

Health

Consultation

September 2006

# **Auditors' Local Evaluation 2006/07**

**Consultation document - September 2006**

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## Introduction

- 1 The Auditors' Local Evaluation (ALE) assesses how well NHS organisations manage and use their financial resources. ALE has been developed to enable auditors to make scored judgements on five key areas:
  - Financial reporting;
  - Financial management;
  - Financial standing;
  - Internal control; and
  - Value for money.
- 2 The assessments were undertaken for the first time at NHS trusts and primary care trusts (PCTs) in 2005/06. The framework is not applicable to foundation trusts. ALE formed the 'use of resources' assessment for non-foundation trusts and PCTs within the Healthcare Commission's annual health check. The Healthcare Commission will publish the use of resources assessment as part of the annual health check on 12 October 2006. At the same time, the Audit Commission will publish the assessments made on the five key areas reviewed as part of the framework and a short briefing paper analysing the assessments made by auditors in more detail.
- 3 The Healthcare Commission has recently published its final guidance for the annual health check in 2006/07 following consultation. This confirms that the ALE assessments will continue to provide the use of resources assessment for non-foundation trusts and PCTs.
- 4 Over the summer, the Commission has been reviewing the approach adopted in 2005/06 in order to capture any lessons to be learnt for updating and developing the methodology for 2006/07. A post-implementation review has been undertaken of how the assessments went. This review sought views from both internal and external stakeholders. The outcomes from this review will be built into the final framework for 2006/07.
- 5 A key point that came out of our review was confirmation that the current framework provided a fair assessment of an organisation's use of resources. The key lines of enquiry (KLOEs) were felt to provide reasonable and achievable levels of assessment. The Commission also considers that, in moving forward to 2006/07, it is important that the assessment framework remains broadly consistent with the previous years so that comparisons between years can be undertaken and improvements demonstrated.
- 6 As a result, a key objective when updating and developing the framework for 2006/07 has been to ensure consistency. The Commission therefore proposes to keep the five domains, the KLOE and the scoring system the same for 2006/07. A limited number of changes are proposed for some of the assurances underpinning the KLOE. Most of these are for clarification based on experience and feedback but some are to take account of developments within the NHS.

- 7 This document asks for comments on these and other suggestions for improvements.

## Responding to this consultation

- 8 Responses to this consultation should reach us by Friday 3 November 2006. Please send your response to [aleconsultation@audit-commission.gov.uk](mailto:aleconsultation@audit-commission.gov.uk) or by post to Andy McKeon, Managing Director Health, Audit Commission, 1st Floor, Millbank Tower, London SW1 4HQ. Responses to the consultation questions set out at the end of this report would be particularly welcome. A standard response document has been produced and is available with other information on the Commission's website, [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk).

## ALE 2006/07

### Coverage

- 9 The Commission intends that ALE will be applied to all existing NHS trusts and continuing PCTs, new PCTs created on 1 October and new strategic health authorities (SHA). KLOEs for SHAs are currently being developed. Auditors will consult directly with each of the ten new SHAs during October in order to develop a more tailored and specific assessment that represents the role and responsibilities of these organisations.

### Key proposals

- 10 The key proposals for ALE in 2006/07 which we wish to outline and consult on are:
  - changes to auditor assurances within the key KLOEs in light of feedback from stakeholders, developments within the NHS and changes in legislation or professional guidance;
  - determining scores; and
  - the approach, including self-assessment and working with other regulators.

### Proposed changes to the ALE KLOEs

- 11 A key objective of our review was to keep broad consistency between years so fair comparisons can be undertaken and improvements demonstrated. So far feedback on 2005/06 has also indicated that the KLOEs themselves were appropriate and worked well. For these reasons, none of the individual 13 KLOE statements (for example, '1.1 The organisation produces annual accounts in accordance with relevant standards and timetables, supported by comprehensive working papers') have been amended. These also remain consistent, with the exception of value for money, with the equivalent use of resources assessment in local government.
- 12 We have reviewed whether any of the audit criteria and specific auditor assurances contained within the KLOEs need modification in the light of feedback from stakeholders, in particular from auditors who applied the framework for the first time in 2005/06, developments within the NHS and any changes in legislation or professional guidance. In the light of this review, we are proposing a number of changes to the format and content of the KLOEs. Our specific proposals have been highlighted in the attached KLOE documents and have been summarised below. Further changes to assurances may be made to the financial management and financial standing KLOEs as a result the Department of Health's (DH) response to the Commission's report to the Secretary of State for Health on the

review of the NHS financial management and accounting regime. The DH has indicated that a response to the review is likely to be published in November.

### **Separate documents for different sectors**

- 13 Separate KLOE documents have been produced for NHS trusts and PCTs. The vast majority of the auditor assurances within the document remain consistent between sectors. However, some assurances have been amended and developed to directly reflect the differing circumstances evident between these sectors.

### **Layout and format**

- 14 Assurances have been linked to specific issues within the audit criteria within each KLOE to clarify how each relates to the other. Each assurance has also been referenced to assist with discussions between auditors, audited bodies and the Audit Commission.

### **Clarification changes**

- 15 A number of assurances have been re-worded to clarify their purpose and improve understanding. These do not change the substance or emphasis of the individual assurance but simply present them in a much clearer and more concise way.
- 16 This is particularly relevant for the value for money section where, following feedback, we have tried to improve and clarify the assurances to increase the understanding of the focus of this particular area of the review.

### **New assurances**

- 17 A number of new assurances have been added to reflect:
  - actions and responses to the Trust development and PCT fitness for purpose programmes;
  - developments and priorities within individual sectors, requirements of the Operating Framework and other new developments within the NHS, such as the DH efficiency and productivity metrics;
  - improved understanding of PCT efficiency and value for money; and
  - new anti-discrimination legislation and related diversity issues.

### **Movement in levels/removals**

- 18 In four cases, assurances have been moved to lower levels in order to reflect more accurately the performance level to which they relate. Some wording and individual assurances have been removed where it was considered that they did not significantly contribute to the assessment.

## Determining scores

- 19 In order to ensure consistency and comparability of assessments, we propose that the scoring framework for determining the scores for each of the five areas and the overall score should remain the same. The rules for determining the overall score will need to be confirmed again by the Healthcare Commission and DH. For information, the scoring framework applied in 2005/06 is included in Appendix 1.

## Approach

- 20 As in 2005/06, auditors will integrate the assessments into their normal audit work. A revised Code of Audit Practice was introduced in 2005/06 and the assessments were integrated with auditors' responsibilities under the Code. Further efforts will be made in 2006/07 to ensure full integration between these responsibilities. The timetable for the assessments is yet to be finalised but it is expected to follow a similar approach to 2005/06, with financial management, internal control and value for money assessments being completed first and financial reporting and financial standing assessments completed as part of the audit of the accounts.
- 21 The first year's assessments have provided a baseline against the set of criteria and assurances. This inevitably required significantly more effort on the part of trusts and PCTs and auditors. It is intended that for existing trusts and continuing PCTs, the assessments in 2006/07 will be more risk-based, building on the baseline assessments and monitoring delivery of improvements recommended by auditors in 2005/06. For new PCTs, auditors will use information and assessments from predecessor organisations and any work undertaken on merger arrangements to inform the audit approach. However, given the inherent risks associated with newly established organisations, it is likely that there will be a requirement for more work to be undertaken at new PCTs and merged trusts than at continuing PCTs or existing NHS trusts.
- 22 The Commission intends that the same approach should be adopted by auditors in sharing and discussing provisional scores with audited bodies. The quality assurance process was considered to have worked well and to be robust. This view was shared by the NHS and Healthcare Commission representatives on our national panels. We are, however, considering whether it should be further refined in the light of experience.

## Self-assessment

- 23 In the first year of ALE, the Commission indicated that a self-assessment process could be voluntarily undertaken by trusts and PCTs should they perceive this to be useful. We were very mindful of the level of self-assessment being undertaken at the time and the potential burden this may place on NHS bodies.
- 24 In practice, a significant number of bodies and auditors used self-assessment to assist in delivering the framework. Auditors found the quality of the self-assessments variable. Where they worked well, auditors considered that they

assisted greatly in managing the process, led to increased engagement with NHS bodies and reduced the amount of work for auditors. In 2006/07, the Commission therefore is encouraging trusts and PCTs to undertake a self-assessment process, although the level and scale will be at the discretion of the audited body. We also recommend that the approach to self-assessment should be discussed with the auditor so that both parties achieve the outcomes they require. We will also be suggesting to auditors that at the start of the process, a meeting should be held between them and key senior managers and non-executives to consider the outcome of the 2005/06 assessments and to discuss and plan the assessment process for 2006/07.

### **Joint working with Concordat signatories and others**

- 25** In 2005/06, the Commission worked closely with the Healthcare Commission in developing and delivering the ALE assessments. The use of the assessments within the annual health check demonstrated the practical delivery of many aspects of the Healthcare Inspection Concordat. We will continue to work very closely with the Healthcare Commission, both nationally and locally, during 2006/07.
- 26** We are also currently undertaking a pilot exercise with the NHS Litigation Authority (NHSLA) to ascertain whether auditors can rely on the work they undertake with trusts on risk management arrangements. If successful, auditors will be advised to rely on the work of the NHSLA in reaching a judgement on KLOE 4.1 and only exceptionally to undertake work themselves in that area.
- 27** Furthermore, we have been working with the DH and NHS bodies to integrate the assessments and use information produced for the trust development and PCT fitness for purpose programmes into our overall approach so that maximum value is gained from these and work is not duplicated.

## Next steps

- 28 Following consultation, we will be finalising the KLOEs and the final framework for 2006/07 in November. Final KLOEs and guidance for both NHS bodies and auditors are expected to be published by the end of November.
- 29 If you have any further queries on this document or any aspect of the ALE framework, please contact either the Audit Commission directly or your local external auditor.

## Key consultation questions

- 30 The questions which we would welcome comments on are:

### **Question 1:**

*Do you consider that the changes made to the assurances within the key lines of enquiry are appropriate and help to clarify the basis of the assessments being made by auditors?*

### **Question 2:**

*Do you feel that the amended assurances for value for money will result in clearer and better assessments and provide a better understanding for the basis of the assessments in this area?*

### **Question 3:**

*In light of your experience in 2005/06, do you agree that the scoring framework should remain the same in order to ensure consistency and comparability between years?*

- 31 We would also be pleased to receive any other comments on the ALE process and proposed approach for 2006/07.

## Appendix 1 – ALE scoring framework

### Determining scores for key lines of enquiry

- 32 Auditors will determine a score for each of the 13 individual KLOEs based on the auditor assurances. The assurances are cumulative, for example an organisation that met the assurances at level 3 could not be given a score of 3 unless it also met the assurances for level 2. In interpreting the assurances and evidence, auditors will exercise professional judgement and form a rounded assessment for each KLOE.

#### Achieving level 2

- 33 To achieve level 2, all or virtually all of the assurances will need to be evident as these are basic requirements for achieving adequate performance. Auditors will be making rounded judgements drawing on the professional standards outlined at level 2.

#### Achieving level 3

- 34 To achieve a level 3 performance and assess the organisation as performing well, the arrangements at level 2 should be embedded and operating effectively with clear outcomes. In addition, virtually all of the assurances at level 3 will need to be evident.

#### Achieving level 4

- 35 To achieve a level 4 performance and assess the organisation as performing strongly, the arrangements at levels 2 and 3 will be embedded and are operating effectively with clear outcomes. There should be evidence of exceptional performance, innovation and notable practice that can be shared with other NHS bodies.

### Determining scores for each of the five areas

- 36 The overall score for each of the five areas of ALE will be the numerical average of the relevant KLOE scores. Some 'dominant' KLOEs have been identified where averaging produces a half score (for example, on financial reporting scores of 2 and 3 on the individual KLOEs will result in an overall score of 2.5). This is only likely in three areas: financial reporting (where there are two KLOEs), financial management (where the asset base KLOE may not be applicable) and value for money (where there are four KLOEs). The dominant KLOEs for each of these areas are as follows:

**Table 1 'Dominant' KLOEs**

Area	KLOE Ref	Key line of enquiry
Financial reporting	1.1	The organisation produces annual accounts in accordance with relevant standards and timetables, supported by comprehensive working papers.
Financial management	2.1	The organisation's medium-term financial strategy/plan, budgets and capital programme are soundly based and designed to deliver its strategic priorities.
Value for money	5.4	The organisation has established arrangements for managing its financial and other resources which demonstrate value for money is being managed and achieved.

### Determining one overall score

- 37 The proposed rules for determining the overall score which will become the Healthcare Commission's use of resources assessment are as follows:

**Table 2 Rules for determining one score**

Overall score	Rules
1	If the score of any of financial management, financial standing or value for money is 1.
2	Financial management, financial standing and value for money must each score at least 2.
3	No score below 2. Financial management, financial standing and value for money must each score at least 3.
4	No score below 3. At least two of the scores for financial management, financial standing and value for money must be 4.