

BOARD PAPER

AUDIT COMMISSION JOINT ANNUAL AUDIT LETTER 2005/06 ISLE OF WIGHT HCT AND PCT

Executive Summary:

The Annual Audit Letter summarises the significant key issues identified from the work that the Audit Commission has carried out during 2005/06. Responsibility for relevant recommendations passed to the NHS PCT with effect from October 2006

Actions requested:

The Board is asked to note the contents of the Joint Annual Audit Letter 2005/06

Aim(s)/objective(s) supported by this paper:

The corporate governance of public services

Author(s) of this paper:

Kate Handy, District Auditor

Extent of Public Involvement taken or planned:

None

**Healthcare Commission Standard / Domain this relates to
Standard No: C7(b)**

Lead Directors responsible for this area of work:

Margaret Pratt, Interim Director of Finance

Date of paper:

29 November 2006

ENC (E)

Annual Audit Letter

October 2006



Annual Audit Letter

**Isle of Wight Healthcare Trust and Isle of Wight
Primary Care Trust**

Audit 2005/2006

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

Status of our reports to the Trust

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 or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

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

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Contents

Purpose, responsibilities and scope	4
The purpose of this letter	4
The responsibilities of the auditor and the Trusts	4
The scope of our work	4
The audit of the accounts	6
Accounting issues	6
The Trusts' use of resources	7
Value for money conclusion	7
Auditor's Local Evaluation	8
Other performance reports	11
Closing remarks	14

Purpose, responsibilities and scope

The purpose of this letter

- 1 The purpose of this Annual Audit Letter (letter) is to summarise the key issues arising from the work that we have carried out during the year. In October 2006, the Isle of Wight Healthcare Trust and PCT will be merged to form the Isle of Wight NHS Primary Care Trust. This letter is addressed to the directors of Isle of Wight Healthcare Trust and the PCT but the responsibility for relevant recommendations will pass to Directors of the new PCT from 1 October 2006. The letter is also intended to communicate the significant issues we have identified, in an accessible style, to key external stakeholders, including members of the public. The letter will be published on the Audit Commission website at www.audit-commission.gov.uk and also on the new PCT's website.
- 2 This letter has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. This is available from www.audit-commission.gov.uk.

The responsibilities of the auditor and the Trusts

- 3 We have been appointed as the Trusts' independent external auditors by the Audit Commission, the body responsible for appointing auditors to local public bodies in England, including primary care trusts and NHS trusts.
- 4 As the Trusts' external auditors, we have a broad remit covering financial and governance matters. We target our work on areas which involve significant amounts of public money and on the basis of our assessment of the key risks to the Trusts achieving their objectives. It is the responsibility of the Trusts to ensure that proper arrangements are in place for the conduct of their business and that public money is safeguarded and properly accounted for. Our role is to assess and report how the Trusts are fulfilling these responsibilities.

The scope of our work

- 5 Our main responsibility as your appointed auditor is to plan and carry out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code). Under the Code, we are required to review and report on:
 - the Trusts' accounts; and
 - whether the Trusts have made proper arrangements for securing economy, efficiency and effectiveness in their use of resources.
- 6 In addition to this, we use our assessments to provide scored judgements for the Healthcare Commission to use as part of its Annual Healthcheck.

- 7 This letter summarises the significant issues arising from both these areas of work and highlights the key recommendations that we consider should be addressed by the new PCT. These recommendations have been previously reported to the Isle of Wight Healthcare Trust and PCT during the year in other reports, and the Trusts have committed to actions as a response. A list of all reports issued to the Trusts in relation to the 2005/06 audit is provided in the closing remarks section at the end of this letter.

The audit of the accounts

- 8 We were able to issue an unqualified opinion on the Isle of Wight Healthcare Trust's accounts on 7 July 2006 and on the PCT's accounts on the 20 July 2006, in advance of the deadline set by the Department of Health. In our opinion, the accounts give a true and fair view of the Trusts' financial affairs and of their net operating costs/income and expenditure for the year. However, we qualified the regularity opinion of the Isle of Wight PCT as the PCT incurred expenditure of £6.6 million in excess of its Revenue Resource Limit specified by the Secretary of State.
- 9 Before we give our opinion on the accounts, we are required to report to those charged with governance, in this case separate meetings of the Audit Committees, significant matters arising from the audit. A detailed report for the Healthcare Trust was issued on 5 July 2006 and the PCT on the 17 July 2006 and only the key issues are summarised here.

Accounting issues

- 10 We are pleased to report a consistently good performance in preparing the accounts of both Trusts. The accounts were produced on time and they were complete.
- 11 Particular strengths were a robust closedown process that assured the integrity of the accounting information in the annual accounts and the quality of underlying records. Working papers were provided prior to the commencement of the audit to a good standard and supplemented where needed by hardcopy working papers.
- 12 The Trusts' joint annual report was prepared at the time we issued our opinion, and we were able to report that information in relevant areas was consistent with the accounts.

The Trusts' use of resources

- 13 We are required to issue a conclusion on whether we are satisfied that a Trust has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.
- 14 We are also required to assess how well NHS organisations manage and use their financial resources by providing scored judgements on the Trusts' arrangements in five specific areas. This is known as the Auditor's Local Evaluation and the scored judgements are provided to the Healthcare Commission to use as part of its Annual Healthcheck.

Value for money conclusion

- 15 We concluded that neither Trust had proper arrangements in place to secure value for money in the use of resources. The VFM conclusion was therefore qualified in the case of both NHS bodies because they were unable to maintain spending within available resources.
- 16 We acknowledge that over recent months steps have been taken by both organisations to strengthen internal procedures to support delivery of the joint financial recovery plan but, given the scale of the underlying economy wide financial deficit, the requirement to maintain spending within available resources for the forthcoming year will be a difficult achievement both for the Trusts individually and their successor body. These issues are referred to further in the subsequent section on financial standing.

<p>Recommendations - ALE report (R1) - August 2006 and Financial Recovery arrangements report (R2-4) - February 2006</p>
<p><i>R1 Put in place arrangements which ensure delivery against efficiency savings plans including exception reporting to the Board.</i></p>
<p><i>R2 Where savings are identified through redundancy, this should be done as part of strategic workforce planning so that the impact on the organisation can be properly assessed and the cost of the initiatives accurately calculated.</i></p>
<p><i>R3 Management should carry out a rolling review of financial savings opportunities throughout the year to identify further areas of savings that can be applied to supplement the original recovery plan.</i></p>
<p><i>R4 Clear priorities for financial recovery should be set which eliminate tensions between financial recovery and other service related targets so that plans for financial recovery are realistic; owned by the organisation and outcome focused.</i></p>

Auditor's Local Evaluation

- 17 We assessed the Trusts' arrangements in five areas. Each area was scored from 1 to 4 (1= below minimum requirements - inadequate performance, 2 = only at minimum requirements - adequate performance, 3 = consistently above minimum requirements - performing well and 4 = well above minimum requirements - performing strongly). A detailed report supporting our assessment and highlighting areas for improvement was issued to the Trusts in August 2006. Our assessment for the Trusts is set out in the table below.

Table 1 ALE scores

Area	Isle of Wight HCT score	Isle of Wight PCT score
Financial reporting	3	3
Financial management	2	2
Financial standing	1	1
Internal control	3	3
Value for money	2	2

- 18 The Trusts' financial reporting and internal control arrangements were identified as performing well. However financial standing was identified as being below minimum requirements requiring urgent action on the part of each Trust individually and collaboratively to address underlying weaknesses. The most significant of these reflect the recommendations made in the value for money and financial standing sections of this letter. Further detailed recommendations are contained within the ALE report. A detailed report supporting our assessment and highlighting areas for improvement was issued to the Trusts in August 2006.

Financial standing

- 19 The Healthcare Trust achieved financial balance in 2005/06 but the brunt of the financial pressures on the Island economy fell on the PCT which suffered a deficit of £6.6 million. The financial pressures in 2006/07 show no abatement with the latest version of the LDP requiring the organisations jointly to achieve £12.9m of savings in order to meet financial targets by the end of the year which includes the recovery of the Healthcare Trust's cumulative deficit of £3.7m.
- 20 At the end of August 2006 the Healthcare Trust had identified savings plans of £3.6m which leaves a further £3.1m of savings still to be found and the PCT was forecasting a £4.5m shortfall in resources. Work is continuing to identify the shortfall in the plans with the support of the Turn-around Director who has been employed to co-ordinate formulation and delivery of the joint recovery plan.

- 21 In addition the SHA has more recently appointed further external support to review the robustness of existing plans and to suggest areas where further savings could be made. However, given the scale of the gap that remains between resources and spending plans it is highly improbable that all the required savings will be delivered by the end of the financial year which will once again find the organisations, collectively in breach of their financial breakeven duties.
- 22 In our annual governance reports this year I drew the Boards' attention to my letter dated 12 May 2005 to both Boards in which I set out my concerns about the ability of both organisations to meet future statutory financial targets. It remains the case that the exercise of my formal audit powers remains an option if the Trusts or their successor body are unable, over the remaining period of the year to put in place proper plans to bring spending into line with available resources and take action to arrest the deteriorating financial position of the Island health economy.
- 23 In the same report I said that although, we recognise that the cost of providing hospital services on the Island may in some areas be disproportionately greater than the mainland due to diseconomies of scale, neither organisation, so far, has been able to quantify the financial impact of this and to generate a longer term solution to provide the financial basis for the sustainable hospital provision on the Island.

Recommendations - ALE report (R5) - August 2006 - Annual governance report (R6) - July 2006

R5 Prepare robust financial plans to achieve recurrent financial balance.

R6 Undertake further work to quantify the financial impact of Island diseconomies on the cost of providing hospital services on the Island and ensure that future decisions on the commissioning of the health services by the PCT are based on robust information.

- 24 A particular focus of our audit work this year has been to help both Trusts identify savings opportunities and improve financial management. Specific reviews include the review of joint financial recovery arrangements and the Acute Hospital Portfolio 6 diagnostic study and these are referred to in other parts of this letter.
- 25 In addition, we have drawn on our cost improvement and benchmarking database to assist the Trusts to identify cost improvement opportunities in support of their financial recovery plan for 2006/07. By comparing the Healthcare Trust and the PCT to other organisations nationally, we identified the potential for savings in some areas of the PCTs' commissioning and also in some services provided by the Healthcare Trust.

- 26 Findings from our work identified a number of service areas where, at first sight the cost of providing services on the Island appeared greater than comparative costs at other health bodies with the potential for savings. For example through greater use of day surgery and reductions in ward staffing levels and in areas of mental health. However, there were questions over whether the cost variations represented real savings opportunities and if so whether these could be realised within the timeframe set for financial recovery.
- 27 Detailed information has been shared with the Turn-around Director of the Trusts and has been used as a basis for challenging some of the underlying assumptions around service costs and models of delivery adopted locally and in supplementing the work already in progress around the formulation of a short and medium term pathway towards sustainable financial balance.

Other performance reports

28 As part of our audit we reviewed:

- acute hospital portfolio 6;
- progress in implementing the national programme for IT;
- consultants contracts;
- use of Health Act flexibilities and service reconfiguration; and
- preparations for the merger of the Trusts into a single Isle of Wight PCT.

29 Although with the exception of our review of merger preparations our detailed work was carried out during 2005/06 and the early part of 2006/07 findings were not formally reported to officers until after the 2005/06 year end.

Acute hospital portfolio 6

30 The Acute Hospitals Portfolio (AHP) is a review of services carried out by the Audit Commission on behalf of the Healthcare Commission. The work is mandatory in all acute trusts. The aim is to inform the Healthcare Trust about its performance compared to other trusts. Three services have been reviewed this year:

- admissions management;
- diagnostic services (including pathology, imaging and endoscopy); and
- medicines management.

31 Separate reports have been issued for medicines management, admissions management and each diagnostics service. As part of the feedback a number of recommendations have been agreed with management to address the key areas for improvement. These have been summarised in separate action plans.

Admissions management

32 Beds are not used most efficiently. There is bed blocking and the flow of patients impeded by high occupancy and delayed discharges. Improved discharge planning and efficiencies linked to reducing length of stays are likely to improve patient flows.

Diagnostic services

33 Full laboratory services for pathology are less accessible than in other trusts nationally, because of the relatively shorter opening hours. Overall costs per request or test are slightly above the national average and staff productivity is low in some areas, thereby suggesting scope for improvement in a number of areas.

34 The Healthcare Trust does not compare well for waiting times for imaging procedures. There is a mixed picture on staff productivity and levels of activity undertaken by radiologists need to be reviewed to identify ways to increase throughput. A high level of the Trust's major imaging equipment is over seven years old; the highest percentage of any trust nationally.

- 35 Overall waiting times for endoscopy are relatively low and the unit is patient-focussed in the information it provides. Overall productivity is in the top 25 per cent of trusts. However, areas for improvement include the timely reporting of examination results to patients and better rota cover for out of hour emergency services. Medium-term capital investment to replace aging endoscopes should be considered.

Medicines management

- 36 The Trust is performing well in this area, with a good focus on preventing medication errors, identifying the patient's allergy status, effective staff training and positive feedback on the pharmacy staff from other Trust staff. In common with many trusts nationally the Trust is not adequately managing controlled drugs. Arrangements would be improved by the formalisation of procedures for the audit, destruction and transportation of these drugs.

National programme for IT - choose and book

- 37 We reviewed progress in implementing the electronic booking system. We found that a significant part of the initial momentum gained during the initial early adopter phase of the project in 2005 has been lost. Progress in taking the initiative further forward is largely at a standstill due to a lack of resources and the PCT is at risk of missing financial incentives if it is unable to reach the target of 90 per cent utilisation of Choose and Book by the end of 2006.
- 38 The options facing the Trusts are either to re-launch the project on the basis of a renewed business case, or suspend implementation entirely until the resources needed for the renewal of the project can be found.

Recommendations - Joint Choose and Book Review - August 2006

R7 Evaluate whether the re-launching of the Choose and Book project is compatible with business priorities and if so prepare a business case advising on the range of options.

Consultants contracts

- 39 The Healthcare Trust is putting in place building blocks which have the potential to support the delivery of benefits from the introduction of the consultants' contracts. However, there is little evidence that, as yet, the Trust has made a formal link between the consultant contract and modernisation initiatives. To address this issue we have recommended that the Trust should:
- give consideration to a modernisation plan linking consultant contract and agenda for change, in order to increase productivity;
 - use the job planning process to identify areas for service redesign and modernisation;

- develop mechanisms to bring together contract cost analysis, benefits realisation planning and performance management of consultants; and
- develop Board level reporting on benefits realisation or other evaluation of the impact of the consultant contract to date.

Health Act Flexibilities and service reconfiguration

- 40** The overall intent of the organisations to develop shared service provision accords with current government policy. The action being taken to identify opportunities for closer alignment of health and social care provision is endorsed by our audit work as good practice. However, the early experiences of the Trusts in progressing joint funding initiatives to date have highlighted important learning points that need to be taken account of in subsequent developments. In particular, there is a risk that pooled funding and joint working arrangements could be developed piecemeal rather than as part of a strategic framework aligned to required outcomes and we have suggested that a strategy and underlying business case is prepared for future proposals.

Preparations for merger

- 41** The merging organisations have made good progress during the transitional phase of the merger assisted by a good approach to project management and the clear prioritisation of tasks. However, there are a number of risks and issues requiring ongoing attention:
- the resilience of information management and technology remains a concern due to its complexity and its impact on all work streams;
 - workforce plans need to be developed further to enable the new PCT to address capacity concerns within vulnerable areas of the organisation, particularly information management and technology and commissioning;
 - a realistic and robust project plan is needed to successfully manage the move to a single shared ledger system within the timescales envisaged; and
 - although financial recovery plans are now in place, their delivery will severely challenge the capacity of the new organisation.
- 42** The above issues have been discussed and agreed with officers and we will shortly issue an action plan containing detailed recommendations.

Closing remarks

- 43 A copy of the letter will be presented at the Audit Committee on 25 September 2006 and copies will be provided to all Board members.
- 44 Further detailed findings, conclusions and recommendations on the areas covered by our audit are included in the reports issued to the Trusts during the year. These are listed in the following table.

Table 2 Reports issued in relation to the 2005/06 audit

Output	Date of issue
Audit Plan*	March 2005
Financial Recovery Arrangements Report**	February 2006
Opinion - Interim Report*	April 2006
Annual Governance Report**	July 2006
Opinion of Financial Statements**	July 2006
Value for Money Conclusion**	July 2006
Acute hospital portfolio 6** <ul style="list-style-type: none"> • Diagnostic services • Admissions management • Medicine management 	August 2006
Consultant contracts*	August 2006
Choose and Book Report**	August 2006
Health Act Flexibilities*	August 2006
Auditors' Local Evaluation Report*	August 2006
Annual Audit Letter*	September 2006

**Joint report to both Trusts. **Individual reports addressed to the individual Trust.*

- 45 The Trusts have taken a positive and constructive approach to our audit, and I would like to take this opportunity to express my appreciation for the assistance and co-operation during the course of the audit.

Kate Handy

**District Auditor
October 2006**