

# Annual Audit Letter

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North Cumbria University Hospitals NHS Trust  
Audit 2009/10

**The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.**

**Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.**

**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 (page 5) and my Auditor's Local Evaluation (ALE) of your arrangements to achieve value for money in your use of resources (page 6). I have included only significant recommendations in this report. The Trust has accepted these recommendations.**

## Audit opinion and financial statements

**1** I issued an unqualified opinion on your financial statements on 10 June 2010.

**2** My audit identified an error in the breakeven note that resulted in the breakeven in-year surplus being overstated by £530k. Management agreed to correct this error and this reduced the breakeven in-year position from a surplus of £857k to a surplus of £327k. The breakeven cumulative position has also been amended from a deficit of £4,357k to a deficit of £4,887k.

## Auditor's Local Evaluation

**3** The Trust has maintained adequate performance in most areas of the assessment in 2009/10 and there is evidence of improvement in some areas. However, the financial standing score has declined to level 1, below minimum requirements. This was, because the Trust does not have robust plans in place to ensure delivery of the 2010/11 financial targets.

**4** The Trust is projecting that it will break even and deliver a surplus of £3 million in 2010/11 but there are significant risks to ensure this target is delivered.

- The 2010/11 financial plans approved in March 2010 include a significant Cost Improvement Programme (CIP) target of £21 million, however the financial plans were approved by the Board without detailed action plans to support these savings targets.
- Detailed action plans to support the CIP savings were not developed at the beginning of the financial year. By early June 2010, only £14 million of planned savings were identified and £7 million of savings remained unidentified.

- The 2010/11 financial plans are based on assumptions about income from the PCT that are subject to arbitration. The outcome of the arbitration may result in additional significant CIP targets that will need to be identified.

## Admitted Patient Care (Inpatient) PbR data assurance

5 The Payment by Results (PbR) Data Assurance Framework is designed to support the improvement of data quality standards that underpin the accuracy of coding and costing under PbR. A targeted external Clinical Coding Audit on inpatient activity at North Cumbria University Hospitals NHS Trust was carried out in November 2009.

6 The Trust's performance is excellent compared with the overall performance of trusts in 2008/09. The Trust HRG error rate has reduced significantly compared with the findings from our previous audits and it is implementing the recommendations from our 2008/09 review, indicating a commitment to improvement.

## Audit fees

7 The indicative fee for the 2009/10 audit was £163,020.

8 I reported the findings from my audit of the 2008/09 IFRS restated accounts in November 2010. In this report I identified that due to the number and nature of errors and amendments arising from this work, my audit had required more resources than I had assumed when calculating the fee for 2009/10. I charged the Trust an additional fee for the audit of the IFRS restated accounts. However, I reduced my fee for the ALE and value for money assessments to reflect a change to my risk assessment as the Trust had started to address the risks I had identified in my planning.

9 My audit of the 2009/10 financial statements has required more resources than I had assumed when calculating the fee for 2009/10. This is because additional work was required to consider the implications of the significant error identified in the breakeven note in the 2009/10 Financial Statements. The identification of this error raised concerns about the financial standing of the Trust and additional work was also required to inform my value for money conclusion.

10 An additional fee of £5,000 will be charged to the Trust for this additional work and the total final fee for the 2009/10 audit is £168,020.

## Future challenges

11 The October 2010 spending review will set the overall public spending levels for the period 2011/12 to 2014/15. The NHS will be required to make significant efficiency savings over the next four years. Demographic change, particularly the ageing population, is also likely to increase demand for health services.

**12** In line with other NHS bodies, North Cumbria University Hospitals NHS Trust faces significant financial pressures from 2010/11 onwards, due to the economic downturn and resulting pressure on the public sector. In addition, commissioning in the NHS will go through a major upheaval and the risks during the transition will be high.

**13** Good financial management and financial resilience will be essential in a period of pressure on public sector spending levels. The Trust must ensure that its immediate and long term financial plans are robust and based on a sustainable financial model.

# 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

**14** I issued an unqualified opinion on your financial statements on 10 June 2010.

**15** The financial statements were prepared and submitted on time. I received a full set of financial statements and supporting summary working papers in accordance with the timetable agreed with management.

**16** My audit identified an error in the breakeven note that resulted in the breakeven in-year surplus being overstated by £530k. Management agreed to correct this error and this reduced the breakeven in-year position from a surplus of £857k to a surplus of £327k. The breakeven cumulative position has also been amended from a deficit of £4,357k to a deficit of £4,887k.

**17** I identified errors in the financial statements and reported these to management. Management agreed to amend the financial statements for most of the errors identified. Many of the adjustments arose because the presentation and classification of items in the notes and disclosures was either not consistent with the underlying information, or inconsistent with the requirements of the relevant accounting standards and the NHS Manual for Accounts.

## Significant weaknesses in internal control

**18** I highlighted issues in respect of asset accounting in my Annual Governance Report in June 2010. Other than these matters, I have not identified weaknesses in the design or operation of internal controls that might result in a material error in your financial statements. I report only those matters that have come to my attention because of the audit procedures I have performed. My audit is not designed to identify all matters that might be relevant to you.

## 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

**19** The Audit Commission has published Key Lines of Enquiry (KLOEs) which auditors use in reaching scored ALE judgements<sup>i</sup>. 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.

Table 1: **ALE scores**

Key area	Scored judgement
Financial reporting	2
Financial management	2
Financial standing	1
Internal control	3

<sup>i</sup> 'ALE for Trusts' guidance available on the Audit Commission website



Key area	Scored judgement
Value for money	2

**23** The Trust has maintained performance in most areas in 2009/10 and there is evidence of improvement in some areas. However, the financial standing score has declined from level 2 to a level 1.

**24** The financial standing theme is assessed at level 1, below minimum requirements, because the Trust does not have robust plans in place to ensure delivery of the 2010/11 financial targets.

**25** The Trust is projecting that it will break even and deliver a surplus of £3 million in 2010/11 but there are significant risks to ensure this target is delivered.

- The 2010/11 financial plans approved in March 2010 include a significant Cost Improvement Programme (CIP) target of £21 million, however the financial plans were approved by the Board without detailed action plans to support these savings targets.
- Detailed action plans to support the CIP savings were not developed at the beginning of the financial year. By early June 2010, only £14 million of planned savings were identified and £7 million of savings remained unidentified.
- The 2010/11 financial plans are based on assumptions about income from the PCT that are subject to arbitration. The outcome of the arbitration may result in additional significant CIP targets that will need to be identified.

## Recommendation

**R1** The Trust must ensure that its immediate and longer term financial plans are realistic and supported by robust detailed action plans.

## VFM conclusion

**26** 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 set out in Appendix 2. In so doing, I identified that:

- In March 2007 the Trust entered into a working capital loan agreement for £12 million with the Department of Health, with a repayment period of 15 years. Under the working capital loan agreement, the Trust needs to generate an annual surplus to meet the loan repayments and to generate the accounting surplus necessary to remove the deficit. In the year ended 31 March 2010 the Trust reported a surplus of £327,000. Whilst the Trust had sufficient cash to meet the loan repayments, the Trust did not deliver the surplus to match the loan repayments and contribute to the recovery of the deficit; and

- the Trust set a balanced budget for the 2010/11 financial year in March 2010. This budget included a Cost Improvement Programme target of £21 million however the Trust has not yet identified where £7 million of this saving will be made. This means that the financial plans are not supported by detailed action plans for the savings that are required to deliver against the agreed recovery plan in 2010/11.

27 I issued a qualified conclusion stating that the Trust had made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2010 except for arrangements to ensure that its spending matches its available resources.

## Approach to local value for money work from 2010/11

28 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.

29 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.

30 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.

## Admitted Patient Care (Inpatient) PbR data assurance

31 The Payment by Results (PbR) Data Assurance Framework is designed to support the improvement of data quality standards that underpin the accuracy of coding and costing under PbR. The Framework, delivered as part of PCT audits and associated fees, includes a rolling programme of independent, targeted external clinical coding audits covering all Acute Trusts in England. The assurance framework is carried out on behalf of the Department of Health (DH) and is a key component of the PbR system.

32 A targeted external Clinical Coding Audit on inpatient activity at North Cumbria University Hospitals NHS Trust was carried out in November 2009 on data from 1 July to 30 September 2009. The areas audited include a national theme and three areas that have been identified using our National Benchmarker. The audit was carried out using Healthcare Resource Group version 4 (HRG4) pricing, and new PbR business rules for 2009/10.

**33** The Trust's performance is excellent compared with the overall performance of trusts in 2008/09. The Trust HRG error rate has reduced significantly compared with the findings from our previous audits and it is implementing the recommendations from our 2008/09 review, indicating a commitment to improvement.

**34** This year the Trust's HRG error rate is 1.3 per cent compared to 11 per cent in 2008/09. The national average in 2008/09 was 8.1 per cent and your Strategic Health Authority (SHA) average error rate in 2008/09 was 8.0 per cent. The financial value of the total or gross errors found is £3,740 from an audit sample of £257,955. The net impact of this means that the Trust is undercharging its commissioners by £2,998 or 1.2 per cent on the sample tested.

**35** The coding arrangements are generally good which is leading to an improvement in coding accuracy, and there have been some major improvements since the audit last year. Coding is now carried out in theatres by Accredited Clinical Coders (ACC) and a rotational system allows for further development of staff within the department.

## **National Fraud Initiative**

**36** The National Fraud Initiative is a computerised data matching exercise designed to identify overpayments to suppliers and benefit claimants and to detect fraud perpetrated on public bodies. The referrals from the current exercise were released to participating bodies in February 2009.

**37** The Trust has made effective use of the NFI functionality to identify and appropriately review data matches.

## Closing remarks

**38** I have discussed and agreed this letter with the Chief Executive and the Director of Finance. I will present this letter at the Board on 5 October 2010 and will provide copies to all board members.

**39** 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
Opinion audit plan	March 2010
Annual Governance Report	June 2010
Opinion on the financial statements	June 2010
Value for Money Conclusion	September 2010
Report by the Statutory Auditor to the Trust Board	October 2010
ALE Report	October 2010

## Future Challenges

**40** In line with other NHS bodies, the Trust faces financial pressure in 2010/11 onwards. This results from the economic downturn and consequent pressure on the public sector, with NHS savings set at £15 to £20 billion over the next three years.

**41** The financial challenge facing the Trust is significant. The Trust needs to recover the historical deficit alongside the delivery of significant savings. The Trust has a challenging cost improvement plan in place and aims to make savings of £21m in 2010/11. The Trust has established an internal turnaround team and is developing a financial recovery plan however delivery of the CIP target for 2010/11 remains very challenging.

**42** Alongside the financial challenge, the Government white paper sets out a significant shift in the way healthcare is commissioned. This proposes the abolition of PCT commissioners from April 2013 and a shift to GP-led consortia. For the Trust this will mean building relationships with GP commissioners and continuing to develop its service delivery model.

## The Audit Commission

**43** The Secretary of State for Communities and Local Government has announced the proposed abolition of the Audit Commission and the transfer of its audit practice to the private sector. This will be from 2012/13 at the earliest and is subject to legislation. Our priority is to ensure our professional standards and commitment will be maintained. You will see no deterioration in customer service and audit quality.

**44** We are working to develop an independent audit practice to continue beyond the abolition of the Audit Commission, including the option of a potential mutualisation or buy-out. Whatever model we adopt, we will remain committed to providing excellent service to our existing clients, and indeed to seeking new ones.

## Concluding comments

**45** 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.

Jackie Bellard

Appointed Auditor

September 2010

## Appendix 1 Audit fees

	Actual	Proposed	Variance
Financial statements and annual governance statement	£96,986	£89,917	+£7,069
Value for money and ALE	£71,034	£73,103	-£2,069
Total audit fees	£168,020	£163,020	+£5,000

## 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.	No
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.



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