

Annual Audit Letter

Hereford Hospitals NHS Trust

Audit 2009/10

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As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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Key Messages

This report summarises the findings from my 2009/10 audit. My audit comprises two elements:

- **the audit of your financial statements (pages 7 to 8);**
and
- **my Auditor's Local Evaluation (ALE) of your arrangements to achieve value for money in your use of resources (pages 9 to 12).**

I have included only significant recommendations in this report. The Trust has accepted these recommendations.

Overview

1 During the year the Trust managed operational pressures generated by high levels of emergency activity and delivered an increased level of surgery to achieve the national standard of 18 weeks from referral to treatment. The Trust achieved unconditional registration from the Care Quality Commission from 1 April 2010.

2 These activity levels in the year created additional financial pressures which added to the Trust's already significant financial challenge. Due to the phasing of the cost improvement program this challenge was greatest during the second half of the year.

3 The Trust planned for a surplus of £1.1 million for the financial year and achieved this financial target having successfully delivered £3.6 million of cost improvements.

4 The improvements in the Trust's performance have been reflected in higher scores in two of the five themes of my Auditor Local Evaluation (ALE) assessment. The Trust is moving forward in several areas and these are becoming part of its financial arrangements. Despite these improvements my overall assessment remains as adequate (level 2) because the Trust did not meet its overall financial target in 2008/09 and there is uncertainty over future financial plans due to the Trust's planned integration with NHS Herefordshire's Provider arm.

5 The integration of health and social care in Herefordshire involving the Trust, NHS Herefordshire and Herefordshire Council is primarily being progressed in order to improve the delivery of services, but is also a response to the increasingly challenging financial situation faced by all three organisations. The financial plans for the new arrangements are currently being developed and it is anticipated that the new, larger organisation will be in place from April 2011.

Audit opinion and financial statements

1 I completed my audit and issued an unqualified opinion on 10 June 2010. This was the first year that the Trust was required to comply with International Financial Reporting Standards (IFRS). They required the accounting for the Trust's Private Finance Initiative (PFI) to be fully included within the Trust's financial statements which was a demanding reporting requirement.

2 The financial statements presented for audit contained some errors and uncertainties. The most significant of these arose from the PFI contract coming on to the Trust's balance sheet. The financial statements were amended to show a retained deficit for the year of £5.091 million. The draft financial statements showed a retained surplus of £1.544 million.

Use of resources

3 The Trust has made improvements in several areas of my Auditor Local Evaluation (ALE) assessment. All three areas assessed within the internal control theme and the four areas assessed within arrangements to secure value for money are now performing well. I assessed the Trust's financial standing as adequate and the overall assessment remained as adequate.

4 In addition to issuing an opinion on the financial statements, I am required to issue a Value for Money (VFM) Conclusion. I issued an unqualified conclusion stating the Trust had adequate arrangements to secure economy, efficiency and effectiveness in the use of its resources.

Audit Fees

5 The audit fee for the financial year 2009/10 was agreed by the Trust in March 2009. This fee excluded technical specialist work required for the Trust's PFI scheme as at the time of agreeing the fee these requirements were not known. The final fees are shown at Appendix 1.

Future challenges

6 The Trust as other public organisations faces an increasingly challenging operational environment as the economic downturn and public spending reductions continue to require reductions in cost and improved services.

7 The new organisation arising from the integration of health and social care services in the county will be required to seek Foundation Trust (FT) status in accordance with Government requirements. The Trust has a good basis on which to build following the preparatory work undertaken in 2008/09.

8 To deliver the Trust's financial target for 2010/11 of £1.1 million a demanding Cost Improvement Program (CIP) is in place which includes expenditure reductions of £4.3 million and increased income of £1.5 million. It will be essential that reporting arrangements to the Board continue to provide realistic assessments of the Trust's position.

9 The announcements in the White Paper, *'Equity and Excellence: Liberating the NHS'*, will have a big impact on the Trust. Commissioning arrangements will change with the setting up of GP consortia.

Financial statements and Statement on Internal Control

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

Overall conclusion from the audit

10 My overall conclusion from my audit of the Trust's 2009/10 financial statements is that they present a true and fair view of the Trust's position. The issues which were addressed as part of this audit are included in 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.

11 The Trust delivered its financial statements for audit on 22 April 2010. I completed my audit and reported my findings to the Audit Committee before issuing my unqualified audit opinion on 10 June 2010. Both the delivery of the financial statements for audit and the issuing of my audit opinion met the deadlines set by the Department of Health.

12 This year 2009/10 was the first year that the Trust was required to report its financial statements in IFRS format as required by the Department of Health's Manual for Accounts. As part of these requirements the Trust accounted for and included its PFI scheme within its assets and liabilities for the first time. PFI accounting is a technically complex area which was not previously a requirement.

13 The financial statements presented for audit contained some errors and uncertainties. The most significant error arose from the PFI contract coming on to the Trust's balance sheet and its impact reduced the draft retained surplus for the year 2009/10 from £1.544 million to a retained deficit of £5.091 million.

14 The Trust signed the PFI contract in 2002. The IFRS accounting requirements meant that the difference between the historic cost of the hospital and its valuation in 2002 was a loss of £50 million. This loss was held within a negative retained earnings reserve on the balance sheet. In subsequent years up to 2008/09 the value of the PFI asset had been correctly increased by indexation as required by accounting practice. In the draft financial statements for 2009/10 the total of these indexation increases of £17 million was taken to a revaluation reserve on the balance sheet rather than to the retained earnings reserve to offset the initial loss which had arisen in 2002.

15 In the current year the valuation of the PFI asset gave rise to a loss in value of £6.6 million which, in the draft statements was charged against the revaluation reserve. As the revaluation reserve should have been nil there were no credits in the revaluation reserve against which to charge this loss and so it had to be charged to operating expenses in the statement of consolidated income. This charge reduced the draft retained surplus from £1.544 million to a retained deficit of £5.091 million.

16 The financial statements were amended for these items before my opinion was issued.

Significant weaknesses in internal control

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

Use of resources

I considered how well the Trust is managing and using its resources to deliver value for money and gave a scored Auditor's Local Evaluation (ALE) judgement. I also assessed whether the Trust put in place adequate corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money (VFM) conclusion.

ALE judgements

18 The Trust has maintained its 'adequate performance' assessment from 2008/09 and demonstrated improvements in two themes of Internal Control and Value for Money.

19 My scored ALE judgements apply the Key Lines of Enquiry (KLOEs) published by the Audit Commissionⁱ which auditors use in reaching scored ALE judgements. The KLOEs provide consistent criteria for assessing and measuring the effectiveness and efficiency of a Trust's arrangements to deliver value for money.

20 Using this methodology, I have made a judgement for each KLOE using the Audit Commission's current four-point scale from 1 to 4, with 4 being the highest level. Level 1 represents a failure to meet minimum requirements.

21 I have also taken into account, where appropriate, findings from previous ALE assessments (updating these for any changes or improvements) and any other relevant audit work.

22 Table 1 shows the Trust's ALE scores for the five key areas. I have reported my detailed findings in a separate report to the Trust.

ⁱ 'ALE for Trusts' guidance available on the Audit Commission website

Table 1: **ALE scores**

Key area	Scored judgement
Financial reporting	2
Financial management	2
Financial standing	2
Internal control	3
Value for money	3

23 The Trust continues to perform adequately in its Financial reporting. I was able to issue an unqualified opinion on the 2009/10 financial statements but they contained more than a small number of 'non-trivial' errors. Internal financial reporting during the year is comprehensive and the clarity of forecasting the monthly and annual position has improved.

24 Improvements were made in arrangements to manage performance against budgets, and in the achievement of the CIP and financial target. Overall my assessment of financial management remained as adequate because the Trust did not meet its target last year (2008/09) and there is uncertainty over future financial plans due to the Trust's planned integration of the provider arm of NHS Herefordshire to deliver services across Herefordshire. Asset management remains the key area for improvement. Key performance indicators for the estates function should be considered by the Board.

25 I have again assessed the Trust's financial standing as adequate although many features of higher performance are in place. The Trust delivered its financial target and loan repayment requirement in the year. Financial projections and the medium term financial plan are not clear and robust partly due to the uncertainty over future organisation. The business plan for 2010/11 includes again a challenging Cost reduction program of £4.3 million together with an income target of £1.5 million. Plans are therefore in place to move the Trust forward but the plan to address the underlying deficit is not yet sufficiently detailed.

26 There has been improvement in all three areas of the internal control KLOE so that I am able to conclude that the arrangements are performing well.

27 For the Value for Money KLOE there has been an improvement in two of the four areas of this KLOE so that I am able to conclude that the arrangements are performing well.

Recommendation

R1 The Board needs to ensure that improvement areas identified by my ALE assessment are included in its wider improvement monitoring processes.

VFM conclusion

28 I assessed your arrangements to secure economy, efficiency and effectiveness in your use of resources against criteria specified by the Audit Commission. My conclusions on each of the areas are positive and are set out in Appendix 2.

29 I issued an unqualified conclusion stating that the Trust had adequate arrangements to secure economy, efficiency and effectiveness in its use of resources, on 10 June 2010.

Risk-based use of resources reviews

30 To support my review of the criteria I undertook the following study.

- Financial Management – Delivery of the Cost Improvement Programme (CIP).

31 I have reported my detailed findings to the Trust in a separate report reported to the Audit Committee in March 2010. The Trust has monitoring arrangements in place to ensure that the recommendations within the report are actioned.

32 The review found that effective monitoring arrangements were in place and the reporting of the CIP position to the Trust Board was clear. The methodology to identify potential CIP schemes was soundly based but the links between this initial work and the subsequent overall £4.5 million CIP for 2009/10 could have been stronger and clearer.

33 The outturn for the year included a contribution of £3.6 million from CIP schemes towards the overall financial position. Of the original CIP schemes identified before the year 55 per cent were delivered and although replacement schemes were identified these were insufficient to deliver the original target level of £4.5 million for 2009/10. The Trust was able to deliver its overall financial target for the year.

Follow Up of Previous Years' Work

34 I have followed up the recommendations made in previous years and whilst some recommendations have been superseded overall satisfactory progress is being made.

35 A key area for improvement remains estates management. The Trust has recognised this and plans are in progress to address this area to ensure that the Trust makes best use of its assets.

Approach to local value for money work from 2010/11

36 Given the scale of pressures facing public bodies in the current economic climate, the Audit Commission has been reviewing its work programme for 2010/11 onwards. This review has included discussions with key stakeholders of possible options for a new approach to local value for money (VFM) audit work. The Commission aims to introduce a new, more targeted and better value approach to our local VFM audit work.

37 My work will be based on a reduced number reporting criteria, specified by the Commission, concentrating on:

- securing financial resilience; and
- prioritising resources within tighter budgets.

38 I will determine a local programme of VFM audit work based on my audit risk assessment, informed by these criteria and my statutory responsibilities. I will no longer be required to provide an annual scored judgement relating to my local VFM audit work. Instead I will report the results of all my local VFM audit work and the key messages for the Trust in my annual report to those charged with governance and in my annual audit letter.

Payment by results (PbR)

Under the PbR data quality assurance framework the Audit Commission has carried out inpatient clinical coding audits, outpatient data quality audits and the continuation of national benchmarking information and analysis at NHS Trusts and NHS Foundation Trusts.

Key Findings – Admitted clinical coding audit

39 In the year one area has been reported on which is on admitted patients clinical coding.

40 The Trust receives income based on Department of Health pricing which is described as Healthcare Resource Group (HRG) pricing. The audit found that the percentage of HRGs changing at the Trust was similar to the national average when compared to the overall performance of trusts in 2008/09.

41 The Trust's HRG error rate is 8.3 per cent against the national average of 8.1 per cent in 2008/09 and your Strategic Health Authority (SHA) average error rate of 6.1 per cent. This error rate represents a slight increase in HRG errors over the previous year.

42 The financial value of the total or gross errors found is £10,694 from an audit sample of £345,505. The net impact of this means that the Trust undercharged its commissioners by £1,322 or 0.4 per cent of the sample tested.

43 Due to the targeted nature of this type of audit and the small sample of activity audited it is not recommended that these results be extrapolated further than the actual sample audited. They do however provide information that will assist both commissioners and providers decide if the controls over the accuracy of their activity data are adequate and highlight areas of concern that they may wish to investigate further.

44 The report from the admitted clinical coding audit for 2009/10 was reported to the July 2010 Audit Committee. The Trust has monitoring arrangements in place to ensure that the recommendations within the report are actioned.

Future challenges

Integration of services

45 The integration of services across Herefordshire will be a significant challenge. The level of work and commitment required has been embraced by the Trust as shown by the roles undertaken by senior management to date.

46 To achieve FT status the Trust must demonstrate that it is a strong and financially viable organisation in a period of financial uncertainty.

47 The economic climate will continue to impact on the trust and as previously noted the Trust continues to face demanding cost improvement programmes. As commissioners seek to implement demand management initiatives the Trust will need to be flexible to deliver the activity composition and volumes required.

Future developments

48 The White Paper *Equity and Excellence: Liberating the NHS* proposes radical changes to NHS organisations. Strategic Health Authorities will be abolished from the end of 2011/12 and Primary Care Trusts a year after. The Trust will need to work with a new set of partners and manage the transition to any new organisation and FT effectively to minimise the risk to its financial sustainability.

49 The Trust produced its first set of Quality Accounts for 2009/10 and from 2010/11 these will be subject to audit. The White paper refers to strengthening external assurance to ensure that these are fair and accurate. More data will be published on clinical performance, the tariff will cover a wider range of services and there will be more 'pay for performance' schemes. All this means a growing requirement for data assurance.

Closing remarks

50 I have discussed and agreed this letter with the Chief Executive and the Director of Finance and Information. I will present this letter at the Audit Committee on 11 October 2010 and will provide copies to all board members.

51 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
IFRS – Restatement of 2008/09	December 2009
Opinion Audit plan	January 2010
Financial Management – Delivery of the Cost Improvement Programme	February 2010
Payment by Results Data Assurance Framework – Admitted patient care clinical coding audit	April 2010
Annual Governance Report	May 2010
Auditor Local Evaluation	September 2010

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

53 Following the Government's announcement of the abolition of the Audit Commission, I would like to re-assure Board members that we will deliver the Trust's 2010/11 and 2011/12 audits. The Audit Commission is writing to all the organisations we audit to explain that current audit arrangements will continue up to and including 2011/12 audits.

Elizabeth Cave
District Auditor

September 2010

Appendix 1 – Audit fees

	Actual	Proposed	Variance
Financial statements and annual governance statement	103,470	86,900	16,570
Value for money	50,000	50,000	0
Total audit fees	153,470	136,900	16,570
Non-audit work	0	0	0
Total	153,470	136,900	16,570

Appendix 2 – Value for money conclusion

Code criteria	Adequate arrangements?
1. The body has put in place arrangements for setting, reviewing and implementing its strategic and operational objectives.	Yes
2. The body has put in place channels of communication with patients and their representatives and other stakeholders including partners, and there are monitoring arrangements to ensure that key messages about services are taken into account.	Yes
3. The body has put in place arrangements for monitoring and scrutiny of performance, to identify potential variances against strategic objectives, standards and targets, for taking action where necessary and reporting to the board.	Yes
4. The body has put in place arrangements to monitor the quality of its published performance information and to report the results to board members.	Yes
5. The body has put in place arrangements to maintain a sound system of internal control.	Yes
6. The body has put in place arrangements to manage its significant business risks.	Yes
7. The body has put in place arrangements to manage and improve value for money.	Yes
8. The body has put in place a medium-term financial strategy, budgets and a capital programme that are soundly based and designed to deliver its strategic priorities.	Yes
9. The body has put in place arrangements to ensure that its spending matches its available resources.	Yes
10. The body has put in place arrangements for managing performance against budgets.	Yes
11. The body has put in place arrangements for the management of its asset base (only applicable to organisations with a significant asset base).	Yes
12. The body has put in place arrangements that are designed to promote and ensure probity and propriety in the conduct of its business.	Yes

Appendix 3 – 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 accounts, auditors must give their 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;
- whether they have been prepared properly, following the relevant accounting rules; and
- for local probation boards and trusts, on the regularity of their spending and income.

Financial statements

The annual accounts and accompanying notes.

Qualified

The auditor has some reservations or concerns.

Unqualified

The auditor does not have any reservations.

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 money, people and time.

International Financial Reporting Standards

Reporting requirements applicable to the financial statements of all NHS bodies from the 2009/10 financial year. These standards also apply to private sector reporting entities, apart from charities.

Key Line of Enquiry

Criteria specified by the Audit Commission for forming the basis of Auditor Local Evaluation assessments. There are 5 themes, supported by 13 sub-themes. All themes and sub-themes are scored on a 1 to 4 scale.

Appendix 4 – Action Plan

Recommendations	
Recommendation 1	
The Board needs to ensure that improvement areas identified by my ALE assessment are included in its wider improvement monitoring processes.	
Responsibility	Director of Finance and Information
Priority	
Date	
Comments	

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