

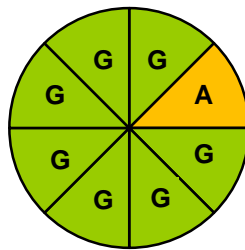
Internal Audit



IJB Financial Assurance

April 2016

Report Assessment



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Introduction

The Public Bodies (Joint Working) Scotland Act 2014 aims to provide better connected and co-ordinated services through the integration of health and social care services provided by local authorities and health boards. Integration Joint Boards (IJBs) are tasked with directing the provision of integrated services and in order to achieve this, resources will be transferred from the health board and local authority. The Scottish Government has issued a guidance note “Guidance for Integration Financial Assurance”, which sets out a process to be followed in order to assess whether the resources delegated to the IJB are adequate to carry out its functions.

The guidance recommends that the process should be undertaken by each of the parties, and a report provided to respective Audit Committees by Internal Audit in relation to the assurance process.

Scope

NHS Lothian has shared a proposed approach to determining the initial sums with partner organisations. We will review the work performed by NHS Lothian to date, to determine the extent to which the proposed methodology follows the Scottish Government guidance, and the extent to which NHS Lothian assurance activity has followed the proposed methodology.

This internal audit does not conclude on the adequacy of the initial sums to be transferred from NHS Lothian to IJBs.

Acknowledgements

We would like to thank all staff consulted during this review for their assistance and cooperation.

Executive Summary

Conclusion

During the process to allocate budgets to the IJBs there has been effective liaison between NHS Lothian and the four IJBs. The allocation method was approved at the December Finance and Resource Committee, however the budgets to be allocated have not yet been finalised and passed to the IJBs for approval, due to the delays in the Scottish Government sign off of the NHS Lothian 2016-17 budget. In addition, there are a number of areas in which NHS Lothian's methodology for calculating the proposed payment should be reviewed during the first year of the IJBs operation.

Summary of Findings

The table below summarises our assessment of the adequacy and effectiveness of the controls in place to meet each of the objectives agreed for this audit. Definitions of the ratings applied to each action are set out in Appendix 1.

No.	Control Objective	Control objective assessment	Number of actions by action rating			
			Critical	Significant	Important	Minor
1	The proposed payments to be made from NHS Lothian to the IJB are aligned to those functions' budgets which are to be delegated to the IJB.	Green		1		
2	The method and assumptions used in calculating the payments for the four IJBs are clearly stated, and the proposed payments have been assessed against actual expenditure on delegated functions for 2014-15 and 2015-16.	Amber		2	1	
3	Material non-recurrent funding and expenditure payments for the delegated functions and the associated risks are identified and assessed.	Green				
4	The medium term financial forecast for the delegated functions and associated assumptions and risks have been reviewed.	Green			1	

No.	Control Objective	Control objective assessment	Number of actions by action rating			
			Critical	Significant	Important	Minor
5	Savings and efficiency targets and expected cost pressures have been incorporated into proposed payments, have been clearly communicated to all partners, and have been risk tested and validated.	Green				
6	The amount set aside for the IJB consumption of large hospital services is consistent with the methods recommended in the IRAG guidance on the set aside resource and the assumptions and risks are assessed.	Green				
7	Risk sharing agreements are in place between NHS Lothian, the Councils and the IJBs which clearly define responsibilities in the event of the IJB exceeding established budgets.	Green			1	
8	Risks have been quantified where possible and measures to mitigate risk have been identified.	Green			1	

Control Objective Ratings

Action Ratings	Definition
Red	Fundamental absence or failure of controls requiring immediate attention (60 points and above)
Amber	Control objective not achieved - controls in place are inadequate or ineffective (21 – 59 points)
Green	Control objective achieved – no major weaknesses in controls but may be scope for improvement (20 points or less)

Main findings

NHS Lothian Finance has undertaken a considerable amount of work to date to review all the cost centres within the general ledger to determine which cost centres should be delegated to the IJBs based on services within functions, and which allocation methods should be used. This task has been particularly difficult and time consuming given the volume of cost centres involved (c.4000) and due to the fact that this is the first year of the IJBs operation and hence the first year NHS Lothian has had to determine the payments to be made to the IJBs.

Each element of the proposed payment from NHS Lothian to the IJBs (core, hosted, set-aside, and GP prescribing) has been assessed to understand the best method to use for calculating the proposed payment, e.g. cost centre, NRAC formula (NHS Scotland Resource Allocation Committee), historical, or PBSG method (Prescribing Budget Setting Group). Numerous discussions have taken place over the course of 2015-16 to determine the best methods at the Section 95 Officers Group, the Finance & Resources Committee (FRC) and informal meetings between the IJB Chief Financial Officers/Chief Officers and NHS Lothian Finance. Final recommendations on the most appropriate calculation methods were presented to the FRC in December 2015 and approved.

The IJB Chief Financial Officers were involved in the exercise to review all the cost centres within the General Ledger to determine which functions should be delegated to the IJBs. The IJB Chief Financial Officers were asked to review the classification of functions to be delegated from the cost centre review and have been informed of the draft calculations based on the work performed to date.

The IJB Chief Officers and Chief Financial Officers were also involved in the financial planning process for 2016-17 to identify cost pressures, non-recurrent funding, and savings through the creation of financial recovery plans. The draft financial plans include the expenditure payments calculated for each of the delegated and set-aside services.

We identified three significant issues for improvement during the review:

- A review of the cost centre classification was performed by NHS Lothian and these were allocated against IJBs based on the available information and methodology at that time. A further review of these cost centres, in addition, to a review of Strategic and Corporate cost centres for any potential additional delegated functions should be performed by NHS Lothian Finance as part of ongoing refinement of this model.
- Although the IJBs became responsible for delivery of services from 1 April 2016, the final proposed expenditure payments and budgets have not been finalised and issued to the IJB Chief Officers for approval; and
- NHS Lothian, in consultation with IJB representatives has used the Scottish Government's IRAG guidance as a starting point for development of an agreed methodology for calculating the IJB payments in 2016-17. Due to concerns about the complexity of activity data in addition to the completeness of data available, some local allocation methods have been agreed with the IJBs for 2016-17. As 2016-17 will act as a transitional year, the agreed methods should be reviewed and adjustments may be

required to subsequent years' allocations. For example reviewing the current PCNRAC 'traditional' model.

Further details of these points, in addition to four important points are set out in the Management Action Plan.

Management Action Plan

Control objective 1: The proposed payments to be made from NHS Lothian to the IJB are aligned to those functions' budgets which are to be delegated to the IJB.

1.1: Not all cost centres relating to delegated services and functions have been correctly classified

Significant

Observation and Risk:

The IJB Integration Schemes set out those functions which are to be delegated from NHS Lothian to the IJB. In order to identify the budgets associated with the delegated functions, NHS Lothian Finance reviewed all cost centres within the General Ledger. The resulting analysis was sent to the NHS Lothian Business Partners and the IJB Chief Financial Officers to review the classifications. Our inspection of the function cost centres delegated to the IJBs identified:

- The IJB integration schemes state that the IJBs should not have budgets relating to under 18s acute services. We identified the budgets for under 18s acute services have not been separated from the acute services delegated to the IJBs. The decision was taken to delegate all acute services for the 2016-17 allocation where it was difficult to extract the budgets for under 18 services. However, it is understood that this method will be reviewed as the IJBs progress through the first year of operation.
- Although the PFI elements of hospitals run under PFI schemes should not be delegated to the IJBs, the non-PFI elements should be e.g. NHS Lothian staff costs. At the time of fieldwork, it was noted that the non-PFI elements had not been classified as a delegated cost centre. We were informed Finance took this approach on the assumption that the majority of costs in these cost centres would be PFI costs (which should not be delegated). However, our analysis of the costs showed that the majority (68%) were non-PFI costs and should be delegated;
- Strategic and Corporate services cost centres (611 in total) have been deemed as a Non Delegated Function. However, of the 611 cost centres nine (1%) have been classified as a delegated function. Finance are aware that a further review of the Strategic and Corporate services cost centres will need to be performed during 2016-17 to identify whether any further cost centres should be also delegated. For example from our review of the 611 cost centres, potential cost centres for delegation include Chronic Fatigue Syndrome, Endocrinology Unit and Genetics.

If NHS Lothian has not correctly classified cost centres into delegated and non-delegated functions, there is a risk that the proposed payments made to the IJBs do not align to the functions delegated to the IJB. As such there is an increased risk that some services, either within the functions delegated to the IJB, or those functions retained by NHS Lothian, will be under-funded.

Recommendation:

All cost centres including the costs within the three areas highlighted above, should be reviewed to confirm that all cost centres relating to delegated functions have been included in the 2016/17 proposed payments to the IJBs, and that no cost centres relating to non-delegated functions have been included. Areas such as those highlighted above should be

prioritised as areas where there are known inconsistencies in approach.

Where NHS Lothian is not able to complete this analysis for 2016/17, the exceptions should be communicated clearly to the IJB Chief Officers, so there is a shared understanding that the basis for calculating the proposed payment will change in future years.

Management Response: The principle of 'universality' was agreed as part of the IJB Health budget setting model. This defines that services that provide care for both adults and children (GMS being the best example) are considered to be delegated on the grounds that to split these services up would be artificial and unhelpful. A further review of the cost centre mapping table has been taken and rectified the point about PFIs. The Integration Schemes do not mention PFIs specifically although capital assets themselves are not delegated to the IJBs. The IJBs themselves have identified that they would wish to undertake a further review and rectify any inconsistent cost centre allocations.

Management Action: A final version of the CC mapping table will be sent to the Chief Officers with a request that they review and then formally agree to this table. A procedure will then be put in place to keep the mapping table up to date as further cost centre amendments take place.

Responsibility: Deputy Director Of Finance (DDoF)

Target date: June 2016

Control objective 2: The method and assumptions used in calculating the payments for the four IJBs are clearly stated, and the proposed payments have been assessed against actual expenditure on delegated functions for 2014-15 and 2015-16.

2.1: Final calculations / payments to be confirmed and approved by the IJB Chief Officers.

Significant

Observation and Risk:

Papers were presented to the Finance & Resource Committee (FRC) in November and December 2015 which set out proposed methods and assumptions for calculating each element of the payment to be made: core, hosted, set-aside, and GP prescribing. Recommendations were made on the most appropriate method after comparing the options as follows:

- Core services – using cost centres;
- Hosted services – using NRAC formula, a model based on a weighted population;
- Set-aside – using NRAC formula; and
- GP prescribing – using the Prescribing Budget Setting Group PBSG method which is based on a weighted population principle.

Within each of the elements exceptions were identified so that a fairer allocation method could be used, e.g. Liberton Hospital's split was based on patient numbers and not NRAC. These exceptions are clearly identifiable in the draft payment figures prepared by NHS Lothian Finance.

While the IJB Chief Officers / Chief Financial Officers have been involved in reviewing the cost centre classifications and have seen the initial draft calculations and budgets, the final proposed expenditure payments and budgets have not been finalised and sent to the IJB Chief Officers for approval.

As the IJBs have officially commenced at 1 April 2016, there is a risk that services are being delivered at a cost which is not in line with the final payments to be provided to the IJBs from NHS Lothian.

Recommendation:

The final proposed payments and budgets should be presented to the IJB Chief Officers for approval as soon as the allocations and calculations have been finalised and the 2016-17 NHS Lothian budgets have been signed off by the NHS Lothian Board.

Management Response: Agreed.

Management Action: Having confirmed the LDP position with the Board a formal offer will be made to the IJBs.

Responsibility: DDoF

Target date: June 2016

2.2: NHS Lothian's approach to calculations should be reviewed during the first year of the IJBs operation.

Significant

Observation and Risk:

The Scottish Government issued statutory guidance on the process for creating IJB budgets: "Guidance for the Integration Financial Assurance" and "Guidance on Financial Planning for Large Hospital Services and Hosted Services". NHS Lothian, in consultation with IJB representatives has used the guidance as a starting point for development of an agreed methodology for calculating the IJB payments in 2016-17. Due to concerns about the completeness of data available, some alternative local allocation methods have been agreed with the IJBs for 2016-17.

As 2016-17 will act as a transitional year, the agreed methods should be reviewed and adjustments may be required to subsequent years' allocations. For example:

- Eight areas from the set-aside budget will be calculated using patient activity information as the PCNRAC method was deemed to be too unrepresentative for these areas. NHS Lothian decided to use one year's patient activity information for the calculation. IRAG guidance recommends that allocations across IJBs should be based on three years' of patient activity information and should be based on the financial cost of using large hospital services in addition to activity statistics.
- NHS Lothian used an adapted NHS Lothian specific NRAC calculation model to apportion costs across the IJBs for hosted and set-aside services, where patient activity statistics were not readily available. The decision was taken to use the PCNRAC 'traditional' model, which was based on population size using population statistics from 2012-13 because it had been previously agreed and used by the CHPs and was readily available. The PCNRAC calculation does not take account of other key factors affecting resource usage, such as deprivation and the cost of providing services across varying geographical areas as they were deemed to be insignificant to the calculation at the time it was originally developed. Management are aware that this PCNRAC methodology should be updated during 2016-17; and
- The guidance states that the budgets allocated to the IJBs should be based on actual expenditure for the previous two or three years. However, the budgets for the IJBs have been based on NHS Lothian's financial plan for 2016-17.

As such, at present there is recognition that budgets do not fully reflect demand for services from individual IJB populations or actual financial resource usage and Finance are aware that the budget process will be required to be reflected upon during 2016-17.

It is currently not possible to determine whether the use of the agreed NHS Lothian methods set out above has resulted in a higher or lower proposed payment to each of the IJBs, or whether any differential in the proposed payment would be material. However, there is a risk that the current method for calculating the proposed payment may result in one party being at a disadvantage when compared to other parties.

Recommendation:

While the allocation methods for the 2016-17 allocations have been agreed with the IJBs, the

underlying detail within the calculations should be communicated to all parties to ensure the IJBs understand and agree the potential implications prior to approving the final payments and budget to be allocated.

Management Response: It is important to remember that guidance is just that. If it is decided not to use the guidance then the requirement is to state that one has not used the guidance and then lay out why the guidance has not been used. The F&R papers along with a range of other documents explain this quite clearly. That said, we continue to refine the costing methodologies and consider that the work of the PLIC project will provide a useful basis for further analysis of set aside budgets. However, NHS Lothian (again this is described in the F&R papers) believes that historic activity is not a good indicator of the 'fair share' of resources utilisations and this proposition has been made to the IJBs who have supported that position.

Management Action:

As discussed above, this work will continue to be refined during 2016/17.

Responsibility: DDoF

Target date: April 2017

<p>2.3: The process to create the IJB proposed payments was not performed in a timely manner.</p>	<p>Important</p>
<p>Observation and Risk:</p> <p>As stated at issue 2.1, the IJBs had not yet been provided with the proposed payments and budgets for 2016-17 at the time of the audit.</p> <p>As the establishment of the IJBs has been a new venture for all involved there has been extensive consultation required between NHS Lothian, the Councils and the IJBs. Despite 2016/17 being the first year in which NHS Lothian Finance was required to calculate payments for the delegated functions and prepare IJB budgets, no timetable was used to guide the process. There is a risk that without a timetable for the process to determine the 2017-18 financial allocation to the IJBs, similar delays will be encountered.</p>	
<p>Recommendation:</p> <p>A project timetable should be developed for the 2017-18 allocation process, which states deadlines, responsible members of staff, and dates when documentation will be provided to the IJB Chief Officers and relevant NHS Lothian management and committees.</p>	
<p>Management Response: Agreed.</p> <p>Management Action: A process will be agreed with the IJBs as part of the redesign of the financial planning process for 2017/18 and beyond.</p>	
<p>Responsibility: DDoF</p>	<p>Target date: December 2016</p>

Control objective 3: Material non-recurrent funding and expenditure payments for the delegated functions and the associated risks are identified and assessed.

We identified no significant issues in relation to this control objective.

During 2015-16 NHS Lothian Finance staff identified all prior non-recurrent funding at the NHS Lothian level, which would also affect the IJBs. This prior year non-recurrent funding was then documented in papers provided to NHS Lothian's Finance & Resources Committee on 13 May, 8 July, and 25 November 2015.

The information relating to prior year non-recurrent funding was used to determine whether services would cease to exist, or would be included as a cost pressure in the 2016-17 financial plans. New non-recurrent funding for 2016-17 has also been identified and included in the draft IJB financial plans as "bundles". The impact of non-recurrent funding has been risk assessed by both NHS Lothian Finance and the IJBs Chief Officers/Chief Finance Officers during the process of creating the IJB (previously CHP) financial plans.

Inspection of the most recent IJB financial plans identified that expenditure payments i.e. core, hosted and set-aside payments, have been included within the financial plans and these reconcile back to the draft calculation schedules of proposed payment.

Control objective 4: The medium term financial forecast for the delegated functions and associated assumptions and risks have been reviewed.

4.1: The IJB budgets for 2017-18 and 2018-19 have not been created.	Important
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Observation and Risk:

The two key pieces of guidance produced by IRAG (*Finance Guidance*, and *Guidance on Financial Planning for Large Hospital Services and Hosted Services*) state that the medium term financial forecast should be reviewed and communicated to the IJBs.

NHS Lothian has not provided the IJBs with financial forecasts for 2018-19 and 2019-20, which would allow them to plan their services more effectively over the medium term. As this is the first year that the allocation process for the IJBs has been conducted it is expected that lessons learned will affect the payment calculation and budget for future years. For example, the functions delegated and calculations will need to be revised to reflect exceptions identified at control objective 1 and control objective 2.2. In addition, the cost centre allocation process will change to use level 6 codes as opposed to level 9 codes (Issue 2.3).

Due to these issues for the 2016-17 allocation process, predictions for the medium term financial positions for the IJBs would have been difficult. However, after changes noted above have been made to the process it is expected that a medium-term financial forecast can be made as part of the 2017-18 allocation round.

If the IJBs are not provided with medium term financial forecasts there is a risk that they will not be able to effectively plan their services over the medium term.

Recommendation:

Once the initial problems noted for the 2016-17 allocation process have been resolved and the 2016-17 budget settled, future budgeting rounds should include the provision of medium-term financial forecasts to the IJBs.

Management Response: The Scottish Government have not yet confirmed a settlement for future years. In principle and on receipt of this information – agreed.

Management Action: Having received indicative positions for 2017/18 and 2018/19 this will become part of the future financial planning process.

Responsibility: DDoF	Target date: March 2017
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Control objective 5: Savings and efficiency targets and expected cost pressures have been incorporated into proposed payments, have been clearly communicated to all partners, and have been risk tested and validated.

We identified no significant issues in relation to this control objective.

The IJB Chief Officers and Chief Financial Officers, in their capacity as NHS Lothian Officers, were asked to develop financial plans for 2016-17 on the basis of the CHPs. Inspection of the 2016-17 plans identified that cost pressures have been included in these plans such as pay uplifts.

For 2016-17 financial recovery plans have been created to identify how savings will be made to achieve a balanced financial position. These plans have been risk assessed by NHS Lothian Finance and by the IJB Chief Officers and Chief Financial Officers. A meeting was held specifically in financial quarter three to discuss and assess the plans.

The IJB plans have been presented to the Finance & Resource Committee as part of the overall NHS Lothian 2016-17 financial plan which is due to be finalised and signed off in May/June 2016.

The IJBs have not received information about the Acute recovery plans and how these may affect set-aside budgets. At the time of our audit these plans were still being developed. The management action at 2.1 should include this information in respect of 2016/17, and we have raised a separate action in our Strategic Planning report about communication with the IJBs in relation to longer-terms Acute Hospitals planning. As a result, we have not raised a separate action here.

Control objective 6: The amount set aside for the IJB consumption of large hospital services is consistent with the methods recommended in the IRAG guidance on the set aside resource and the assumptions and risks are assessed.

We identified no significant issues in relation to this control objective.

NHS Lothian has chosen to use the PCNRAC method to calculate the proposed set-aside budget. However, it was identified that PCNRAC was not suitable for all services to be included in the set-aside payment and alternative methods have been applied to these exceptions. For example, for the Liberton Hospital, Physiotherapy, and Cardiology, patient usage statistics provided a more accurate split than PCNRAC.

As highlighted at CO 2.2, NHS Lothian has considered the methodologies proposed in the IRAG guidance in preparing the PCNRAC calculation and agreed a local costing method. This costing methodology will be reviewed and refined during 2016/17.

Control objective 7: Risk sharing agreements are in place between NHS Lothian, the Councils and the IJBs which clearly define responsibilities in the event of the IJB exceeding established budgets.

7.1: Risk sharing agreements are not sufficiently detailed

Important

Observation and Risk:

The Integration Schemes for each of the four IJBs state that NHS Lothian and the relevant Council will have to manage any IJB overspends. These statements are the extent of the risk-sharing agreements between NHS Lothian and the Councils. The statements in the Integration Schemes are high level and do not state specifically what function overspends NHS Lothian or the relevant Council will be responsible for.

The IRAG guidance states that partners should consider the use of risk-sharing agreements so that financial risks are shared as part of the introduction of the IJBs. While we recognise it may not be practical to have risk sharing agreements in place for the first year of the IJBs' operation, this is something that should be addressed in the future.

Where there are future disagreements between NHS Lothian and the relevant Council over who is responsible for dealing with an overspend, a detailed risk-sharing agreement might be of benefit in promptly apportioning responsibility and so resolving issues in a timely manner.

In addition, in time when the IJB builds up reserves, it may be beneficial for a risk sharing agreement to be created between all three parties; the IJB, NHS Lothian and the Council.

Without a risk sharing agreement, NHS Lothian retains a significant financial risk in the event of an overspend by the IJBs. Dependant on where the overspend/variances arises, NHS Lothian may have limited or no influence on controlling that overspend, thus reducing the financial stability of the organisation.

Recommendation:

In future, NHS Lothian should work with the IJBs and Councils to create more detailed risk-sharing agreements.

Management Response: Agreed in principle. The Integration Schemes for the four IJBs are not all the same. The West Lothian scheme states that overspends are the responsibility of the partner who has incurred them. The other schemes are less clear on this matter. There is an issue about to whom the risk lies – on the understanding that the risk lies with NHS Lothian in this report then the key risk would be the movement of NHS Lothian funds that then impacted on NHS Lothian's ability to deliver its objectives. NHS Lothian can only have a risk sharing agreement with the IJBs, it can't have an agreement with the Councils for delegated functions because the Councils are also simply funders of the IJBs. This is a very complex matter with a series of risk issues and we are continuing to refine what the risks are and how they can be managed. NHS Lothian will work with the IJBs.

Management Action: Further discussion with the individual IJBs.

Responsibility: Director of Finance

Target date: March 2017

Control objective 8: Risks have been quantified where possible and measures to mitigate risk have been identified.	
8.1: Risks relating to the financial assurance process have not been stated in Datix.	Important
<p>Observation and Risk:</p> <p>Risks affecting the organisation should be recorded in the electronic risk and incident management system Datix. The system allows risks to be recorded along with named responsible staff, review and implementation dates, and actions taken to mitigate the risk. The IJB financial allocation process is an area of significant risk to NHS Lothian as the organisation is handing control of significant parts of its operation to new bodies, along with the related financial resources.</p> <p>No risks related to the allocation process have been stated in Datix apart from five risks relating to East Lothian IJB. These include a risk that the allocations from NHS Lothian and the Council are not sufficient to meet targets, and that the parent bodies do not provide sufficient support to allow the IJB to fulfil its functions.</p> <p>The Quality & Safety Assurance Lead has stated that risks to NHS Lothian from the introduction of the IJBs will be stated in Datix as the work of IJBs develops. Risks affecting the IJBs themselves are in the process of being developed for all four IJBs.</p> <p>If risks relating to the allocation process, for example dealing with IJB overspends, are not entered into Datix there is a risk that effective actions are not taken to mitigate risks.</p>	
<p>Recommendation:</p> <p>All relevant risks related to the financial allocation process and the introduction of the IJBs should be entered into Datix. The risks should include review and implementation dates, and have named responsible members of staff.</p>	
<p>Management Response: Agreed.</p> <p>Management Action: Update Datix.</p>	
Responsibility: DDoF	Target date: December 2016

Appendix 1 - Definition of Ratings

Management Action Ratings

Action Ratings	Definition
Critical	The issue has a material effect upon the wider organisation – 60 points
Significant	The issue is material for the subject under review – 20 points
Important	The issue is relevant for the subject under review – 10 points
Minor	This issue is a housekeeping point for the subject under review – 5 points

Control Objective Ratings

Action Ratings	Definition
Red	Fundamental absence or failure of controls requiring immediate attention (60 points and above)
Amber	Control objective not achieved - controls in place are inadequate or ineffective (21 – 59 points)
Green	Control objective achieved – no major weaknesses in controls but may be scope for improvement (20 points or less)