



Accountants &
business advisers

**Royal National Orthopaedic
Hospital NHS Trust**

Audit Annual Letter 2004/05

September 2005

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1 Introduction

- 1.1 This Annual Audit Letter summarises the findings of our audit work at the Royal National Orthopaedic Hospital NHS Trust ('the Trust') for the year ended 31 March 2005.
- 1.2 Our audit has been carried out in accordance with the Audit Commission's Code of Audit Practice (the Code) and Statement of Responsibilities of Auditors and of Audited Bodies. The contents of this report should be viewed in the context of this more formal background.

Responsibilities of the auditor

- 1.3 The main objective of the auditor is to plan and carry out an audit that meets the requirements of the Code by adopting a risk based approach that focuses work on your significant financial and operational risks.
- 1.4 We agreed with the Trust those areas of significant financial and operational risk that we would review during the financial year to 31 March 2005 and reported this in our Outline Audit Plan for 2004/05, presented to the Audit Committee on 18 January 2005. This Annual Audit Letter reports the findings from our work completed during this period.
- 1.5 Our 2004/05 audit was structured around the three main elements of the Code and this report follows that structure:
- Aspects of performance management
 - Financial aspects of corporate governance
 - accounts opinion (including core financial systems).

Key issues

- 1.6 The Trust has faced a particularly challenging year as a result of continued financial pressures and the need to address the findings from the independent waiting list investigation.
- 1.7 Against this background the Trust incurred a deficit of £3.8m for the year, primarily as a result of overspending in a number of areas and a reduction of approximately £1.6m in the value of income from managed care work and other waiting list work. The financial position going forward remains very challenging, with the impact of changes to funding through Payments by Results and the costs of managing the redevelopment of the site. Demonstrating an ability to operate within its available financial resources will be key to the Trust obtaining approval from the Strategic Health Authority on the Outline Business Case.
- 1.8 The Trust has again been awarded a zero star rating, the lowest level of performance, in the recent publication of the Healthcare Commission's Star Ratings. This rating was the result of the Trust failing to achieve a number of key indicators, including waiting times, booking systems and financial balance.

Overall conclusions and recommendations

- 1.9 A summary of our findings and conclusions is shown in Section 2, with more detailed commentary included in the main body of this report.
- 1.10 Detailed findings and recommendations have been communicated in reports to officers during the year and a record of reports issued is shown in Appendix 2.

Status of this report

- 1.11 The audit has been carried out in accordance with the Audit Commission's Code of Audit Practice (the Code) and Statement of Responsibilities of Auditors and Audited Bodies and this report should be viewed against this more formal background. The report is addressed to directors and officers and is prepared for the sole use of the Trust and no responsibility is taken by auditors to any director or officer in their individual capacity or to any third party.
- 1.12 External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

Confirmation of independence

- 1.13 We are required to make an annual declaration relating to our independence and objectivity and can confirm that the Audit Commission's requirements have been complied with and that we are not aware of any relationships that may bear on the independence and objectivity of the audit partner and staff.

Acknowledgement

- 1.14 We would like to take this opportunity to thank the Trust's staff for their assistance and co-operation during our audit.

2 Overall conclusions

2.1 The following table sets out our conclusions for each separable Code area:

Aspects of Performance Management
<p>We have reviewed the following national Red Risk performance management areas:</p> <ul style="list-style-type: none"> • Core Financial Management • Workforce Contracts (including Agenda for Change) <p>The Core Financial Management review identified some aspects of good practice within the Trust's financial management procedures but also a number of areas where significant change is required, principally around the budget setting and monitoring processes.</p> <p>With Workforce Contracts we recognised that the Trust had achieved a great deal in its implementation of the consultant contract and in progress towards implementing Agenda for Change, although further development will be required to ensure that the change in contracts assist in service redesign and modernisation and in achieving the objectives of the Trust.</p> <p>The diagnostic review of comparative performance for the Phase 5 Acute Hospital Portfolio on Ward Staffing highlighted that patients were generally satisfied with the level of care they receive at the Trust. However in some areas the Trust's costs appear high and some areas of potential inefficiency in the use of temporary staff were noted for further investigation.</p> <p>Following the investments made in new systems and procedures in the past eighteen months, the Trust's arrangements for ensuring the high quality of data were considered good for overall management arrangements and ward records. However we recognised that a programme of training and periodic reviews of data quality will need to be put in place to ensure that data quality remains a priority.</p> <p>The Trust is progressing towards obtaining approval for its Outline Business Case for site re-development but, as noted above, its ability to achieve and maintain financial balance over the medium term is still in the process of being established.</p> <p>During the year we noted that the Trust has not made progress in developing robust arrangements for monitoring the implementation of external audit recommendations, although we recognise that the intention is to integrate this within the risk management processes going forward.</p>
Financial Aspects of Corporate Governance
<p>Legality</p> <p>Our review noted that the procedures for awarding contracts on the basis of single tenders could be improved, by ensuring that the Board is made aware when contracts are let without a full competitive tendering process.</p> <p>There were no other issues arising from our work that we wish to bring to your attention with regard to your arrangements for ensuring the legality of financial transactions.</p>
<p>Financial Standing</p> <p>The Trust reported a deficit of £3,793k for 2004/05, and has a cumulative breakeven deficit of £3,769k.</p> <p>The Trust has failed to achieve some financial targets as, in addition to failing to break-even, the Trust did not meet its Capital Resource Limit or Capital Cost Absorption Rate during 2004/05 .</p> <p>The Trust has agreed with the Strategic Health Authority to recover the cumulative deficit by the end of 2006/7 but, based on current performance levels, there is a risk that the Trust may breach its statutory duty to break even over the three year period.</p>

Financial Standing (continued)

Current performance against the 2005/06 budget (as reported to the Trust's September Board meeting) shows a cumulative deficit of £794,000, although we understand that the last two months have reported a break-even performance.

The Trust's ability to report a break-even position for 2005/06 and to recover the deficit reported in 2004/05 is dependent on the achievement of the medium term sustainability plan, which includes a number of assumptions on income levels and asset sales which are not directly within the Trust's control.

Systems of Internal Financial Control

The Statement on Internal Control published by the Trust highlighted that progress is being made in developing its internal control and risk management arrangements but that further work was required to address gaps in the arrangements, particularly around the need to more closely monitor the expenditure of the Trust to achieve financial balance.

Aligned to this is the need to ensure that the Internal Audit plan is linked to the Trust's risk management process and that the management of risks is regularly reviewed to ensure that the controls identified are operating effectively.

The core financial systems were generally found to be adequate as a basis for preparing the accounts, but further work is required to keep systems documentation up to date and to ensure that recommendations on internal control weaknesses are addressed.

We were able to place more reliance this year on Internal Audit's work for opinion purposes, however we have made some recommendations for improving the joint audit arrangements for future periods.

Standards of conduct and the prevention and detection of fraud and corruption

Our work has not identified any significant weaknesses in the Trust's policies and procedures for the prevention and detection of fraud and corruption and for maintaining proper standards of financial conduct.

However, our review of the Local Counter Fraud Service provided for the year identified that the programme of work was largely reactive and was not influenced by those local risk factors that affect the Trust.

Statement of Accounts

As a result of delays in the provision of supporting information required to complete the audit we were only able to provide our audit opinion on the financial statements on 10 August 2005, eighteen working days after the Department of Health deadline.

Our opinion confirmed that the financial statements presented a true and fair view of the state of affairs of the Trust as at 31 March 2005 and of its income and expenditure for the year then ended.

A number of presentational changes were made to the financial statements during the course of our audit to ensure that the accounts complied with the Manual for Accounts and a number of unadjusted misstatements were reported in our SAS 610 report, which cumulatively suggested that the deficit on the Income and Expenditure Accounts was potentially understated by approximately £557,000.

The Department of Health is currently proposing to reduce the timetable for auditing accounts by a further two weeks for 2005/06 and therefore a significant improvement will be required in your arrangements for preparing the information for audit, to enable this timetable to be achieved.

- 2.2 We have included Board recommendations on the key issues arising from our work within Appendix 1.

3 Aspects of performance management

- 3.1 It is the responsibility of the Trust to put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources at its disposal and to set strategic aims and objectives, develop service and business plans, and to set and monitor local and national performance targets.
- 3.2 Auditors are required to review and, where appropriate, report on the arrangements that the Trust has put in place to secure economy, efficiency and effectiveness in its use of resources.
- 3.3 Our work in this area involved considering the Trust's:
- overall performance management arrangements including the arrangements in place to implement recommendations from previous audits
 - arrangements to manage relevant national risks defined as 'red risks' by the Audit Commission and other work as mandated by the Healthcare Commission
 - arrangements to manage other local risks identified from our risk-based planning as set out in our Outline Audit Plan.

Overall arrangements

- 3.4 Over the course of the past year the Trust has made progress with the development of its performance management framework. A three year sustainability plan has been developed and is supported by a Modernisation and Improvement Plan for 2005/06 which allocates responsibility for specific actions to directors at the Trust.
- 3.5 It will be important to closely monitor the delivery of these plans to ensure that the Trust is in a good position to respond to the challenges it now faces, including its financial position, the more demanding NHS Plan targets and the management resource required to progress the site redevelopment.

Red Risks

- 3.6 The Audit Commission identified a number of potentially significant risks for 2004/05 that health bodies were likely to face. These risks were designated "red risks" by the Audit Commission based on the fact that they absorb a significant amount of public money and impact comprehensively on the NHS as a whole.
- 3.7 As described in our Outline Audit Plan for 2004/05, we considered the relevance and significance of those red risks to the Trust and, based on the information available to us, agreed to undertake detailed work on:
- Core Financial Management
 - Workforce Contracts
- 3.8 The results of our work in these areas and our related assessments are set out below.

Core Financial Management

- 3.9 The objectives of this review were to:
- establish the robustness of the Trust's budget setting and monitoring processes
 - assess the effectiveness of corporate governance arrangements for financial management

- establish the strength of the financial controls in place
- confirm the baseline financial position for the organisation and the extent of the recurrent deficit
- give a view on the viability of any financial recovery plans.

3.10 The review performed this by considering arrangements through two modules

- Getting the basics right – a review of those processes that are crucial to ensuring effective decision making processes are in place at the Trust.
- Financial standing – work to review and assess the level of the recurrent underlying deficit and help identify the main causes.

3.11 Our work identified that whilst the Trust could demonstrate good practice in some areas, particularly the provision of financial information, there were a number of areas in which improvements were required to ensure the successful future financial management of the Trust. It should be noted that our review was carried out in the Autumn of 2004 and early 2005 and we understand that there have been changes to a number of the Trust's financial management arrangements since the audit was carried out. The key issues identified from this review are set out below:

Getting the basics right

3.12 Our review found that, prior to the development of its sustainability plan, the Trust did not have a well developed planning process that formally linked together the Local Development Plan, capacity planning, the local service plans and financial planning. The planning process was relatively short term and there was no formalised medium term financial plan.

3.13 There is an agreed timetable for setting the Trust's budget but in previous years this timetable has slipped and the budget has not been finalised before the start of the year. Budgets have also been set based on the availability of funding (top down) rather than to reflect the funding required to deliver priority services and targets (zero-based) and they have included unidentified savings

3.14 There has been a low level of involvement of departments in the budget setting process, and a lack of buy-in to the detailed budget, although steps were taken to improve this for the 2005/06 budget setting process.

3.15 Departments have also not been sufficiently involved in budget monitoring and explaining the variances identified. This has previously been attributed to a lack of resource within the Finance Department to follow up variances with departments, which has now been addressed, but it may also be partly be due to a lack of understanding of the budget monitoring reports.

3.16 In terms of financial reporting, both the production of monthly balance sheets for Board reporting packs and the integration of management and financial reporting processes are areas in which the Trust is considered to have adopted good practice. The Trust is also aware of the need to monitor its cash flow position very closely and it performs both high level and detailed cash flow forecasts throughout the year.

Financial standing

3.17 Prior to 2004/05, the Trust had a record of achieving financial balance, although there have been a number of non recurring items in recent years that have enabled it to achieve this position.

3.18 The financial forecasts developed on a monthly basis show the true position for the Trust at that time and forecasted to the year end. However they are undermined by budget overspends and there has been a poor culture of financial responsibility within the Trust, with

the Finance Department not being well regarded by some departments.

- 3.19 At a senior level there is a detailed understanding of the Trust's financial position, although at the time of our audit there appeared to be a view, amongst some senior staff, that it was a finance issue, which the Finance Department need to address.
- 3.20 Whilst the Trust has performed some review of its services to allow redesign and modernisation, there is no ongoing review programme for ensuring service efficiency. We have recommended that management should undertake regular benchmarking exercises of services, to identify the underlying causes of higher costs, or below average performance. The data provided under the Acute Hospital Portfolio reviews should assist with this process.
- 3.21 The current recovery plan projects a deficit of £1.9m for 2005/06, but it has not yet been formally approved by the SHA as they are expecting the Trust to break even in 2005/06 and recover the deficit from 2004/05 by the end of March 2007. As noted above, the latest break-even financial performance for July and August suggests that the cost improvement measures may be taking effect, however the achievement of the overall recovery plan is still subject to a number of risk factors that are not within the Trust's control.

Workforce Contracts

- 3.22 It is the Trust's responsibility to put in place arrangements to ensure the proper implementation of the new workforce regime, and to monitor its adequacy and effectiveness in practice.
- 3.23 The aim of this review was to make an assessment of the adequacy of the Trust's arrangements for implementing, managing and monitoring workforce change. Our review focused on the reforms that have the most significant impact on trusts:
- New consultant contracts;
 - Agenda for change.
- 3.24 Overall we concluded that the Trust has been managing the relevant processes well, although we recognised that there were areas where further improvements could be made to ensure that the Trust obtained the most benefit from the arrangements.
- 3.25 The Trust has been proactive in ensuring a high level of communication with its consultants, to keep them fully informed of the implications, and to allow them to make informed decisions.
- 3.26 There has been recognition of the link between the consultant contract and achieving the Trust's aims and objectives, although there has been no detailed analysis of how this will occur. The implementation of Agenda for Change has been identified as a key priority for the Trust, albeit not reflected in a 2004/05 Trust business plan, or in some service plans.
- 3.27 Whilst the Trust has ensured that the additional costs of the consultant contract have been reflected in its annual budget, it has not completed a formal analysis of the cost impact on the Trust of future pay progressions, which makes financial planning for future years difficult.
- 3.28 A high level assessment of the Agenda for Change costs for 2004/05 has been carried out, although the delays experienced with implementation meant the Trust was unable to complete a full analysis of the current and medium term financial impact of Agenda for Change for the preparation of its 2004/05 financial statements.
- 3.29 In implementing the new consultants contract and Agenda for Change there has been awareness that the new contracts can provide benefits for potential service redesign and modernisation, although there has been no detailed planning of this to date, the focus of efforts being in support of the redevelopment of the hospital.
- 3.30 Throughout the processes, the Trust's emphasis has been on completion of the work rather than reviewing for potential benefits and as a result there has not been a formal process to

identify the benefits that the Trust wished to achieve from them. We recommended that, in due course, the Trust should carry out an assessment of the value for money of the contract reform using the guidance provided by the National Development Board.

Acute Hospitals Portfolio

- 3.31 The Acute Hospitals Portfolio is a national benchmarking exercise, supported by the Audit Commission and Healthcare Commission, intended to review performance in the delivery of specific services at local trust level. It involves collecting and benchmarking local performance information against national comparatives and, in discussions with local trust service managers, interpreting the information and highlighting potential areas for improvement.
- 3.32 Phase 5 of the portfolio included a review of :
- Accident and emergency;
 - Ward staffing; and
 - Day surgery.
- 3.33 In each area we set out to evaluate the progress made since the original audit was undertaken in 2000/01. Our other objectives are set out below along with our assessments and key messages. The topics on Accident and Emergency and Day Surgery were not covered as they were not applicable to RNOH. The key issues from the review of Ward Staffing are set out below:

Ward staffing

- 3.34 Within this area of our audit we aimed to:
- identify the scope for improving the quality of nursing care delivered, from a patient perspective, through comparison with other trusts;
 - analyse and compare the numbers and grade mix of ward staff, including the use of bank and agency nurses;
 - assess some specific areas of staff management;
 - compare costs on a ward-by-ward basis with similar wards in other trusts; and
 - assess further support available, including modern matrons and specialist nurses.
- 3.35 The results of the national inpatient surveys show that overall patients are generally satisfied with the level of care that they receive at the Trust. The auditor's review of the equipment on the wards found that they were clean and safe to use.
- 3.36 Nevertheless, the Trust has a high level of patient complaints, accidents and incidents compared to all trusts, and these levels have not declined since 2000/01. However, from our discussions with staff, we understand that the Trust has satisfactory procedures in place to address the issues raised, and pro-actively seeks the view of patients and staff in an attempt to improve the patient experience. This could contribute to a higher recorded number of complaints.
- 3.37 The Trust's usage of bank and agency staff is very high. Some measures have been put in place to monitor and control ward rostering more closely and our review highlighted that there is scope to reduce reliance on temporary staff cover by better management of staff sickness levels, annual leave, study leave and staff retention.
- 3.38 Ward staff costs have in total decreased from 2000/01 due to a decrease in the proportion of higher grade nurses and the Trust has a high level of staff who perform domestic and administrative tasks, which enables nurses to concentrate on patient care. However, actual

costs are still in the upper quartile compared to all Trust's and specialist Trusts, mainly as a result of the high usage of bank and agency staff.

- 3.39 A number of action points arose from our review which the Trust has agreed to implement.

Performance information

- 3.40 This year the Healthcare Commission mandated a further data quality study on ward staffing, to complement the phase 5 Acute Hospitals Portfolio audit work.
- 3.41 Our assessments of the Trust's arrangements, and the Healthcare Commission's definitions of those assessments, are set out in the following tables.

Area of review	Assessment
Overall arrangements	Good
Ward staffing	Good

Rating	Definition
Excellent	Contains all the elements of good practice and arrangements appear to be working well.
Good	Most elements of good practice are in place but there is some room for improvement in a small number of areas.
Weak	Some elements of good practice in place with some or no plans to remedy any failings.
Poor	There are significant shortfalls against good practice.

- 3.42 Data quality is key to the Trust ensuring that it is able to meet its NHS Plan targets. Following the irregularities identified in the recording of patient data in 2004, the Trust committed significant resources to improving data quality, through the validation of the waiting lists, the implementation of the new waiting list policy and the installation of a new Patient Administration System (PAS) in early 2005.
- 3.43 The Trust has a high level of corporate awareness of the need for good data quality, with the achievement of CNST Level 2 status and active implementation of the Essence of Care programme.
- 3.44 The resource put in place to validate waiting lists in 2004 has ensured the accuracy of the waiting list data at that point in time, and the Trust has well developed processes for reviewing patients' medical records, with regular peer reviews of records being performed at ward level and record keeping audits undertaken by clinical governance staff.
- 3.45 Some policies and procedures still need to be updated in line with current guidelines and to take account of the changes in processes that will be required on the introduction of centralised booking.
- 3.46 To ensure that data quality remains a high priority and that new policies and procedures are consistently applied, we have recommended that it will be important to ensure that on-going training is available for staff post induction, and to carry out periodic reviews of data quality across a range of systems, including PAS data.

Other local risks

Waiting list management

- 3.47 We note that the Trust has made progress in addressing some of the weaknesses in the management information systems, as identified by the waiting list issue noted within our 2004 Annual Audit Letter. This has included work on the replacement of the patient administration system, the centralisation of the booking process and the monitoring of information in relation to the waiting list as a whole. It is important that this progress is maintained in light of the continued national focus on the achievement of waiting list targets and the need for the Trust to meet targets set by its commissioning bodies.

Site re-development

- 3.48 The Trust has continued to develop its Outline Business Case during 2004/05 although the timetable for submission to the Strategic Health Authority for approval has slipped slightly. This is due to concerns over the Trust's financial viability and a delay in receiving planning consent for the redevelopment.
- 3.49 The Trust has carried out a project risk analysis and put in place controls to manage those risks as the project develops. However we note that there has been no independent review of the risk assessment or the project controls during 2004/05 and the 2005/06 draft Internal Audit plan does not currently include any specific resource for this area.
- 3.50 Given the current stage of the project, we have not been requested to provide any comments on the proposed accounting for the Scheme, other than its impact on the useful lives of the assets which will be demolished.

Follow up of audit recommendations

- 3.51 We have considered the arrangements that the Trust has in place to ensure the timely implementation of audit recommendations. We note that all audit recommendations are now included on the risk register, however there is no current process of review to establish if they have been addressed by the due dates.
- 3.52 We are aware that a software tool will be used to provide greater analysis and monitoring of risks, but that the implementation of this tool has taken longer than was anticipated. From our own review of progress, we have concluded that there continue to be notable delays in the implementation of agreed audit recommendations.

Aspects of performance management recommendations

- 3.53 *The Trust should ensure that a system is developed to monitor the action taken to implement both internal and external audit recommendations within the agreed timescales.*
- 3.54 *The Board should ensure that procedures to improve the overall risk management of the Trust are further developed to allow for improved monitoring and regular updating of the risks identified.*

4 Financial aspects of corporate governance

4.1 It is the responsibility of the Trust to put in place proper arrangements to ensure the proper conduct of its financial affairs and to monitor their adequacy and effectiveness in practice.

4.2 Our audit of the financial aspects of corporate governance has covered the following areas:

- Legality of financial transactions;
- Financial standing;
- Systems of internal financial control; and
- Standards of financial conduct and preventing and detecting fraud and corruption.

Legality of financial transactions

4.3 It is the responsibility of the Trust to act within the law and to put in place proper arrangements to ensure that its financial affairs are conducted in accordance with the law and relevant regulations.

4.4 Auditors are required to consider whether the audited body has put in place adequate arrangements to ensure the legality of transactions that might have significant financial consequences.

4.5 In that context we have considered the Trust's arrangements for awarding contracts under the hospital redevelopment and for Internal Audit, as part of our review of arrangements in these areas. We have noted that in a number of instances contracts have been awarded for redevelopment work on the basis of single tenders. We have also noted that the Internal Audit contract has been extended annually for the last three years, without market testing.

4.6 Where contracts are awarded on this basis we have recommended that it is reported to the Board, to enable it to consider whether appropriate value for money is being obtained and that the relevant Trust standing orders have been followed.

4.7 We have not identified any problems with the implementation of, and compliance with, key legislation.

Financial standing

4.8 It is the responsibility of the Trust to conduct its financial affairs appropriately and to put in place proper arrangements to ensure that its financial standing is soundly based.

4.9 Auditors are required to review financial performance in the year, assess the Trust's ability to meet known statutory and other financial obligations, and respond to developments which might have an impact on the financial standing.

Financial performance 2004/05

4.10 The Trust reported a deficit of £3,793k for 2004/05 and a cumulative breakeven deficit of £3,769k.

4.11 Although the Trust set a balanced budget for the year, it was apparent from an early stage that there would be difficulties in delivering this, particularly in light of the waiting list issue and the response required to ensure the patients affected could be treated.

4.12 As a result a financial recovery plan was developed during the year to assist in reducing the projected deficit. This was implemented over a number of months and, whilst it helped the Trust achieve some reduction in costs, its effectiveness was restricted by a lack of buy-in from departments.

- 4.13 The Trust is currently negotiating with the Strategic Health Authority about the period over which this deficit can be recovered. However, current performance (as presented to the September Board meeting) indicates that there is a risk that it will fail to achieve its statutory duty to break even over the required three year period.
- 4.14 In addition to failing to break even during 2004/05, the Trust failed to meet other financial targets, as detailed in the table below.

Financial target	2003/04	2004/05
Breakeven Cumulative breakeven performance £'000s	24	(3,769)
Remain within external financing limit Target £'000s Performance £'000s	4,315 4,315	(1,437) (1,441)
Remain within capital resource limit Target £000s Performance £'000s	1,754 1,754	1,097 1,112
Achieve capital cost absorption at 3.5% of average relevant net assets Performance %	2.3	2.8

- 4.15 In addition to the targets above, the Trust is required to achieve NHS targets for the prompt payment of invoices and the Better Payment Practice Code requires that 95% of undisputed non-NHS invoices (by both number and monetary value) are paid within 30 days. The performance since 2003/04 has deteriorated as shown by the following table which shows that the Trust is well below the 95% requirement, with poor performance principally being attributed to cash flow issues.

Better payment practice code	2003/04 %	2004/05 %
Value of non-NHS invoices paid within 30 days	55.43	54.24
Number of non-NHS invoices paid within 30 days	61.58	59.18

Budget setting and monitoring arrangements

- 4.16 As noted in section 3 above, we have reviewed the Trust's budget setting and monitoring arrangements in detail as part of our review of Core Financial Management. This work has identified some areas of good practice, such as in the provision of accurate financial monitoring information. However, a number of significant improvements need to be (and have already started to be) made, particularly in relation to the inclusion of departments within the budget setting process and the follow up of budgetary variances arising during the year.

Financial performance 2005/06

- 4.17 As part its budget setting process, the Trust agreed to set a £1.9m target budget deficit for 2005/06, with recovery of the cumulative deficit by the end of March 2007 as a result of asset sales and a number of other measures being implemented in the current year. Within this budget it was assumed that other funding sources would be obtained to finance the on-going site redevelopment costs.

- 4.18 The Trust's most recent finance report, for the period to August 2005, indicates that at the end of the 5 month period the Trust had incurred a deficit of expenditure over income of £794k, against a break-even budget. This has been due to slippage of approximately £0.6m on the cost improvement programme and a shortfall in planned income of approximately £0.2m as a result of reduced activity from budgeted levels.
- 4.19 By applying this level of performance across the remainder of the year, there is potential for an over-spend of £1.8m against the final budget, if no further cost improvements occur. However analysis of the variance at the end of August indicates that the overspend was largely incurred in the first three months of the year.
- 4.20 Although the Trust appears to have started to make progress towards the achievement of the budget and actions contained in its Cost Improvement Plan, there remains a considerable amount of work to do to ensure that the Trust is able to recover the 2004/05 deficit by the end of the 2006/07 financial year. The achievement of the recovery plan is also subject to a number of asset sales, the precise details and timing of which is not solely within the Trust's control.
- 4.21 Given the impact of the Trusts' current financial position on its long term future and the site redevelopment process, it is important that action to contain costs within the available resource remains a high priority.

Systems of internal financial control

- 4.22 It is the responsibility of the Trust to develop and implement systems of internal control, including systems of internal financial control, and to put in place proper arrangements to monitor their adequacy and effectiveness in practice.
- 4.23 Auditors are required to consider whether arrangements are adequate to satisfy officers and directors that its systems of internal financial control are both adequate and effective in practice.

Assurance Framework

- 4.24 All NHS bodies were required to review their compliance with the Assurance Framework and the core Controls Assurance Standards at 31 March 2005 and to disclose the results of this review in the Statement on Internal Control within their financial statements. From 1 April 2004 onwards, the Assurance Framework had to be in place and embedded for the full year to meet the requirement to report full Statement on Internal Control compliance.
- 4.25 There has been satisfactory progress in developing and embedding a robust assurance framework and working towards the new Standards for Better Health. Accordingly, Internal Audit's opinion of the assurance framework in support of the Trust's Statement on Internal Control stated that the Trust has an Assurance Framework that is designed and operating to meet the requirements of the 2004/05 Statement on Internal Control guidelines and provides reasonable assurance that there is an effective system of internal control to manage the principal risks identified by the organisation.
- 4.26 Whilst the Framework has not been a specific Board agenda item during the year, elements of the Framework have been discussed and reviewed during the course of the year and we understand that arrangements have been put in place to provide quarterly monitoring reports to the Board for 2005/06.
- 4.27 The Statement on Internal Control sets out the following gaps in controls which require addressing
- inadequate capital investment in the current site to be addressed by the new site development
 - poor communication channels and incident reporting levels

- the risk management strategy requires embedding
 - no specification and standards for some services provided
 - reporting lines for financial accountability are not clearly documented
 - progress on the modernisation plan is currently only reported on an ad hoc basis to the Board
 - individuals are failing to comply with policies and procedures on waiting list management.
- 4.28 The action points to address these gaps include providing additional training, putting in place new systems and policies and strengthening performance management arrangements. We recommend that the Board monitors the implementation of these action plans.
- 4.29 The Statement on Internal Control identified that there had been two significant control issues during the year which required addressing. The weaknesses identified were the outpatient and inpatient waiting list breaches identified in the summer of 2004 and the failure of the Trust to achieve its breakeven duty. The Trust has produced detailed action plans to address both of these issues, which were disclosed within the body of the statement.
- 4.30 We recommend that the Board monitors the implementation of these action plans to address the weaknesses in internal control arrangements.

Internal Audit

- 4.31 The Internal Audit service provided for the year was satisfactory and, for the purposes of our audit opinion, we were able to place more reliance on their work than in prior years.
- 4.32 We have previously identified a number of opportunities for improving the effectiveness of the joint working arrangements with Internal Audit at the Trust. We are pleased to report that, following the discussions held last year, there has been an improvement in the effectiveness of the joint working arrangements during 2004/05, although there remains some further scope for improvement.
- 4.33 Aligned to this is the need to ensure that the Internal Audit plan is linked to the Trust's risk management process to ensure that an appropriate level of resource is being directed to the highest risk areas.

Wider control environment

- 4.34 As reported last year, whilst system procedures and processes have been documented, this documentation is not kept up to date and the processes detailed within them are not always followed in practice.
- 4.35 There are no other matters arising from our review of the Trust's wider control environment that we wish to bring to your attention.

Standards of financial conduct and preventing and detecting fraud and corruption

- 4.36 It is the responsibility of the Trust to ensure that its affairs are managed in accordance with proper standards of financial conduct and that it has arrangements in place to prevent and detect fraud and corruption.
- 4.37 Auditors are required to consider whether arrangements to maintain proper standards of financial conduct are adequate. It is not the auditors' function to prevent or detect breaches of proper standards of financial conduct or fraud and corruption. However, in all aspects of their work auditors are alert to the possibility of breaches of proper standards of financial

conduct and of fraud and corruption.

- 4.38 Our work has not identified any significant weaknesses in the Trust's policies and procedures for the prevention and detection of fraud and corruption and for maintaining proper standards of financial conduct.

Local Counter Fraud Service (LCFS)

- 4.39 Our review of the Local Counter Fraud Service provided during the year has noted that the work was largely reactive in nature, with proactive work focused on the promotion of an anti-fraud culture.
- 4.40 As in previous years, we have also noted that the Trust has not performed a risk assessment of its operations to identify those areas that are more susceptible to fraud and thereby ensure that they are subject to periodic review.

Financial aspects of corporate governance recommendations

- 4.41 ***The Board should continue to closely monitor the financial position of the Trust to ensure that the financial recovery plan and statutory duty to break-even over a three year period "taking one year with another" is achieved.***
- 4.42 ***The Board should monitor the implementation of the action plans developed to address the gaps in the internal control systems highlighted in the Statement on Internal Control and the extent to which the future LCFS programme of work is derived from an assessment of the fraud risks facing the Trust.***

5 Opinion

5.1 The Trust's published accounts are an essential means by which it accounts for its stewardship of the resources at its disposal and its financial performance in the use of those resources. It is the responsibility of the Trust to:

- maintain proper accounting records
- prepare financial statements that give a true and fair view of the financial position of the Trust and its expenditure and income for the year
- ensure the regularity of transactions

5.2 Auditors are required to audit the financial statements and to give their opinion as to whether they present a true and fair view of the financial position and a Trust's income and expenditure for the year then ended and have been prepared in accordance with relevant legislation and applicable accounting standards.

Core financial systems

5.3 We have found that the Trust's core systems are adequate as a basis for preparing the accounts, although a number of control weaknesses were noted.

5.4 We communicated the detailed findings from our audit of the core financial systems in our Interim Audit Report. Management has agreed to address all recommendations raised and has produced an action plan with agreed implementation dates.

Statement of accounts

5.5 The financial statements were prepared and submitted to the NHS Executive on 3 June, 14 working days after the deadline of 13 May. The financial statements and initial supporting evidence files were made available for audit on 6 June. However, due to delays in preparing the accounts, not all supporting working papers were made available to us at the start of our audit. As a result of these delays and a lack of evidence to support the accounting treatment of some material balances in the accounts we were unable to complete our audit to enable the accounts to be submitted in line with the Department of Health timetable of 15 July. The Trust subsequently provided the evidence required and following audit review and some adjustments being made to the accounts, we were able to complete our audit and issue an unqualified opinion on the accounts on 10 August 2005.

5.6 Based on current consultation proposals, the timetable for the preparation and audit of the Trust's accounts may be shortened by up to two weeks for 2005/06. In light of the delays experienced this year, it is important that consideration is given as to how the process can be improved to enable the Department of Health deadlines to be met.

5.7 During the course of our audit we identified a number of errors and misstatements, some of which have been adjusted by management in the final version of the financial statements. The key potential misstatements related to the following items.

- A national revaluation exercise was performed during the year, with all of the Trust's assets having been reviewed and revalued as necessary. As a result of this review some amendments were required to be made to the valuation of specific fixed assets within the balance sheet to reflect the District Valuer's assessment of their loss in value.
- During the course of the year the Trust made arrangements for the sale of a cottage as a part of its financial recovery plan. The sale of the cottage generated a profit of £228k which was included in the Income and Expenditure Account for the period. Whilst, the auction took place on 16 March, the sale did not complete until after the year end and the sale was initially incorrectly accounted for in 2004/05.

- There were a number of large differences between the Trust's NHS debtors disclosed in the TAC forms and the balances agreed by the respective NHS body. As a part of the closedown process NHS bodies were required to agree their debtor, creditor, income and expenditure totals with other bodies, and an exercise was carried out by the Department of Health to match these amounts. Many of the unconfirmed debtor balances related to SLA over performance.

5.8 Our SAS610 Report included details of:

- key financial controls issues and complex and judgmental matters addressed during the course of our final audit
- audit adjustments made to the accounts to correct errors and misstatements
- immaterial errors and misstatements identified during the audit that were not adjusted by management
- matters specifically required by Auditing Standards to be communicated to those charged with governance.

5.9 The draft SAS610 report was presented to 'those charged with governance' at the Audit Committee on 13 July. A final SAS610 report was later issued in August, once the accounts had been agreed, with acknowledgement of the value of the remaining unadjusted misstatements being provided at that time.

Audit opinions

5.10 A true and fair audit opinion was given on the financial statements on 10 August 2005 and the summarisation schedules were certified as being consistent with the financial statements.

Statement on Internal Control

5.11 The Trust included the required statement in its accounts, which followed the prescribed guidance and we have reported that the disclosures are not misleading or inconsistent with our knowledge of the Trust gained during our audit.

5.12 The statement included in the financial statements did not require amendment to be compliant with the guidance. Further details are included in section 3 of this report within the Assurance Framework.

Advanced timetable and Whole of Government Accounts

5.13 As noted above, the NHS Executive has proposed that the accounts closedown and submission processes are to be brought forward for the 2005/06 financial year and that it is likely that the Trust's audited accounts will need to be made available to the Executive earlier than this year. This will allow the Executive to prepare consolidated national accounts for inclusion within the Whole of Government Accounts framework.

5.14 The Trust has, for the past three years, struggled to meet the deadline imposed by the Department of Health, which has impacted on the efficiency of our audit as well as the deadline not being achieved this year. We have concerns that the Trust will be unable to meet any advanced deadline for both the preparation of the financial statements, and the working papers required for the audit, without a fundamental review of the accounts preparation process.

Recommendations

5.15 ***The Board should ensure that the Trust has adequate arrangements in place to bring forward the timetable for preparation and approval of its accounts in future years.***

6 Audit fees and planned audit work

6.1 We are required to disclose an analysis of our proposed and actual audit fees for the year and provide an explanation for any significant variations for each element of our work.

6.2 Our proposed audit fee was set out in the Outline Audit Plan 2004/05 at the start of the year. The outturn fee position against that proposed fee is summarised below:

Audit area	Planned Fee 2004/05 £	Actual Fee 2004/05 £
Performance management	57,699	57,699
Financial aspects of corporate governance	38,225	38,225
Accounts	40,076	55,058
Total	136,000	150,982

6.3 As a result of delays in the provision of information required to complete our audit we have incurred additional costs on the completion of the our work. We prepared an analysis of these costs and have agreed an appropriate fee for this additional work with the Trust.

6.4 Our planned work for the 2005/06 financial year has been discussed with management and reported in the Outline Audit Plan presented to the Audit Committee on 19 April 2005. Since our plan was prepared we have received additional clarification of the scope of work that will be required for the Healthcare Commission on data quality and the scope of work for the ALERT assessments which will support our value for money conclusion. We are currently discussing the impact of this with Trust management.

Appendix 1 – Recommendations and Board Action Plan

These recommendations relate to the issues raised in this Annual Audit Letter. We have communicated detailed findings and recommendations in our reports and memoranda during the year and a record of reports issued is shown in Appendix 2.

Recommendation	Management response
The Trust should ensure that a system is developed to monitor the action taken to implement both internal and external audit recommendations within the agreed timescales.	The risk management software database is to include a register of audit recommendations, to monitor implementation of those recommendations, and to provide a reporting mechanism to the Audit Committee.
The Board should ensure that procedures to improve the overall risk management of the Trust are further developed to allow for improved monitoring and regular updating of the risks identified.	The risk management software database is being developed and staff resource has been assigned to maintain and monitor identified risks on that database.
The Board should continue to closely monitor the financial position of the Trust to ensure that the financial recovery plan and statutory duty to break-even over a three year period "taking one year with another" is achieved.	The key monitoring forum is the Finance Committee, which will continue to closely monitor the effectiveness of the financial recovery plan and all other possible measures to achieve the break-even targets.
The Board should monitor the implementation of the action plans developed to address the gaps in the internal control systems highlighted in the Statement on Internal Control and the extent to which the future LCFS programme of work is derived from an assessment of the fraud risks facing the Trust.	The Board will continue to monitor the implementation of the action plans developed to address gaps in the 2004/05 statement of internal control. The risk management team will continue to evaluate the internal control systems leading up to the 2005/06 statement. The future direction of the LCFS programme will be developed using a risk based approach.
The Board should ensure that the Trust has adequate arrangements in place to bring forward the timetable for the preparation and approval of its accounts in future years.	The Trust will begin early planning for the accounts preparation process, agreeing a timetable and monitoring achievement of milestones to ensure timely delivery of the accounts. The process will be critically examined to undertake as much preparatory work as possible before the year end.

Appendix 2 - Audit reports and opinions issued for 2004/05

Outline Audit Plan	January 2005
Data Quality	March 2005
Acute Hospitals Portfolio	March 2005
Core Financial Management	April 2005
Workforce Contracts	April 2005
Interim Audit Report	June 2005
SAS610 Report (Draft)	July 2005
SAS610 Report (Final)	August 2005
Accounts Audit Opinion and Certificate	August 2005