Annual Audit Letter

Portsmouth 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.**

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

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

Audit opinion and financial statements

I issued an unqualified opinion on the financial statements. The accounts and associated working papers were well prepared and there were no material errors affecting the bottom line.

I reported detailed matters arising from the audit to the Trust's Audit Committee in June 2011.

Value for money

My audit highlighted that the Trust achieved over £30 million savings in 2010/11 and has good project management arrangements in place for future savings. However I issued an 'except' for value for money conclusion because:

- local demand management schemes aim to reduce the Trust's activity and income;
- due to the current Private Finance Initiative scheme the Trust has a significant level of fixed costs which it will be difficult to reduce in the short term; and
- the Trust needs to achieve a very high level of savings in future years in order to break even and in my view these may be difficult to achieve without external support.

Current and future challenges

The £20 billion efficiency target by 2014 outlined in 'Liberating the NHS' will be a significant challenge for the NHS nationally.

Over the next four years the Hampshire health system is facing a £365 million challenge. The Trust has a Cost Improvement Programme saving target for 2011/12 of £30.5 million which will be challenging. The Trust needs to deliver these savings whist developing an effective relationship with the new PCT cluster.

My audit confirmed the Trust is focusing on these areas. It has sound assurance, risk management and performance management frameworks in place to monitor its progress. They must, however, ensure that planned actions actually deliver the required outcomes.

Key challenges for the future will include:

- achieving further savings to reach financial balance;
- continuing to develop relationships with commissioners and other stakeholders at a time of considerable change in the NHS including the clustering of local PCTs;
- reconfiguring the estate to reflect changes in service provision; and
- responding to potential reductions in demand.

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

I issued an audit report including an unqualified opinion on the financial statements. The financial statements and working papers presented for audit were complete and were prepared to a good standard. The finance team did well to maintain this standard whilst meeting tighter deadlines.

Significant issues arising from the audit

Before undertaking my audit I review the Trust's financial statements and set a threshold below which I judge any error to be trivial. I then report to the Audit and Assurance Committee any errors, adjusted or unadjusted, over this threshold.

I highlighted two issues above this level, as follows.

- In accordance with the provisions set out in the Manual for Accounts, the Trust should recognise income for clinical activity in progress at the year end. This is to ensure consistency with the fundamental matching concept. The Trust had not done this and income and receivables were therefore understated by an estimated £2.2 million. As in previous years the Trust has followed the advice of the Strategic Health Authority in not recognising this income. This is consistent with other NHS Trusts in the area. I did not regard this as a material error given the Trust's total turnover.
- The Trust was required to make a prior period adjustment due to a change in accounting requirements with regards to impairments incurred in 2009/10. When making this change the Trust used the incorrect figure resulting in an error of £895,000 between the Income and Expenditure reserve and the revaluation reserve.

Internal control

Overall the Trust has a sound system of internal control. For 2010/11 the Head of Internal Audit reported to the Audit Committee significant assurance that there is generally a sound system of internal control that is being applied consistently.

I did not identify any significant weaknesses in your internal control arrangements. However, I did identify a number of areas where the level of control could be improved.

- one of the bank reconciliation had not been reconciled to the ’cleared balance’; and
- a number of Information Management and Technology policies had not been updated in accordance with planned deadlines.

Management accepted my recommendations relating to the above issues.

We also noted that the Head of Internal Audit opinion was provided before the Internal Audit plan had been fully delivered. One audit report relating to 2010/11 was not finalised until after the year end which resulted in two high risk recommendations being excluded from the Head of Internal Audit opinion and the Statement of Internal Control.

Other matters

There were a number of adjustments required to the draft financial statements which impacted only on some of the disclosure notes. These were reported in detail to the Audit Committee in June 2011.

The Trust has adjusted the accounts in all instances.

I also identified two matters with regards to the financial reporting processes.

- The Trust made a prior period adjustment of £168,000 to correct a coding error included within the 2009/10 financial statements. IAS8 states that such an adjustment should only be made where material and as such we would not anticipate one to be made in this instance.
- The Trust revalued its plant and equipment assets included within the Statement of Financial Position using a forecast 2010/11 GDP deflator, obtained in December 2008. The Trust should use the actual indices that are available at the beginning of each financial year. The difference between the indices used would not result in a material error in the financial statements.

Management accepted my recommendations relating to the above.

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.

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission.

- The Trust has proper arrangements in place for securing 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).
- 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).

My audit highlighted that the Trust achieved over £30 million savings in 2010/11 and has good project management arrangements in place for future savings. However I issued an “except” for value for money conclusion because:

- local demand management schemes aim to reduce the Trust's activity and income;
- due to the current Private Finance Initiative scheme the Trust has a significant level of fixed costs which it will be difficult to reduce in the short term; and
- the Trust needs to achieve a very high level of savings in future years in order to break even and in my view these may be difficult to achieve without external support.

Work to support the value for money conclusion

In 2010/11 I identified a number of significant risks relevant to my value for money conclusion. For each risk, I considered the arrangements put in place by the Trust to mitigate the risk. The risks, how I addressed them and my conclusions are ser out in the table below.

Risk	How addressed	Conclusion
Non delivery of challenging savings plans will result in financial targets not being met.	**Review of the Trust's Cost Improvement Programme (CIP)** This included a review of the Trust's performance in meeting statutory financial targets and achieving planned savings.	The Trust did well in 2010/11 to achieve over £30 millions savings particularly around workforce controls where savings of £12 millions were made. The health system 'gap' of £6 millions remained unresolved and required Strategic Health Authority support.
The impact of local health economy changes on the Trust and the part that the Trust plays in delivering wider health economy targets.	**South East Hampshire Sustainability Review** I reviewed how the Trust is working with partner organisations to deliver sustainable health systems in South East Hampshire.	My review of financial sustainability in the wider health economy shows that whilst all the partners are increasingly working together they have still yet to significantly reduce demand in the local health community.
The impact of contract variations of the PFI scheme	**Contract Monitoring** I identified three areas of risk: ■ management of the contract, including approval of variations; ■ performance monitoring of the contract; and ■ benchmarking and market testing undertaken.	The combined procedures adopted by Carillion and the Trust provide robust monitoring of the contract. The two parties are involved in dialogue and negotiation over the interpretation of contract terms. This is consistent with PFI schemes which have only recently become operational.

Review of Cost improvement Programme

The Trust did well in 2010/11 to achieve over £30 millions savings particularly around workforce controls where savings of £12 millions were made. The health system 'gap' of £6 millions remained unresolved and required Strategic Health Authority support.

There is evidence that the Trust has carried out a proper review of the 2010/11 savings plan process and has made significant changes to the process for establishing its 2011/12 savings plans. These include more robust savings plans supported by detailed plans, engagement with Clinical Services Centres via workshops, and improved reporting and monitoring procedures. The Turnaround Committee is key to driving these changes forward and it is therefore important that the right staff attend these meetings. Overall we concluded that the Trust has developed good arrangements for managing its cost improvement programme.

The Trust continues to face tough challenges in the next financial year and beyond as it has to continue to deliver a significant level of savings. The savings plan of £29 millions falls marginally short of the savings required for 2011/12 and some areas of risk remain.

The Trust must ensure that it closely monitors delivery of its savings programme, in particular those areas currently rated as red and amber. In addition the Trust needs to develop plans to show how commissioner QIPP savings will be delivered by the individual directorates.

South East Hampshire sustainability review

In 2009 management consultants McKinsey & Company ran a programme on 'Achieving sustainability in South East Hampshire' across the three local organisations of Portsmouth City Teaching PCT, Hampshire PCT and Portsmouth Hospitals NHS Trust (PHT). The work concentrated on understanding the financial challenge in the health community and thinking through the changes required in clinical practice to deliver high-quality but affordable services.

In 2009/10 the auditors of the three bodies reported concerns about the lack of tangible progress in addressing the points made in the McKinsey review. We concluded there was little evidence of coordinated action to address the issues. We found that:

- project and performance management arrangements needed improving to support the delivery of workstreams;
- the three local organisations needed to engage with other partners to keep a strategic overview of the health system;
- it was not clear if the focus, pace and scale of the programme of work would be enough to close the financial gap; and
- it was not clear if there was strong enough leadership and commitment from all partners to deliver the required outcomes.

As part of my 2010/11 we followed up on the recommendations we made in 2009/10. We found improvements in:

- the quality and coverage of performance information used to manage delivery of the Sustainability Plan;
- clinical engagement and support for the delivery of workstreams; and
- evidence of partnership working across the economy.

However the local health community did not deliver some of the key schemes as originally planned and fell £6 million short of the 2010/11 financial target.

Having quantified the scale of the challenge, identified the actions required and the mechanisms to deliver these actions it is now important for the focus to be on delivery. This will require strong leadership across the health system.

Contract monitoring

In 2005, Portsmouth Hospitals Trust signed a PFI agreement with The Hospital Company and Carillion for the redevelopment of the Queen Alexandra Hospital. Services have been functional since 2009/10. The annual unitary payment for the scheme pays for construction and services. Aside from the redevelopment of the hospital site, the payment also covers:

- the contractor's financing costs;
- hard facilities management costs - the costs of maintaining the building in an acceptable condition for the period up to contract expiry and to meet specified conditions at handback to the Trust; and
- soft facilities management costs - the costs of services required to run the hospital, but not directly related to the building e.g. catering, cleaning, porters, grounds maintenance. Some of these costs are subject to additional payments where activity exceeds the specification.

The combined procedures adopted by Carillion and the Trust provide robust monitoring of the contract. The two parties are involved in dialogue and negotiation over the interpretation of contract terms. This is consistent with PFI schemes which have only recently become operational.

In practice, it is still early in the life of the operational period of the contract. The Trust and The Hospital Company still need to agree a number of procedures and definitions. This will take time and there is a trade off between the Trust pushing for early resolution and maintaining an effective working relationship with the contractor. We note that The Hospital Company has acknowledged many of the issues raised by the Trust and these are being discussed and resolved.

The Trust has established robust mechanisms for considering and approving variations. These procedures link in to the Trust's budget process to ensure that funding is available to meet the cost of a variation. Procedures are also in place to review the cost of any proposed variations to ensure that the cost is reasonable and to monitor the status of all variations.

The contract allows for benchmarking of soft FM costs and, if necessary, market testing of the services. As the main service period did not begin until 2009, benchmarking will not occur until 2014. The benchmarking exercise will allow the Trust to reconsider the value for money of soft FM service provision.

Payment by results – data assurance framework

Accurate coding and cost data is important. It is the underlying information used for contracting and helps decide both local and national prices for work undertaken by hospitals. The 2010/11 audit programme included a review of reference cost submissions by the Trust.

Reference costs are the average cost to the NHS of providing a defined service in a given financial year. In 2009/10 92 per cent of trusts and PCTs used reference cost data to support local pricing and contract negotiations. Reference costs are key to:

- calculating and developing the national tariff;
- producing Programme Budgeting data;
- assessing various NHS productivity analyses, for example the Office of National Statistics public healthcare output; and
- calculating the weighted capitation formula used to inform PCT allocations.

Our audit focused on four key areas.

- We looked at the management arrangements to produce reference cost data in four areas that support good quality reference costs. We found that the Trust were meeting a satisfactory standard in two areas, and performing well in the remaining two areas.
- Total costs - The Trust has accurately reported its total costs with regard to reference costs. The Trust has correctly removed all non-relevant expenditure from the reference cost quantum.
- Total activity - The reported activity within reference costs reconciles to Hospital Episode Statistic (HES) data.
- Allocation of total costs to activities - The reported cost allocations are in line with cost allocations made by other trusts. The findings confirm the Trust is adhering to the costing manual.

There were two high priority recommendations for improvement at the Trust. The areas for improvement identified were as follows.

- To enable improvement in information available to the Trust and the methodology for allocating costs, information on the reference cost submission and comparison of the Reference Cost Indicators should be presented to the Board.
- To further improve the level of information available to and used by the Trust:
  - ensure that there is a cyclical plan to ensure all specialties respond to queries from the Project Accountant; and
  - ensure that all specialties are a member of a costing group where appropriate.

The Trust accepted and responded positively to all recommendations made in the report.

Payment by results in 2011/12

We will deliver a full programme of data assurance reviews in 2011/12. It will consist of the following.

- A continuation of our work on assessing the adequacy of commissioners' arrangements for ensuring the accuracy of its providers' data.
- Follow-up of all previous audit work.
- A national audit programme at all acute trusts reviewing the accuracy of coding and other data that feeds payments under PbR.
- An updated PbR National Benchmarker providing more information and support to commissioners as well as providers.

Quality Account

The Health Act 2009 placed a requirement on NHS bodies to publish prescribed information relevant to the quality of the services they provide. Following the events at Mid Staffordshire NHS Foundation Trust, Monitor reviewed its approach to assessing how effectively the board of applicant trusts ensured good governance of the quality of care they provide. This led to a new framework and approval for evaluating quality governance in applicants. In 2009/10 Monitor started a dry run external assurance of the quality reports of Foundation Trusts (FTs). In 2010/11 the external assurance requirement for FTs is included within Monitor's Audit Code for NHS FTs.

The DH asked the Audit Commission to arrange for auditors to provide assurance on NHS trusts' 2010/11 quality accounts. The DH is aiming for a consistent approach to quality accounts assurance for FTs and non-FTs from 2011/12. Therefore for NHS trusts the first year of external assurance was carried out as a ‘dry run’.

The DH's external assurance arrangements required me to:

- review your arrangements for satisfying yourself the quality accounts are fairly stated and follow relevant requirements; and
- Test 2 performance indicators included in the quality account.

My work highlighted that the Trust Board demonstrates leadership for the quality of information and has established arrangements to ensure that systems are in place to measure performance against documented standards. The Trust has satisfactory systems in place to collect and verify the information included in the quality accounts and has recognised where further improvements are possible.

My testing of the performance indicators confirmed the data reported in the quality accounts. The testing demonstrated that satisfactory systems and processes are in place and adhered to thus ensuring adequate data quality of the information used for the performance indicators.

The testing demonstrated that good systems are in place to provide satisfactory data for the calculation of the Clostridium Difficile and Hospital Associated Thrombosis performance indicators. However there is some scope for prompter identification of thrombosis cases that are actually hospital related. In addition, there is a risk that not all events are being captured and reported because the hospital mortuary services (following post mortem) are not required to report thrombosis cases. The Trust has already recognised these weaknesses and has plans in place to address the issues.

My review highlighted two high risk recommendations as follows.

- Recognise the relationship between the Statement on Internal Control and the Quality Accounts, and ensure that any inconsistencies between them are intentional and can be justified.
- The Trust should seek to improve the evidence supporting the Statement of Directors Responsibilities, including:
  - the Audit Committee should review the adequacy of the mechanisms in place to provide assurance to support the signing of the Statement of Directors Responsibilities; and

- the Trust should ensure that there is a year-end review of the evidence to support the Statement.

I also made three other recommendations, and the Trust has put in place an action plan to address the improvement areas identified.

Closing remarks

I have discussed and agreed this letter with the Chief Executive and the Director of Finance. I presented this letter at the Audit Committee on 29 September 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	November 2010
South East Hampshire Q2 Update	November 2010
PBR data assurance framework – Review of reference cost data	March 2011
Final Accounts – Interim Memo	March 2011
Final Accounts – Annual Governance Report (ISA260)	June 2011
Quality Account Report	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 co-operation during the audit.

Patrick Jarvis
Engagement Lead

September 2011

Appendix 1 - Fees

	Actual	Proposed	Variance
Scale fee set by Audit Commission		£207,209	£0
Audit fee charged	£195,000	£195,000	£0
Quality Account fee	£15,000	£15,000	£0
Non-audit work	£0	£0	£0
Total	**£210,000**	**£210,000**	**£0**

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 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.

If you require a copy of this document in an alternative format or in a language other than English, please call:
0844 798 7070

Design and production by the Audit Commission Publishing Team.

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

www.audit-commission.gov.uk

September 2011