

Public Interest Report

September 2006



Public Interest Report

Royal Cornwall Hospitals NHS Trust

Audit 2005/2006

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- Auditors may report aspects of their work widely to the public and other key stakeholders.

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Introduction

- 1 I am the external auditor appointed by the Audit Commission to audit the accounts of Royal Cornwall Hospitals NHS Trust ('the Trust').
- 2 I am issuing this report in the public interest under section 8 of the Audit Commission Act 1998. This section of the 1998 Act requires me to consider whether, in the public interest, I should make a report on any significant matter coming to my attention, to bring it to the notice of the audited body and the public.
- 3 The Trust has faced financial challenges for a number of years and I have been closely monitoring its response to these challenges. My predecessor and I have highlighted our views on the Trust's financial position in a number of reports and discussions with executive directors, non-executive directors and the Board.
- 4 I have been prompted to report publicly because of the recent dramatic deterioration in the Trust's financial position, as a result of a failure to deliver its 2005/06 budget. The purpose of this report is to state publicly my views on:
 - the seriousness of the Trust's financial position and the risk that it will breach its statutory financial responsibilities;
 - the reasons for the deterioration in the Trust's financial position;
 - the adequacy of the Trust's action taken to date and the further action planned to improve the Trust's financial position; and
 - the action that the Trust now needs to take to meet its statutory financial duties and to improve its financial position on a sustainable basis.

Background

- 5 NHS trusts are required to meet specific statutory financial duties and targets, emphasising the importance that is placed on financial management. NHS trusts must achieve a break-even position on income and expenditure, taking one financial year with another, measured over a three-year period. Exceptionally, the period for this break-even duty can be extended to a four or five-year period, if this is approved by the relevant local Strategic Health Authority (SHA).
- 6 This means that trusts must seek to contain their expenditure within the income received each year. If a trust makes a deficit in one year, this must be recovered through a corresponding surplus within the following financial years, so that the cumulative position over the three to five-year period is breakeven.
- 7 NHS organisations with particular financial difficulties have sometimes been provided with non-recurring financial support. Such support can, however, only be a temporary measure, providing time to allow trust boards to develop and implement effective recovery action.

The Trust has faced financial challenges for a number of years

- 8 The Trust's spending has exceeded its available income for a number of years. It incurred significant deficits in each of the 2001/02, 2002/03 and 2003/04 financial years as shown in Table 1.

Table 1 Financial position - 2001/02 to 2003/04

The Trust has faced financial challenges for a number of years

	2001/02	2002/03	2003/04
Deficit/(Surplus) - £000s	4,225	5,210	5,845

- 9 In light of these deficits, my predecessor and I reported our concerns on the Trust's financial position in our Annual Audit Letters to the Board in each of these years. In October 2004, I emphasised the need for the Board to monitor the Trust's financial position closely and ensure that robust plans are in place, and are being delivered in practice, to achieve financial balance.
- 10 In 2004/05, the Trust set a balanced budget but only after allowing for the receipt of £10.864 million of non-recurring financial support. The final outturn for the year was a surplus of £13.581 million. However, this was only after the receipt of further non-recurring financial support from the South West Peninsula Strategic Health Authority (SWPSHA) of £15.513 million which enabled the Trust to achieve its statutory breakeven duty by 31 March 2006. Without the financial support, the Trust would have incurred a deficit of £12.796 million as shown in Table 2.

Table 2 Financial position - 2004/05

The Trust had a deficit of £12.796 million before financial support

	£000s
Planned Deficit	0
Actual Deficit/(Surplus) recorded in the 2004/05 accounts	(13,581)
Non-recurring financial support	10,864
Additional non-recurring financial support	15,513
Deficit (before financial support)	12,796

- 11 In light of this position, I wrote to the Trust Board in February 2005 setting out my concerns on the Trust's financial standing and its ability to meet its statutory financial targets. I emphasised the need to resolve the Trust's underlying financial deficit by developing timely and robust recovery plans. I also recommended that the Board should:
- seek monthly financial and activity reports, challenge variations from budget and ensure that these reports were in a simple and easy to understand format, thereby allowing a better focus on the key issues;
 - monitor the adequacy of the action being taken to address high risk areas; and
 - develop contingency plans to safeguard the Trust's position should the expected improvements not materialise.
- 12 As the Trust moved into 2005/06, it did not need to generate a surplus to recover its accumulated deficit as this had been addressed in 2004/05 through the receipt of the additional non-recurring financial support from the SWPSHA. It did, however, face significant challenges in addressing its underlying financial position and the need to absorb additional cost pressures.

The Trust's financial position deteriorated significantly in 2005/06

- 13 The Trust prepared a balanced budget in 2005/06 although this again relied on significant non-recurring financial support amounting to a net value of £12.031 million. Delivery of this budget was also dependent on the achievement of efficiency savings of £7.5 million, equating to 3.4 per cent of its budgeted income, and the effective management of a number of significant financial risks which were identified as part of the budget-setting process.
- 14 Despite the preparation of a balanced budget for 2005/06, I reported continuing concerns on the Trust's financial position in my Annual Audit Letter to the Board in October 2005. At that time, there was already slippage against the 2005/06 budget and a number of significant cost pressures and risks were beginning to materialise. Consequently, I emphasised the need to:
- ensure detailed monitoring of the recovery programme;
 - quantify risks to the delivery of the plan and take action to manage these;
 - develop contingency plans should the financial risks identified materialise; and
 - develop and agree a medium-term financial strategy.
- 15 Since this time, the Trust has been the subject of a number of detailed external reviews. I have been awaiting the results of these reviews before deciding whether to issue a public interest report.

- 16 The Trust ended 2005/06 with an underlying deficit of £27.718 million after taking into account the net effect of non-recurring financial support in 2005/06. This is shown in Table 3 and represents an extremely worrying deterioration on the previous year's position.

Table 3 Financial position - 2005/06

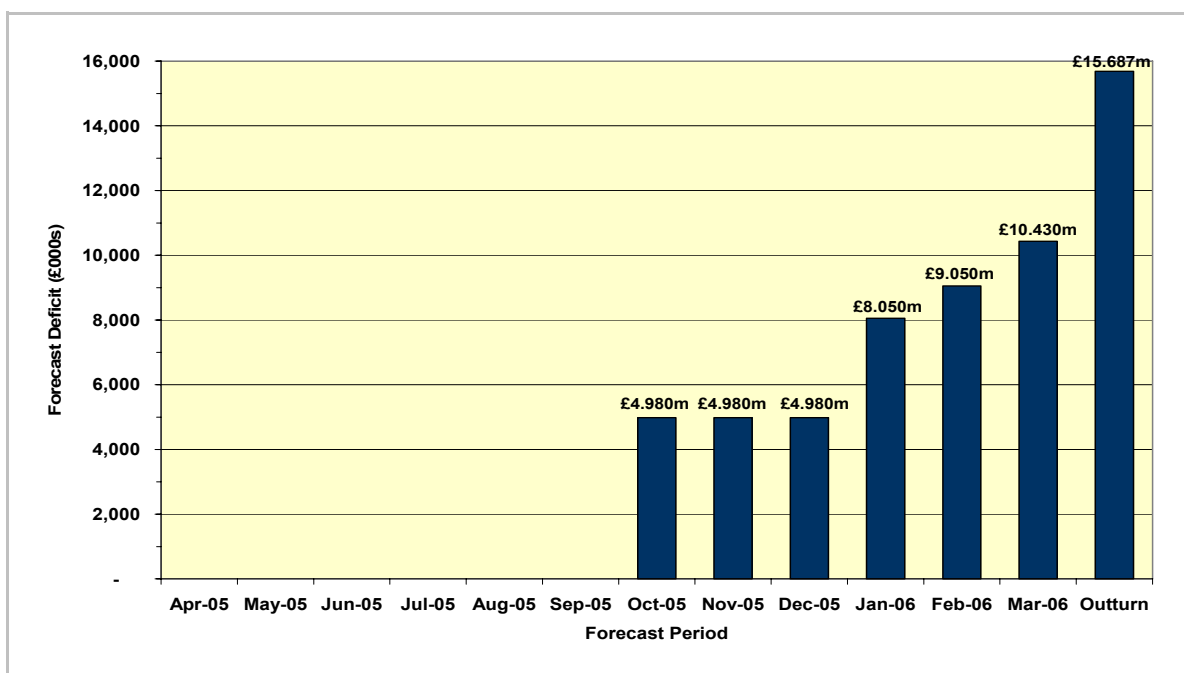
The Trust's underlying financial position deteriorated significantly in 2005/06

	£000s
Planned Deficit	0
Actual Deficit recorded in the Trust's 2005/06 accounts	15,687
Non-recurring financial support (net)	12,031
Deficit (before financial support)	27,718

- 17 Of particular concern is the fact that the Trust forecast a breakeven position until a report to the Trust Board in December 2005 forecast a deficit of £4.980 million based on its actual financial performance for the period from April 2005 to October 2005. Over the remaining months of the 2005/06 financial year, the forecast position deteriorated rapidly. In May 2006, the Trust prepared its 2005/06 financial statements which recorded a deficit of £15.687 million. The deteriorating forecast position during the year is illustrated in Figure 1. My views on the reasons for this deterioration are outlined in the next section of this report.

Figure 1 2005/06 Financial forecasts

The Trust's financial position deteriorated rapidly in the latter part of the year



Why did the Trust's position deteriorate so significantly?

- 18 The Trust clearly faced a number of significant external financial pressures during the year which contributed to this position. Most significantly, the Trust has estimated that the cost of the national Agenda for Change initiative was £2.5 million more than originally budgeted. However, in my view, the primary reasons for the deterioration in the Trust's financial position are as follows.
- The Trust has not developed a timely medium-term financial strategy which seeks to restore financial stability over a challenging but realistic period of time.
 - The Trust's plans have been reliant on temporary financial support and non-recurrent savings whilst longer-term service redesign has not been progressed at a sufficient pace.
 - The 2005/06 budget was not presented to the Board until July 2005, some four months into the financial year. As a result, there was an inevitable lack of clarity on the Trust's financial position for a substantial part of the year. This may also have led to individual service budgets being perceived as imposed rather than owned by those responsible for managing them.
 - Complete and detailed recovery plans for the £7.5 million of efficiency savings required in 2005/06 were not in place prior to the start of the financial year and these plans were not adequately monitored during the year.
 - Budget holders did not exercise effective financial control during the year.
 - The Trust's financial forecasts were inaccurate and, in some respects, erroneous. For example, capital charge assumptions were too optimistic and based on an unsound assessment resulting in an under-estimation of £2 million.
 - The financial risks identified as part of the budget-setting process were not adequately managed or monitored during the year.
 - Contingency plans to deal with additional cost pressures during the year were not developed until October 2005 and were reliant on high-risk, non-recurring initiatives such as the sale and leaseback of Trust assets, which ultimately did not come to fruition.
 - There was insufficient challenge of financial information and the Trust's position by the Board.
- 19 Furthermore, the Trust's financial difficulties have been exacerbated by disagreements with the organisations which commission healthcare services from it. This has resulted in delays in agreeing financial and service plans and a lack of alignment between primary and secondary care activity plans.

The Trust's response to its financial problems

- 20 The Trust is working with a team of independent consultants to prepare a medium-term 'Turnaround Plan'. This Plan is in the process of being compiled and I have not, therefore, commented upon it in this report. However, I am pleased to note that its objectives are to:
- outline how the Trust can achieve recurrent financial balance whilst maintaining and improving its clinical performance and the patient experience;
 - identify longer-term strategic areas where the Trust needs to undertake further analysis but which should provide additional savings;
 - identify opportunities to address the Trust's accumulated deficit; and
 - demonstrate the Trust's commitment to securing change, service improvement and achieving its financial duties.
- 21 In April 2006, the Trust appointed a new Director of Finance and Information who has brought renewed vigour to addressing the Trust's financial problems. This has included the provision of additional financial training to members of the Trust Board, the introduction of improved financial reporting and the development of more robust accountability and performance management arrangements.
- 22 In May 2006, the Trust and the SWPSHA jointly commissioned a review of the Trust's finances from independent professional advisors to identify the key reasons for the deteriorating financial position and the actions required to address any weaknesses identified. This report identified a number of significant weaknesses in the Trust's financial management arrangements. However, I am pleased to note that the Trust is in the process of preparing an action plan to address the recommendations resulting from this review.

The future is uncertain

- 23 The finalisation of the Trust's 2006/07 budget has been delayed. This is partly as a result of late changes by the Department of Health to the national tariff, the primary mechanism by which the Trust receives its income. However, further delays resulted from protracted local discussions on future finance and service delivery plans due to the size of the Trust's deficit and the need for a full evaluation of its 2005/06 position.
- 24 However, the Trust's plans indicate that a further significant deficit is forecast. In particular, I note that the Trust and SHA have agreed a control deficit of £20 million in 2006/07. A significant element of this is the £15.687 million deficit incurred in 2005/06 which, under the current NHS finance regime, is deducted from the SHA's overall quantum of income in 2006/07.

Action required by the Board

- 25 It is the Board's responsibility to ensure that the Trust meets its statutory financial duties and to provide scrutiny and challenge on its financial performance. In doing this, it needs to address the following issues.
- Finalise and implement the 'Turnaround Plan', ensure that it meets its stated objectives and develop arrangements for monitoring its delivery.
 - Develop a culture of financial discipline and control throughout the whole Trust and ensure that all staff understand the financial impact of their decisions.
 - Develop stronger relationships with the Trust's commissioners to ensure that there is agreement and consistency between primary and secondary care plans.
 - Ensure that budgets and associated recovery plans are developed and agreed in advance of the financial year to which they relate.
 - Review and challenge financial plans and monitoring reports to ensure that assumptions are reasonable and robust and that appropriate action is being taken to address problem areas.
 - Ensure that financial risks are adequately identified, managed and monitored during the year and that contingency plans are established to address new or emerging issues.

The way forward

- 26 I recognise that the Trust may not be able to achieve all of the required improvements on its own. Equally, the Trust will need to demonstrate to its partners through tangible outcomes that it is tackling and resolving the issues facing it.
- 27 The Trust has started to respond positively to my recommendations and is taking action to address the issues I have raised. However, the Board must not underestimate the magnitude of the challenge it faces and must make robust and sustained efforts to improve financial management arrangements and secure financial recovery.
- 28 I will continue to monitor the Trust's progress in delivering sustainable financial recovery and consider if I need to take any further action in exercise of my formal audit powers under the Audit Commission Act 1998. In particular, I will review and monitor both the financial plans for the current year and the 'Turnaround Plan' as part of my 2006/07 audit.

Lee Budge
District Auditor

7 September 2006