

Internal Audit



Fixed Assets

January 2018

Internal Audit Assurance assessment:

Objective One	Objective Two	Objective Three	Objective Four	Objective Five
Significant Assurance	Significant Assurance	Significant Assurance	Significant Assurance	Significant Assurance

Timetable

Date closing meeting held: 30 November 2017

Date draft report issued: 26 January 2018

Date management comments received: 29 January 2018

Date Final report issued: 30 January 2018

Date presented to Audit and Risk Committee: 26 February 2018

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Introduction

At the end of September 2017, NHS Lothian accounted for 4,372 completed assets (i.e. those not under construction), with a net book value of £733.639million. Following a verification exercise carried out by Property & Asset Management Finance throughout financial year 2016/17, 496 assets with a net book value of £730k were disposed of or written-off. Work is continuing to implement a comprehensive verification process, supported by annual checks.

NHS Lothian refers to the Government Financial Reporting Manual (FReM) and the NHS Scotland Capital Accounting Manual (CAM) for its accounting activities. The CAM interprets the accounting guidance contained in the FReM, which itself provides guidance on the application of International Financial Reporting Standards (IFRS), adapted and interpreted for the public sector context, and includes the treatment of assets and liabilities within the accounts. The Board's Standing Financial Instructions include accounting for fixed assets, in addition to management of an asset register and the security of assets.

Capital Finance are in the process of updating their Financial Operating Procedures, which are currently in draft and include accounting for fixed assets and related transactions. These are due to be completed by 31 March 2018.

Scope

The audit reviewed the controls and processes surrounding fixed assets, including the process of verification checks. This audit has considered the extent to which assets are identified, recorded, verified and accurately reflected in the accounts. The audit sought to ensure that depreciation is appropriate and in accord with both NHS Lothian policy and the prevailing regulations, and that asset disposals and write offs are valid, authorised and correctly reflected in the accounts. Confirmation was also required that assets are appropriately protected and insured.

Acknowledgements

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

Executive Summary

Summary of Findings

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

No.	Control Objectives	Assurance Level	Number of findings			
			Critical	High	Medium	Low
1	Assets are correctly and accurately reflected in the accounts.	Significant Assurance	-	-	-	-
2	Assets are identified, recorded and regularly verified.	Significant Assurance	-	-	-	-
3	Depreciation is appropriate and in accord with both NHS Lothian policy and the prevailing regulations.	Significant Assurance	-	-	-	1
4	All asset disposals and write offs are valid, authorised and correctly reflected in the accounts.	Significant Assurance	-	-	-	-
5	Assets are appropriately protected and insured.	Significant Assurance	-	-	-	-
TOTAL			-	-	-	1

Conclusion

All control objectives identified for this audit have been reviewed and it is concluded that each provide significant assurance from the review.

There is effective oversight of fixed assets within the organisation through the work of the Property & Asset Management Finance (PAMF) team. In addition, reporting by the PAMF to the Finance and Resources Committee is clear, timely and supports effective decision making in respect of fixed assets.

Controls in place are in line with NHS Lothian policy and relevant legislation.

Main Findings

We identified one issue from this review, which has been graded as 'low':

- When reviewing the asset register we identified a number of assets which were fully depreciated. Following the completion of an asset verification process during 2017 it is likely that this value and number of assets has reduced since the end of the 2016-17 financial year. However the asset verification process did not address the specific risk of fully depreciated assets.

Further details of this point are set out in the Management Action Plan.

Management Action Plan

Control objective 1: To ensure that all capital expenditure is justified and approved.

We found no significant weaknesses in relation to this control objective.

Capital expenditure is authorised by different individuals depending on the nature of the addition. For capital additions in excess of £250k a business case is required prior to approval by the Board, subcommittee or other governance group. Other capital expenditure is subject to standard procurement controls, where expenditure is approved before it is made and in line with established governance procedures.

Reconciliations are performed and reviewed on a monthly basis to ensure that information in the General Ledger and Fixed asset register is consistent.

Control objective 2: To ensure that all assets are identified, recorded and regularly verified.

We found no significant weaknesses in relation to this control objective.

NHS Lothian are in the final stages of undergoing a significant asset verification review of all assets held. Following this process the Capital Finance – Financial Operating Procedures have been updated to include a quarterly verification exercise of a sample of assets. This verification process does not relate to property and land assets, however there are other arrangements in place for this verification, such as annual revaluation and these are reflected in the local procedure.

Arrangements for asset verification were included within the previous Financial Operating Procedures. Although they were not followed for previous financial years, which were subject to a full Fixed Asset Register verification exercises.

To verify the existence of property and land, NHS Lothian relies on the rolling valuation process provided by their valuers (GVA), and for which an annual valuation report is provided.

<p>Control objective 3: Depreciation is appropriate and in accord with both NHS Lothian policy and the prevailing regulations.</p> <p>Associated risk of not achieving the control objective: Assets may be inaccurately recorded in the asset register and financial reports.</p>	<p>Low</p>
<p><u>Observation and risk</u></p> <p>When reviewing the asset register we identified a number of assets which were fully depreciated. As at 31 March 2017, the asset register recorded 1,188 fully depreciated assets, at a total gross value of £128m. These assets are primarily related to medical equipment.</p> <p>As NHS Lothian have recently undergone an asset verification process it is highly likely that this value and number of assets has reduced. However the asset verification process does not address the specific risk of fully depreciated assets. Fully depreciated assets can either be in use or not in use.</p> <p>If in use a net book value of zero is inappropriate, and assets should be revalued at their value in use. If assets are not in use they should be disposed of and not reflected in the asset register.</p> <p>There is a risk that having a number of fully depreciated assets on the asset register could result in inaccurate financial reporting. If assets are in use then there is a risk that a useful economic life approach to their treatment is inappropriate and could result in inaccurate depreciation charges.</p> <p>If the asset is not in use then there is also a risk that it is being inaccurately recorded on the asset register, although the net book value is zero there is still a gross value which is reported on the financial statements resulting in inaccurate financial reporting as these assets should be disposed of.</p>	
<p><u>Recommendation</u></p> <p>NHS Lothian should implement controls to identify whether a fully depreciated asset is still in use. If an asset is in use the Board should implement controls to ensure that useful economic lives are appropriately considered.</p> <p>NHS Lothian should undergo a review of current fully depreciated assets to identify and resolve those assets held on the asset register.</p> <p>Going forward, the board should implement controls in order to mitigate the risk of fully depreciated assets being held on the asset register inappropriately.</p>	
<p><u>Management Response</u></p> <p>Recommendation agreed.</p>	

Management Action

A review of the assets with nil NBV which have been confirmed to be in use following asset verification will be carried out to assess whether useful lives should be revised.

Once full verification is complete we will undertake an exercise to revise appropriateness of useful economic life approach for specific groups of assets

Responsibility:

Head of Property and Asset Management
Finance

Target date(s):

31/7/18 for conclusion of review of assets with zero NBV.

31/12/18 for conclusion of full verification process and revision of procedure to determine useful economic life of specific groups of assets.

Control objective 4: Ensure that all asset disposals and write offs are valid, authorised correctly and reflected in the accounts.

We found no significant weaknesses in relation to this control objective.

Disposals are processed through the fixed asset register, which calculates the required journal entries which on a monthly basis are posted to the General ledger. We have reviewed a random sample of seven disposals, concluded during financial year 2016-17, and are satisfied that journals posted are appropriate.

For assets being disposed of that have an existing net book value there are different approval limits depending on the net book value. From our sample tested we noted that all disposals were approved at the appropriate level and in accordance with the Board's Financial Instructions.

Control objective 5: Assets are appropriately protected and insured.

We found no significant control weaknesses in relation to this control objective.

In line with the majority of public assets NHS Lothian 'self-insures' up to the Scottish Government level. This means that in the event where significant assets would need to be replaced at unplanned short notice, funding would be sought from the Scottish Government. The only exception to this is the PPP facilities which do have insurance cover.

Operationally there are contingency plans in place for service provision, but this is focused on short term as a response to unexpected events.

Appendix 1 - Definition of Ratings

Findings and management actions ratings

Finding Ratings	Definition
Critical	A fundamental failure or absence in the design or operating effectiveness of controls, which requires immediate attention
High	A key control failure has been identified which could be either due to a failure in the design or operating effectiveness. There are no compensating controls in place, and management should aim to implement controls within a calendar month of the review.
Medium	A control failure has been identified which could be either due to a failure in the design or operating effectiveness. Other controls in place partially mitigate the risk to the organisation, however management should look to implement controls to fully cover the risk identified.
Low	Minor non-compliance has been identified with the operating effectiveness of a control, however the design of the control is effective

Report ratings and overall assurance provided

Report Ratings	Definition	When Internal Audit will award this level
No assurance	The Board cannot take any assurance from the audit findings. There remains a significant amount of residual risk.	The controls are not adequately designed and / or operating effectively and immediate management action is required as there remains a significant amount of residual risk (for instance one Critical finding or a number of High findings)
Limited assurance	The Board can take some assurance from the systems of control in place to achieve the control objective, but there remains a significant amount of residual risk which requires action to be taken.	<p>This may be used when:</p> <ul style="list-style-type: none"> • There are known material weaknesses in key control areas. • It is known that there will have to be changes that are relevant to the control objective (e.g. due to a change in the law) and the impact has not been assessed and planned for. <p>The controls are deficient in some aspects and require management action (for instance one 'high' finding and a number of other lower rated findings)</p>
Moderate assurance	The Board can take reasonable assurance that controls upon which the organisation relies to achieve the control objective are in the main suitably designed and effectively applied. There remains a moderate amount of residual risk.	<p>In most respects the "purpose" is being achieved. There are some areas where further action is required, and the residual risk is greater than "insignificant".</p> <p>The controls are largely effective and in most respects achieve their purpose with a limited number of findings which require management action (for instance a mix of 'medium' findings and 'low' findings)</p>
Significant assurance	<p>The Board can take reasonable assurance that the system(s) of control achieves or will achieve the control objective.</p> <p>There may be an insignificant amount of residual risk or none at all.</p>	<p>There is little evidence of system failure and the system appears to be robust and sustainable.</p> <p>The controls adequately mitigate the risk, or weaknesses are only minor (for instance a low number of findings which are all rated as 'low' or no findings)</p>