Report by the Statutory Auditor to the Trust Board

North Cumbria University Hospitals NHS Trust

Audit 2009/10

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Introduction

1 I am the auditor appointed by the Audit Commission for North Cumbria University Hospitals NHS Trust (the Trust). Under the Code of Audit Practice, I have a responsibility to consider whether the Trust has put in place proper arrangements for financial management and to report on those arrangements.

2 The purpose of this report is to draw to the Board's attention specific concerns I hold about the arrangements in place at the Trust for financial management and financial standing. I am concerned about:

- the robustness of the Trust's financial plans for 2010/11; and
- the Trust's ability to deliver the financial recovery plan required to meet its statutory breakeven duty by 2015/16.

Background

3 NHS Trusts have to meet several key statutory financial targets that include a responsibility to breakeven, taking one year with another.

4 Paragraph 2(1) of Schedule 5 to the National Health Service Act 2006 states that: 'each NHS trust must ensure that its revenue is not less than sufficient, taking one financial year with another, to meet outgoings properly chargeable to revenue account'. This is known as the statutory break-even duty.

5 When a trust incurs a deficit for a specific financial year it has a statutory duty to put in place a robust long-term recovery plan to return it to recurrent financial balance within three, or exceptionally five years.

6 The Trust incurred deficits of £0.478 m in 2001/02, £1.803m in 2002/03 and £4.143m in 2003/04, resulting in a cumulative deficit of £6.424m at 31 March 2004. The former Cumbria and Lancashire SHA, now part of NHS North West, agreed the Trust should breakeven over the five years ending 31 March 2007.

7 As at 31 March 2007 the Trust had not reported the required surplus to achieve the agreed breakeven duty and had a cumulative deficit of £6.258m.

8 In March 2007 the Trust entered into a working capital loan agreement for £12m 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. Under the agreement the Trust may retain a cumulative deficit until 31 March 2016.

9 In July 2007, the appointed auditor issued a report to the Secretary of State for Health. The report, under Section 19 (a) of the Audit Commission Act 1998, stated the Trust had breached its statutory breakeven duty under Paragraph 2(1) of Schedule 5 to the National Health Service Act 2006. The report, also stated the Trust had agreed a plan but that it did not bring it back into statutory breakeven until 2016. This report remains in force until the Trust eliminates the £6.258m deficit in full.

Delivery of the financial recovery plan

10 I have concerns about some of the assumptions and the robustness of the planned savings in the Trust's financial plans for 2010/11. As a result, I am also concerned about the Trust's ability to deliver the minimum surplus required to remove the cumulative deficit, and to return to a breakeven position by 2016.

11 As set out above, the Trust needs to deliver a surplus each year starting in 2008/09. In 2008/09 the Trust delivered a surplus of £0.993m, in line with the plan. The reported surplus in the 2009/10 draft accounts was originally £0.857m. However, this was amended to £0.327m to correct an error in the calculation of the statutory breakeven position. As a result the Trust did not achieve the required surplus to contribute to the recovery of the deficit.

12 The cumulative deficit at 31 March 2010 is £4.887m. Under the agreement with NHS North West the Trust may retain a cumulative deficit until 31 March 2016. To remove the cumulative deficit by this date, the Trust must deliver a minimum annual surplus of £0.814 m each year from 2010/11 to 2015/16. This is a challenging target in the context of past performance and the expected significant pressures on public spending over the coming years.

Financial plans for 2010/11

13 In March 2010 the Trust Board agreed a budget for 2010/11 that aims to deliver a surplus of £3m. I have concerns about the robustness of this financial plan. In particular, I am concerned about two key assumptions:

- the budget assumes the Trust can deliver Cost improvement Plan (CIP) savings of £21m, however as of June 2010 the Trust had not identified where £7m of this saving would be made; and
- the budget is based on contract income from Cumbria PCT of £181 m. About £20m of this amount was in dispute. Following the conclusion of arbitration, the revised contract value is expected to be approximately £173m. It is not clear whether additional savings will need to be made to address this reduction in the contract value.

CIP Savings

14 In March 2010 the Board approved the 2010/11 financial plans to achieve a surplus of £3m 'subject to further discussion of the £21m CIP targets'. The Trust has already delivered significant CIP savings in the past two financial years and thus, delivering more significant savings is likely to be challenging.

15 The Board considered a further financial report at its meeting in June 2010. This report stated that the Trust had identified £13.9m of deliverable schemes but there were no detailed plans to support how the remaining £7.1m of savings would be made.

16 The supporting information and actions to achieve the £13.9m of deliverable schemes is limited and not all schemes appear to be supported by detailed costing or actions. In addition, some these savings are not recurrent and therefore represent only a one-off benefit. Some savings are subject to negotiation of policy or contract agreements and are therefore at risk if these negotiations do not deliver the required saving or within the required timescale.

17 As of the end of July 2010, delivery of the CIP savings is approximately £2.2m behind the planned CIP delivery profile. The Trust has established an internal turnaround team and is developing a financial recovery plan, however delivery of the CIP target for 2001/11 remains very challenging.

Income assumptions

18 The 2010/11 financial plans assumed income from Cumbria PCT of £181m but the contract had not been agreed because about £20m of the contract value was in dispute. Following the conclusion of arbitration, the revised contract value is expected to be approximately £173m. It is not clear whether additional savings will need to be made to address this reduction in the contract value.

Delivery of the financial plans for 2010/11

19 I am concerned about the robustness of the Trust's plans to deliver the 2010/11 financial plans. My specific concerns are that:

- the Board approved the 2010/11 budget without robust action plans setting out how the challenging £21m CIP target will be delivered;
- three months into the financial year, the Trust had still to identify how £7m of CIP savings will be delivered;
- the CIP target may increase above £21m depending on the impact of the arbitration process with the PCT. It is not clear where additional savings will be made if the income levels are lower than expected by the Trust; and
- £13.9m of identified CIP schemes were not fully supported by robust detailed action plans. Some savings identified are not recurrent and there are risks to the delivery of some schemes for example where negotiations have yet to be completed.

Next steps

Trust Board

20 The Trust needs to ensure that it continues to recover the cumulative deficit, in line with the agreed recovery plan, and establishes a sustainable financial position. The requirement to deliver the financial recovery plan needs to be viewed as a continuing priority that is balanced and aligned with the operational demands placed on the Trust. This process needs to be led and communicated effectively by the Executive Management Team, with the full support of the Board, to ensure there is appropriate Trust-wide ownership of, and acknowledged responsibility for, the financial recovery.

21 The Board needs to:

- review the robustness of the financial plans for 2010/11 to ensure that all assumptions are robust and that all savings targets are supported by robust and detailed action plans for delivery;
- review the financial plans for 2010/11 and future years to ensure the plans will deliver against the agreed financial recovery plan and achieve breakeven by 2016; and
- ensure that financial reports to the Board clearly identify the Trust's overall performance against the statutory breakeven duty, allowing the Board to monitor this position throughout the year.

Appointed Auditor

22 As the appointed auditor to the Trust I have a specific responsibility under Section 19 of the Audit Commission Act 1998 to refer immediately to the Secretary of State if the Trust:

- is likely to breach its statutory duty by failing to achieve break-even; or
- the Trust has a recovery plan but is at high risk of not achieving break even duty in line with this recovery plan.

23 Also Section 8 of the Audit Commission Act 1998 requires that I consider whether to issue a report in the public interest on any significant matter that comes to my attention in the course of the audit. This could include a failure to deliver against an agreed recovery plan.

24 The Trust's financial plans for 2010/11 and future years are very challenging and the Trust Board has a significant task to ensure that the financial recovery plan is delivered to secure breakeven by 2016.

25 The Trust has delivered challenging CIP targets in the past two years and delivered a surplus of £0.993 m in 2008/09. Therefore I do not intend to issue a referral to the Secretary of State or a Public Interest Report at this stage.

26 I will continue to monitor the financial position of the Trust. I will reconsider whether I need to take further action under the Audit Commission Act 1998 once the month six financial performance information is available.

27 The Trust Board should formally respond to this report within one month, setting out the action it plans to take to address the issues raised.

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Engagement Lead

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