

Government and Public Sector

March 2008

# Final

## **Public Interest Report**

Hinchingbrooke Health Care NHS Trust

The Members of the Board  
Hinchingbrooke Health Care NHS Trust  
Hinchingbrooke Park  
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Cambridgeshire  
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March 2008

Members of the Board

### **Hinchingbrooke Health Care NHS Trust – Public Interest Report**

We attach our report in the public interest issued under section 8 of the Audit Commission Act 1998 (the Act), which also constitutes a referral to the Secretary of State under section 19 of the Act. Our report considers the financial position of the Trust as at November 2007.

This report should be considered at a full Board meeting of the Trust as soon as possible after the report has been received. The Board should also take its response to a full meeting of the Board. We would expect this to include a decision on whether this report requires the Trust to take any action, and, if so, what action should be taken. In accordance with the Trust's Standing Orders, Board meetings are open to the public and we would expect this report to be discussed in the open part of the Board meeting.

A copy of this report has been issued to the Department of Health, the Audit Commission, and the East of England Strategic Health Authority.

Yours faithfully



**PricewaterhouseCoopers LLP**

Appointed Auditor of Hinchingbrooke Health Care NHS Trust

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Section 8 of the Audit Commission Act 1998 requires an external auditor appointed by the Audit Commission to consider whether, in the public interest, there should be a report on any matter coming to their notice, for it to be considered by the body concerned or brought to the attention of the public. This report has been prepared under section 8 of the Audit Commission Act 1998 to bring attention to the financial position of Hinchingsbrooke Health Care NHS Trust as at November 2007 and for it to be considered by the audited body. The matters in this report came to our attention during the course of our audit work. Our work was designed to identify significant financial standing issues affecting Hinchingsbrooke Health Care NHS Trust as at November 2007. Our work was not designed to be a comprehensive analysis of the financial position of the Trust or to identify all actual and/or possible operational, financial planning or internal control weaknesses. It should also be noted that the information included in this report relating to the current financial position of the Trust has not been subject to an audit in accordance with Auditing Standards or any other audit procedures designed to verify its accuracy. Reports prepared by auditors addressed to, and prepared for the Board of the Trust are for the sole use of the audited body. Auditors do not accept any duty of care or responsibility to any director or officer in their individual capacity, or to any third party.

## I Executive summary

- 1 Hinchingbrooke Health Care NHS Trust (the Trust) is a local hospital trust serving the Huntingdonshire area, with income for 2006/07 totalling £72 million.
- 2 The Trust did not achieve its forecast break-even position in 2004/05 and reported a deficit of £1.6 million, following a number of year end audit adjustments, including the write off of a debtor and the requirement for a provision in respect of new terms and conditions of employment of staff.
- 3 In 2005/06, the Trust was aware of the need to reduce costs, in line with activity expectations. Its financial plans for that year of breaking even were reliant upon a number of non-recurrent measures, including the sale of residences. The planned measures did not occur and there were other movements against the forecast position that resulted in the Trust reporting a deficit of £7.8 million for the year.
- 4 The Trust was successful in delivering its revised target for cost improvements in 2006/07. However, the financial turnaround process initiated by the Trust in the summer of 2006 confirmed that cost improvements, including a significant number of redundancies would not provide sufficient savings to enable the Trust to breakeven in that year. In 2006/07, the reported deficit for the year was £13.4 million and the accumulated deficit carried forward at 1 April 2007 was £22.9 million. The Cambridgeshire Strategic Health Authority (the SHA) extended the Trusts break-even period to 31 March 2009.
- 5 The Board agreed a budget for 2007/08 with a planned deficit for the year of £17.6 million. This would result in a cumulative deficit of £40.5 million at 31 March 2008.
- 6 In the latest finance report to the Board for the period to 30 November 2007, the Trust is showing a deficit of £8.4 million compared with a planned deficit of £9.6 million. The latest forecast for the year is for a deficit of £15.8 million compared with the original plan of a deficit of £17.6 million.
- 7 There have been a number of factors which have contributed to the deterioration of the Trust's financial standing:
  - A Diagnostic and Treatment Centre (DTC) received the approval of the SHA and the Department of Health (DH) and was opened in October 2005. Increased activity was to be generated by a shift in referrals to the Trust but this was not the case as initially local Primary Care Trusts had changed their commissioning intentions away from hospitals and into the community, in line with new DH guidance.
  - The national introduction of 'Payment by Results' (PbR), a system for paying hospitals based on results, was accompanied by transitional funding adjustments which resulted in the Trust not receiving full payment in 2006/07 and 2007/08, for its activity based on nationally determined prices.
  - Under these arrangements, the Trust's income for 2006/07 was reduced by a transitional charge of £5.5 million. The Trust also suffered an additional transitional charge of £4.6 million due to incorrect data submitted by the Trust to the DH. The net reduction in income under PbR for 2007/08 is £15.5m.
- 8 The Board received an updated financial recovery plan in January 2007. The Trust's priority in developing this plan was to prevent any further deterioration in its ongoing financial position rather than to address its cumulative deficit. At the same time Cambridgeshire PCT (the PCT) began a consultation exercise on the future of the

hospital's services. The outcome of the consultation exercise, reported in July 2007, was that the preferred option for the future of the Trust was a redesign of services resulting in a reduction in operating costs over the next two years. As part of the reduction in costs, the Trust Board agreed in principle to the dissolution of the Trust, probably after 1 April 2009.

- 9 During and following the consultation exercise, the Trust has been working closely with the PCT to establish the commissioning needs of the local population in more detail to allow planning for these future services, including the financial implications.
- 10 As the statutory auditors of the Trust, we must consider the Trust's financial standing and in the light of the results of our review, consider our duties under section 8 of the Audit Commission Act 1998. This requires us to issue a report in the public interest where we consider that a matter is sufficiently important to be reported on in order for it to be considered by the body concerned or brought to the public's attention.
- 11 We have previously drawn the Board's attention to the seriousness of the Trust's financial position and the need to return the Trust to financial balance as a matter of the highest priority. We have undertaken work which has identified recommendations designed to assist the Trust in this process. Some, but not all of these recommendations had been implemented at the time of our follow up work.
- 12 In our view, although the Board is working towards achieving in-year financial breakeven in 2008/09, it will not be able, without external support, to achieve its statutory duty to breakeven on a cumulative basis by 31 March 2009. The reason for this is the scale of the latest projected accumulated deficit at 31 March 2008 (£38.7 million) and the absence of a financial recovery plan to deliver this outcome. We have, therefore, concluded that we need to issue a formal report in the public interest on the Trust's financial standing, and under s19 of the Audit Commission Act 1998, we are also required to make a referral to the Secretary of State.

## II Historical financial performance

### Introduction

- 13 The Trust is a local hospital trust serving the Huntingdonshire area, with income for 2006/07 totalling £72 million. Of this income, 89% was received from its main commissioner, Cambridgeshire Primary Care Trust (the PCT).
- 14 Although this report concerns only one organisation, the circumstances should be understood within the context of the health economy within which the Trust operates. Decisions made by one body in the health economy may have significant effects upon others.

### Annual performance against the statutory financial duty

- 15 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.” NHS trusts would normally plan to meet this duty by achieving a balanced position on their income and expenditure accounts each and every year.
- 16 In 1997 the Department of Health, Treasury and the Audit Commission agreed that the duty will be assumed to be met if expenditure is covered by income over a rolling three year period. Exceptionally, the breakeven duty is assumed to be met if expenditure is covered by income over a rolling five year period. Such an extension to the period requires the support of the Strategic Health Authority.
- 17 As shown below, the Trust’s performance against this statutory duty has steadily and significantly deteriorated over the last three years. On 20 April 2007, the East of England Strategic Health Authority (the SHA) granted the Trust an extension to the rolling break even period to five years.

	2004/05	2005/06	2006/07
	£'000	£'000	£'000
Accumulated deficit brought forward	(263)	(1,829)	(9,581)
Deficit for the year	(1,566)	(7,752)	(13,354)
Accumulated deficit carried forward	(1,829)	(9,581)	(22,935)
Breakeven cumulative position as a percentage of turnover	2.5%	13.2%	31.7%

Source: audited accounts

- 18 The cumulative deficit at 31 March 2004 did not exceed the threshold of 0.5% of income, regarded as material by the Department of Health and 2003/04 is not counted in the five year period. The Trust is, therefore, now in year 4 of its breakeven period and, in order to meet its statutory duty, it is required to recover the cumulative deficit by 31 March 2009.

### 2004/05

- 19 The 2004/05 draft accounts reported a breakeven position. However following audit adjustments, the most significant of which were the write-off of a debtor balance and the inclusion of a provision in respect of the national “Agenda for Change” programme (which updated the terms and conditions of employment for relevant staff), the final accounts reported a deficit of £1.6 million and a cumulative deficit of £1.8 million, being 2.5% of income.

## 2005/06

- 20 In 2005/06 the Trust was aware of the need to reduce costs and was forecasting an outturn close to breakeven. However, this was dependent upon non-recurrent measures, such as the disposal of residences and additional support from Huntingdonshire PCT that did not occur. The Trust reported a deficit of £7.8 million for the year, partly as a result of the Diagnostic and Treatment Centre (DTC) that opened in October 2005.
- 21 In response to projected increases in population in South Cambridgeshire, a formal business case was submitted for a Diagnostic and Treatment Centre (DTC) funded by a Private Finance Initiative (PFI). The scheme received approval and the £22 million DTC opened in October 2005. The increased activity required for the facility to be financially viable was to be generated partly by a shift in referrals to the Trust. However, when the DTC opened, activity levels were significantly less than expected, as commissioners began to move patient care out of hospitals and into the community in line with the aims of “Our health, our care, our say: a new direction for community services” published by the DH in January 2006. We understand from the Trust that the DTC is now operating at capacity for the five full days it is contracted for and the Trust has a remaining half day to use as it sees fit.

## 2006/07

- 22 The 2006/07 Income and Expenditure Account reported a deficit of £13.4 million for the year. Two other factors affected the forecast outturn.
- 23 First, the DH ceased to apply the Resource Accounting and Budgeting (RAB) regime, whereby deficits accumulated in prior years were automatically deducted from the income of Trusts in the following financial year. As a consequence of removing the “RAB/double deficit” issue from the NHS finance regime, the Trust’s 2006/07 income was not subjected to a RAB deduction, and the year’s Income and Expenditure Account improved by £8 million compared to the original forecast.
- 24 Second, following the national introduction of payment by results (PbR), the DH introduced transitional adjustments designed to cushion the losers, over time, towards the tariff costs, and correspondingly to limit gainers to what could be afforded during the transition period. The aim of the transitional adjustments for Trusts has been to limit any financial instability due to the introduction of PbR through a phased transition to operating under full PbR tariff.
- 25 These transitional adjustments were based on data returned by NHS Trusts and PCTs during 2006/07. Data was validated by SHAs and confirmed with organisations prior to use. The data submitted by the Trust showed that it was a “gainer” under PbR, meaning its income would be greater under PbR than it would otherwise have been under local prices. The transitional adjustment for the Trust for 2006/07 was originally calculated to be a reduction in its income of £19.1million. However, during 2006/07, the Trust notified the Department that it had submitted incorrect data and overstated its gain under PbR. Following notification of this error, the DH Finance and Investment Sub-Committee agreed to a one-off non-recurrent payment of £9 million in 2006/07. The total reduction in the Trust’s income in 2006/07 was £10.1 million of which £4.6million related to the incorrect data submitted by the Trust to the DH.
- 26 The deficits arising from 2004 through to 2007 have had an impact on the Trust’s available cash resources. Pending the outcome of a review by the DH of the funding options available to the Trust over the next two years, the Trust received temporary Public Dividend Capital (PDC) of £27.3 million in 2006/07 in order to strengthen its cash position. The DH initiated an independent review of the finances of a number of severely financially challenged Trusts with a view to agreeing a permanent solution.

The Board believe that the temporary PDC will not be repayable or if repaid, renewed, in 2007/08.

### **How the Trust responded to its financial problems**

- 27 The Trust initiated its own turnaround process in the summer of 2006 and the baseline assessment confirmed that there was an underlying deficit. The Trust's financial recovery plan (FRP) required £9.6 million of savings to be delivered by 31 March 2007. However, following review by external consultants, the cost improvement target was revised to £4.2 million. The revised cost improvements were achieved in 2006/07. However, the turnaround process clarified that the cost improvements identified, including a significant number of redundancies, would not provide sufficient savings to enable the Trust to breakeven in 2006/07.
- 28 The Trust established a Finance Committee in November 2006 whose purpose includes carrying out detailed scrutiny of the Trust's cost budgets and assisting the Director of Finance and the Board in financial recovery planning.
- 29 The Trust produced an updated FRP, which was presented to the Board in January 2007. However, this document did not include a plan that resulted in the Trust achieving its cumulative breakeven duty over a five year period ended March 2009. We understand that the Trust's priority in developing this FRP was to stop any further deterioration in its in-year financial position rather than to address the cumulative deficit.
- 30 In early 2007, the PCT started a consultation in respect of the future services at Huntingdon "Seeking Sustainable Health Services for the People of Huntingdonshire". The results of the consultation were reported in early July 2007 and the preferred option was for service redesign based on reduced activity. This would require achieving a significant level of savings to achieve in year financial balance. As a contribution to making these savings, the Trust Board has agreed, in principle, to the dissolution of the Trust as a corporate entity, probably at the end of the 2008/09 financial year. The SHA is leading the work to identify successor arrangements although this is at an early stage and the outcome is presently uncertain.
- 31 During and following the consultation, the Trust has been working with Cambridgeshire PCT to establish its purchasing intentions in more detail to allow the planning to take place to show the future shape of services, use of the current site and workload and financial profiles. This represents the 'Sustainable Hospital Project', which was launched in March 2007 and was reported back on to the Board in September 2007. The further work required to develop the Sustainable Hospital Project will contribute to the further development of the FRP.
- 32 As noted above, the Trust's current focus is on achieving and then maintaining in-year operational financial balance. The budget for 2007/08 agreed by the Board in March 2007 planned for a £2.5 million operational deficit after a net £15.1 million reduction to income in respect of the national transitional arrangements for PbR and continued impact of the Trust PbR error; a total deficit of £17.6 million. This is an agreed 'control total' with the SHA and was re-stated in the Operational Plan agreed by the Board in June 2007. The plan for 2007/08 requires savings totalling £2.0 million, in order to achieve the planned £17.6 million deficit. This would result in a cumulative deficit of £40.5 million at 31 March 2008. The Trust's revised aim in the current financial year is to eliminate the £2.5 million operating deficit, and doesn't include recovery of the net loss of income due to PbR which is now being correctly reported by the Trust as £15.5 million.

- 33 The Board's January finance report for the eight months ended 30 November 2007 reports a deficit of £8.4 million compared to a budgeted deficit of £9.6 million for that period. This is £1.2 million better than plan. The Trust's current forecast outturn for the year is a deficit of £15.8 million compared with the planned deficit of £17.6 million. The latest forecast for the operational deficit for the year is £0.3 million compared with the original plan of £2.5 million. The Board report also identifies the risks to achieving these forecasts and the action that is being taken to mitigate those risks.
- 34 The Trust's overall funding position continues to be supported by the temporary PDC received in 2006/07. The latest cash flow forecast shows that the Trust will need further significant cash support at 31 March 2008.

### III Previous audit concerns raised

35 We summarise below the comments and concerns that we have included in our formal reporting to the Trust from 2004/05 to date in relation to its financial management and financial standing.

#### 2004/05

36 In our annual Audit Letter, issued in December 2005, we reported that the Trust's financial position remained extremely difficult. We emphasised that it was important for directorates and the Trust to have realistic and robust FRPs and recommended that the Board's monitoring of the Trust's progress in the delivery of these plans be given the highest priority. We also recommended that the Board should monitor the usage of the DTC and ensure that value for money was obtained.

#### 2005/06

37 In March 2006 we reported our findings from our 'red risk' review of financial management, which focused on financial planning, treasury management and financial standing. The objective of the review was to determine whether effective arrangements were in place and being applied in practice.

38 The key findings we reported to the Trust were that:

- The Trust would benefit from additional, more robust planning, in the form of a medium term financial plan, and a detailed FRP, to enable the Trust to demonstrate how it is planning to achieve a recurrent breakeven position, in both the short and medium term future.
- Given that a significant proportion of the overspend was due to directorate overspending, changes within the organisational culture of the Trust were crucial. Areas which could be improved included involvement of budget holders in the budget setting process, adequacy of financial training for budget holders and the degree of control which budget holders were able to exercise over their delegated budgets.
- The financial plan for 2005/06 incorporated a significant element of cost improvements. We were not able to verify whether these estimates were realistic, or whether the Trust was underperforming against these targets. We recommended that the Trust should review the achievability of the planned savings, and ensure that realistic forecasts were built into reports to the Board.

39 In our annual Audit Letter dated November 2006, we reported our view that the Trust's financial position was now a matter for serious concern. We set out our view that the requirement to meet the statutory financial breakeven duty by returning the Trust to recurring financial balance and to repay its historic deficit needed to be a matter of the highest priority for the Board and management and that effective monitoring by the Board of monthly financial performance over the remainder of the financial year was essential.

40 We also noted that the FRP needed to be implemented as soon as possible, that there was an urgent need to finalise the service level agreement with Cambridgeshire PCT and to finalise agreements with the DH in respect of securing cash resources.

## 2006/07

- 41 Given the initiation of turnaround work and that an FRP was being developed, we were not minded to issue a public interest report early in the 2006/07 year. We judged that it was appropriate to await the outcome of the “Seeking Sustainable Health Services for the People of Huntingdonshire” consultation that started early in 2007 and reported in July 2007.
- 42 In July 2007 we reviewed the actions taken by management in response to the action plan set out in our ‘red risk’ review of financial management report. This included a review of the Trust’s FRP presented to the Board in January 2007(see paragraph ...)  
The main findings from our review included:
- The FRP did not include a plan to break even over the five year period ended 31 March 2009 and needed to be updated for significant events since it was presented to the Board in January 2007.
  - The FRP needed to be strengthened to comply with the DH’s guidelines on the form and content of financial recovery plans.
  - We were pleased to see that the majority of the planned savings for 2007/08 of £2.0 million were supported by detailed plans.
  - Good progress had been made in respect of the recommendations in other areas. In particular the establishment of a dedicated Finance Committee and improvements in the Finance Reports to the Board. Some recommendations, however, remained to be fully addressed, including formalisation of the Trust’s Medium Term Financial Strategy and financial training for budget holders.
- 43 We summarised the contents of our financial management report in our 2006/07 Audit Letter (September 2007), where we reiterated the seriousness of the Trust’s financial position. In view of the Board’s responsibility for ensuring that the Trust meets its statutory financial duty, a copy of our Audit Letter was sent to each member of the Board. We explained in our Audit Letter our special reporting powers under section 8 of the Act in relation to public interest reporting. We also stated that we would continue to assess the Trust’s financial standing in our consideration of whether we needed to use these powers.

## IV The need for a public interest report

- 44 By the end of 2006, it was clear that the Trust's financial position was a matter for serious concern. In our view, the Board has been taking appropriate action by initiating a turnaround process, developing a FRP and then working with Cambridgeshire PCT and the SHA to consult on appropriate future services in Huntingdon.
- 45 However following the development of the FRP and the completion of the consultation process, it has become clear that the Trust will be unable to achieve the cumulative element of its statutory breakeven duty by 31 March 2009 without external support, given the scale of the cumulative deficit (which is projected to be £38.7 million at 31 March 2008) and the absence of a plan to do so. This date coincides with the possible date of the dissolution of the Trust. Indeed, following the consultation in early 2007 "Seeking Sustainable Health Services for the People of Huntingdonshire", the Trust will need to continue to achieve a significant level of savings in order to achieve in year financial balance.
- 46 We have therefore concluded that there is now a need to issue this report in the public interest on the Trust's financial standing in view of the likely failure to meet its statutory financial duty to achieve cumulative breakeven over the five year period ending 31 March 2009.
- 47 Under s19 of the Audit Commission Act 1998, we are required to make a referral to the Secretary of State when we have reason to believe that an NHS trust:
- "is about to make, or has made, a decision which involves or would involve the incurring of expenditure which is unlawful, or
  - is about to take, or has taken, a course of action which, if pursued to its conclusion, would be unlawful and likely to cause a loss or deficiency."
- 48 As the Trust is not likely to achieve its statutory break even duty for the five year period ending 31 March 2009, we are required by s19 to make a referral to the Secretary of State. This report therefore also constitutes a referral to the Secretary of State under section 19 of the Audit Commission Act 1998.

## V Recommended actions

49 The Trust needs to take action to:

- Deliver savings in line with plans and timetable.
- Continue to closely monitor all categories of income and expenditure and where necessary, reduce them in line with anticipated reductions in activity.
- Determine the shape of future hospital services and their related budgets by finalising work on the Sustainable Hospital Project.
- Update the existing FRP in the light of the above and our detailed recommendations from our Financial Management follow up report.

50 In view of the size of the Trust's cumulative deficit, and the apparent inability of the Trust to meet its statutory breakeven duty without additional financial support, the Board must now, as a matter of urgency, engage with the DH, the SHA and its commissioners to identify and implement a solution that will enable the Trust to achieve its statutory duty by 31 March 2009. The existing FRP should then be reviewed and updated to ensure that it satisfactorily addresses the need to recover the Trust's cumulative deficit. In the event that a significant deficit remains at 31 March 2009, the SHA will need to find a resolution for the cumulative deficit or address the impact on any successor body.

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