 'Scotland's Public Finances: Addressing the Challenges'.

The key issues from these outputs are summarised in this annual report.

4. As part of our audit, we have also made use of the work of other inspection bodies including the Board's internal audit service and Audit Scotland's Public Reporting Group.
5. This report is addressed to both the Board and the Auditor General for Scotland and will be published on Audit Scotland's website, www.audit-scotland.gov.uk.

Financial Statements

Introduction

6. The annual financial statements are the principal means of accounting for the stewardship of the resources made available to the Board. In this section we summarise the issues arising from our audit of the 2012/13 financial statements.

Overall conclusion

An unqualified audit opinion on the financial statements

7. The annual accounts are due to be approved by the Board on 27 June 2013. We have included, within our independent auditor's report, an unqualified opinion on the financial statements for the year ended 31 March 2013.
8. The information given in the Operating and Financial Review and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements. In addition, the part of the Remuneration Report to be audited has been properly prepared in accordance with applicable legislation and directions made thereunder by Scottish Ministers.
9. We are also satisfied that the Governance Statement complies with guidance from Scottish Ministers.

An unqualified audit opinion on regularity

10. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors to certify that, in all material respects, the expenditure and income shown in the financial statements was incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have issued an unqualified opinion on the regularity of transactions.

Good administrative processes were in place

11. We received draft annual accounts and supporting papers of a high standard, in line with our agreed audit timetable. We are pleased to report that the audit process ran smoothly, and our thanks go to the finance team for their assistance with our work.
12. Arrangements are in place to enable the annual accounts to be submitted to the Scottish Government and the Auditor General for Scotland prior to the 30 June 2013 deadline.

Board Members' responsibilities

13. It is the responsibility of the Board and the Chief Executive, as Accountable Officer, to prepare the financial statements in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder. This means:
 - applying on a consistent basis the accounting policies and standards approved for NHS Scotland by Scottish Ministers;
 - making judgements and estimates that are reasonable and prudent;

- stating whether applicable accounting standards as set out in the Financial Reporting Manual (FReM) have been followed, subject to any material departures disclosed and explained in the financial statements; and
- preparing the accounts on a going concern basis unless it is inappropriate to presume that the Board will continue to operate.

14. Board members are responsible for ensuring that proper accounting records are maintained which disclose with reasonable accuracy at any time the financial position of the Board and enable them to ensure that the accounts comply with the National Health Service (Scotland) Act 1978 and the requirements of Scottish Ministers. They are also responsible for safeguarding the assets of the Board and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditor responsibilities

15. We audit the financial statements and the part of the Remuneration Report to be audited and give an opinion on:
- whether they give a true and fair view of the financial position of the Board and its net operating cost for the year then ended;
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements;
 - whether the part of the Remuneration Report to be audited has been properly prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers;
 - whether the information given in the Operating and Financial Review and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
 - whether expenditure and income has been incurred and applied in accordance with guidance from Scottish Ministers (the regularity opinion).
16. We also report by exception as to whether the governance statement does not comply with guidance from Scottish Ministers. In arriving at our opinion we:
- consider the adequacy of the process put in place by the Chief Executive as Accountable Officer to obtain assurances on systems of internal control; and
 - assess whether disclosures in the statement are consistent with our knowledge of the Board.

Independence

17. International Standard on Auditing (UK & Ireland) 260, "communication with those charged with governance" requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence. We can confirm that we have complied with the APB's Ethical Standard 1 – Integrity, Objectivity and Independence. In our professional judgement the audit process has been independent and our objectivity has not been compromised.

Internal Audit

18. Internal audit is a key component of the Board's corporate governance arrangements. During 2012/13, the Board appointed KPMG as internal auditors (appointment commenced October 2012). This service was previously provided by PricewaterhouseCoopers (PwC).
19. In accordance with ISA 610 – Considering the work of internal audit, *“the external auditor should perform an assessment of the internal audit function when internal auditing is relevant to the external auditor's risk assessment.”* During the year we carried out a review of the internal audit function provided by KPMG.
20. Overall we concluded that the internal audit service complies with Government Internal Audit Standards and is a service which we can place reliance on. To avoid duplication of effort and to ensure an efficient audit process we have made use of internal audit work where appropriate. We are grateful to the internal audit team for their assistance during the course of our audit work.

Key areas of audit focus and significant findings

21. We are required by international auditing standards to report to the Board the main issues arising from our audit of the financial statements. The most significant issues are noted below.

Exit Packages

22. During 2012/13, the Board incurred £224,000 in relation to four staff departing early from the organisation (as disclosed in note 24 in the annual accounts). From review of documentation on two of these cases we noted the following:
 - The Board does not currently have a policy in place for early departure schemes. For the two cases reviewed, the packages offered to these individuals were approved by the Chief Executive and the Chair. These individuals left the organisation between July and August 2012. A paper was presented to the Board in December 2012 to provide members with an update on the context, process and cost of these agreements (for three of the four cases).
 - The Remuneration Committee terms of reference (April 2013) require the Committee to ‘consider any redundancy, early retiral or termination arrangement in respect of all State Hospital staff, excluding early retirals on grounds of ill health, and approve these or refer to the Board as the Committee sees fit’. As noted above, for the two individuals who left the organisation between July 2012 and August 2012, a paper was presented to the Board in December 2012.
 - For each case reviewed, we noted that a compromise agreement was put in place. These were prepared by the NHS Scotland Central Legal Office on behalf of the Board. As noted in the paper presented to the Board in December 2012, compromise agreements were put in place to “protect the organisation from future legal claims in respect of the termination of employment, severance payment (where applicable) and any potential breaches in confidentiality”.
23. The Scottish Public Finance Manual (SPFM) states the following:

A Scottish Government (SG) sponsored body must obtain prior approval from the SG for a new severance, early retirement or redundancy scheme or changes to a previously approved scheme. Approval lasts for the duration of the scheme.

Any proposal by constituent parts of the Scottish Administration (including SG Executive Agencies and non-ministerial departments) or bodies sponsored by the SG to offer a financial consideration to secure the voluntary resignation of an employee outwith any existing (and approved) scheme must be approved by the relevant SG Finance Business Partner (or equivalent) and SG Human Resources Division before any offer is made, whether orally or in writing.

Scottish Government *Scottish Public Finance Manual: Severance, Early Retirement and Redundancy Terms*

24. In May 2013, Audit Scotland published a report '*Managing early departures from the Scottish Public Sector*'. This report sets out the main principles of good practice for early departure schemes. The report also makes reference to the use of compromise agreements.

Compromise agreements should be clear about which employment rights are being waived and should not be used to limit public accountability.

The use of compromise agreements has attracted significant interest, with fears that they can be used to silence whistle blowers. The Scottish Government has recently emphasised that confidentiality clauses should only be used appropriately. It is essential that in reaching compromise agreements, public sector organisations adhere to the principles of transparency and accountability. Organisations must also understand any restrictions in terms of what employment rights have been waived by the employee.

Audit Scotland '*Managing early departures from the Scottish Public Sector*'

25. While we concluded that the transactions had been accounted for correctly in the financial statements, we recommend that the Board develops a policy for early departures and ensures this is approved by the Board and the Scottish Government and circulated to all staff. We would also encourage the Board to review the principles highlighted above and ensure that they are being complied with.

Action Plan Point 1

Hospital redevelopment

26. The redevelopment of hospital facilities provides new accommodation; four ward hub and cluster buildings, an off-ward activity centre, essential services building and estates compound, reception building and family centre. The administration centre and occupational health facilities have also been refurbished.
27. The project was split into 3 phases, with the final phase (phase 3, landscaping works) being completed during 2012. During the year, the Board's valuer assessed the completed value of phase 3 at £3.124m. Overall there was a reduction in the value compared with the total costs incurred. An impairment charge of £2.649m has therefore been recognised in the statement of comprehensive net expenditure. The Board has received Annually Managed Expenditure ('AME') funding from the SGHSCD to meet this cost. Overall we concluded that the Board has accounted for the impairment in accordance with the Capital Accounting Manual and relevant standards.

Staffing

28. During the year the Finance and Performance Management Director and acting Director left the organisation. An appointment has since been made to this post. There was however a period where the finance team operated without a Director. Although arrangements were put in place to cover this period, there was a risk that the financial records were subject to errors and inaccuracies during this time. We have carried out audit testing as appropriate covering this period to ensure accounting transactions were correctly recorded in the financial statements. We identified no control issues during our audit testing.

Equal Pay

29. In 2012/13, in common with all other NHS boards, the Board has disclosed an un-quantified contingent liability in its financial statements in respect equal pay. The Board has received 34 claims under the Equal Pay Act 1970 mainly from women seeking compensation for past pay inequalities with male colleagues. The NHS Scotland Central Legal Office and Equal Pay Unit are continuing to monitor the progress of all equal pay claims in NHS Scotland as well as developments elsewhere that may further inform the position. They continue to advise that it is not possible to provide any financial quantification at this stage because of the lack of information available. On the basis of this view, the appropriate accounting treatment is to disclose the claims as an unquantifiable contingent liability.

NHS Superannuation Scheme

30. The Board participates in the NHS Superannuation Scheme for Scotland. This is a defined benefit pension scheme, where contributions are credited to the Exchequer and invested in a portfolio of Government securities. The Board is unable to identify its share of the underlying assets and liabilities on a consistent and reasonable basis and therefore the amount charged to the statement of comprehensive net expenditure represents the Board's contributions payable to the scheme in respect of each year.
31. The Board's annual contributions to the scheme are based on a five yearly actuarial valuation. The most recent actuarial valuation was for the year to 31 March 2004. Given that the Scheme ought to be subject to a full actuarial valuation every five years, we would have expected a more up to date valuation to have been reflected in the 2012/13 accounts. While this is outwith the control of the State Hospitals Board for Scotland, the periodic actuarial valuation is key to determining the adequacy of employer and employee contributions to the scheme.

Management override

32. Audit standards require us to include the risk of management override as a significant risk on every audit. This is because management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records by overriding controls that otherwise appear to be operating effectively. Although the level of this risk will vary from entity to entity, the risk is nevertheless present in all entities.
33. We have reviewed the accounting records for significant unusual transactions or transactions outside the normal course of business and have obtained, where applicable, supporting evidence to ensure that all such transactions are valid and accounted for correctly.

Audit adjustments and unadjusted items

34. We did not identify any audit adjustments during our audit other than amendments to the disclosure notes.

Management representations

35. We have requested that a signed representation letter, covering a number of issues, be presented to us at the date of signing the financial statements.

Qualitative aspects of accounting practices and financial reporting

36. During the course of our audit, we consider the qualitative aspect of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements. The following observations have been made:

Qualitative aspect considered	Audit conclusion
The appropriateness of the accounting policies used.	We have reviewed the significant accounting policies, which are disclosed in the financial statements, and we consider these to be appropriate to the Board.
The timing of the transactions and the period in which they are recorded.	We did not identify any significant transactions where we had concerns over the timing or the period in which they were recognised.
The appropriateness of the accounting estimates and judgements used.	Significant accounting estimates and judgements have been made on property and equipment depreciation rates and on provisions and contingent liabilities. In our opinion all such estimates and judgements are appropriate and have been accurately reflected in the financial statements.
The potential effect on the financial statements of any uncertainties, including significant risks and disclosures such as pending litigation that are required to be disclosed in the financial statements.	In 2012/13 the Board has disclosed an un-quantified contingent liability in its financial statement in respect of equal pay. (Refer to paragraph 29).
The extent to which the financial statements have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed in the financial statements.	Our testing identified no significant unusual transactions in the period.
Apparent misstatements in the directors' report or material inconsistencies with the financial statements.	There has been no misstatement or material inconsistency between the financial statements and the directors' report.
Any significant financial statement disclosures to bring to your attention.	All disclosures made are required by relevant legislation and applicable accounting standards. Key areas of audit focus and significant findings are detailed in paragraph 21 onwards.

Qualitative aspect considered	Audit conclusion
Disagreement over any accounting treatment or financial statement disclosure.	There was no disagreement during the course of the audit over any accounting treatment or disclosure.
Difficulties encountered in the audit.	There were no difficulties encountered in the audit.

Use of resources and performance

37. This section of the report sets out the main findings from our review of how the Board manages its key resources in terms of financial performance.

The Board's financial performance in 2012/13

The Board has met its key financial targets in the year

38. The Board is required to work within the resource limits and cash requirements set by the Scottish Government Health and Social Care Directorates (SGHSCD). As shown in the table below, the Board met all of its key financial targets in 2012/13.

Performance against key financial targets

Financial Target	Target £'000	Actual £'000	Underspend £'000	Target achieved
Revenue Resource Limit - Core	32,256	32,252	4	Yes
Revenue Resource Limit – Non core	5,400	5,400	0	Yes
Capital Resource Limit	1,581	1,581	0	Yes
Cash Requirement	37,200	37,098	102	Yes

(Source: Annual Report and Accounts for the year ended 31 March 2013)

39. The Board reported a £4,000 under-spend against its Revenue Resource Limit (RRL). The baseline RRL for the year was £33.241m. This was revised throughout the year and the final RRL (£32.256m) includes £400k which is an approved carry forward from 2011/12.
40. At the outset, the Board forecast to breakeven at the year-end. During the year, however, the Board identified a potential overspend and steps were subsequently taken to ensure the forecast breakeven position was achieved. Steps taken included:
- **A reduction in nursing overtime.** In December 2012, nursing overtime costs had increased by 73%, compared to December 2011. To reduce these costs, management created a Nursing Resources Administration Team. This team was responsible for documenting the underlying reasons for increasing costs in this area and developing options for reducing them.
 - **Vacancy management.** Management continue to review long term vacancies to assess whether the posts are required, and whether the vacant posts can be carried out by less senior staff.
 - **Identification of cost savings.** Regular meetings have been established between the finance team and budget holders to identify cost savings.
 - **Postponement of refresher safety training courses for non-clinical staff.**

41. We have analysed the Board's 2012/13 outturn into recurring and non-recurring items. This is shown in the table below:

Achievement of 2012/13 surplus	£000
Recurring income	34,163
Recurring expenditure	(34,532)
Recurring savings	1,025
Underlying recurring surplus/(deficit)	656
Non-recurring income	5,689
Non-recurring expenditure	(6,714)
Non-recurring savings	373
Non-recurring surplus/(deficit)	(652)
Financial surplus/(deficit)	4
Underlying recurring surplus/(deficit) as percentage of recurring income	1.9%

(Source: financial dataset to be submitted to Audit Scotland)

42. The table above shows that the Board delivered its surplus through efficiency savings of £1.398m, which exceeded the savings target of £1.389m. The table below sets out the actual savings delivered during 2012/13 against the planned savings. Finance reports presented to the Board during the year include a summary of progress against the savings target.

Savings plans 2012/13

Source of savings	Savings Target £'000	Actual savings £'000	Variance £'000
Hospital Redevelopment Savings			
• Workforce plan	970	341	(256)
• Drugs and Prescribing	10	10	0
• Procurement	0	0	0
• Support Services	11	276	265
• Estates and Facilities	398	398	0
Total recurring savings	(1,389)	1,025	(365)
Non recurring savings (vacancy management)	0	373	373
Grand Total	1,389	1,398	9

(Source: Finance report as at 28 February 2013 – presented to the Board)

43. The hospital redevelopment is expected to generate revenue savings. In March 2012, the Scottish Government confirmed that the total revenue savings anticipated are £1.804m. By 2012/13, £1.304m of redevelopment savings had been achieved by the Board (cumulative over a three year period commencing 2010/11). The Board aim to repay the remaining target amount by 2015/16.

Future Financial Plans

44. The Board has prepared a three year local delivery plan (LDP) covering the period 2013-2016. The LDP was previously prepared on a five year basis but, in line with guidance from the Scottish Government, the most recent LDP covers three years. The LDP has been approved by the Scottish Government.
45. The LDP includes a summary of the financial plan, which projects a breakeven position over the next three years. To achieve this however the Board is dependent on the realisation of its savings plan. For 2013/14, the LDP states that £1.355m of savings are to be achieved. Included within this are £0.226m of, as yet, unidentified savings.
46. The Board recognises that achieving the savings target will be challenging. Significant pressures include:
- **Workforce plan numbers and skills mix:** due to the fall in staff turnover and the national no-compulsory-redundancy policy, the Board has not been able to achieve the planned workforce numbers as set out in the Full Business Case (hospital redevelopment). The workforce plan is currently under review.
 - **Unknown service contract costs and increases:** As the new hospital has only been fully operational since September 2011, the full costs of running the site are still not fully understood.
 - **Utility costs:** these continue to rise, giving both a price and usage pressure in 2013/14.
47. The achievement of future financial targets will depend on continuing tight control of expenditure, delivery of a challenging savings plan and may also require some difficult decisions to be taken in areas such as workforce planning. This will be a key area which the Board will have to monitor very closely.

Capital Resource Limit

48. The Board reported a break even position against its Capital Resource Limit (CRL) in 2012/13 with total capital expenditure of £1.581m. Capital resources are expected to reduce to £300k in 2013/14 and 2014/15. There is no anticipated resource for property in the three year financial plan. This presents a challenge for the Board in terms of implementing its property and asset management strategy, particularly in areas such as information management and technology and security.

Scotland's Public Finances: Addressing the Challenges – Follow Up review

49. 'Scotland's Public Finances: Addressing the Challenges' was published by Audit Scotland in August 2011. The report provided an overview of the scale of budget cuts expected to be faced by the Scottish public sector in the period 2010/11 to 2014/15, and how public bodies were beginning to respond to the

challenges of reducing expenditure. In particular, the report highlighted some of the main cost pressures facing public bodies and emphasised the importance of achieving long-term financial sustainability.

50. During 2012/13 we carried out a targeted follow up review based on the findings in this report. The aim of the review was to assess how the Board is responding to the challenges of public sector budget constraints. Our review focussed on two main questions:

- Does the Board have sustainable financial plans which reflect a strategic approach to cost reduction?; and
- Do senior officials and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?

51. We noted during our review that the Board has a detailed budget setting process in place that facilitates the development of short and medium term financial plans. Members of the senior management team and the Board provide appropriate scrutiny and review of financial plans, both during the approval process and throughout the year. Our review did however identify areas for development. We have issued a separate report on our findings. Included within this report are recommendations for the Board to consider.

Performance Management Framework

52. The Board has developed a performance management framework and receives reports on organisational performance and finance at every meeting. Performance reports are based on the Local Delivery Plan (LDP) and its associated targets and measures. The performance management reporting framework is now aligned to the hub and cluster arrangement. It was previously aligned to wards.

53. Performance is reported on a 'priority-ordered' exceptions basis with a red, amber and green system in place to identify performance levels. In addition, the performance reports set out progress against LDP targets. The LDP performance measures are aligned with the ministerial objectives of; Health improvement for people in Scotland; Efficiency/governance improvements; Access more quickly to service; and Treatment appropriate for patient (HEAT).

54. The Board receives regular and detailed performance and financial information which facilitates scrutiny and challenge. Key risk factors which may impact on achievement of financial and non-financial outcomes are also identified and discussed.

Best Value Arrangements

55. Best value is defined as continuous improvement in the performance of functions. The positive impact of the best value concept in local government led Scottish Ministers to introduce a non-statutory best value duty on all public sector Accountable Officers (across health and central government) in 2002. This was reinforced by refreshed Ministerial guidance highlighting the importance that the Scottish Government places on best value as a means of supporting public service reform. The *Scottish Public Finance Manual* now places a duty on the Chief Executive, as Accountable Officer, to make arrangements to secure best value.

56. Overall the Board has developed appropriate arrangements for achieving best value. The Board has established a rolling programme of best value reviews (commencing 2009/10) which aims to provide coverage across all the best value themes (Vision and Leadership, Effective Partnerships, Governance and Accountability, Use of Resources and Performance Management) as well as two cross cutting themes (Equality and Sustainability). Due to staff changes in 2012/13, however, no best value reviews were carried out. These have been rescheduled to be carried out during the next financial year.

Governance

57. Corporate Governance is concerned with the structures and processes for decision-making, accountability, control and behaviour at the upper levels of organisations. The Accountable Officer and the Board are responsible for ensuring the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions and for monitoring the adequacy and effectiveness of these arrangements.

Governance Arrangements

58. During 2012/13 there have been three new appointments to the Board. An induction programme is in place for all new board members covering the local delivery plan, the strategic objectives of the Board and introductory meetings with senior management. The Board continually reviews and monitors its performance. All board members are subject to an annual appraisal by the Chair. The committees of the Board undertake an annual self-assessment of their performance and report this to the Board.

Systems of internal control

59. During the year we reviewed the Board's key accounting systems and internal financial controls. As reported in our interim management report, we identified no significant weaknesses in relation to the internal financial controls in place over the Board's key accounting systems. We found the internal financial controls to be well designed and operating effectively.
60. Between December 2012 and January 2013, the Chair of the Board received three letters, each raising a number of concerns over certain aspects of the organisation's operations. The Chair has taken personal responsibility for addressing these concerns and, where appropriate, has commissioned the Board's internal auditors or external advisors to carry out investigatory work.
61. The Chair tasked internal audit to investigate and report on three of the concerns raised. Their findings were reported to the Audit Committee in April 2013. Internal audit made a number of recommendations; seven have been classified as high¹ and five as moderate priority. No critical recommendations have been raised. The Board is currently acting upon these recommendations. In April 2013, for example, the Board approved revised terms of reference for the remuneration committee.
62. Investigatory work continues to be carried out by an external advisor. We intend to continue to monitor the outcome and response by the Chair to these concerns.
63. The governance statement included within the Board's 2012/13 annual accounts discloses no significant internal control weaknesses. Reference is however made to the letters that the Chair received during the year and the work on-going in response to these. Our audit identified no additional issues which we consider need to be disclosed in the governance statement.

¹ A high rated recommendation is defined by internal audit as an 'issue which represents a control weakness, which could have or is having a major adverse effect on the ability to achieve process objectives.'

64. This is in keeping with the findings from internal audit who have reported that 'based on our work undertaken in this period, but subject to the modification of scope², we are of the opinion that the Board's systems provide a reasonable basis for maintaining control and that the control framework provides reasonable assurance regarding the effective and efficient achievement of strategic objectives'
65. The Board's previous internal auditors, PwC, also provided a summary of work performed during 2012/13. While not providing an annual opinion, the report sets out the results from the work carried out during the period. PwC reviewed patient's funds and key financial controls and reported three recommendations. No critical or high risk recommendations were identified.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

66. We have reviewed the arrangements for adopting and reviewing standing orders, financial instructions and schemes of delegation and complying with national and local codes of conduct. We also considered controls over register of interests. We are pleased to report that our audit identified no significant issues of concern in relation to standards of conduct and the prevention and detection of bribery and corruption. We did note in our interim management report that some of the Board's existing policies and procedures are out of date and should be refreshed. Work is currently underway by the Board to address this.

Prevention and detection of fraud and irregularity

67. Our audit was planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity. As part of our governance work we reviewed the Board's arrangements to prevent and detect fraud and irregularity. We concluded that the Board's internal controls and financial procedures were adequate to prevent and detect material fraud and irregularity.

National Fraud Initiative

68. The National Fraud Initiative (NFI) is a counter-fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and the Audit Commission to identify fraud and error. These exercises are undertaken every two years as part of the statutory audits of the participating bodies. In 2012 Audit Scotland reported that the cumulative outcomes from NFI in Scotland were around £78 million.
69. The NFI works by using data matching to compare a range of information held on bodies' systems to identify potential inconsistencies or circumstances that could indicate fraud or error, which are called 'matches'. Where matches are identified these are made available to bodies to investigate via a secure web application. Bodies investigate these and record appropriate outcomes based on their investigations.

² Internal audit's modification of scope: 'At the request of the Board, we performed three investigative reviews during the period which were in response to specific operational matters; a number of recommendations were identified. As a result of the nature of the assignments and management's prioritisation of these reviews, the originally approved plan was not fully performed, giving rise to a modification of scope'.

70. The State Hospitals Board for Scotland has received 666 matches for investigation, which is far higher than would be expected. Although payroll data for each health board was submitted nationally by NHS National Services Scotland, management were not aware of this and also submitted payroll data. We understand that many of the matches released for investigation were as a result of duplication of data. The key officer responsible for NFI at the Board has reviewed this information to filter out those high risk matches which do require to be investigated.
71. During our interim audit we considered the arrangements in place for participating in the NFI exercise. Despite the data duplication issue, overall the arrangements appear reasonable. The Audit Committee receives fraud updates which, going forward, will include commentary on the NFI process. The key officer responsible has reviewed all high risk matches. To date the Board has not identified any fraudulent matches.

Appendix 1 - Action plan

- 72.** Our action plan details the control weaknesses and opportunities for improvement that we have identified during 2012/13, in the course of our audit. It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements that may exist.
- 73.** To assist the Board in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been graded. The grading structure is summarised as follows:

Grade 5	<ul style="list-style-type: none">• Very high risk exposure - Major concerns requiring Board attention.
Grade 4	<ul style="list-style-type: none">• High risk exposure - Material observations requiring management attention.
Grade 3	<ul style="list-style-type: none">• Moderate risk exposure - Significant observations requiring management attention.
Grade 2	<ul style="list-style-type: none">• Limited risk exposure - Minor observations requiring management attention
Grade 1	<ul style="list-style-type: none">• Efficiency / housekeeping point

Action Plan Point	Issue Identified	Risk and Recommendation	Management Comments
1	<p>The Board does not currently have a policy in place for early departure schemes.</p> <p>The Board uses compromise agreements to protect the organisation from future legal claims in respect of the termination of employment, severance payment (where applicable) and any potential breaches in confidentiality.</p>	<p>There is a risk that the Board has not complied with the Scottish Public Finance Manual and is not currently following best practice guidelines.</p> <p>The Board should develop a policy for early departures and ensure this is approved by the Board and the Scottish Government and circulated to all staff.</p> <p>We would encourage the Board to review the principles within the Scottish Public Finance Manual and Audit Scotland's report on Managing Early Departures in the Scottish Public Sector and ensure that they are being complied with.</p> <p>Risk Rating 4</p>	<p>Recommendation accepted. Policy to be developed and approved by 31 August 2013.</p>

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