

Annual Audit Letter

September 2006



Annual Audit Letter

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

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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. Although this letter is addressed to the directors of the PCT, it 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 PCT 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 PCT

- 3 We have been appointed as the PCT's independent external auditors by the Audit Commission, the body responsible for appointing auditors to local public bodies in England, including primary care trusts.
- 4 As the PCT's 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 Trust achieving its objectives. It is the responsibility of the PCT to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for. Our role is to assess and report how the PCT is 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 PCT's accounts; and
 - whether the PCT has made proper arrangements for securing economy, efficiency and effectiveness in its 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 health check.
- 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 PCT. A list of all reports issued to the PCT in relation to the 2005/06 audit is provided in the closing remarks section at the end of this letter.

Key messages

- 8 Table 1 summarises our Code of Audit opinions.

Table 1 Code of Audit opinions

Audit Code Area	Opinion
Accounts	We issued an unqualified opinion on the PCT's accounts and a qualified opinion on the regularity of expenditure because the PCT exceeded its spending limit by £3.9 million.
Use of Resources	Our conclusion on the PCT's arrangements to secure value for money in its use of resources was qualified because of weaknesses in financial management and financial standing.

- 9 Table 2 summarises our key messages and recommendations. Where appropriate these should be carried forward to the new Gloucestershire PCT.

Table 2 Key conclusions and required actions

Message	Recommended action
Auditor's Local Evaluation*	
<p>We have assessed whether the PCT has adequate arrangements in five areas. Each area was 'scored' between 1 and 4, as follows:</p> <ul style="list-style-type: none"> financial reporting - 1 financial management - 1 financial standing - 1 internal control - 2 value for money - 2 <p>(1 = inadequate, 2 =adequate, 3 = performing well and 4 = performing strongly)</p>	<p>The Board should consider the recommendations in our report on the Auditor's Local Evaluation. The significant recommendations are listed in Table 3 of this letter.</p>

Message	Recommended action
Financial standing	
<p>In February 2006, we reported on the weak financial standing of the PCT. At the end of 2005/06, the PCT reported a deficit of £3.9 million and did not meet its statutory financial duty. In 2006/07 the financial position continues to be challenging and we have significant concerns over financial recovery plans.</p>	<p>Before merging with other PCTs, the Board should assure itself that planned budgets and savings plans are realistic and deliverable. The PCT should develop a sound medium-term financial strategy, realistic budgets and a robust financial recovery plan.</p>
Practice based Commissioning	
<p>The Gloucestershire PCTs are making good progress in establishing arrangements for Practice based Commissioning.</p>	<p>Working with partner NHS bodies, the PCT should ensure that plans for the implementation of PbC remain on track during and past the period of re-organisation.</p>
National Programme for IT (NPfIT)/Connecting for Health (CfH) – follow-up	
<p>Our follow-up review of the health community's programme management of NPfIT/CfH concluded that AGW has performed well in 2005/06 with considerable progress achieved in all areas reviewed. However, concerns remain over:</p> <ul style="list-style-type: none"> • capacity of NHS bodies to implement new IT systems during reorganisation; and • lack of clarity over funding arrangements. 	<p>Working with partner NHS bodies, the PCT should develop detailed and costed implementation plans for NPfIT/CfH systems and ensure that plans remain on track.</p>
Workforce contract reforms – follow-up	
<p>The AGW health community has made satisfactory progress in implementing workforce contract reforms. However, few NHS bodies have considered how they will achieve value for money from the contract reforms and few have identified any specific benefits.</p>	<p>The Board should ask for a report on progress in implementing workforce contract reforms.</p>

* *Auditors Local Evaluation (ALE)*

ALE scores are provisional until completion of Audit Commission internal quality processes. Comparative scores from other NHS bodies will be published in October 2006.

The audit of the accounts

- 10 The production of the statutory annual accounts is the principal means by which NHS bodies discharge their accountability to taxpayers and users of services for their stewardship of public money.
- 11 We are required to issue an opinion on PCT accounts and whether they represent a 'true and fair' picture of the PCT.
- 12 We are also required to issue an opinion on the 'regularity of expenditure' and whether the expenditure incurred by the PCT is in accordance with the statutory powers conferred on it by central government.

Accounts

- 13 On 20 July 2006, we completed our audit. We issued the following opinions:
 - unqualified 'true and fair' opinion; and
 - qualified opinion on the regularity of expenditure because the PCT overspent by £3.9 million and was in breach of a government spending limit ('revenue resource limit').
- 14 On 6 July 2006, we issued our Governance Report to the PCT's Audit Committee. We reported the following significant matters to the Committee.
 - Financial standing – we have continuing concerns on the arrangements the PCT has for maintaining sound financial standing. This is covered in further detail on page 12, under the section - 'Financial standing'.
 - Accounts submission – the PCT just missed the Department of Health deadline (15 May 2006) for submission of its accounts.
 - Working papers – we recommended further improvements to the working papers supporting the accounts.

Auditors Local Evaluation – financial reporting

- 15 Our work on the audit of PCT accounts also forms the basis of our 'scored' assessment on financial reporting. The scored assessment is included in the annual health check which will be published by the Healthcare Commission in October 2006 (see pages 9-11 for further details).
- 16 The PCT was assessed as achieving a level 1 score; that is, inadequate arrangements were in place for financial reporting in 2005/06.

Part-year accounts for the merging PCT for 2006/07 (April – September)

- 17 On 1 October 2006, the PCT will merge with other PCTs in Gloucestershire to form the new Gloucestershire PCT. The merging PCT will be required to produce full statutory accounts for the half-year period prior to merger, that is, from April to September 2006. This will be at time when the new PCT will be undergoing significant change and accounts risks typically increase. We have recommended a number of improvements to the accounts closedown process although these will now fall to the new Gloucestershire PCT to implement.

The PCT's use of resources

- 18 We are required to issue a conclusion on whether we are satisfied that the PCT 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.
- 19 We are also required to assess how well NHS organisations manage and use their financial resources by providing scored judgements on the PCT's 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 health check.

Value for money conclusion

- 20 Our conclusion on the PCT's arrangements to secure value for money in its use of resources was qualified because of weaknesses in financial management and financial standing. The key areas for improvement are summarised in Table 3 under the section 'Auditor's Local Evaluation' (ALE).
- 21 We have discussed our findings with executive directors and senior managers at the PCT and they have responded positively to the need for improvement and change. A report on our ALE assessments and improvements will be issued to the PCT in September 2006.
- 22 To help the PCT improve its arrangements we will seek to identify notable practice in the areas where the PCT scored lowest and share this with the new PCT at the earliest opportunity.

Auditor's Local Evaluation

- 23 We assessed the PCT's arrangements in five areas. Each area was scored from 1 to 4 (1= poor and below minimum standards, 2 = fair, 3 = good and 4 = excellent). These scores are averaged into a single score and will be published by the Healthcare Commission as part of the annual health check in October 2006.
- 24 We have summarised our scores (provisional) and key recommendations in Table 3 over the page.

Recommendation
<i>R1 The Board should consider the recommended areas for improvement identified in our report on the Auditor's Local Evaluation, in the use of resources.</i>

Table 3 ALE scores

Area	ALE Score	Conclusions	Key recommendations to achieve the next level
Financial reporting	1	<p>The PCT just missed the Department of Health's (DH) deadline (15 May 2006) for submission of draft accounts.</p> <p>Despite the efforts of the PCT, working papers to support the accounts were again a problem in 2005/06. Some improvements have been made, although there is still considerable room for improvement.</p>	<ul style="list-style-type: none"> • Ensure accounts are submitted in accordance with the DH timetable. • Provide all working papers at the start of the audit and to the required standard. • Produce the annual report as part of the accounts process.
Financial management	1	<p>Financial management and financial forecasting have improved during 2005/06, however, the PCT's budget was overspent at the year-end and the savings plan was not sufficient to bring the PCT back into balance in 2005-2006.</p>	<ul style="list-style-type: none"> • Develop a sound medium-term financial strategy, realistic budgets and a robust financial recovery plan which are sufficient to bring the PCT back into financial balance.
Financial standing	1	<p>At the end of 2005/06, the PCT reported a deficit of £3.9 million and did not meet its statutory financial duty.</p>	<ul style="list-style-type: none"> • Covered in more detail later in this letter and under the separate heading 'Financial Standing'.

Area	ALE Score	Conclusions	Key recommendations to achieve the next level
Internal control	2	<p>The PCT manages its significant business risks well.</p> <p>There are adequate arrangements to maintain a sound system of internal control and ensure probity and propriety in its business.</p>	<ul style="list-style-type: none"> • Develop the risk management process further by ensuring the Assurance Framework becomes fully embedded in the PCT's business processes. • Raise staff awareness of the requirement to make appropriate disclosures of gifts, hospitality and pecuniary interests and provide evidence of peer review/monitoring.
Value for money	2	<p>The PCT has sound arrangements in place for setting, reviewing and implementing strategic objectives.</p> <p>The key area for development is in demonstrating that value for money is being managed and achieved in the services the PCT provides.</p>	<ul style="list-style-type: none"> • Provide evidence that data quality is sound for all published information and that information provided to senior managers and the Board is open to review and scrutiny. • Develop a clear and realistic longer term plan to improve efficiency.

Financial standing

- 25 At the end of 2005/06, the PCT reported a deficit of £3.9 million and did not meet its statutory financial duty.
- 26 Our mid year report (February 2006) on Financial Standing reported on the weak financial position of the PCT and our concerns that the financial recovery plan would not enable the PCT to achieve financial balance in 2005/06. At the year-end our assessment has not changed, however, we note that the PCT did almost achieve in-year financial balance (£0.8 million deficit), unfortunately it was unable to achieve sufficient savings to clear the previous year's deficit (£3.1 million).
- 27 In preparation for merger the three Gloucestershire PCTs have developed financial plans that collectively forecast financial balance in 2006/07. For this to be achieved the PCTs must deliver a savings plan totalling £28 million, of which £10 million is currently unidentified. West Gloucestershire PCT's share of the total savings is £10.4 million and their contribution to financial balance is based on delivering a deficit of £3.1 million with Cheltenham and Tewkesbury PCT producing a surplus sufficient to achieve financial balance across the three PCTs.
- 28 The latest budget monitoring report to 30 June 2006 shows that West Gloucestershire PCT is reporting an overspend of £2.8 million and forecasting a deficit of £9.7 million. This is £6.6 million higher than the PCT's planned deficit. The difference represents the level of unidentified savings (£4.2 million) required within the PCT's plans, slippage on agreed plans and variances against baseline budgets.
- 29 The PCT, with the rest of the health community, is currently in negotiation with the Strategic Health Authority about amending financial plans for 2006/07. However, this negotiation may not be complete by the date of the final PCT board meeting to enable the signing off of a balanced budget prior to merger.
- 30 We will continue to monitor the position, however at this stage we believe that the new PCT will inherit significant deficits from at least two and possibly all three demising PCTs. In particular we are concerned that:
 - the PCT's deficit positions are exceeding forecasts early in 2006/07;
 - there is a significant proportion (36 per cent) of the savings plan unidentified;
 - there is significant slippage against the 2006/07 savings plan;
 - financial forecasts do not include potential severance or redundancy costs which may arise following PCT reconfiguration; and
 - management capacity is stretched at a time of significant organisational change.
- 31 The new PCT will need to develop a sound medium-term financial strategy, realistic budgets and a robust financial recovery plan that deliver its strategic objectives.

Recommendations

R2 Before merging with other PCTs, the Board should assure itself that planned budgets and savings plans are realistic and deliverable.

R3 The PCT should develop a sound medium-term financial strategy, realistic budgets and a robust financial recovery plan.

Specific risk based work**Practice based Commissioning**

- 32** Practice based Commissioning (PbC) is a key government reform which represents a significant opportunity to commission services nearer to the patient. It entitles primary care clinicians (GPs) to hold budgets which can then be used to make service changes to benefit patients.
- 33** We concluded that:
- the Gloucestershire PCTs are different stages of implementation, however, new county wide arrangements for PbC should assist with developments in this area;
 - the PCTs are making steady progress towards achieving Department of Health (DH) targets for sign up to PbC, with the majority of Gloucestershire GPs signed up to the implementation of PbC;
 - good progress has been achieved in ensuring that PbC is used to advance strategic aims and in facilitating service redesign; and
 - arrangements for the financial management of PbC are adequate.
- 34** Concerns remain over:
- the ability of the PCTs to deliver the county-wide Financial Recovery Plan and Integrated Service Improvement Plan whilst providing sufficient incentives to encourage GPs to embrace PbC;
 - management capacity to drive the PCT agenda during a period of re-organisation; and
 - the PCT's ability to demonstrate arrangements for recognising the benefits realisation and improvements in value for money.

Recommendation

R4 Working with partner NHS bodies, the PCT should ensure that plans for the implementation of PbC remain on track during and past the period of re-organisation.

Follow-up

National Programme for IT (NPfIT)/ Connecting for Health (CfH) – follow-up

- 35 In 2004/05 we undertook an AGW-wide review of the health community's programme management. Our follow-up review has assessed programme management as adequate. The AGW health community has performed well in 2005/06 and maintained good progress against our previous action plan. Concerns remain over:
- capacity at both the health community and local strategic partners to deliver the systems at a time of massive change and disruption; and
 - the lack of clarity over funding arrangements for NPfIT/CfH beyond 2006/07 due to NHS re-organisation.
- 36 A summary of our assessment is shown in Table 4.

Table 4 Follow-up summary

Aspect of performance management	Conclusion
Governance structure	Performing strongly
Programme management	Performing well
Risk management	Performing well
Capacity and skills	Performing adequately
Finance	Performing adequately
Business and cultural change	Performing adequately

- 37 The PCT is part of the Gloucestershire health community and whilst risks flagged are not specific to the PCT the wider AGW concerns could impact on the PCT during the implementation process.

Recommendation

R5 Working with partner NHS bodies, the PCT should develop detailed and costed implementation plans for NPfIT/CfH systems and ensure that plans remain on track.

Securing the benefits of the workforce contract reforms – follow-up

- 38 In 2004/05 we reviewed the implementation of workforce contract reforms across Avon, Gloucestershire and Wiltshire health community. Our work in Gloucestershire focused on the GP out-of-hours service. Across the health community we found little progress had been made in securing benefits and delivering improvements in value for money expected from workforce contract reforms.
- 39 During 2005/06 we reviewed the progress made across the health community and in Gloucestershire. We concluded that the health community is now making satisfactory progress in ensuring that workforce contract reforms contribute to organisational strategy and service redesign. However, we found that:
- few organisations had considered how they would achieve value for money from the contract reforms - Gloucestershire has focused on benchmarking as a means to demonstrate value for money;
 - few organisations had identified the specific benefits to be achieved from workforce contract reforms and implemented robust performance management arrangements for delivery. Whilst Gloucestershire PCTs have developed benefits realisation plans for Agenda for Change, they do not plan to performance manage delivery of these in the immediate-term; and
 - the SHA needs to take a stronger leadership role to ensure that workforce contract reforms contribute to strategic fit, modernisation and service redesign across the health community.

Recommendation

R6 The Board should ask for a report on progress in implementing workforce contract reforms.

Closing remarks

- 40 This letter has been discussed and agreed with the Chief Executive and the Director of Finance. A copy of the letter will be presented at the Audit Committee on 6 September 2006 and copies will be provided to all Board members.
- 41 Further detailed findings, conclusions and recommendations on the areas covered by our audit are included in the reports issued to the PCT during the year. These are listed in the following table.

Table 5 Reports issued in relation to the 2005/06 audit

Output	Date of issue
Audit Plan	August 2005
Financial Standing	February 2006
National Programme for IT/Connecting for Health (AGW-wide report)	April 2006
Annual Governance Report	July 2006
Opinion on Financial Statements	July 2006
Value for Money Conclusion	July 2006
Interim and Final Accounts Memorandum	July 2006
Securing the benefits of the workforce contract reforms	July 2006
Auditor's Local Evaluation	August 2006
Annual Audit Letter	September 2006

- 42 The PCT has 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.

Stephen Malyn
District Auditor
July 2006