
Hereford Hospitals NHS Trust

Annual Audit Letter

Audit 2006/07

October 2007



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Key messages

- 1 This Annual Audit Letter summarises the key issues arising from my 2006/07 audit. The Trust's key organisational objective continues to be achieving Foundation Trust status. Although not successful at the Department of Health assessment stage in late 2006 the corporate agenda continues to be clearly focused on implementing the developments necessary to deliver Foundation Trust status. My audit plan for 2006/07 recognised this challenge and included work on relevant areas.
- 2 The Trust Board has changed significantly with new Executive Management Team members and changes to Non Executive Directors. The new team are moving forward with the Trust's strategic objectives and face a challenging period to demonstrate the Trust's 'fitness for purpose' for Foundation Trust status.
- 3 The Trust was again dependent on non-recurrent measures to achieve financial balance in 2006/07. The underlying deficit identified early in the year was not fully addressed by the delivery of savings plans and the external 'Financial Due Diligence' for the Trust's Foundation Trust application identified savings delivery as a major risk. The 2007/08 budget includes savings in excess of £3.0m. Savings plan identification and monitoring has improved but delivery of savings was significantly behind at the end of July 2007.
- 4 The Trust borrowed £3.3m at the end of the 2006/07 to maintain its liquidity. Repayments are required over a three year period. The Trust must therefore deliver a surplus from 2007/08 to 2009/10 to meet this commitment.
- 5 Collection of income for the activity undertaken at the Trust remains a significant issue. As at the 31 March 2007 there was a high level of debt due to the Trust, which reflected two issues:
 - disputes with Welsh Commissioners; and
 - failure to provide activity information supporting oncology activity.
- 6 High levels of debt adversely impact on the Trust's cashflow, and on its revenue position. Its ability to successfully negotiate contracts and secure payments for the work it does is a key factor in returning the Trust to recurrent financial balance, and creating financial stability.
- 7 I concluded that the Trust had proper arrangements in place to secure economy, efficiency and effectiveness in the use of resources. The only exception to this was with regard to the management of the Trust's asset base. Although the Trust's Integrated Business Plan included key estates priorities this was not sufficiently supported by a comprehensive estates strategy.

- 8 The Trust maintained its overall score of 'adequate' (for financial standing, financial reporting, the internal control, financial management and value for money) in my Auditors Local Evaluation (ALE) assessments of its use of resources. Although improvements were identified in some areas relating to ALE the Trust's scores did not increase sufficiently to achieve a level 3 score for any of the five themes. I have agreed a detailed action plan to help the Trust focus on improvement areas for the 2007/08 ALE assessment.
- 9 In response to the risks highlighted in my audit plan I also undertook work on Capacity Planning and Payment by Results.
 - Capacity Planning; The development of the Trust's capacity planning is fundamental to its ability to provide a full range of services as a Foundation Trust. My review identified that further action is necessary by the Trust to develop a robust approach to capacity planning and to ensure that its own plans are consistent with other NHS bodies in the health economy.
 - Payment by Results; My review identified that the Trust's procedures for the management of PbR were satisfactory. Particular strengths included the use of performance information to drive improvement, and the Trust's relatively low outpatient waiting times. I also identified that the Trust was relatively efficient compared to its peer group. Areas for improvement included:
 - resolving the pockets of potential inefficiency, such as HRG C58, Intermediate Mouth or Throat, where unit costs are 53 per cent above the national average, and A & E activity where Hereford has the third highest average unit cost; and
 - considering the financial return on contracts with Welsh commissioners to ensure that they make an effective rate of return to the Trust.
- 10 Progress has been made with the implementation of action plans arising from my 2005/06 work in two key areas; new Consultant contracts benefits realisation and emergency admissions and demand management. In both of these areas, however there remains work to be done to fully implement my recommendations.

Recommendations

The Board needs to ensure that:	
<i>R1</i>	<i>Progress is made with the 2007/08 savings plan to ensure that the Trust is able to return to recurrent financial balance, and make its scheduled loan repayment.</i>
<i>R2</i>	<i>Contractual agreements, invoicing processes and debt collection are sufficient to deliver income for completed activity.</i>
<i>R3</i>	<i>The recovery of debts from Welsh Commissioners is monitored and action is taken to recover old and disputed debt.</i>
<i>R4</i>	<i>An approved estates strategy is in place for the non-PFI estate.</i>
<i>R5</i>	<i>There is a focussed approach to delivering the improvements detailed in the ALE action plan.</i>
<i>R6</i>	<i>A robust approach to capacity planning is developed that is consistent with the plans of other NHS bodies in the health economy.</i>
<i>R7</i>	<i>Key profitability variables are identified and monitored at Board level, by linking income and activity at service level.</i>
<i>R8</i>	<i>Action plans for Consultant Contracts Benefits Realisation and Emergency Admissions and Demand Management are fully implemented.</i>

Purpose, responsibilities and scope

- 11 I have addressed this letter to the directors and members of the Trust as it is the responsibility of the Trust to ensure that arrangements are in place for the conduct of its business and that it safeguards and properly accounts for public money. I have made recommendations to assist the Trust in meeting its responsibilities.
- 12 This letter also communicates the significant issues to key external stakeholders, including members of the public. I will publish this letter on the Audit Commission website at www.audit-commission.gov.uk. In addition the Trust is planning to publish this letter on its website.
- 13 As the Trust's appointed auditor, I am responsible for planning and carrying out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code). Under the Code, I review and report on:
 - the Trust's accounts; and
 - whether the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 14 The Audit Commission uses my assessments to provide scored judgements for the Healthcare Commission to use as part of its annual health check.
- 15 This letter summarises the significant issues arising from both these areas of work and highlights the key recommendations that I consider the Trust Board should be addressing. I have listed the reports issued to the Trust relating to the 2006/07 audit at the end of this letter.

Audit of the accounts

- 16 I issued an unqualified opinion on the Trust's accounts on 22 June 2007, before the deadline set by the Department of Health. In my opinion the accounts gave a true and fair view of the Trust's financial affairs and of its income and expenditure for the year.
- 17 Before giving my opinion I reported to those charged with governance, in this case the Audit Committee on the issues arising from the 2006/07 audit. I issued this report on 18 June 2007 and a supplementary letter to the Chair of the Audit Committee on 20 June 2007. The most significant issues arising are summarised in this letter.

Audit opinion on the financial statements

- 18 My work on the 2006/07 financial statements identified a small number of significant issues which were reported to the Audit Committee on 22 June 2007. There was no overall movement in the surplus reported in year. I have highlighted these issues below.
- 19 The accounts included a £6.9m adjustment to deferred income in relation to PFI funding. The adjustment effectively increased the Trust's income by £6.9m. The accounting treatment for this change was agreed with me prior to the commencement of the audit. The Trust did not deliver sufficient savings to close the £4.0m budget gap identified at the beginning of 2006/07 and without this adjustment would not have achieved a surplus.
- 20 I raised concerns with the Audit Committee about the high level of provision for doubtful debts from Welsh Health Bodies, particularly Powys LHB. Although sufficient evidence was provided before I issued my audit opinion I remain concerned that over £1.0m of debt was in dispute with Powys LHB. I noted in my letter to the Audit Committee Chair that the Trust's Integrated Business Plan includes income growth projections and an important part of this is Welsh income. The Trust needs to consider its contractual agreement processes with service purchasers, its invoicing and debt collection arrangements to ensure that it receives appropriate remuneration for the work it undertakes on behalf of commissioners.
- 21 A provision of £457,000 was made against a debt relating to oncology services. This arose as the Trust was unable to provide supporting activity information for oncology referrals following the implementation of the new Patient Activity System in October 2006. The loss of data extraction capacity had an adverse financial impact on the Trust's financial position.

- 22 The accounts included £860,000 relating to provisions for redundancy costs. The inclusion of such provisions is determined by Financial Reporting Standard (FRS) 12 'Provisions, Contingent Liabilities and Contingent Assets'. I concluded that the requirements of FRS12 were not met and reported this to the Audit Committee. The Committee decided not to adjust the accounts for this matter. As the value was below the materiality level I had set for the audit I was able to issue my audit opinion despite this misstatement. The Trust has recently approved a number of redundancies.

Accounting performance

- 23 The preparation of the financial statements is a vital process in the financial stewardship of a Trust. The deadline for submission to the Department of Health was moved forward for 2006/07. I am pleased to report that the Trust met this deadline and submitted by the 1 May 2007.
- 24 I agreed with the Trust the working papers and other information I would require to facilitate an efficient audit. These were met and were generally of a good standard, with the exception of debtors and provisions.
- 25 As part of my audit, I consider the systems of accounting and financial control and report to you any material weaknesses identified. My review of controls did not identify any significant weaknesses. I ensured that key weaknesses in the financial systems identified by Internal Audit or ourselves were disclosed when preparing the Statement on Internal Control.

Summary financial statements

- 26 I also reviewed the Trust's 2006/07 Annual Report, which included the summary financial statements. The review process identified some content and presentational issues where I requested amendments to meet the requirements set out in the NHS Trust Manual for Accounts. The necessary amendments were made prior to the publication of the annual report.

Trust's use of resources

- 27 I am required conclude on whether the Trust has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.
- 28 I am also required to assess how well NHS organisations manage and use their financial resources by providing scored judgements on the Trust's arrangements in five specific areas. This is known as the auditor's local evaluation (ALE). The Audit Commission provides the scores to the Healthcare Commission (HC) to use as part of its annual health check.

Value for money conclusion

- 29 I concluded that the Trust had proper arrangements in place to secure economy, efficiency and effectiveness in the use of resources except that it did not put in place arrangements for the management of its asset base. This was due the Trust failing the requirements relating to the management of its asset base, in particular the absence of an agreed estates strategy.

Auditor's local evaluation judgement (including financial standing)

- 30 I assessed the Trust's arrangements in five areas. I scored each area from 1 to 4 (1= inadequate and below minimum standards, 2 = adequate, 3 = performing well and 4 = performing strongly). I issued a detailed report supporting my assessment and highlighting areas for improvement to the Trust on 1 October 2007.

Table 1 ALE scores

Element	Assessment
Financial reporting	Adequate
Financial management	Adequate
Financial standing	Adequate
Internal control	Adequate
Value for money	Adequate
Overall assessment of the Audit Commission	Adequate

(Note: 1=lowest, 4=highest)

- 31 The key issues arising from the audit, as reflected in the above judgements where appropriate, are as follows.

- 32 Although the Trust demonstrated that it was achieving the minimum requirements in all the areas assessed, it was disappointing that the score for each of the five themes did not improve on 2005/06. I noted improvements in a number of areas, but these were not sufficient to improve the overall scores.
- 33 My key findings are as follows.
- Financial reporting; The production of accounts was good but the lack of adequate supporting information in two key areas; debtors and provisions, prevented the Trust progressing beyond level 2.
 - Financial Management; Financial planning and budgetary monitoring was strong, but the delay's in agreeing the 2006/07 contract with the PCT and the Trust's budget before the beginning of the financial year were limiting factors. The absence of a current estates strategy meant that the level 2 requirements for the Trust's management of its asset base were not achieved.
 - Financial standing; I assessed the Trust as a level 2 as it continued to have an underlying deficit during 2006/07 and needed a non-recurrent adjustment (see earlier) to deliver financial balance in 2006/07.
 - Internal Control; key financial systems operated satisfactorily during the year and improvements were made in the management of business risks. However, as noted in the Standards for Better Health Declaration, the risk management arrangements were not embedded throughout the year. Also business continuity and disaster recovery plans were not in place in 2006/07.
 - Value for Money; The development of the Integrated Business Plan (IBP) has improved the Trust's strategic objective setting process, including measurable outcomes. I assessed this element of the Value for Money KLOE at level 3. A lot of work is also being done to develop patient and community involvement in the Trust. However, the Trust does not have an approved communication strategy in place and arrangements to communicate with hard to reach groups were limited. The Trust continues to develop its performance framework and improvements were made to both the governance framework and reporting. Improvements were also made to data quality arrangements during 2006/07, but these were not fully embedded in 2006/07. There is a high level of commitment to efficiency improvements, and a number of activities have been undertaken (most notably LEAN thinking). The Trust needs, however, to provide evidence that demonstrates the efficiency improvements made by this work.
- 34 I have highlighted the issues that the Trust needs to address to improve its ALE score in a separate report and anticipate that the improvements the Trust is making will be reflected in the 2007/08 ALE assessment. It is important that a focused and structured approach to ALE improvements is demonstrated as this was lacking for 2006/07. To support this I have included an ALE Action Plan with my report.

Specific risk-based work

- 35 I also carried out a specific pieces of work as follows:
- capacity planning;
 - payment by results, and
 - follow up reviews.
- 36 The significant issues arising from my work in these areas are summarised in this letter.

Capacity planning

- 37 The Board has made a commitment to continue to provide a full range of services to the local health economy, whilst making the improvements necessary to meet the standards of a new Foundation Trust. This requires robust capacity planning arrangements to meet the requirements of the local health economy, and deliver recurrent financial savings. My conclusions are as follows.
- The trust's approach to capacity planning is not robust. Long term capacity planning is recognised as a priority for the Trust but effective arrangements are not yet in place to support this. This results in considerable pressures on beds and theatre resources and regular overspill to the day case unit.
 - There is a fragmented approach to addressing capacity and efficiency across the health economy. The Trust and PCT are working to different sets of planning assumptions as the PCT's target for reduced emergency admissions was not considered realistic by the Trust. As a result the planning arrangements are not facilitating effective joint working on capacity issues across the economy. The need to improve in this area is recognised by the Trust, PCT and Local Authority. The Unscheduled Care Project is developing joint working to manage demand on secondary care services in the County.
 - Improvements are needed to the content of performance reports. Activity reports do not include targets based on capacity or commissioning intentions. Data problems following the replacement of PAS mean that there is a lack of confidence in some performance information. These accepted deficiencies in information hamper the Trust's ability to effectively forecast impacts on capacity.
 - A more rigorous approach to the introduction of schemes to ease capacity pressures is required. A range of initiatives have been introduced to achieve efficiencies and remove bottlenecks. In order to demonstrate their effectiveness and measure compliance, monitoring arrangements need to be strengthened. This will help to identify benefits and identify the need for corrective action where appropriate.
- 38 An action plan supporting my report has been agreed with the Director of Operations and I understand that progress is being made with the implementation of my recommendations.

Payment by Results

- 39 My review identified that the Trust's procedures for the management of PbR were satisfactory. Particular strengths included:
- the Trust has a Data Quality PAS User Group with membership across all departments, as well as a cross cutting group with Hereford PCT, led by the Health Informatics Services;
 - performance information linking activity and income is made available to Care Groups. This information is actively used to address issues and to drive improvement;
 - controls are in place to capture activity and minimise the likelihood of mis-pricing of activity; and
 - as part of the move to 18 week waiting times I compared the Trust within its peer group for outpatient waiting times (to see if it was prepared for this move). 2006/07 quarter three returns confirmed that Hereford was the highest performer, ie had the lowest waiting periods, within its peer group.
- 40 My review of the efficiency of service costs highlighted that overall the Trust was relatively efficient compared to its peer group. However, within the overall service costs there are pockets of potential inefficiency for the Trust to consider. Key areas are:
- elective areas such as HRG C58, Intermediate Mouth or Throat, where unit costs are 53 per cent above the national average; and
 - for A & E activity Hereford has the third highest average unit cost.
- 41 Other areas for improvement are:
- the financial return on contracts with Welsh commissioners need evaluating and the Board needs to consider which services it wishes to continue with, and the basis on which contracts should be negotiated;
 - Data Quality is not a formal agenda item at EMT, and is not regularly reported to the Board;
 - Cashflow management needs improving, both through modelling the impact of variable monthly income from the PCT and more effective debt collection; and
 - performance monitoring information reported to the Board needs to link income with activity.
- 42 I agreed my action plan with the Director of Finance and this was presented to the October Audit Committee meeting.

Follow up reviews

- 43 I reviewed progress with two reports issued in 2005/06:
- Consultant Contracts Benefits Realisation; and
 - Emergency Admissions and Demand Management.

This identified that although progress has been made in both areas there is still work required to fully implement the agreed recommendations.

National Fraud Initiative

- 44 The National Fraud Initiative is a computerised data matching exercise designed to identify overpayments to suppliers and benefit claimants and to detect fraud perpetrated on public bodies. The referrals from the current exercise were released to participating bodies in January 2007. These were followed up by the Trust's Local Counter Fraud Specialist.

Closing remarks

- 45 I have discussed and agreed this letter with the Chief Executive and the Director of Finance. I will present the letter at the Audit Committee and will provide copies to all Board members.
- 46 Further detailed findings, conclusions and recommendations on the areas covered by my audit are included in the reports issued to the Trust during the year.

Table 2 Reports relating to the 2006/07 audit

Report	Date of issue
Audit plan	March 2006
Financial systems review	April 2007
Report to those charged with governance	June 2007
Opinion on financial statements	June 2007
Value for money conclusion	June 2007
Auditors' local evaluation	September 2007
Annual audit letter	October 2007

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

Mark Stocks
Engagement Lead

October 2007