

**Management response to
KPMG's internal audit report**
*Learning and Implications from
Peterborough and Stamford
Hospitals NHS Foundation Trust*

26 June 2012

Management response to KPMG's internal audit report "Learning and Implications from Peterborough and Stamford Hospitals NHS Foundation Trust"

Introduction

Following the significant financial challenges facing Peterborough and Stamford Hospitals NHS Foundation Trust (the Trust) Monitor commissioned KPMG to produce an independent report looking at the underlying causes and whether more could have been done to prevent them. The report looks primarily at what happened at the Trust and Monitor's regulatory processes.

In their report, KPMG acknowledge that Monitor wrote to the Trust in 2006, stating that it believed the long-term affordability of a proposed new PFI hospital to be in significant doubt. This letter was copied to the Department of Health and HM Treasury.

The report describes how Monitor's power to intervene as the regulator was very limited in scope. This is because the financial breach that might arise as a result of Peterborough entering the PFI was prospective. Monitor's regulatory approach, and one of the key principles of the foundation trust policy, is that the boards of foundation trusts have primary responsibility for the performance of their trust.

At the time the contract was signed, Peterborough's financial risk rating under Monitor's Compliance Framework was satisfactory. Under the guiding legislation, the National Health Service Act 2006, Monitor can use its intervention powers only where there is a current and significant failure by an FT to comply with the terms of its Authorisation or there was a previous such failure and a likelihood that the FT would repeat that failure. That was not the case at the time the contract was signed by Peterborough. Responsibility for committing to the PFI rested with Peterborough's management. As stated in KPMG's report, Monitor did not have the power to prevent it from committing to an unaffordable PFI in 2007.

The new hospital opened in December 2010, but the full scale of the Trust's financial problems did not become apparent until March 2011. One of the main causes of the delay in realising the extent of the challenge was caused by the Trust not updating the business case for the new hospital, which was based on unrealistic estimates. If realistic projections had been available, action could have been taken one to two years earlier to deliver some additional Cost Improvement Plans. However, this would not have prevented the £32m of forecast deficit for 2011/12 attributed to the structural costs of the PFI and commissioning decisions.

The KPMG report includes some recommendations for Monitor to help identify potential problems of this nature at an earlier stage. Monitor agrees with all the recommendations in the KPMG report and our response is set out in more detail below. Some of these recommended actions have already been dealt with by changes we had made to our regulatory approach based on our experience of dealing with trusts in significant financial difficulty. Since 2009, Monitor has been able to block PFIs where there are serious doubts over long-term affordability via the Prudential Borrowing Code for NHS Foundation Trusts.

Consideration is currently being given as to the powers we will have under the new licence for NHS providers as described in the Health and Social Care Act (2012). However, we will also take action to implement the remaining recommendations in the KPMG report.

Monitor is committed to operating with transparency and using evidence to support our decision making. The KPMG report has therefore been [published on Monitor's website](#) alongside this response.

List of KPMG recommendations:

Primary recommendations:
1. When foundation trusts make significant long-term investments, require foundation trust management to update the assumptions and financial projections of the business case ahead of the go live date.
2. Within APR, require any foundation trust with an impending significant investment to demonstrate how the projections incorporate the impact of the investment, with specific focus on the years after implementation.
3. Where Monitor has concerns as to the accuracy/robustness of financial projections, require independent challenge.
Secondary recommendations
4. Enhancements to APR: 4.1 Take a holistic view of risks at a foundation trusts. Consider using a balanced scorecard approach and defining a wider range of red flag and escalation triggers. 4.2 Increased use of information from stakeholders to gain a different perspective on foundation trust performance. 4.3 Greater focus on the sustainability of the foundation trust, considering the contracting environment and competition. Consider providing specific guidance in relation to its expectations for long term projections e.g. on PFIs. 4.4 Greater involvement of Compliance teams in final challenge process to decide trusts' risk categorisation. 4.5 Document APR appropriately and in a single document. 4.6 Tailor APR stage 2 to specific trust requirements: potentially utilise more in-depth and diagnostic (root cause) analysis. 4.7 Change the focus of APR to concentrate on the longer-term, certainly more than the immediate financial year. 4.8 Place a greater emphasis on foundation trust's own plans rather than asking them to compile template plans and seek additional information to support areas of concern/risk.
5. Exercise a degree of control over work conducted by external advisers, both where trusts are in significant breach and/or have been identified as high risk.
6. Define escalation and intervention triggers in addition to FRR and governance risk ratings. These should be aligned to the assessment of holistic risk, utilising a range of analytical tools drawn from such bodies as the FSA.
7. Consider asking foundation trusts to carry out diagnostic reviews on identified risks, with Monitor defining the scope.
8. Include Compliance Managers and Senior Compliance Managers in Compliance Executive Committee and Compliance Board Committee discussions.
9. Explore mechanism to liaise with external auditors of foundation trusts.
10. Consider reassessment of foundation trusts where holistic risk has been identified.
11. For all foundation trusts for which there are long term contracts relating to significant investments, check that Monitor's previous views and comments have been captured on the system and that these foundation trusts are dealt with as per primary recommendations.

Response to recommendations

We agree with all recommendations in both the primary and secondary sections. In a number of the recommendations Monitor has already taken action or is in the process of implementing changes to address the point.

A number of the recommendations relate to Monitor's APR (annual planning review) process. The APR process for 2012/13 is currently being finalised. Monitor intends to incorporate as many of the recommendations into this year's process as practicable, however some changes may not be possible (for example because the consultation on Monitor's compliance framework for 2012/13 is now closed). Where this is the case, Monitor will address these issues in the work to adapt the compliance framework in the light of the Health and Social Care Act 2012.

Monitor's regulatory regime relies on the accuracy and reliability of information submitted by the Trust. We acknowledge that in certain high risk situations Monitor should do more to confirm and assure the reliability of this information.

Primary recommendations

1. Require foundation trusts that are making significant long-term investments to update the financial projections of the business case showing the impact of changes in assumption over time.

1.1. The issue here relates to significant investments (as defined in the compliance framework) which have been approved but are not yet fully operational and for which a substantial time lag exists between approval and implementation. This includes PFIs and other capital investments, but not acquisitions and mergers which are not typically subject to such time lags. The APR process requires trusts to submit an up to date financial forecast for the current year and the subsequent 2 years. However, APR has not previously required Trusts to update the business case assumptions on significant investments.

1.2. From APR 2012/13 we will require foundation trusts meeting this definition to update the assumptions within their investment business case and their three year forecast and provide us with:

- 1.2.1. a summary of the assumptions underpinning the original business case;
- 1.2.2. a summary of any changes in assumptions compared with the original business case and the reason for the change; and
- 1.2.3. the impact that these changes have on the board's assessment of the financial viability of the trust.

This information will help inform our overall risk assessment of the trust at APR and decisions as to Monitor's regulatory approach and requirement for further work to be carried out (see 2 and 3 below).

2. Within the APR process, Monitor should require any foundation trusts with an impending significant investment to demonstrate how the projections incorporate the impact of the investment. A specific focus should also be placed on the years after the implementation of the investment.

2.1 Foundation trusts are required to provide updated financial forecasts together with appropriate financial commentary concerning these plans as part of the APR

process. In the 2012/13 process trusts with significant investments which have been approved but have not gone live yet have been required to provide additional information as detailed in 1.2 above.

2.2 Trusts which are planning significant long-term investments also potentially face higher risks. For APR 2012/13 Monitor will require these trusts to provide us with a summary of:

2.2.1 the assumptions underpinning the business case for the PFI or investment;

2.2.2 an assessment of the financial viability of the investment.

2.3 Trusts which already have operational significant long-term investments also potentially face higher risks. For APR 2012/13 Monitor will require these Trusts to provide the same information as in 1.2 above.

2.4 This information will be subject to a desktop review and form part of a call with the trust to confirm understanding and challenge assumptions. Where Monitor is not satisfied that this analysis has satisfactorily demonstrated how the significant investment is affecting the trusts' financial outlook, Monitor may require further work to be carried out (see 3. below).

3. Where Monitor has concerns as to the accuracy/robustness of financial projections, it should require independent challenge; this could be through a well-focussed APR 2 review or at any other stage of Compliance engagement.

3.1 Monitor sometimes requires independent, professional challenge in certain high risk situations, for example where trusts have been escalated or found in significant breach, in risk reviews of significant acquisitions and in APR stage 2. This may be to provide greater assurance as to the reliability of forecasts and plans, but may also be to provide diagnosis of the nature and scale of the underlying problems and to provide recommendations on actions to solve the problems.

3.2 In the 2012/13 APR process, Compliance teams will be able to request independent challenge of financial projections where serious risks have been identified (see 2, 4.1, 4.3, 4.7). This might be implemented via a stage 2 review or recommending to the trust to bring in external advisers. In either case, Monitor will expect to set the scope of the review (see 5).

Secondary recommendations

4. Matters that should be considered in planning the APR process:

4.1 Take a holistic view of risk and consider using a balanced scorecard and defining a wider range of red flag and escalation triggers:

4.1.1 Within the APR process, Monitor assesses the risk that Trusts might breach their terms of authorisation within the forthcoming period. The approach adopted for the 2011/12 APR process has proven to be effective, with the large majority of subsequent significant breach decisions occurring in the group of Trusts considered highest risk (other than Trusts already in significant breach).

4.1.2 Without losing the robustness of our current approach, we will extend the risk categorisation and calibration process for APR 2012/13. This will include identification of Trusts which are exposed to particular risk factors :

examples potentially include high fixed costs as a result of significant investments (see 1), significant expansion outside of core capability/expertise, longer-term risk to sustainability (see 1.1, 4.3). Based on the experience in APR 2012/13 and input from Monitor's assessment work, we will consider how this approach could be developed into a balanced scorecard or other risk tool.

- 4.2 Increased use of information from stakeholders:
 - 4.2.1 The 2011/12 APR process introduced the requirement for teams to review PCT finances at a high level and review a summary of CQC comments on foundation trusts within their portfolio. We are examining ways to extend and improve this process in APR 2012/13.
- 4.3 Greater focus on the longer term sustainability; considering the contracting environment and competition. Consider providing specific guidance in relation to expectations for long term projections e.g. on PFIs:
 - 4.3.1 The APR process is the only forward looking process within the current Compliance Framework. It is, however, limited in only requiring a three year financial forecast. Monitor will, therefore, identify Trusts which are potentially exposed to longer-term sustainability issues and which may require further analysis (see 4.1). This might be carried out via a stage 2 review within APR or by trusts bringing in external support (see 2.3).
 - 4.3.2 Monitor will look at further development of this approach as part of the work on the new Compliance Framework in the light of the Health and Social Care Act 2012.
- 4.4 Greater involvement of Compliance teams in final challenge process to decide trusts' risk categorisation:
 - 4.4.1 Trusts identified as being high risk within APR are assessed to decide whether they should be subject to a stage 2 review. In the 2012/13 process Compliance teams will make recommendations to senior management for stage 2 reviews supported by a business case. Where the recommendation is not accepted by senior management (as was the case for Peterborough in APR 2010/11), teams will now be involved in a final decision making process to recheck the business case and challenge the validity of the decision not to proceed. This will both increase the involvement of teams in the final decision making process and facilitate feedback to the teams.
- 4.5 The APR process should be documented in a single document:
 - 4.5.1 There are a number of existing documents on the APR process, in particular with regards to the work that relationship teams do in reviewing information and preparing internal reporting packs. As part of the planning for APR 2012/13, we will update this documentation for changes to the APR process and to address potential gaps. We will also ensure that there is a single overarching document, which provides an overview of the entire process and incorporates any recommendations for future improvements.
- 4.6 APR Stage 2 work should be tailored to specific foundation trust requirements: potentially more in-depth and diagnostic (root cause) analysis:
 - 4.6.1 Fourteen Trusts were selected to undergo a stage 2 review in APR 2011/12. These reviews were focussed on confirming the risks identified in the first stage of APR to facilitate engagement with the Trust Board to address the risks.

- 4.6.2 In APR 2012/13 stage 2 reviews will address specific risk areas (e.g. longer-term sustainability, financial governance, quality governance, Board effectiveness and risk), more focussed on establishing the nature/scale of underlying problems and on providing suggested solutions. Monitor may request Trusts to commission their own reviews (subject to Monitor's input on scope) where this is more appropriate, for example where a review is likely to be lengthy.
- 4.7 Change the focus of APR for foundation trusts with major investments to concentrate on the longer-term:
 - 4.7.1 The APR process will be altered for those foundation trusts that have undertaken a significant investment (see 1, 2, 3, 4.3 of this paper).
- 4.8 Place greater emphasis on the foundation trust's existing plans when completing APR rather than asking for plans to be compiled; requesting additional information on particular areas of risk:
 - 4.8.1 Monitor adopted an approach of analysing Trusts' existing plan documentation some time ago. In recent years, however, it has required Trusts to submit plans to a specified template in order to facilitate analysis. For APR 2012/13 we have decided to continue with the template approach, but with some supplemental requirements in areas of greater focus (risk analysis (including risks to quality), CIPs, financial commentary).
 - 4.8.2 Monitor will reconsider the approach as part of the work on the new compliance framework in the light of the Health and Social Care Act 2012.
- 5 Exercise a degree of control over work conducted by external advisers, both where Trusts are in significant breach and where Trusts have been identified as high risk:**
 - 5.1 For Trusts in significant breach Monitor expects to agree the scope of any relevant, external review and to be a joint addressee of any subsequent report. For Trusts not in significant breach Monitor would usually expect to agree the scope of any external review which is relevant to an important regulatory issue.
- 6 Define escalation and intervention triggers in addition to FRR and governance risk ratings that are aligned to the assessment of holistic risk; further consideration should be given to the range of tools that are used by such bodies as the FSA:**
 - 6.1 Changes to intervention and escalation triggers are subject to agreement in the annual consultation on the Compliance Framework. Changes to the FRR calculation have been made in the 2012/13 Compliance Framework and include : amendments to the return on capital employed calculation to reflect the cost of capital, ensuring we have greater clarity on the financial impact of PFIs and other financing instruments; adjusting financial submissions to exclude one-off sources of income, which might obscure the underlying financial position.
 - 6.2 Further development of risk triggers will be considered as part of the current work in drafting license conditions to reflect, as far as appropriate, the overall terms of the Compliance Framework in the context of the forthcoming requirements of the

Health and Social Care Act 2012. The draft license conditions will be subject to full public consultation in accordance with legal requirements.

7. Consider asking foundation trusts to carry out diagnostic reviews on identified risks, with Monitor defining the scope:

7.1. Diagnostic reviews are one of the options for addressing issues at Trusts found in significant breach. Monitor will also consider asking trusts not in significant breach to carry out diagnostic reviews where appropriate; for example, where serious risks have been identified in APR and a suitably scoped review would take longer than is feasible in a stage 2 review (see 4.6.2).

8. Consider including the Compliance Manager and Senior Compliance Manager in committee discussions concerning escalation:

8.1. Compliance managers and senior compliance managers are invited to Compliance Executive Committee and Compliance Board Committee meetings for the relevant agenda items. Monitor actively encourages Compliance team members to lead discussions on their Trusts.

9. Explore a mechanism to liaise with external auditors of foundation trusts:

9.1. Under the existing APR process Monitor receives a report on each foundation trust's financial accounts from the trust's external auditors. This includes their audit opinion, audit risks, details of any adjustments to the financial accounts that the auditors have identified and highlights any weaknesses in the trust's control environment.

9.2. In APR 2012/13 we will formalise the process for liaising with external auditors where:

9.2.1. the auditor's have issued a qualified opinion;

9.2.2. there are material audit adjustments;

9.2.3. the auditors have identified significant weaknesses in the trust's control environment; or

9.2.4. Our risk assessment of the trust at APR (see 4.1) indicates that the trust is high risk and a discussion with the external auditors is expected to provide additional insight into the issues identified.

10. Consider reassessment of Trusts, where holistic risk has been identified.

10.1. There are good reasons to consider periodic reviews of foundation trusts along the lines of a 'reassessment'. This will be addressed in work adapting the compliance framework in the light of the Health and Social Care Act 2012.

11. For all foundation trusts for which there are long term contracts in process, check that Monitor's previous views and comments have been captured on the system and that these foundation trusts are dealt with as per primary recommendations.

11.1. Monitor has substantially upgraded its information systems to improve the capture of relevant information and team knowledge relating to foundation trusts. We will further develop the system so that trusts with significant investments can easily be identified within it. Additionally, the system will be checked for all trusts to ensure that all relevant information is filed.

Monitor, 4 Matthew Parker Street, London SW1H 9NP

Telephone: 020 7340 2400

Email: enquiries@monitor-nhsft.gov.uk

Website: www.monitor-nhsft.gov.uk

© Monitor (June 2012)

Publication code: IRREP 06/12

This publication can be made available in a number of other formats on request. Application for reproduction of any material in this publication should be made in writing to enquiries@monitor-nhsft.gov.uk or to the address above.