

North Western Health Board

Report of the Comptroller and Auditor General for presentation to the Houses of the Oireachtas

This report has been prepared pursuant to Section 6 (4) of the Comptroller and Auditor General (Amendment) Act, 1993.

1. Construction of new Headquarters

Legal Framework for Capital Expenditure by Health Boards

Prior to the introduction of the Health (Amendment) (No.3) Act, 1996 where a health board proposed to acquire or dispose of any land under its control, there was a specific requirement to obtain the consent of the Minister. Upon the passing of the 1996 Act into law, the statutory obligation of the Minister continued to apply in cases where the transaction was initiated and commenced prior to the enactment date.

Section 3 of the 1996 Act defined specific functions known as "reserved functions" and granted these exclusively to the Boards of the health boards. Section 18 of that Act provides that as part of these reserved functions, the Boards may acquire or dispose of land subject to any general directions given by the Minister with the consent of the Minister for Finance. The proceeds of sale of land is to be applied to a purpose to which capital money may be properly applied by the Board.

Section 17(d) of the 1996 Act provides that a health board may not borrow money without the prior consent of the Minister for Health and Children given with the concurrence of the Minister for Finance and the borrowing shall be subject to such terms and conditions (if any) as may be specified by the Minister with the consent of the Minister for Finance.

The period since 1996 has seen the full introduction, by the Department of Health and Children, of accounting standards for health boards which were formulated on the basis of professional standards and reflect fully the new accountability for capital asset expenditure and disposal under the control of the health boards. The Department's standards reflect the principles advocated in the 1996 legislation in that all capital proceeds from disposals must be applied to further capital purposes or future capital acquisitions.

Audit Concern

In the course of the audit of the 2001 financial statements, I noted that in March 2001 the Board had concluded a contract for the construction of a headquarters building at Manorhamilton, Co Leitrim. The total value of the contract including VAT was £6,331,047 (€8,038,771). This cost included the costs of construction, fitting out and furnishing. As it appeared that the Board did not have firm arrangements in place to fund this expenditure I asked the Chief Executive Officer if the prior approval of the

Department of Health and Children had been obtained for the project and the source of funding for the development.

CEO's Response

Origin of Project

The CEO traced the origins of the project back to June 1998 when the Board's Technical Services Officer submitted a report to the CEO in relation to headquarters offices. The buildings were identified as being non-compliant with building regulations and the Safety, Health & Welfare at Work Act 1989. The latter had been highlighted on many occasions by the staff Trade Union in industrial relations meetings with Board management. The existing buildings, built in 1974 and augmented by a former workhouse, had by 1998 become significantly inadequate in terms of functioning as an integrated corporate facility. A process was then initiated to define requirements and consider the options in relation to addressing the established shortcomings in the existing facilities. Two main options were identified namely:

- upgrade the existing offices together with an extension
- a complete new building.

This report recommended the new build option for further evaluation.

In July 1998 the Board prepared an outline planning brief for a refurbishment/new build with an initial cost estimate of €857,000. Architects were invited to make presentations for a part refurbishment/part new build project. Following consideration of these presentations a recommendation to appoint a firm of Architects was approved by the Board.

In August 1998, under instruction from the Board, the architects submitted a draft Development Control Plan for headquarters recommending refurbishment/extension of the existing building. Following detailed assessment and review, the Management Team decided that an extension/refurbishment would not be sufficient to deliver on the need to have an integrated central facility.

At this stage a formal project team, representative of the full Management Team was delegated responsibility for the project. This team was chaired by an Assistant Chief Executive Officer. At a meeting on 8 February 1999 the project team considered the issue of what should be based at corporate headquarters, the number of staff to be based there, and the common facilities to be provided including training rooms, meeting rooms, interview rooms, boardroom, library etc. Following this a discussion document was considered and approved by the Board's Management Team in February 1999.

The basis of this document was that in designing an effective headquarters the process should begin by defining the corporate strategy including the main sources of corporate value creation. The process should then draw out key/core principles derived from the corporate strategy on the role that corporate management and staff would be expected to play in its successful implementation. It should then conclude with detailed decisions about what functions should be located in corporate

headquarters, how they would interact, what specific responsibilities should be, how they should be staffed, and how they should relate to the service users at the centre or throughout the Health Board.

Arising from this the critical design considerations to be included in the brief for the new corporate head office facilities were;

- (a) The building should provide a model healthy work environment and set a standard in terms of compliance with health and safety obligations
- (b) The building and its facilities should combine utilitarian features with an appropriate civic ambience and should be self contained
- (c) the building should provide a high-tech training environment
- (d) the entrance foyer and reception area facilities should incorporate a physical design which reflects the best and latest in terms of dealing with customers
- (e) appropriate on-site catering and other facilities to enable staff interaction should be provided
- (f) the design concept should be symbolic in relation to the concepts of health promotion from both the staff and public perspective
- (g) provision of meeting rooms, interview rooms, training and library facilities should be included in the building.

(All of these were singularly lacking in the existing buildings)

- (h) the new building should reflect the status of the Board as the largest employer in the North West
- (i) the building should make a definite and positive contribution to the built environment

Progressing the Project

The Board then set about formalising the brief and engaged in consultation with staff on the design review. A draft schedule of accommodation was produced and proofed against the Corporate Headquarters Strategy document.

At this stage it was apparent that the project which would be required to meet the stated needs would push costs above the E.U. Procurement directive threshold for services. This would have required disengaging the Design Team and procuring a new one. This was not done because

1. The knowledge of the project which the design team had acquired during the feasibility stage would have been lost had the design team not been re-appointed.
2. Design team fees to that stage would have to be re-incurred.
3. Approximately six months would have been lost to the project.

The design team were then instructed to prepare outline drawings in relation to project options. On detailed consideration of these outline drawings in the context of the strategic vision for corporate head office facilities it became apparent that the footprint of the proposed building needed to be extended to provide for future expansion - a sound and reasonable aspect to good planning and to cater for the smooth integration of the various functional departments within the building.

At this stage a detailed appraisal was carried out in relation to possible sites for the building and the recommendation was that the new building should be provided on a site adjoining Our Lady's Hospital, Manorhamilton.

In June 1999 the Architect was requested to produce a site plan and a conceptual design plan for the proposed building. In September 1999, the Board's Management Team approved the plans and the design principles proposed. In December 1999 application was made for planning permission followed by a Fire Certificate application.

Planning permission was granted in March 2000 and in May 2000 a PIN notice was advertised in the OJEC. In August 2000 a works notice was advertised in OJEC with a closing date for tenders of 6 December 2000. The tender report from the Quantity Surveyors was received in February 2001 with a recommendation in the amount of €8,038,771 (to include VAT, loose furniture and blinds and audio visual equipment). The contractor commenced on site on 16 May 2001.

The Board have been in occupation of the new building for some time now. While the project's final accounts will not be signed off for some time yet (under normal procedures), the cost report dated 10 March 2003, shows the approved contract cost at €8,146,111, an increase of just €107,000 (1.3%) on the contract price.

Funding and Costs

The CEO informed me that the Board viewed the project as being totally separate from the programme of service infrastructural development, which was being undertaken under the auspices of the National Development Plan. Thus capital funding was not sought from the Department of Health and Children for the project.

The Board considered that alternative funding by way of a loan, which would be significantly self financing and cost effective, was much more preferable and realisable. The Board calculated that the savings on property rental and other charges would amount to €447,000, savings on rental of rooms for board meetings, training etc. would amount to €100,000 and savings on travel and subsistence would amount to €150,000 giving an overall saving of €697,000 per annum. These economies would exceed the cost of loan repayments over a period of 20 years. Further savings are anticipated from the use of technology and the utilisation of the existing building for an expansion of community based services and for the development of social day care services for older persons, all of which reduce the requirement for further new capital works to respond to these development needs.

Having decided against NDP funding the Board sought approval from the Department for a loan to finance the project in July 2001 and again in December 2001. The Department of Health and Children made the Board aware that the current Department of Finance policy was not favourable to the granting of approvals for borrowing. At no stage did the Department of Health and Children indicate that the proposal in itself was intrinsically unsound.

In the meantime the North Western Health Board has funded the construction costs from the proceeds of disposals of fixed assets (amounting to €4.1m at the end of 2002) and from funding generated from the management of working capital.

The CEO informed me that the total costs incurred to the end of December 2002 were:

Construction costs	€5.5m.
Professional Fees	<u>€0.9m</u>
Total	<u>€6.4m</u>

He also informed me that additional costs to completion are:

Construction costs	€2.5m
Professional fees	€0.3m
Commissioning	€0.3m

This will result in a final cost of €9.5m.

The CEO said that the Board is continuing its attempts to obtain sanction from the Department of Health and Children for a loan facility to provide the cash flow for this project.

The Views of the Department of Health and Children

The Accounting Officer of the Department of Health and Children informed me that the Department only became aware of proposals for this project in July 2001 when the North Western Health Board sought approval from the Finance Unit for a loan of £6.5m (€8.2m) for the proposed project. No Departmental approval for the project, or the associated loan, was obtained. The project has not been indented by the Board to be funded under their National Development Plan. The Department has not agreed to provide any funding for the building, nor has the Department agreed that the building may be funded or part-funded by way of a charge against the Board's non-capital moneys. No sanction has been sought or obtained from the Department of Finance for this project.

The Accounting Officer also stated that the Hospital Planning Office of the Department had no involvement in the procurement of the project. The Department's understanding of the project is that the estimated cost for the building in the original design brief (July 1998 costs) was £0.7m (€0.89m). This design brief and budget cost was for the alteration and extension of the existing building. An option appraisal carried out by the design team, following its appointment by the Board for the project, indicated that the Board's accommodation needs could not be met from the design brief's requirements and budget costs. The scope and functional content of the project was then revised and the Board decided to proceed with a new HQ building without any agreement from the Department.

The Accounting Officer also noted that, as the original estimate of the project was less than £1.0m, the design team appointment was in accordance with government public procurement procedures. However the fees for the current project exceed the threshold above which advertising in the EU Journal is obligatory. This would have been known to the Board following the option appraisal and it should have taken appropriate action to regularise the procedure at that time.

Regarding the request for loan approval, the Accounting Officer said that in July 2001 the North Western Health Board wrote to the Department's Finance Unit giving a brief outline of the project which had an estimated cost £6.5m (€8.25) and seeking approval in principle to secure a loan for the project. In November 2001 the Board again wrote to the Department stating that it sought to develop the HQ project and also Community Care facilities at Sligo. Both projects were proposed to be developed through borrowing of £13.7m (€17.4m). Following discussions between the Board and the Department on the potential for loan funding, the Board wrote to the Department indicating the nature of the rental commitments the Board planned to liquidate and to utilise to fund the proposed borrowings.

The Accounting Officer informed me that it was made clear to the Board on several occasions that the Department was not in a position to advance approval for the borrowing proposed. It was also clarified that Department of Finance sanction would be required for any such funding arrangement and in the opinion of the Department of Health and Children, the proposals submitted would not secure Department of Finance sanction.

The Accounting Officer emphasised that the Department had no involvement in the decision to proceed with the project, no approval or funding has issued and the construction of the project had commenced prior to the Department becoming aware of the development.

2. Shortcomings in Internal Controls

The Board operates an automated purchasing system designed to ensure that

- goods and services are only ordered when appropriately authorised
- payment for such goods is only made when the Board has satisfied itself that the goods and services have been received
- expenditure in relation to the purchase of goods and services is properly recorded in its books of account and in the annual financial statements.

The system operates in the following way. In each of the almost one hundred cost centres within the Board there are approved personnel (Buyers) who are responsible for ordering goods and services. Buyers are required to generate electronically a Purchase Order which records details of the goods or services and the appropriate cost centre and expense code. Generally speaking, a Purchase Order should only be generated in response to a requisition signed by a budget holder.

When goods or services are received at the various locations they are checked against the relevant Purchase Order for quantity and quality. If satisfied, a designated receiver of goods other than the Buyer will generate a Goods Received Note (GRN) electronically. The creation of a GRN acts as confirmation that goods or services have been properly authorised, that they have been received and that payment may be made in due course on foot of a supplier's invoice.

When an invoice is received it is checked against open GRNs. If it is matched the GRN is closed on the system and the invoice is recorded as matched and payable.

Cheques are issued centrally and are triggered by requesting the system to pay all matched invoices up to a certain date. When an invoice is not matched with an open GRN it should be referred to the relevant Buyer to resolve the discrepancy prior to processing the invoice for payment.

If the Purchasing system operates correctly the Board can be assured that goods and services ordered and paid for through the system have been properly authorised and that payment has only been made in respect of goods and services actually received.

The system also allows the Board to ensure that its books of account are kept up to date by recording all expenditure as it is incurred. In particular, the aggregate value of open GRNs at the end of any period represents expenditure incurred by the Board on goods and services during that period where the relevant invoice has not yet been processed.

The Board also has a system for paying certain expenditure outside the Purchasing system. This is intended to be used only to pay certain items such as utility bills where the costs of the service are not known in advance. It is not intended to be used for the bulk of the Board's expenditure on goods and services.

During the 2002 audit, and prior to the conclusion of the 2001 audit, I conducted additional work to verify the reliability of the accruals contained in the Board's financial statements. As a result of this work, it came to light that the Board's Purchasing system was not operating as originally intended. In particular, it became clear that the figure for open GRNs recorded in the Board's books of account at the end of 2001 was overstated by a significant amount. The Board had recognised this fact itself in 2001 and made a provision of €451,000 in the financial statements against the apparent overstatement pending a full reconciliation of supplier invoices.

In response to enquiries which I raised in relation to the operation of the Purchasing system, the Board decided in August 2003 to commence a full reconciliation of the creditors and accruals recorded in its books against supplier statements. That exercise has confirmed that accruals at 31 December 2001 are overstated. It is not possible to determine the amount of the overstatement but based on the reconciliation recently completed by the Board it is estimated at €2m. It follows that the accumulated deficit at 31 December 2001 is overstated by the difference between this amount and the provision already made i.e. by approximately €1.6m.

I asked the CEO to explain how the overstatement came about. The CEO informed me that the bulk of the overstatement occurred because the system had been bypassed by paying some invoices without going through the matching process. In addition, in some cases goods received and recorded on GRNs may have been subsequently returned without the GRN being adjusted.

The CEO has assured me that in making a provision against the apparent overstatement of the "goods received not invoiced" accrual the Board recognised that a full reconciliation of the accrual with supplier statements was required.

He informed me that this reconciliation had now been completed and is the basis on which an adjustment has been made to 2002 accounts. The invalid GRNs identified

have been removed from the system, cumulative expenditure has been adjusted and the Balance Sheet as at 31 December 2002 has been revised to reflect actual liabilities.

He further stated that no advantage accrued to the Board as a result of the overstatement of expenditure in 2001 as the resultant overrun had to be treated as a first charge on the 2002 allocation.

A number of steps have been taken to reinforce existing control procedures to ensure that the problem does not recur.

- Training has been undertaken with staff to ensure that standing accounting control procedures are complied with
- A certification process has been introduced to ensure that goods received through the purchase ordering system are not paid without going through the matching process
- Additional training has been provided to buyers in relation to the return of goods
- Monthly control reporting has been introduced to monitor the age and value of GRN records on the system and facilitate the maintenance of accurate accrual records
- Systems for routine creditor reconciliation have been revamped and additional resources allocated to this role
- Additional focus has been placed on all Balance Sheet/Control Account reconciliations

The CEO also assured me that the net outcome of this issue is a stringent focus on observation of and compliance with the Board's policies and control procedures in all areas. The Audit Committee of the Board have been fully apprised of the situation as have the Internal Audit function and both will be monitoring the position going forward.



John Purcell

Comptroller and Auditor General

22 December 2003