

# Brent Teaching Primary Care Trust 2003/04 Audit Letter



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15 November 2004

Ladies and Gentlemen

**Audit Letter 2003/04**

We are pleased to present our Audit Letter for 2003/04. We hope that the information contained in this report provides a useful source of reference for non-executive and executive directors.

Yours faithfully

PricewaterhouseCoopers

Encs

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## **Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies**

In April 2000 the Audit Commission issued a revised version of the Statement of Responsibilities of Auditors and Audited Bodies. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end, and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this statement.

The matters raised in this and other reports that will flow from the audit are only those which have come to our attention arising from, or relevant to, our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks in your business or all internal control weaknesses. Reports and letters prepared by appointed auditors and addressed to Board members and Directors are prepared for the sole use of the audited body, and no responsibility is taken by auditors to any Board members or Directors in their individual capacity, or to any third party.

# Executive Summary

## The purpose of this report

- 1 We are required, under the Audit Commission's Code of Audit Practice (the Code), to issue an annual Audit Letter to the PCT on completion of our audit, demonstrating that the Code's objectives have been addressed and summarising all issues of significance arising from our work.
- 2 Our Audit Plan set out the risks that we identified as part of our audit planning, together with the targeted work that we planned to perform in order to address these risks. We have issued a number of reports during the audit year detailing the findings from our work. A list of these reports is included at Appendix A.
- 3 This Annual Audit Letter summarises our work for the year ended 31 March 2004, including our audit of the 2003/04 financial statements of Brent Teaching Primary Care Trust ('the PCT').
- 4 We have discussed the issues within this Audit Letter with the Audit Committee on 14 October 2004.
- 5 Figure 1 summarises our responsibilities under the Code:

- Opinion



- Use of resources
- Performance information

- The legality of financial transactions
- Financial standing
- Systems of internal financial control
- Standards of financial conduct and the prevention and detection of fraud and corruption

**Figure 1**

6 We have set out below what we consider to be the key issues arising from our audit work:

### Accounts and Governance

**Financial standing:** As at July 2004 the PCT had identified significant cost pressures totalling £6.9m impacting upon its ability to meet financial targets during 2004/05. The PCT has also identified a number of potential cost savings that would enable it to meet financial targets, however there are significant risks associated with these savings. In addition, the savings plans do not address the underlying financial problem, which appears to result partly from an underlying structural deficit inherited when the PCT was formed. It is vital that the PCT continues to identify savings that will allow it to meet financial targets in 2004/05, whilst also seeking to find a long-term solution to the underlying problem.

**Year end accounts preparation:** There were considerable delays to this year's audit that resulted in the accounts being submitted one week after the Department of Health deadline. There is scope for significant improvement in the quality and timeliness of the PCT's audit deliverables that would ensure that this situation is not repeated. In particular, it is essential that the PCT prepare complete draft financial statements and summarisation schedules in advance of the audit commencing, and that these drafts are fully reviewed to minimise future amendments. All supporting documentation should be reviewed by the PCT and held on-site, to enable the audit team to easily access required information.

The PCT has now pulled out of the shared services arrangement, and this should facilitate improvements to the year end accounts process. It is vital that the PCT take this opportunity to establish efficient and effective year end procedures that will enable the audit to run smoothly in future years.

**System generated accruals:** Our review of accruals amounting to some £1.1 million, generated automatically from various systems (PEPS, Wessis and Agency), indicated that supporting documentation was not available to verify the existence of all of the individual balances. Many of the accruals were over one year old and some of them predated the formation of the PCT. The failure to monitor and review the information held on these systems means that it is now difficult to verify the existence of many of the balances and it is essential that the PCT carry out a thorough review of every balance on each system, with a view to substantiating their existence.

**Accounting for fixed assets:** Further to problems identified last year the PCT has continued to capitalise revenue expenditure inappropriately. Our review of all asset additions during 2003/04 resulted in amendments to the financial statements of £773k. This demonstrates a need for estates and finance staff to undertake training on the detailed capital accounting requirements (Financial Reporting Standards 11 and 15 and the Capital Accounting Manual). The PCT should establish effective controls over the fixed asset cycle to ensure that only expenditure compliant with these regulations is capitalised.

**Financial monitoring and reporting:** As part of our interim audit review we reported weaknesses in the PCT's budgetary control structure and financial monitoring procedures. The Board did not approve the budget for 2003/04 formally and we raised concerns regarding the accuracy of the financial information in the monthly finance report to the Board. The PCT had been forecasting a breakeven position throughout much of the year, however the final position was an underspend of £2.1 million. Of this underspend approximately £1.6m related to funds outside of the PCT's control, including resource held for the Patients Choice programme, and a reduction in the provision for continuing care cases. In addition there were £777k of audit adjustments that increased the final underspend.

The PCT have sought to implement improvements to the budgetary control process to ensure that information provided to budget holders and to the Board is both timely and more accurate. It is crucial that the PCT continue to improve in this area, to enable management to monitor the financial performance and standing of the PCT effectively throughout the year.

### Performance

**Star ratings:** In the Department of Health's recent 'star ratings' the PCT was awarded one star and 6 of the 9 Department of Health key targets were achieved. However, the PCT under-achieved targets in respect of outpatients waiting longer than the standard and total time in A&E of 4 hours or less, and significantly under-achieved regarding 4-week smoking quitters.

The PCT recognises the need to respond to this assessment by developing an appropriate action plan that will deliver performance improvements. This plan should be developed in an appropriate amount of detail and be included alongside the current performance management report at the PEC and Board.

8 The detailed recommendations from this year's Audit Letter are summarised in Appendix B.

# Accounts and Governance

**We have commented on the following key areas in this section:**

- Financial Standing;
- Accounts;
- Systems of internal financial control
- Standards of financial conduct and the prevention and detection of fraud and corruption
- Legality of transactions

## Financial standing

### Financial targets

9 The PCT is required to meet a number of financial targets. The table below summarises the PCT's performance against these targets:

Performance target	2003/2004 actual reported	Achieved
<b>Remain within revenue resource limits</b> <b>This is a statutory duty under the Health Act 1999.</b>	The PCT spent £318,590k compared with a Revenue Resource Limit (RRL) of £320,653k. The PCT was therefore underspent by £2.1m (2002/03: £1m).	✓
<b>Remain within capital resource limit</b>	The PCT was set a capital resource limit of £6,227k and capital expenditure was 4,625k. The PCT remained within its capital resource limit.	✓
<b>The provider function should achieve full cost recovery.</b>	The PCT achieved over recovery of £123k.	✓

10 The PCT met all of its financial targets for 2003/04.

### Other financial duties

11 In addition to the main financial targets above NHS bodies have to meet other financial duties which are:

Duty	Reported outturn
Management costs: NHS bodies have to calculate their management costs in accordance with the guidance issued by the Department of Health. No limits on management costs were set for 2003/04.	Management costs of £10,273k were reported in 2003/04 (£8,904k for 2002/03).
Better payment practice code: NHS bodies are required to pay all non-NHS trade creditors within 30 days of receipt of the invoice.	87% of bills were paid within 30 days (78% in 2002/03). This represents an apparent improvement in performance during 2003/04. However, we have concerns surrounding

Duty	Reported outturn
	the calculation of this figure, as noted elsewhere in this report.
Limits on cash balances: PCTs are required to maintain their year end balances within these limits: <ul style="list-style-type: none"> <li>discretionary accounts £70,000</li> <li>non-discretionary accounts £30,000</li> </ul>	The year end cash balances amounted to £0k (2002/03: £87k).

### Current financial position

- 12 As at July 2004 the PCT had identified significant cost pressures totalling £6.9m impacting upon the PCT's ability to meet financial targets whilst delivering all its services during 2004/05. Analysis of these cost pressures shows that £6.2m relates to over-commitments in the budget and in the Local Development Plan. The PCT believes that this situation is partly a result of a structural deficit inherited when the PCT was formed, which in prior years has been managed through receipt of non-recurrent funds and slippage in PCT activity. In addition to these cost pressures a further £760k relates to current overspends against budget.
- 13 Despite these cost pressures the PCT is forecasting a small surplus of £23k for 2004/05. The PCT is anticipating slippage in some projects resulting in savings of £3m, with a further £2m saving anticipated through renegotiation of payments due to North West London Hospitals NHS Trust under the Service Level Agreement (SLA). A final saving of £1.9m is to be achieved through a range of measures, including some freezing of non-essential expenditure, potential savings in relation to continuing care, and also achievement of savings identified by ATOS KPMG Consulting as part of their review at the PCT.
- 14 There are clearly significant risks associated with these plans. The PCT is currently relying on a number of outside factors in order to achieve financial targets, and there is a significant risk that the anticipated savings from renegotiation of SLAs and reassessment of continuing care provision may not materialise. Failure to achieve anticipated savings from any of these plans would have a serious impact on the PCT's position. Furthermore, by relying on slippage to achieve financial stability the PCT is not dealing with the underlying problem, and is simply deferring these pressures to future years. It is vital that the PCT acts to find a long-term solution to this underlying financial position.

**Recommendation:** The PCT should continue to identify measures by which financial targets for 2004/05 can be met, and progress against each of the anticipated savings targets should be reported in detail at each Board meeting. The PCT should ensure that the Strategic Health Authority are kept aware of the position.

The PCT should also seek to find a long-term solution to the underlying financial problems, which may include an assessment of the level of service that the PCT can sustain in the long-term given the resources at its disposal. The PCT should involve the Strategic Health Authority in these discussions.

### Accounts

- 15 The purpose of our accounts work was to perform an audit of the final accounts of the PCT, in accordance with approved Auditing Standards.
- 16 We have issued unqualified true and fair audit opinions in relation to the following:
- Financial statements and their associated summarisation schedules; and
  - Summary Financial Statements contained within the annual report.
- 17 We also issued an unqualified regularity opinion on the financial statements. This opinion requires us to report on whether, in all material respects, expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.
- 18 The audited financial statements were submitted to the DHSC on 23 July 2004, missing the specified

deadline by one week. This was due to significant delays in the accounts closedown process, noted below, and the need to resolve a number of serious audit issues identified during our work. These are noted later in this report.

### **Audit deliverables**

- 19 During this year's audit we encountered serious problems with the quality of information received from the PCT, and this resulted in considerable delays to the audit process. Although our initial visit began as planned on 10 May 2004, a number of key documents and working papers had not been prepared by the PCT as agreed with us earlier in March. In addition to this, the audit work we were able to perform raised a number of major concerns that required additional attention from PCT staff before any further audit work could be carried out. These problems meant that only limited work could be carried out during this initial visit.
- 20 Further discussions with PCT staff, together with a subsequent audit visit in June, indicated that problems around adequate supporting documentation and audit trails remained. Consequently, we agreed with the PCT that the audit team would withdraw until early July to allow the PCT to prepare complete financial statements and ensure that adequate working papers were in place for all components of the accounts.
- 21 During our final visit in July we found that there had been significant revisions to the draft financial statements and we also continued to encounter problems with working papers and the timely receipt of supporting documentation. Once the information had been received we identified a number of accounting issues that required additional work. In order to ensure that we could resolve these issues satisfactorily we agreed with the PCT that the financial statements would not be submitted by the deadline but, instead, were submitted one week later.
- 22 The PCT has now pulled out of the shared service arrangement with North West London NHS Trust, and has taken on full responsibility for the management of its financial services. This should assist in implementing improvements to the quality and timeliness of audit deliverables, which will be particularly important if the audit deadline is moved forward in 2004/05.

**Recommendation:** The PCT should implement a range of improvements to the timeliness and quality of audit deliverables. Draft financial statements should be completed prior to the commencement of the audit, and should be subject to a detailed review by the Director of Finance prior to being passed to the audit team.

All balances in the financial statements should be supported by detailed working papers, and the finance team should have a strong understanding of all balances. Key contacts should be established for all balances, and the PCT should ensure that these contacts are available during the audit as required.

The PCT should ensure that all documents included on the deliverables list have been prepared and reviewed in advance of the audit. Where there are potential delays or problems being encountered, the PCT should raise these as early as possible with the audit team.

- 23 The working papers supporting the creditor balances were of particular concern. This was also an issue in the previous year when we recommended a number of improvements in relation to the distinction between NHS and Non-NHS creditors, and between creditors and accruals. However, no changes were made to the process in 2003/04 and, as a result, we incurred a lot of additional audit time and the PCT had to re-analyse the creditor balances in order to prepare an adequate audit trail. In future years early preparation of these balances and working papers in the appropriate format will enable the audit to be completed more efficiently, and will avoid the need for PCT staff to spend additional time explaining the working papers to the audit team.

**Recommendation:** The information provided at the year-end to support the disclosure of PCT creditors needs to be enhanced. Separate journals should be created for NHS and Non-NHS balances, and these journals should be clearly split between accruals and creditors. Supporting documentation for all journals, such as invoices or PCT calculations, should be held on file and made available for audit testing.

## Accounting issues

### System generated accruals

- 24 In addition to everyday ordering of goods and services, the PCT uses three automatic systems for dealing with utilities and employment agency costs. These are the PEPS, Wessis and Agency systems. In all cases, these work by recording purchase order numbers or expected quarterly charges, and then clearing these against invoices as they are received. All costs are therefore incorporated into the PCT's ledger, and any outstanding orders for which no invoice has been received are shown as accruals at year end. In the 2003/04 financial statements the total value of accruals relating to these systems was £1.1m.
- 25 During our audit we noted that many of the accruals were extremely old, some of them pre-dating the formation of the PCT, and that a number of the utility accruals related to sites that were no longer in use. The PCT were unable to provide detailed supporting information to prove that these accruals represented true liabilities. Furthermore, the PCT only has limited processes to monitor the data held on these systems throughout the year, and no review had been undertaken of the year end information to assess its accuracy.
- 26 We performed additional work in an attempt to verify these accruals but the results of this exercise did not allow us to confirm that all of the balances were valid. Instead, we had to rely on analytical procedures and a review of subsequent payments sufficient to enable us to conclude that the balances were not materially misstated. However, the lack of any supporting documentation and the absence of control over these systems raises serious concerns about the PCT's management of these balances. The PCT has accepted that a thorough review is required to clear these balances, where appropriate, and to ensure that in future only valid accruals are generated.

**Recommendation:** The PCT should, as a matter of urgency, carry out a thorough review of the PEPS, Wessis and Agency systems. This must involve analysing all balances held on these systems and assessing whether they represent true liabilities or whether they should be written back to the income and expenditure account. For all decisions, full supporting information will be required, including an assessment of why the accrual was initially raised, and why the PCT has reached its subsequent decision. Where the PCT feels that an accrual is valid, supporting evidence should be retained to prove the accuracy of the accrual. This review should be carried out by December 2004, and the results presented to PwC for a full audit assessment.

Going forward, the PCT should develop procedures to allow these systems to be monitored. An appropriate finance officer should review the accruals held on the systems each quarter, and evidence should be retained of action taken as a result of this review. The PCT should ensure that the year-end balances are fully reviewed prior to the preparation of the financial statements.

### Accounting for fixed assets

- 27 Last year we raised an issue concerning controls over fixed asset additions and the potential incorrect capitalisation of a number of small items. The decision was taken not to adjust for these items in the 2002/03 accounts, as the PCT assured us that a full review of all capital additions made during the year was underway, and that processes were being established to ensure that this would not become a recurring issue.
- 28 However, at the year end we were disappointed to note that this review had not been carried out and no progress appeared to have been made. Our preliminary testing identified a number of errors, including the capitalisation of large items of revenue expenditure. As a result we undertook a much more detailed review of additions made during the year to confirm whether they had been correctly classified. This additional work identified incorrectly capitalised expenditure of £773k. The PCT has adjusted for all the errors identified.
- 29 The PCT had not reviewed capital additions for compliance with accounting principles and there is a need for a better understanding of how these principles should apply in practice. The PCT was also accruing to budget on outstanding capital projects, resulting in the recognition of capital additions before the expenditure had actually been incurred. It is important that the PCT take action to improve controls over classification of capital expenditure so that it can better monitor expenditure against its capital resource limit. We will seek to review all capital additions up to December 2004 during our interim audit, and will perform further procedures as part of our final audit visit to test additions made to the end of the year.

**Recommendation:** The PCT should act to ensure that appropriate internal controls exist to give assurance that only capital additions are being included on the balance sheet. The estates team should be given information explaining the requirements of capital accounting principles (FRS 11, FRS 15, and the Capital Accounting Manual) and reminded of the importance of correctly classifying all additions. An appropriate member of the finance team should be responsible for reviewing all additions and ensuring appropriate classification in the financial statements.

The finance department should ensure that copies of all invoices are retained for review by the audit team throughout 2004/05.

- 30 Our review of the depreciation charge indicated that the PCT does not charge depreciation on assets in the year of purchase. This is not in line with the Capital Accounting Manual, which states that assets should be depreciated from the quarter following the quarter in which the asset first became available for use. This results in an understatement of depreciation in the income and expenditure account, and an associated overstatement of assets. It was not possible to quantify the value of this error for 2003/04 due to the high level of additions, but the potential value was deemed immaterial for adjustment.

**Recommendation:** The PCT should review its depreciation policy and ensure that in future years this is in compliance with the Capital Accounting Manual.

- 31 The PCT received additional funding totalling £9,118k from the Strategic Health Authority during 2003/04 to account for costs relating to both the impairment of the Kingsbury Hospital development and accelerated depreciation to be charged on Willesden Hospital and Pound Lane Clinic to the date of demolition. Review of the calculation provided initially to support the level of funding required showed that a number of assumptions had been incorrect, resulting in over-funding of £176k. There is a risk that the Strategic Health Authority could potentially reclaim this funding and this may impact on the PCT's ability to meet its resource limit during 2004/05.

**Recommendation:** The PCT should discuss this issue with the Strategic Health Authority early in 2004 and obtain confirmation about whether it will be required to repay the excess funding received. This will help the PCT to monitor its financial performance and forecast its final position against the resource limit.

### Back to back provisions

- 32 In the PCT's 2003/04 financial statements there was a total of £2,313k of provisions relating to back-to-back arrangements with other NHS bodies. The PCT is informed of these balances by the NHS body responsible via a year end schedule, which explains the movements in the balances throughout the year and notifies the PCT of the outstanding year end balance. During our review of the supporting documentation we noted that, whilst the PCT had included the figures as per the information provided by the relevant bodies, it did not have a detailed understanding of these balances, and did not carry out a review of the information received to confirm its accuracy and reasonableness. The PCT should have a better understanding of how these balances are compiled and should avoid simply relying on external bodies for information, as this increases the risk that costs are transferred in these provisions that do not relate to the PCT.

**Recommendation:** The PCT should discuss all back-to-back provisions with the NHS body involved, and ensure that it has a detailed understanding of the nature of these provisions and that it is confident that all costs are being validly recharged to the PCT.

### Early retirement costs

- 33 In the prior year Audit Letter we raised the issue that the PCT had not complied with guidance for calculating the provision for pre-1995 early retirements. This error affects all staff under 60 at the balance sheet date. The PCT agreed to obtain the relevant information from the NHS Pensions Agency to allow this provision to be reviewed and amended in line with the guidance. However, review of this provision in 2003/04 showed that no adjustment had been made. This issue affects a total of 14 individuals, but it is not possible to verify the value of the error without obtaining all the required information. The PCT have noted that there have been delays in obtaining the relevant information from the Pensions Agency.

However it is important that the PCT take control of this situation and actively seek to obtain this information and correct any potential error.

**Recommendation:** The PCT should review the calculation of the early retirement provision for all individuals under 60 years old to ensure that the provision is consistent with NHS policy. Where amendments are required, these should be adjusted in the 2004/05 accounts, and the PCT should ensure that Westminster and Kensington & Chelsea PCT are kept informed of developments. A detailed audit trail should be retained by the PCT.

### Continuing care

- 34 The PCT incurs significant costs in relation to providing continuing care for its residents. As part of our audit we performed testing on a sample of this expenditure. We noted that the primary system used in previous years for recording continuing care costs was the Microsoft Access Continuing Care system (MACC). Results of our testing and discussions with PCT staff highlighted that the raw data held on this system was unreliable, primarily due to extensive access rights and lack of monitoring of the information leading to potential unauthorised modification of standing data. We have been informed that the PCT have now discontinued use of MACC, and have moved to an excel based system whilst a decision is taken about whether to purchase a new continuing care system.
- 35 We noted that there appeared to be a lack of review of information provided by the continuing care team for inclusion in the financial statements. During our audit testing we identified accruals totalling £292k for patients who had passed away, either during or before the financial year. These were adjusted in full by the PCT, but highlighted weaknesses in the monitoring of continuing care costs recorded in the PCT's accounts.

**Recommendation:** The PCT should review the systems used by the continuing care team, and assess whether there is a requirement for updated systems to be purchased or developed. Consideration should be given to the extent of access rights required by each member of the continuing care team, and procedures should be introduced to ensure that there is full review of all amendments made to the database.

The PCT should also ensure that there is full review of costs recognised by the PCT in relation to continuing care.

### Provider full cost recovery

- 36 The PCT has a statutory duty to achieve full cost recovery on the activities of its provider function. As a result, it is important that the PCT's costs are allocated accurately between the provider and commissioning functions and that all income due to the provider function is correctly recognised. In 2003/04 the gross operating cost of the provider function was £46,446k, and the total income was £46,579k, resulting in an over recovery of £123k.
- 37 The PCT has made an attempt to split costs accurately between the two functions by charging direct costs appropriately. There are also other indirect, shared costs to be allocated such as corporate services. These have been allocated based on the corporate budget established when the PCT was first created. Consequently, this is based on a budget relating to Parkside NHS Trust, inflated for generic cost pressures, and not based on actual expenditure.

**Recommendation:** The PCT should review the allocation of joint costs between its provider and commissioning functions. This allocation should be based on actual expenditure, and supporting evidence should be retained to explain the methodology behind the allocation of each joint cost. This should subsequently be reviewed annually to ensure that it remains a reasonable estimation of actual cost allocation.

- 38 Whilst some of the provider income is met from SLAs with external bodies, the majority relates to services commissioned by the PCT from itself. The total value of this income, as stated in the financial statements, is £35,211k. However, the two sides of the PCT have not dealt with each other in an arm's length manner, meaning that there is no signed SLA detailing the level and cost of services to be provided. As a result, it is not possible to verify that this balance represents valid provider income.

**Recommendation:** The PCT should ensure that the provider and commissioning arms of the organisation deal with each other in an arm's length manner. Any contracts and services between the two sides of the PCT should be

managed as they would be with an external body, with formal negotiations taking place and an official SLA being agreed and signed. Whilst it is not expected that the PCT would raise invoices to itself, some form of verification of services performed should be carried out by the commissioning arm and a clear audit trail should be maintained to provide assurance that the provider income recognised in the accounts does relate to services provided.

- 39 During our testing of income earned by the provider function from external bodies, it was noted that formal SLAs had not been agreed with commissioners. As with healthcare expenditure, these SLAs should contain clear and specific performance targets. The lack of such SLAs exposes the PCT to a risk that commissioners may refuse to pay for some services on the basis of underperformance, and the PCT's legal position would be weakened without adequate contractual documentation. We are aware that this is an ongoing problem within the NHS generally, but would encourage the PCT to seek to agree SLAs with commissioning bodies where possible.

**Recommendation:** The PCT should ensure that it agrees and signs SLAs for all services provided. These agreements should include performance indicators and monitoring against these should be performed on a regular basis. These should be reviewed and signed each year, and copies should be retained at PCT headquarters to provide a clear audit trail.

#### **Review of bank reconciliations**

- 40 Bank reconciliations are completed by a member of the finance team and should be reviewed by the Financial Controller or the Director of Finance. We noted that there was no evidence of review of the year-end bank reconciliation.

**Recommendation:** All bank reconciliations should be subject to timely review by an appropriate officer. Both the preparer and the reviewed should sign and date the reconciliation as proof of timely completion.

#### **Better payment practice code**

- 41 The PCT is required to comply with the Better Payment Practice, under which all non-NHS invoices should be paid within 30 days. Performance against this target is reported within the financial statements. Our work showed that the disclosure had been overstated, as all queried invoices were shown as paid within the deadline, and any invoices in excess of 90 days were assumed to have been queries, and were therefore also included as paid within the deadline. During 2003/04 management of this process was carried out by the Shared Service Organisation, and inadequate information had been retained to allow a more accurate figure to be calculated retrospectively. From 2004/05 the PCT will be responsible for this process.

**Recommendation:** The PCT should ensure that the designated officer responsible for managing performance against the Better Payment Practice Code is aware of all guidelines relating to the calculation of this target. Detailed supporting working papers should be retained to support the PCT's disclosure. Performance against the Code should be reported to the Board as part of the monthly Finance Report.

## Statement of internal control

- 42 In 2003/04, all NHS bodies in England were again required to produce a Statement on Internal Control (SIC) consistent with the guidance issued by the Department of Health on 15 September 2003 and 8 April 2004. The SIC was included in the financial statements and the Annual Report.
- 43 The SIC disclosed whether the PCT had an Assurance Framework in place by 31 March 2004.
- 44 We reviewed the SIC as to whether it complied with Department of Health guidance and whether it is misleading or inconsistent with other information known to us from our audit work. We found no areas of concern to report in this context.

## Systems of internal financial control

- 45 It is the responsibility of the PCT to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as auditors is to consider whether the Trust has put adequate arrangements in place to satisfy itself that its systems of internal financial control are both adequate and effective in practice.
- 46 We carried out a review of the PCT's systems of internal financial control in December 2003 and February 2004. During 2003/04 the PCT has made some progress in developing its systems of internal financial control, and work continues to move this process forward, particularly in the development of policies and procedures across a wide range of areas.
- 47 However, we noted a number of areas where the PCT needs to make further improvements to the systems of internal financial control, and we have already issued a report explaining these findings. Of vital importance is the development of the budgetary control structure, with key issues noted during 2003/04 being the failure of the Board to authorise the budget, and the weakness of financial reporting to budget holders and to the Board.
- 48 The Board has formally agreed the PCT's budget for 2004/05, and it is important that any changes to this budget are notified to the Board as they take place. In order to be of use in managing the financial performance of the PCT, finance reports must be accurate and timely. Reported expenditure should include accruals, but these should be based on detailed estimates, and not accrued to budget. During 2003/04 the PCT was consistently forecasting a breakeven position to the Board. However, the final position was £2.1m underspent, representing monies that could have been spent by the PCT to improve the health of the local population. Accurate financial reporting and forecasting is essential to ensure that the PCT are aware of potential financial pressures or underspends, and can managed these positions appropriately. We have been assured that action has been taken to improve in these areas, and we will assess these as part of our interim review in 2004/05.

**Recommendation:** The PCT should include approval of budget amendments as a standing item within the monthly finance report.

The PCT should ensure that improvements have been made to the financial reporting structures, and that finance reports are accurate and timely, and include a reasonable assessment of accruals and forecast year end position. The PCT should monitor movements in the financial position and forecast year end position, and ensure that appropriate action is taken.

Detailed records supporting the finance reports should be retained for review by the audit team as part of the interim audit visit.

## Standards of financial conduct and the prevention and detection of fraud and corruption

- 49 The prime responsibility for the prevention and detection of fraud and irregularities rests with the PCT's management. It is the responsibility of the PCT to ensure that its affairs are managed in accordance with proper standards of financial conduct and to prevent and detect fraud and corruption. It is our responsibility to consider whether the PCT has put in place adequate arrangements to maintain proper standards of financial conduct and to prevent and detect fraud and corruption. It is not the auditors' function to prevent or detect breaches of proper standards and our work does not remove the possibility that fraud or corruption has occurred and remained undetected.

- 50 The key issue that we raised in respect of the PCT's arrangements was that the Fraud and Corruption policy remained outstanding. We reported this to you in our Internal Controls Report on July 9<sup>th</sup> 2004.

## **The legality of financial transactions**

### **GP Fundholder savings**

- 51 In line with Department of Health guidance, there was a requirement for all remaining historic GP Fundholder savings to be utilised in line with agreed spending plans during 2003/04. During our audit testing we noted that £54k of savings had not been spent within this timescale, and the PCT had consequently released these funds to its income account.
- 52 This treatment of outstanding savings is not permitted, as the funds do not belong to the PCT. Any release of funds is only permitted following discussion with the GPs and formal authorisation. As a result the PCT reinstated the remaining balance in the 2003/04 financial statements. The PCT should now seek to discuss this balance with the relevant GPs and either agree spending plans for the remaining balance or confirm that the GPs are willing to give these funds to the PCT.

**Recommendation:** The PCT should identify to which GPs the remaining fundholder savings balances relate, and should notify these GPs of the outstanding balance. The PCT should initiate discussion with the GPs to ensure that these balances are cleared in the 2004/05 financial year.

- 53 We noted no further issues with respect to the legality of financial transactions.

# Performance management

## **Key overall messages emerging from our Performance work:**

In the 2003/04 Department of Health performance star ratings, the PCT was awarded 1 star (the PCT also received 1 star in 2002/03).

There is a strong commitment to partnership working. Real efforts have been made to involve stakeholders via the Professional Executive Committee and Priority Action Groups.

The management team is stretched but coping. There is clarity about accountability for delivering specific changes.

There is scope for the PCT to take a more proactive approach in developing performance monitoring, ensuring information is relevant, comprehensive, timely and acted upon.

At the time of the review, data quality in relation to waiting times data from North West London Hospitals NHS Trust was identified as an issue of concern.

The whole system service modelling project is being led by the Public Health Unit to inform commissioning on the type and level of services required in the community.

A summary of our findings from Performance work carried out at the Trust during the 2003/04 financial year appears below. Appendix A contains a list of Performance Reports issued to the Trust. Please refer to these reports for more detailed findings from this work together with the Trust's agreed action plans.

## **Targeted audit work: Continuing Care**

54 As part of our 2003/04 audit programme, we agreed to carry out a review of the system used for continuing care placements at Brent PCT. We identified some areas of strength, such as the joint Continuing Care Assessment Tool that had been developed across all organisations in North West London. However, a number of key issues were also identified:

- Staff conducting continuing care assessments may not all be trained in how to use the assessment tool, nor have a good understanding of the wider processes around continuing care funding;
- In some care groups such as Mental Health and Learning Disabilities, there is a number of staff involved in conducting continuing care assessments; this makes it more difficult to ensure consistency. There are also continuing tensions between PCT staff and Social Services staff around consistency of assessments; and
- Documentation supporting continuing care assessments and decisions around eligibility for funding was not complete and comprehensive in all cases.

## **Audit Commission use of resources studies**

55 The Audit Commission required us to undertake the following mandatory studies in 2003/04:

- NHS Plan Implementation; and
- Reference Costs and Healthcare Resource Groups (HRGs)

## NHS Plan Implementation

56 The review was undertaken in October to December 2003, and focused on three areas:

- The Local Delivery Plan (LDP) and Capacity Planning Process;
- Patient Experience; and
- Progress against Planning and Priorities Framework (PPF) Targets.

57 Key findings were as follows.

### Overall conclusions

58 At the time of review the PCT had made good progress over the previous year. Management capacity had increased and the management team was stronger and more focused. Relationships with partners and stakeholders had continued to develop. In order to ensure further advancement, the PCT should ensure that strategies and action plans are in place in all priority areas.

### The LDP and Capacity Planning Process

59 Despite the tight timescale for LDP completion, the PCT made good efforts to include relevant stakeholders in the process of setting priorities for LDP funding. In some instances, relevant stakeholders were also consulted in the drawing up of the operational Service Delivery Plans. However, due to cost pressures, the PCT was not able to fund all priorities identified by the service leads in 2003/04.

### Patient Experience

60 Processes were in place to seek patient views; the PCT needs to ensure that patients' views are used to inform service planning and delivery.

### Progress against PPF Targets: Key Messages

61 *Primary Care Access:* The PCT had implemented a number of access initiatives, and its access figures were demonstrating an upward trend. However, meeting 100% access targets on an ongoing basis (24 hours for a Primary Care Professional and 48 hours for a GP) will be challenging.

62 *Older People:* In view of the Brent Emergency Care Access Development (BECAD) / Willesden Hospital projects, there were no plans to establish the kind of specialist stroke service envisaged within the National Service Framework by April 2004. At the time of the review, it was unclear what the implications would be for both acute and community provision of stroke care. The achievement of the falls standard is dependent on appropriate resources being allocated. At the time of our review, a business case for additional therapy posts and a falls coordinator had been submitted, but funding priorities for the 2004/05 LDP had not yet been agreed.

63 *PCT Contribution to Other Targets:* The PCT was working closely with its secondary sector providers to support them in achievement of their targets. The PCT will need to monitor closely the impact of its investments as joint plans are implemented over the coming year.

64 *Smoking in Pregnancy:* At the time of the review, progress against this target could not be gauged due to the paucity of performance information available. No baseline had been set nor any monitoring information collected. The PCT was aware that closer links between the Smoking Cessation Service and the local maternity services needed to be developed and this was being taken forward by the newly appointed smoking cessation coordinator.

### Reference costs and resource groups

65 The Department of Health plans to change the way in which trusts are funded over the next 5 years. The new system is called "Payment by Results" and healthcare contracts will be priced in accordance with a national tariff. It is critical that NHS bodies build a better understanding of how their costs are made up. Our review provided a measurement of progress at this critical time.

66 During our review we noted a number of serious problems with the PCT's reference costs submission. There appeared to be limited understanding of the guidelines surrounding completion of the reference costs submission, and this had resulted in material errors to the submission. Consequently, we concluded that the submission was unlikely to provide meaningful unit costs with which to compare the PCT to other NHS bodies. The PCT had used a historic expenditure spreadsheet dating from the predecessor organisation, Parkside NHS Trust, to prepare the reference cost submission. The PCT had then attempted to reconcile this spreadsheet to the financial statements. In addition, the reference cost submission included costs that were not relevant to PCTs, such as Public Dividend Capital. The PCT had not analysed its costs between direct, indirect and overhead costs as required by the Costing Manual.

# Audit plan 2004/05 and fees update for 2003/04

## Audit Plan 2004/05

- 67. We have issued our Audit Plan for 2004/05 and we presented it to Audit Committee on 6 July 2004.
- 68. Given the dynamic environment within which you operate, we will revisit our Audit Plan in advance of the commencement of our final accounts audit to ensure that it remains appropriate for the 2004/05 financial year.

## Fees update for 2003/04

- 69. We reported our fee proposals as part of our Audit Plan for 2003/04, which we presented to Audit Committee. These fee proposals covered the 17 month period from 1 November 2002 until 31 March 2004.
- 70. Our actual fees were in line with our proposals:

	2002/03 Outturn	2003/04 Outturn	Total 2002/04 Outturn
Accounts and Governance	146,500	115,500	262,000
Performance	24,000	24,000	48,000
Total	<b>170,500</b>	<b>259,000</b>	<b>310,000</b>

\* We are currently in discussion with the Director of Finance on additional costs incurred for the completion of audit of the accounts in 2003/04.

# Appendix A – Audit reports issued in relation to the 2003/04 financial year

- Performance reports for work carried out in 2003/04:
  - NHS Plan Implementation
  - Reference Costs and Healthcare Resource Groups (HRGs)
- Internal control report
- Audit opinion for 2003/04 financial statements

# Appendix B – Recommendations and Management response

A number of controls issues were raised with management during the planning stage of our 2003/04 audit and we obtained management responses for those issues. We reported those issues to the Audit Committee on 9<sup>th</sup> July 2004 in our Internal Controls Report.

This appendix therefore relates only to additional issues encountered during the final audit process.

Recommendation	Management response
<p><b>Financial position</b></p> <p>The PCT should continue to identify measures by which financial targets for 2004/05 can be met, and progress against each of the anticipated savings targets should be reported in detail at each Board meeting. The PCT should ensure that the Strategic Health Authority are kept aware of the position.</p> <p>The PCT should also seek to find a long-term solution to the underlying financial problems, which may include an assessment of the level of service that the PCT can sustain in the long-term given the resources at its disposal. The PCT should involve the Strategic Health Authority in these discussions.</p>	<p>This would be included regularly in the Finance Reports presented to the Board.</p> <p>This would be addressed as a part of LDP process.</p>
<p><b>Audit deliverables</b></p> <p>The PCT should implement a range of improvements to the timeliness and quality of audit deliverables. Draft financial statements should be completed prior to the commencement of the audit, and should be subject to a detailed review by the Director of Finance prior to being passed to the audit team.</p> <p>All balances in the financial statements should be supported by detailed working papers, and the finance team should have a strong understanding of all balances. Key contacts should be established for all balances, and the PCT should ensure that these contacts are available during the audit as required.</p> <p>The PCT should ensure that all documents included on the deliverables list have been prepared and reviewed in advance of the audit. Where there are potential delays or problems being encountered, the PCT should raise these as early as possible with the audit team.</p>	<p>The process followed for 2003/04 audit was in line with the previous year when the audit went smoothly.</p> <p>The majority of balances in financial statements were supported by detailed working papers and they were in line with the previous year.</p> <p>Most of the documents on the deliverable list were prepared and included in the working papers file. It might have not been filed in the order required by the Auditors.</p> <p>However, the recommendations would be implemented to ensure smooth audit process for 2004/05 audit.</p> <p>Manu Patel would implement the recommendations by 31 May 2005.</p>
<p>The information provided at the year-end to support the disclosure of PCT creditors needs to be enhanced. Separate journals should be created for NHS and Non-NHS balances, and these journals should be clearly split between accruals and creditors. Supporting documentation for all journals, such as invoices or PCT calculations, should be held on file and made available for audit testing.</p>	<p>The information to be provided at the year-end to support the disclosure of creditors would be enhanced in accordance with the recommendations. Mike McGowan and Manu Patel would implement the recommendation by 31 May 2005.</p>

Recommendation	Management response
<p><b>System generated accruals</b></p> <p>The PCT should, as a matter of urgency, carry out a thorough review of the PEPS, Wessis and Agency systems. This must involve analysing all balances held on these systems and assessing whether they represent true liabilities or whether they should be written back to the income and expenditure account. For all decisions, full supporting information will be required, including an assessment of why the accrual was initially raised, and why the PCT has reached its subsequent decision. Where the PCT feels that an accrual is valid, supporting evidence should be retained to prove the accuracy of the accrual. This review should be carried out by December 2004, and the results presented to PwC for a full audit assessment. Going forward, the PCT should develop procedures to allow these systems to be monitored. An appropriate finance officer should review the accruals held on the systems each quarter, and evidence should be retained of action taken as a result of this review. The PCT should ensure that the year-end balances are fully reviewed prior to the preparation of the financial statements.</p>	<p>The tPCT recognised the weaknesses in the systems and it was flagged up with the shared services in August 2003. This was one of the major considerations for tPCT to bring the financial services back in house. The financial services were brought in house towards the end of financial year and hence there was no sufficient time to review the systems. The systems are being reviewed currently and the data would be cleaned up by 31<sup>st</sup> December 2004. This would be actioned with the help of IT consultant by Mike McGowan for PEPS and by Manu Patel for WESIS and Agency System. Both Mike and Manu would review the accruals quarterly in accordance with the recommendations.</p>
<p><b>Accounting for fixed assets</b></p> <p>The PCT should act to ensure that appropriate internal controls exist to give assurance that only capital additions are being included on the balance sheet. The estates team should be given information explaining the requirements of capital accounting principles (FRS 11, FRS 15, and the Capital Accounting Manual) and reminded of the importance of correctly classifying all additions. An appropriate member of the finance team should be responsible for reviewing all additions and ensuring appropriate classification in the financial statements. The finance department should ensure that copies of all invoices are retained for review by the audit team throughout 2004/05.</p>	<p>The total capital expenditure disallowed was £773k. However, £648k was disallowed due to timing difference. The tPCT accrued £648,000 as creditors for capital expenditure to provide for the remaining balances of planned capital projects, which were not completed by 31 March 2004. The tPCT was being prudent to accrue for the capital commitments in line with the previous year.</p> <p>Capital Resource Limit allocated by NHS is largely for backlog maintenance and Information Technology equipment. However, there is a conflict that if the capital funds are used in accordance with the allocation, some of the capital expenditure might not strictly comply with FRS 11 and FRS 15. It appears that the auditors have applied the FRS 11 and FFRS 15 rigidly and this has resulted in some of the capital expenditure disallowed. In total the capital expenditure disallowed was £125k out of £5,398k originally capitalised. This represented 2.3% of the capital expenditure.</p> <p>Manu Patel would implement the recommendations.</p>
<p>The PCT should review its depreciation policy and ensure that in future years this is in compliance with the Capital Accounting Manual.</p>	<p>The tPCT follows the depreciation policy in compliance with the Capital Accounting Manual. As the large proportion of Capital Expenditure was of assets under construction, they were capitalised in the last quarter of the year and therefore would be depreciated in the first quarter of 2004/05.</p> <p>Manu Patel would implement the recommendations by 31 March 2005.</p>

Recommendation	Management response
<p>The PCT should discuss the issue of excess funding for impairments and accelerated depreciation with the Strategic Health Authority early in 2004 and obtain confirmation about whether it will be required to repay the excess funding received. This will help the PCT to monitor its financial performance and forecast its final position against the resource limit.</p>	<p>The tPCT would be receiving funding in 2004/05 for accelerated depreciation for Willesden and Monks Park. This excess funding would be taken into consideration when the final amount is agreed by 31 March 2005.</p>
<p><b>Back to back provisions</b></p> <p>The PCT should discuss all back-to-back provisions with the NHS body involved, and ensure that it has a detailed understanding of the nature of these provisions and that it is confident that all costs are being validly recharged to the PCT.</p>	<p>The information for back-to-back provisions are collected and validated by the Strategic Health Authority and this is checked against tPCT's anticipated expenditure and projected payments. All discrepancies are discussed with the respective NHS body and adjustments agreed.</p>
<p><b>Early retirement provision</b></p> <p>The PCT should review the calculation of the early retirement provision for all individuals under 60 years old to ensure that the provision is consistent with NHS policy. Where amendments are required, these should be adjusted in the 2004/05 accounts, and the PCT should ensure that Westminster and Kensington &amp; Chelsea PCT are kept informed of developments. A detailed audit trail should be retained by the PCT.</p>	<p>The tPCT had not been successful to obtain the information from either shared service provider or Pensions Agency. However, if the names of the 14 individuals were provided, the tPCT would make attempt to review the calculation of early retirement provision and make adjustments, if any.</p> <p>Manu Patel would implement the recommendations by 31 March 2005.</p>
<p><b>Continuing care</b></p> <p>The PCT should review the systems used by the continuing care team, and assess whether there is a requirement for updated systems to be purchased or developed. Consideration should be given to the extent of access rights required by each member of the continuing care team, and procedures should be introduced to ensure that there is full review of all amendments made to the database.</p> <p>The PCT should also ensure that there is full review of costs recognised by the PCT in relation to continuing care.</p>	<p>The tPCT is currently reviewing the systems for Continuing Care.</p> <p>Samih Kalakeche with the help of Andrew Scheiner is leading on this project. This would be completed by 30 June 2005.</p> <p>The tPCT has now established a link with the Local Authority to obtain information on deaths so that this can be periodically checked with the Continuing Care database to help with the accruals and payment of invoices. The tPCT is in process of recruiting a Management Accountant for Joint Working Directorate. He or she would review regularly the costs of Continuing Care in future.</p>
<p><b>Provider full cost recovery</b></p> <p>The PCT should review the allocation of joint costs between its provider and commissioning functions. This allocation should be based on actual expenditure, and supporting evidence should be retained to explain the methodology behind the allocation of each joint cost. This should subsequently be reviewed annually to ensure that it remains a reasonable estimation of actual cost allocation.</p>	<p>The tPCT would review the allocation of joint costs between Provider and Commissioning functions.</p> <p>Mike McGowan and Chris Evans would implement the recommendation by 31 December 2004.</p>
<p>The PCT should ensure that the provider and commissioning arms of the organisation deal with each other in an arm's length manner. Any contracts and services between the two sides of the PCT should be managed as they would be with an external body, with formal negotiations taking place and an official SLA being agreed and signed. Whilst it is not expected that the PCT would raise invoices to itself, some form of verification of services performed should be carried out by the</p>	<p>A Primary Care Commissioning Strategy has been developed and agreed. Deputy Director of Primary Care Commissioning is implementing it. A Service Level Agreement is being finalised for Brent PCT's provider services and commissioning strategy describes how this will be monitored.</p> <p>Jane Lindo would implement the recommendations by 31 December 2004.</p>

Recommendation	Management response
<p>commissioning arm and a clear audit trail should be maintained to provide assurance that the provider income recognised in the accounts does relate to services provided.</p>	
<p>The PCT should ensure that it agrees and signs SLAs for all services provided. These agreements should include performance indicators and monitoring against these should be performed on a regular basis. These should be reviewed and signed each year, and copies should be retained at PCT headquarters to provide a clear audit trail.</p>	<p>SLAs will be finalised and signed and performance will be monitored on a regular basis through the management team and the Board. Andrew Parker would implement the recommendation.</p>
<p><b>Review of bank reconciliations</b> All bank reconciliations should be subject to timely review by an appropriate officer. Both the preparer and the reviewed should sign and date the reconciliation as proof of timely completion.</p>	<p>Nish Attavar has always carried out the bank reconciliation on a monthly basis. Manu Patel would review the bank reconciliations every month.</p>
<p><b>Better payment practice code</b> The PCT should ensure that the designated officer responsible for managing performance against the Better Payment Practice Code is aware of all guidelines relating to the calculation of this target. Detailed supporting working papers should be retained to support the PCT's disclosure. Performance against the Code should be reported to the Board as part of the monthly Finance Report.</p>	<p>The tPCT has reviewed the data collection and improved the reporting of the information and this is reported to Strategic Health Authority and the Board. Manu Patel has already implemented the recommendation. The performance against Better Payment Practice code has been reported to the Board regularly as part of the Finance Report.</p>
<p><b>Systems of internal financial control</b> The PCT should include approval of budget amendments as a standing item within the monthly finance report. The PCT should ensure that improvements have been made to the financial reporting structures, and that finance reports are accurate and timely, and include a reasonable assessment of accruals and forecast year end position. The PCT should monitor movements in the financial position and forecast year end position, and ensure that appropriate action is taken. Detailed records supporting the finance reports should be retained for review by the audit team as part of the interim audit visit.</p>	<p>The tPCT has improved the financial reporting and includes a reasonable assessment of accruals and forecast year-end position. A detailed timetable has been produced and the information reviewed by Senior Finance Staff. Mike McGowan has already implemented recommendations.</p>
<p><b>GP Fundholder savings</b> The PCT should identify to which GPs the remaining Fundholder savings balances relate, and should notify these GPs of the outstanding balance. The PCT should initiate discussion with the GPs to ensure that these balances are cleared in the 2004/05 financial year.</p>	<p>Professional Executive Committee (PEC) would discuss and deal with the remaining GP fund-holder savings.</p>

