Annual Audit Letter

Hereford Hospitals NHS Trust

Audit 2010/11

Contents

Traffic light explanation

Red ■ Amber ◆ Green ●

Key messages

This report summarises the findings from my 2010/11 audit. My audit comprises two elements:

- **the audit of your financial statements; and**
- **my assessment of your arrangements to achieve value for money in your use of resources.**

Key audit risk	Our findings
Unqualified audit opinion	●
Proper arrangements to secure value for money	◆

Overview

1 During 2010/11 the Trust focussed on integrating health and social care services in Herefordshire with NHS Herefordshire (Herefordshire PCT) and Herefordshire Council This innovative arrangement is mainly to improve the delivery of services but is also a response to the increasingly challenging financial situation faced by all three organisations. The arrangements for this larger organisation came into being on 1 April 2011 together with a change in the name of the Trust to Wye Valley NHS Trust.

2 The Trust faced a significant financial challenge to deliver a target surplus of £1.1 million and £5.1 million of cost improvements. Activity levels in the year created extra financial pressures and the phasing of the cost improvement programme (CIP) caused this challenge to be greatest during the second half of the year.

3 In response to the pressures the Trust revised the planned £1.1 million surplus downwards and at the year-end reported an annual surplus of £46k having achieved £2.3 million of its £5.1 million CIP/QPP.

4 This year because the Trust had declared a small surplus of £46k I looked closely at the breakeven calculation. I identified an error of almost £1 million in the Trust's reporting of its statutory breakeven duty. This will increase pressure on the Trust in future years as it will need to produce sufficient surplus to correct the past error in addition to planning to meet annual targets on the amended basis.

5 The 2011/12 CIP programme of £6.2 million is very challenging and the Trust is closely monitoring its financial position and delivery of services. Action is being taken to address areas falling behind plan. It is crucial that this is effective to establish a more stable financial position as the Trust prepares for Foundation Trust status.

Audit opinion and financial statements

6 The financial statements presented for audit contained an error of almost £1 million in the note of the Trust's performance against its statutory breakeven duty. The accounts were not adjusted for this or a smaller error within the primary statements.

7 I was able to conclude that the accounts were not materially misstated for the following reasons:

- the errors identified are together not greater than my headline materiality of £1.15 million;
- over the rolling three-year period the Trust has been able to meet its statutory duty within the tolerance specified by the Department of Health; and
- the impact of the misstatement in the Trust's performance against its statutory performance target is significant although not fundamental to a reader of the accounts and does not affect the retained surplus for the year.

8 I completed my audit and issued an unqualified opinion on 9 June 2011.

Value for money

9 As well as issuing an opinion on the financial statements, I issue a statutory Value for Money conclusion.

10 I concluded the Trust had adequate arrangements to secure economy, efficiency and effectiveness in the use of resources except for in those in place for securing financial resilience. I therefore issued a qualified 'Except for' Value for Money conclusion.

11 The Trust delivered some of its planned savings programme in 2010/11. Whilst there were some understandable reasons giving rise to unplanned costs there was insufficient focus on the savings plan and over half of planned savings were not delivered. As at 1 April 2011 the Trust had again not identified enough detailed schemes to deliver the total CIP in 2011/12 and delivery of savings is currently behind plan.

12 The Trust has recognised and responded to the challenge it faces with its CIP/QPP for 2011/12. From the beginning of 2011/12 the Trust has set up a specific team to deliver this programme and reporting frequency increased to fortnightly rather than monthly. However I concluded, on the basis of the evidence available in June, that the arrangements were not sufficiently robust to ensure financial resilience.

Current and future challenges

13 Like other public organisations the Trust faces an increasingly challenging environment.

- NHS Trusts continue to be required to make year-on-year efficiency savings, including 4 per cent for 2011/12.
- The Trust is seeking Foundation Trust (FT) status in line with Government requirements. On 28 March 2011 the Trust signed a formal agreement with the Strategic Health Authority and the Department of Health to deliver its application for FT status by October 2012 and to achieve FT status by April 2014. Sound financial health will be essential to achieving FT status.
- In July 2010 the government published the White Paper 'Equity and Excellence: Liberating the NHS'. This will result in radical changes to NHS structures with GP Consortia (Clinical Commissioning Groups) replacing Primary Care Trusts.

14 Significant changes have been made locally to meet these challenges.

- The establishment of a more integrated arrangement to manage beds across the County has achieved impact in the year. The Trust has delivered the lowest reported length of stay in the last five years. The transfer of staff from NHS Herefordshire and the delivery of adult social care services under a section 75 agreement with Herefordshire Council were effective from 1 April 2011. These new service provision arrangements have to become established at the same time as the economic downturn and public spending decreases requiring reductions in cost and improved services.
- It will be important that the whole health economy succeeds in changing the referral pattern and the contribution of primary care to enable future savings plans to be delivered, including the planned closure of Dore Ward this year.
- The Trust has worked in partnership with Herefordshire Council and NHS Herefordshire to develop the Shared Services Partnership with the aim of saving money from 'back office' support services. The partnership came into being on 1 April 2011.

Financial challenges remain very significant.

- To deliver the Trust's financial target for 2011/12 of £0.5 million (before technical accounting adjustments) a demanding Cost Improvement Programme (CIP) is in place including reviews of organisational structures. It will be essential that reporting arrangements to the Board continue to provide realistic assessments of the Trust's service delivery and finances (including its cash flow position). Corrective timely action to address any areas falling behind plan is required.
- The Trust has a substantial PFI contract which ends in 2029. The liability of the Trust under the PFI deal is greater than the value of the related asset by £50 million. The Trust is one of several Trusts who hold such PFI contracts who have contacted the Department of Health regarding these costs and at the time of my writing this letter the outcome of any review is not known.
- The financial pressures on the Trust continue to be reflected in its cash flow position. The Trust is working with its commissioners to improve its position.

Financial statements and statement on internal control

The Trust's financial statements and Statement on Internal Control are important means by which the Trust accounts for its stewardship of public funds.

Overall conclusion from the audit

15 My overall conclusion from my audit of the Trust's 2010/11 financial statements is that they present a true and fair view of the Trust's position. The issues I addressed are within my Annual Governance Report. I presented this report to the Audit Committee who considered it before adopting the financial statements and before I issued my opinion.

16 The Trust delivered its financial statements for audit on 20 April 2011. I completed my audit and reported my findings to the Audit Committee before issuing my unqualified audit opinion on 9 June 2011. Both the delivery of the financial statements for audit and the issue of my audit opinion met the deadlines set by the Department of Health.

17 This year because the Trust had declared a small surplus of £46k I looked closely at the breakeven calculation. The financial statements presented for audit contained a significant error within the note of the Trust's performance against its statutory breakeven duty. As well as an error relating to the under provision against debtors of £107k within the primary statements. The accounts were not adjusted for these errors.

18 The significant error is that the Trust's calculation of its breakeven performance for the year had not been fully adjusted for the impact of bringing the PFI hospital onto the balance sheet under IFRS. The impact is that the Trust's performance against its breakeven target is overstated by around £1 million in 2010/11 and £1 million 2009/10 (£2 million cumulatively).

19 When the PFI hospital came on balance sheet in 2009/10 there was a substantial impairment consequently the net assets on which Public Dividend Capital (PDC) is payable reduced and the Trust ended up with negative net assets. Therefore the impact of bringing the hospital on balance sheet was that no PDC was payable, compared with an estimated £1 million payable under UKGAAP. Department of Health (DoH) guidance states that a dual accounting adjustment is required to eliminate the impact of PFI assets and liabilities on trust balance sheets including the impact on the amount of PDC dividends payable. I identified that the Trust had made adjustments for all the necessary items other than that relating to the impact on the PDC dividend. There is also an error in the accounts of approx. £107k relating to under provision against NHS Herefordshire debtors.

20 The Trust calculated the required adjustment to the 2010/11 breakeven calculation as £932k. This adjustment and the under provision of 107K would together have reduced the reported breakeven performance for the year to a £993k deficit. The Trust's duty to break even taking one year with another is in practice measured over a rolling time period of three years. If the adjustment had been backdated to 2009/10, the first year of IFRS, the Trust would have failed its cumulative break-even duty over three years by £381k. However, this is within the tolerance allowed by the Department of health and therefore I regard the Trust as having met its statutory duty.

21 I concluded that whilst the accounts do contain a significant error they are not materially misstated because:

- over the rolling three-year period the Trust has been able to meet its statutory duty within the specified tolerance of 0.5 per cent of its turnover (£600k);
- the error in the break-even performance note is below my headline materiality level; and
- the impact of the misstatement in the reporting of the Trust’s performance against its statutory performance target in a note to the accounts is significant although not fundamental to a reader of the accounts and does not affect the retained surplus for the year.

22 The Trust was aware of an issue in its reporting of its statutory breakeven duty prior to the audit and considered its position supported by the Strategic Health Authority. I understand that it is not the only Trust to have excluded the specified adjustment for PDC in their calculation of the financial performance target.

23 Subsequently the Trust obtained agreement from the DOH to extend the rolling period over which it must break even to five years. The SHA has promised to provide additional funding of around £1 million for 2011/12 to enable the Trust to compensate for the error without increasing its planned CIP/QPP for the year. If current plans are delivered, the Trust will meet its break even duty in 2011-12 after adjusting for the prior year error. It will, however, still need to make sufficient surplus to enable the break even duty to be met in the next few years.

Internal control

24 I did not identify any significant weaknesses in your internal control arrangements.

Value for money

I considered whether the Trust is managing and using its money, time and people to deliver value for money. I assessed your performance against the criteria specified by the Audit Commission and have reported the outcome as the value for money (VFM) conclusion.

25 I assess the Trust's arrangements to secure economy, efficiency and effectiveness in its use of resources against two criteria specified by the Audit Commission. The two criteria are:

- Financial resilience – The organisation has proper arrangements for securing financial resilience; and
- Securing economy, efficiency and effectiveness – The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

26 My overall conclusion is that the Trust has proper arrangements to secure, economy, efficiency and effectiveness in its use of resources except that the Trust did not have in place adequate arrangements for ensuring financial resilience.

27 My conclusion on each of the two areas is set out in the following table.

Value for money criteria and key messages

Criterion	Key messages
1. Financial resilience **The organisation has proper arrangements in place to secure financial resilience.** Focus for 2010/11: The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.	During 2010/11 the Trust focussed on integrating services with the provider arm of NHS Herefordshire (Herefordshire PCT) and with Herefordshire Council's adult social care with the aim of establishing a more sustainable organisation for the future. £2.3 million of the target £5.1 million Cost Improvement Programme (CIP) was delivered in 2010/11. The Trust recognised this result was likely during the early part of the year as insufficient schemes had been identified to provide the full amount.

Criterion	Key messages
	To maintain services to its patients the Trust incurred costs of £1.2 million by opening beds in the community (Bromyard) and reopening a ward planned for closure (Dore). Costs of £0.5 million were incurred by the Trust on arrangements for transition to Wye Valley NHS Trust for which specific funding was not received. For all these reasons the Trust required non-recurrent funding of £2.8 million from the SHA and the Trust's overall financial target was reduced from £1.1 million to break-even. The business plan for 2011/12 had a CIP of £6.2 million and at the start of the year insufficient detailed schemes to deliver this total had been identified. The error in the break even performance target calculation will increase pressure on the Trust in future years by about £2 million more than previously forecast
2. Securing economy efficiency and effectiveness **The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.** Focus for 2010/11: The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.	Pressure created by a continued increase in emergency activity in 2010/11 have been managed through establishing a more collaborative and integrated arrangement to manage beds across the County, reducing the number of excess bed days. These arrangements have continued into 2011/12 through the formation of Wye Valley Trust. The Trust is an innovative arrangement to provide acute services together with the provider services previously provided by NHS Herefordshire and adult social care through a section 75 agreement with Herefordshire Council. Integration of the management of care is intended to provide ongoing improvement in care provided and efficiency savings. The business case was subject to external due diligence review and challenge together with being approved by each body with the support of the SHA. The Trust has also worked in partnership with Herefordshire Council and NHS Herefordshire to develop the Shared Services Partnership with the aim of saving money from 'back office' support services. The partnership came into being on 1 April 2011. The monthly financial reporting of the Trust's finances is comprehensive and provided on a timely basis. These arrangements will provide a strong asset to the Board in continuing to deliver robust information.

Qualified Conclusion

28 The Audit Commission requires me to report by exception where significant matters come to my attention, which I consider to be relevant to proper arrangements to secure economy, efficiency and effectiveness in the Trust's use of resources.

29 The Trust did not deliver its planned CIP savings in 2010/11. Whilst there were some understandable reasons giving rise to unplanned costs there was insufficient focus on the savings plan and over half of planned savings were not delivered. As at 1 April 2011 the Trust had again not identified sufficient detailed schemes to deliver the total CIP in 2011/12 and delivery of savings is currently behind plan.

30 The Trust has recognised and responded to the challenge it faces with its CIP for 2011/12. From the beginning of 2011/12 the Trust has set up a specific team to deliver this programme and reporting frequency increased to fortnightly rather than monthly. However I concluded, on the basis of the evidence I saw in June that its arrangements were not sufficiently robust to ensure financial resilience.

Payment by results data assurance framework

31 In 2010/11 the Department of Health asked the Audit Commission to review the quality of costing information by reviewing the 2009/10 reference cost submissions at all acute trusts. Reference costs are the average cost to the NHS of providing a defined service in a given financial year and have various uses including the calculation and development of the national tariff. The host commissioning PCT, NHS Herefordshire covers the cost of this review.

32 I reviewed the Trust's arrangements over the four areas of engagement, activity reporting, approach to costing and data capture systems and found that all these arrangements were at or above minimum requirements.

33 The Trust's reference cost submission in 2009/10 was materially accurate overall with its reported cost allocations mainly in line with those made by other trusts.

34 My findings were reported and presented to the Audit Committee in March and July 2011. The Trust has monitoring arrangements in place to ensure that action is taken on the recommendations.

Quality accounts

35 In 2010/11 the Department of Health external assurance arrangements required me to:

- review the Trust's arrangements for satisfying itself that the quality accounts are fairly stated and follow requirements; and
- test two performance indicators included in the quality accounts using a prescribed method and sample sizes.

36 The Trust met the requirement to circulate a draft of the quality accounts to stakeholders by the 30 April 2011.

37 The arrangements the Trust has in place over the four areas of governance arrangements, systems and processes, use of prescribed toolkit and review of the statement of directors' responsibilities were reviewed. The review found that all these arrangements were satisfactory. The statement on directors' responsibilities was signed on the 27 June 2011 ahead of the 30 June 2011 statutory deadline.

38 The Department of Health does not provide a set of mandated performance indicator definitions and the Trust is able to decide the definitions it uses. This is a national issue and will lead to inconsistency in reporting of indicator performance between health bodies. I completed detailed testing on the following performance indicators:

- Healthcare associated infection – MRSA Bacteraemia infection; and
- Clinical effectiveness – Improving Stroke Care – CT scan within 24 hours in patients with stroke.

39 I found no errors in the testing of the indicator of MRSA infections. My testing on improving stroke care – CT scan within 24 hours in patients with stroke found a transcription error. The figure within the draft quality accounts recorded 46.2 per cent. Following testing based on the prescribed method this figure was amended to 83.9 per cent.

40 I issued my report on the 27 June 2011 before the 30 June 2011 deadline.

41 The external assurance on the Trust's quality accounts for 2010/11 was reported to the Audit Committee in July 2011. The Trust has monitoring arrangements in place to ensure that action is taken on the recommendations within the report.

Closing remarks

I have discussed and agreed this letter with the Chief Executive and the Director of Resources. I will present this letter at the Audit Committee on 21 October 2011 and will provide copies to all board members.

Further detailed findings, conclusions and recommendations in the areas covered by our audit are included in the reports issued to the Trust during the year.

Report	Date issued
Audit plan	January 2011
Payment by Results Data Assurance Framework – Reference costs data quality audit	March 2011
Annual Governance Report	June 2011
External assurance on the Trust’s Quality accounts	July 2011

The Trust has taken a positive and constructive approach to our audit. I wish to thank the Trust staff for their support and cooperation during the audit.

Elizabeth Cave
District Auditor

13 October 2011

Appendix 1 – Fees

	Actual (£)	Proposed (£)	Variance (£)
Audit fee	136,660	134,160	2,500
Payment by results	0	0	n/a
Quality accounts	15,000	15,000	0
Total audit fees	151,660	149,160	2,500
Non-audit work	0	0	n/a
Total	**151,660**	**149,160**	**2,500**

Appendix 2 – Glossary

Statement on internal control

Public bodies must provide assurance that they are appropriately managing and controlling their money, time and people. The Statement on Internal Control (SIC) is an important document for communicating these assurances to Parliament and citizens.

The SIC is the means by which the Chief Executive Officer declares his or her approach to and responsibility for, risk management, internal control and corporate governance. It is also used to highlight weaknesses which exist in the internal control system within the organisation. It forms part of the Annual Report and Accounts.

Audit opinion

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

If I agree that the financial statements give a true and fair view and that the spending and income was regular, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view; or
- I find that some spending or income was irregular.

Value for money conclusion

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

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