

To: The Board

For meeting on: 26 March 2014

Agenda item: 7

Report by: David Bennett, Chief Executive

Report for: Discussion

TITLE: National Audit Office Report on Monitor

Summary:

This report provides the Board with the National Audit Office (NAO) report on Monitor and whether its regulation of NHS foundation trusts has been effective.

Colleagues from the NAO will be attending the Board meeting to provide a brief presentation of the key findings of the report.

Recommendations:

The Board is asked to comment upon the findings of the NAO report on Monitor.

Public Sector Equality Duty:

Monitor has a duty under the Equality Act 2010 to have due regard to the need to eliminate unlawful discrimination, advance equality of opportunity and foster good relations between people from different groups. In relation to the issues set out in this paper, consideration has been given to the impact that the recommendations might have on these requirements and on the nine protected groups identified by the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion and belief, gender and sexual orientation).

It is anticipated that the recommendations of this paper are not likely to have any particular impact upon the requirements of or the protected groups identified by the Equality Act.

Exempt information:

None of this report is exempt under the Freedom of Information Act 2000.



National Audit Office

Report

by the Comptroller
and Auditor General

Monitor

Monitor: Regulating NHS foundation trusts

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Amyas Morse, is an Officer of the House of Commons and leads the NAO, which employs some 860 staff. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of almost £1.2 billion in 2012.



National Audit Office

Monitor

Monitor: Regulating NHS foundation trusts

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 25 February 2014

This report has been prepared under Section 6 of the
National Audit Act 1983 for presentation to the House of
Commons in accordance with Section 9 of the Act

Amyas Morse
Comptroller and Auditor General
National Audit Office

20 February 2014

This report examines whether Monitor's regulation of NHS foundation trusts has been effective.

© National Audit Office 2014

The text of this document may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not in a misleading context.

The material must be acknowledged as National Audit Office copyright and the document title specified. Where third party material has been identified, permission from the respective copyright holder must be sought.

Links to external websites were valid at the time of publication of this report. The National Audit Office is not responsible for the future validity of the links.

10357 02/14 NAO

Contents

Key facts 4

Summary 5

Part One

Role, governance and resources 11

Part Two

Assessing and authorising trusts 19

Part Three

Addressing risk in NHS foundation trusts 27

Appendix One

Our audit approach 42

Appendix Two

Our evidence base 44

The National Audit Office study team consisted of:
Rosie Buckley, George Graham, Rachael Lindsay and David Raraty, under the direction of Laura Brackwell.

This report can be found on the National Audit Office website at www.nao.org.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Enquiries: www.nao.org.uk/contact-us

Website: www.nao.org.uk

Twitter: @NAOorguk

Key facts

147

NHS foundation trusts
at 31 December 2013

25

NHS foundation trusts
in breach of their
regulatory conditions
at 31 December 2013

£48m

Monitor's budget for
core running costs in
2013-14

- 337** staff employed by Monitor at 31 December 2013
- 3** NHS foundation trusts breached their regulatory conditions within 12 months of being authorised
- 16 per cent** of NHS foundation trusts rated at 30 September 2013 as being at highest risk of governance failure
- 6 per cent** of NHS foundation trusts rated as being at highest risk of financial failure assessed on their position at quarter two of 2013-14
- 98** NHS trusts had not achieved foundation trust status at 31 December 2013

Summary

1 Monitor was created in 2004 as the independent regulator for NHS foundation trusts. It assesses NHS trusts for foundation trust status, and authorises those that meet the requirements to be financially sustainable, well led and locally accountable. It regulates NHS foundation trusts and intervenes where trusts are in significant breach of their regulatory conditions to help them become compliant again.

2 The government's aim is for all NHS trusts to become NHS foundation trusts, either in their own right or after merger or reconfiguration. NHS foundation trusts are self-governing, enjoy greater financial and operational freedoms than NHS trusts, and are directly accountable to Parliament. At 31 December 2013, there were 147 NHS foundation trusts providing acute, mental health, ambulance and community health services.

3 The Health and Social Care Act 2012 expanded Monitor's role. It is now the sector regulator for health services. Its new responsibilities include ensuring the continuity of services, setting prices for NHS-funded care jointly with NHS England from April 2014, and enforcing rules to prevent anti-competitive behaviour by healthcare commissioners and providers.

4 Monitor is an executive non-departmental public body sponsored by the Department of Health (the Department). It is independent of government in its regulatory judgements. In 2013-14, Monitor's budget for core running costs is £48 million and it has over 300 staff.

Our report

5 Monitor is an increasingly important part of the health system. Its responsibilities now stretch beyond regulating individual NHS foundation trusts to ensuring continuity of services for patients. Along with the other main regulator, the Care Quality Commission, Monitor is vital to making the reformed health system work effectively and giving the Department assurance in its stewardship role for the health system.

6 Monitor's remit is expanding with significant, high profile, new responsibilities. At the same time, its traditional role of regulating NHS foundation trusts is becoming more challenging. The number of NHS foundation trusts is expected to rise to meet the government's policy commitment. The threat to trusts' sustainability is growing as the need to make substantial efficiency savings in the NHS puts trusts under increasing financial pressure. And the focus on care quality and effective regulation is greater than ever in the wake of the problems at Mid Staffordshire NHS Foundation Trust. These factors mean that the extent and complexity of Monitor's work will increase.

7 Against this background, our review of Monitor is well timed. This report examines Monitor's performance in regulating NHS foundation trusts and how well it is responding to the new challenges it faces. We set out our audit approach in Appendix One and our evidence base in Appendix Two.

Key findings

Role, governance and resources

8 Monitor has made good progress in preparing for its expanded role.

Between 2010-11 and 2013-14, Monitor's core running costs more than trebled as it prepared to take on its new responsibilities. It met key milestones in 2013, including licensing all existing NHS foundation trusts and publishing a new NHS pricing framework jointly with NHS England. Recruiting the capability Monitor needs and having sufficient capacity, particularly among senior staff, remain key risks to a successful transition. At 31 December 2013, of the 450 staff Monitor expects it will need, 113 posts (25 per cent) remained vacant. Some 51 staff were filling essential roles on an interim basis (paragraphs 1.7, 1.8 and 1.16).

9 Monitor has more to do to explain how it will exercise its new responsibilities.

Stakeholders are unclear how Monitor will coordinate with other bodies including NHS England and the NHS Trust Development Authority. Some also raised concerns about what responsibility Monitor has for assessing the impact on trusts of the prices it sets, as well as potential tension between Monitor's new responsibilities to prevent anti-competitive behaviour while enabling integrated care. Monitor has published guidance on how it will interpret and enforce competition regulations. However, it has taken on some of its new powers more quickly than it has been able to publish guidance and explain to trusts how things will work in practice (paragraphs 1.9 to 1.11).

10 Monitor's governance has not been good practice in that the same person acted as both chair and chief executive for nearly three years. The Secretary of State appointed an interim chair in January 2014 and expects to make a permanent appointment in autumn 2014. The Department approves Monitor's budget and business plan. The Department has not systematically assessed Monitor's performance, but is seeking to strengthen its oversight of its arm's-length bodies (paragraphs 1.13 and 1.14).

Assessing and authorising trusts

11 Monitor has rigorous processes and standards for assessing NHS trusts applying for foundation trust status, which it has adapted and strengthened. Monitor uses quantitative and qualitative evidence in assessing applicant trusts, which it tests by comparing evidence from different sources. Trusts must show that they are financially sustainable, well led and locally accountable. In July 2010, Monitor introduced new criteria for testing trusts' governance arrangements for ensuring care quality in the light of lessons from failings in patient care at Mid Staffordshire NHS Foundation Trust. It has kept under review its assumptions for testing trusts' financial plans and updated them to reflect the more challenging financial environment (paragraphs 2.2, 2.3, 2.6, 2.8 and 2.9).

12 NHS trusts are finding it more difficult to meet the standard Monitor applies. The assessment process is taking longer, and the number and proportion of successful applications has fallen over the last four years. Monitor authorised just two trusts in 2012-13. At 31 December 2013, 98 NHS trusts had not attained foundation trust status. Evidence from NHS foundation trusts is that Monitor's assessment process had a beneficial impact on their trust, although it demanded a lot of management time (paragraphs 2.5, 2.7, 2.10, 2.13 and 2.14).

13 Monitor's assessment has focused primarily on the strength of individual applicant trusts, rather than wider risks in local health economies. The interdependence and viability of organisations in local health economies will be an increasingly important part of Monitor's assessments, in view of the need to ensure that services are sustainable. Monitor is considering how to engage better with commissioners, local authorities and other stakeholders as part of its assessments and how to analyse the viability of local health economies (paragraph 2.9).

14 Few NHS foundation trusts have got into difficulty soon after being authorised, indicating that Monitor's assessment decisions have been sound. Monitor has set a standard for authorisation which it considers good NHS trusts can achieve. Its aim is that no trust should breach its regulatory conditions within 12 months of authorisation. Just three of the 147 trusts authorised since Monitor was established in 2004 did so. For some trusts that got into difficulty after authorisation, it is likely that some of the underlying issues were present at the point of authorisation (paragraphs 2.15 to 2.19).

Addressing risk in NHS foundation trusts

15 The growth in risk in the foundation trust sector may put unsustainable pressure on Monitor's capacity to regulate trusts in difficulty or maintain continuity of services. At 30 September 2013, Monitor rated 16 per cent of NHS foundation trusts as highest risk in governance terms, compared with 13 per cent at 31 March 2012; and 6 per cent as highest risk in financial terms, compared with 2 per cent at 31 March 2012. At 31 December 2013, 25 NHS foundation trusts were in breach of their regulatory conditions, an all-time high. The enhanced monitoring and intervention that these trusts require takes an increasing amount of Monitor's resources (paragraphs 3.6, 3.11, 3.14, 3.30 and 3.31).

16 Monitor has historically used mainly retrospective performance measures in assessing risk, but it strengthened its approach in October 2013. The metrics Monitor uses to assess governance risk, such as performance against clinical targets, have not always warned of underlying issues. Similarly, the indicators that Monitor used to calculate financial risk ratings did not consider trusts' future commitments and projections. Monitor changed its risk assessment framework in October 2013 and now includes information from third parties, including patients and whistleblowers, in assessing governance risk. From summer 2014, Monitor plans to publish forecast 'continuity of service' ratings as an indicator of the risk of future financial failure (paragraphs 3.7, 3.9, 3.12 and 3.13).

17 Monitor's interventions have helped trusts in difficulty to improve. Assessing the impact Monitor has is difficult because of the range of influences on a trust and the difficulty of demonstrating what would have happened if Monitor had not taken action. However, people we interviewed at our case study trusts considered that they took faster or more effective action, or both, because of Monitor than they would have done otherwise. Monitor's interventions have worked well where the underlying issues are internal to the trust, such as poor leadership or financial management. NHS foundation trusts have regularly taken radical action, such as changing their chair or chief executive, in response. Monitor has often also required trusts to commission external consultancy support or employ turnaround directors (paragraphs 3.21 and 3.24 to 3.27).

18 Monitor's influence has been less effective where the cause of the trust's difficulties relate to underlying issues in the local health economy. For an increasing number of trusts in difficulty, the underlying causes are rooted in the local health economy, for example where commissioners are in financial difficulty. In recent months, Monitor has changed its approach to intervening in these trusts. In some cases it has started working with commissioners, the local authority and the NHS Trust Development Authority to find solutions to address these wider issues. Monitor needs to rely on informal influence in these situations, as well as its formal powers of intervention (paragraphs 3.16 to 3.17 and 3.28).

19 Monitor has started to increase its work to strengthen governance and financial management in NHS foundation trusts to try to reduce the risk of trusts getting into difficulty. Monitor seeks to support and develop the foundation trust sector. For example, it provides training to strengthen the capability of boards and publishes good practice guidance. To date, Monitor has devoted only a small proportion of its resources to this type of work, and it has not assessed the overall impact or reach of this activity (paragraphs 3.31 to 3.33).

Conclusion on value for money

20 We consider that Monitor has achieved value for money in regulating NHS foundation trusts. Its processes for assessing and monitoring trusts are robust, its judgements have mostly been sound, and it has refined its approach in the light of experience. The balance of evidence suggests that Monitor has generally been effective in helping trusts in difficulty to improve. Its impact is particularly clear where the issues arise from weaknesses in trusts' internal management.

21 Monitor recognises that it needs to adapt how it regulates to address underlying weaknesses in local health economies that increase the risk of financial or clinical failure in individual trusts. It has started to take a more holistic and proactive approach in a number of cases. It will need to continue to develop its approach and work closely with other agencies within the NHS, as well as the Department, if it is to continue to be an effective regulator and provide value for money.

Recommendations

22 Monitor is acting in a number of the areas we have highlighted. Our recommendations are designed to reinforce these actions, and help Monitor meet the challenges it faces in regulating NHS foundation trusts in an increasingly difficult environment and in taking on significant new responsibilities.

- a Monitor should supplement its formal powers of intervention by fully using informal powers of influence and persuasion to broker solutions.** Increasingly the difficulties NHS foundation trusts face cannot be solved by the trusts alone. They require integrated action across local health economies. Monitor needs to work closely with other bodies, including local commissioners, to develop solutions that maximise benefit for the NHS overall. It must ensure that its staff have the skills and authority to adopt this kind of approach.
- b Monitor should, working with the Care Quality Commission, address gaps in its clinical expertise and understanding of frontline NHS operations.** Monitor could improve its capability by training its existing employees or recruiting staff with relevant NHS experience and clinical skills. However, it is the Commission that regulates the quality and safety of the care that NHS foundation trusts provide. Monitor should draw on the Commission's knowledge and skills as far as possible to avoid duplication.

- c Monitor needs to explain more fully to the NHS how it will exercise its new responsibilities.** There is currently a gap in understanding, and therefore concern, about how Monitor will apply its new powers to benefit patients. In particular, Monitor must make clear how it will weigh up the benefits to patients of potential improvements in the quality of care and cost savings that may arise from service reconfiguration and integration against reduced choice and competition.
- d Monitor should assess the value of its work to strengthen financial management and governance in NHS foundation trusts and identify which activities are the most effective.** Monitor's regulatory approach has been effective but there is a question as to how 'scalable' the approach is if the number of trusts in breach of their regulatory conditions continues to grow. Monitor needs to establish the best ways of reducing risk in the foundation trust sector and focus resources on these areas.
- e The Department should appoint a permanent chair of Monitor as soon as possible.** Monitor was unable to comply with its own guidance on corporate governance, as the same person was both the chair and the chief executive for three years. The Department appointed an interim chair in January 2014. An independent chair is needed to boost the capacity of Monitor's senior team, hold the executive management to account and strengthen Monitor's accountability to Parliament.

Part One

Role, governance and resources

1.1 This part of the report covers Monitor's role, including its new responsibilities under the Health and Social Care Act 2012, governance and resources.

Role

1.2 Monitor was created in 2004 as the regulator for NHS foundation trusts. At 31 December 2013, there were 147 such trusts. They, together with 98 NHS trusts,¹ provide acute, mental health, ambulance and community health services. NHS foundation trusts are self-governing, have greater financial and operational freedoms from government than NHS trusts, and are directly accountable to Parliament. The government intends that all NHS trusts will become foundation trusts, either in their own right or following reconfiguration or merger.

1.3 Since April 2013, Monitor has had a broader role as the sector regulator for health services in England. It has a statutory duty to protect and promote the interests of people using healthcare services, including a role in ensuring service continuity. This represents a shift in focus towards the sustainability of services in the round, rather than protecting individual NHS foundation trusts from failure. Monitor will therefore need to work closely with other bodies to identify and address risks in local health economies.

1.4 Monitor's main responsibilities since it was set up have been to:

- assess NHS trusts for foundation trust status and authorise those that meet the requirements;
- operate a regulatory regime to ensure NHS foundation trusts are financially sustainable, well led and locally accountable, and take regulatory action if there is evidence that an NHS foundation trust is in significant breach of the conditions Monitor sets; and
- provide support and guidance to the boards and governors of NHS foundation trusts to help them to carry out their roles effectively.

¹ The figure of 98 does not include NHS Direct, which is also an NHS trust. Unlike other trusts, NHS Direct is a national body that provides health and advice services to patients.

1.5 **Figure 1** shows how Monitor fits into the health system. It has to work closely with other bodies, particularly the following:

- The Care Quality Commission, which regulates the quality and safety of the care that NHS foundation trusts, along with other health services, provide. The Commission registers trusts, inspects whether they comply with essential standards of quality and safety, and takes enforcement action where they fail to meet the standards. Monitor oversees NHS foundation trusts' arrangements for ensuring care quality and, where clinical problems persist and affect the performance of the trust, it intervenes to help improve governance. The Commission also provides Monitor with its view on NHS trusts applying for foundation trust status.

Monitor and the Commission have agreed a memorandum of understanding to help them work effectively together. Both organisations consider that their relationship is growing stronger as it matures. There is frequent, constructive contact at senior levels and operational staff increasingly share information about particular trusts.

- The NHS Trust Development Authority, which oversees the performance of the remaining NHS trusts. The Authority supports NHS trusts to improve service quality and sustainability, and to achieve foundation trust status. Monitor and the Authority have a partnership agreement to help them work effectively together. They meet regularly to discuss NHS trusts' progress towards foundation trust status.

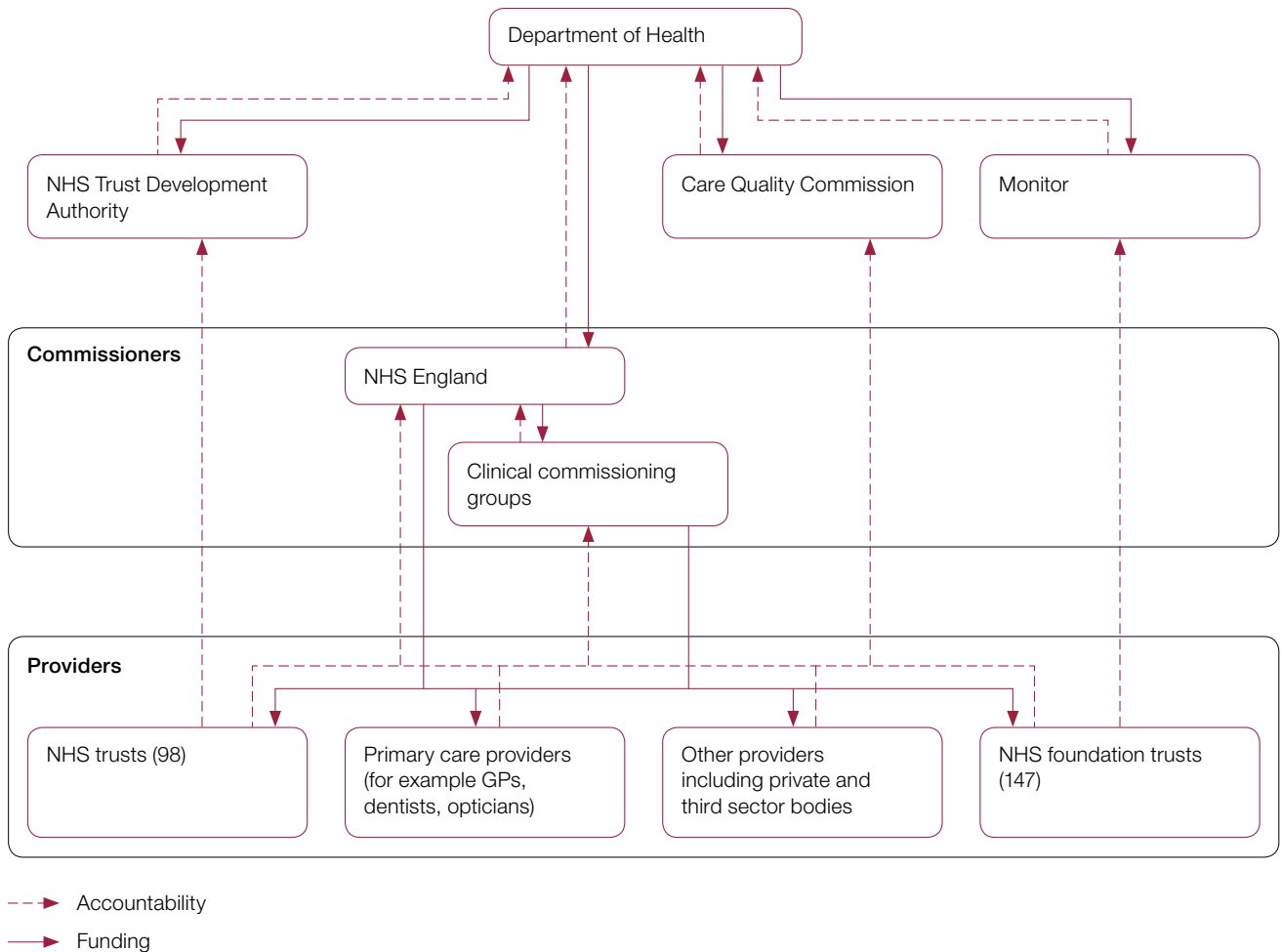
New responsibilities

1.6 Under the Health and Social Care Act 2012, Monitor's role expanded to include significant new functions:

- **Licensing healthcare providers.** Monitor must license NHS foundation trusts by April 2013 and other providers by April 2014, unless they are exempt.² Licence conditions allow Monitor to fulfil its duties of enabling care to be provided in an integrated way, ensuring continuity of services where a provider gets into financial difficulty, and overseeing how NHS foundation trusts are governed.
- **Preventing anti-competitive behaviour.** In April 2013, Monitor became responsible for preventing anti-competitive behaviour by healthcare commissioners and providers. It enforces competition rules through licence conditions for providers and the procurement, choice and competition regulations for commissioners.
- **Pricing.** From April 2014, Monitor and NHS England will be jointly responsible for the payment framework for NHS-funded care. NHS England will define the services required and design the pricing structure, and Monitor will set prices (the national tariff). Setting the tariff is important because it can influence how commissioners and providers work, as well as how services are designed. Monitor also sets the rules governing how providers and commissioners may themselves determine prices.

² A number of providers are exempt from having to hold a licence from Monitor, including NHS trusts and providers of primary medical and dental services.

Figure 1
How Monitor fits into the health system



Notes

- 1 The figure shows, in a simplified way, the main lines of accountability and funding flows between organisations in the health system.
- 2 Monitor is accountable to the Department for its performance and value for money, but is independent of government in terms of its regulatory decisions.

Source: National Audit Office

1.7 Monitor has made good progress in preparing for its expanded role. It met key milestones during 2013, including licensing all NHS foundation trusts and working with NHS England to develop and publish a pricing framework.

1.8 An important aspect of the transition has been recruiting additional staff with appropriate skills for Monitor's expanded role, including economists and legal professionals. At 31 December 2013, Monitor had 337 staff, 75 per cent of the 450 staff it expects to need to carry out all its functions. Where business critical posts have not been filled, Monitor has made use of interim staff. At 31 December 2013, 51 staff were working on an interim basis. An ongoing risk to a successful transition, which Monitor has itself highlighted, is whether senior staff have the capacity to handle the demands of Monitor's wider responsibilities and increasingly challenging 'business as usual'.

1.9 Our interviews with stakeholders indicate some confusion and concern about how Monitor's expanded role will work. Some NHS foundation trusts were concerned about how Monitor would work with other bodies, including NHS England and the NHS Trust Development Authority, to fulfil its new responsibilities. For example, they were unclear how it would work with NHS England in setting tariff prices, including who would assess the tariff's impact on trusts, particularly where prices are used to incentivise providing care in community settings rather than in hospitals.

1.10 Another issue stakeholders raised was about potential tension between Monitor's different responsibilities, particularly between preventing anti-competitive behaviour and enabling care to be provided in an integrated way. Concerns were raised about the impact competition could have on service reconfiguration. In relation to any proposed merger, the competition authorities will draw on Monitor's advice when weighing up the implications of reduced competition and choice against the expected benefits to patients. Monitor issued a joint statement with the Competition Commission and the Office of Fair Trading in October 2013, which made a commitment to putting patients' interests at the heart of the merger process.³

1.11 Monitor has now set out how it intends to support organisations considering a merger, and has also issued guidance to support NHS commissioners in understanding and complying with the procurement, choice and competition regulations. However, Monitor has taken on some of its new powers more quickly than it has been able to publish guidance and explain to trusts how things will work in practice.

Governance

1.12 Monitor is an executive non-departmental public body, sponsored by the Department of Health (the Department). It is independent of government in terms of its regulatory decisions. It is accountable directly to Parliament and to the Department for its performance and value for money.

³ Joint statement from the Office of Fair Trading, the Competition Commission and Monitor, *Ensuring that patients' interests are at the heart of assessing public hospital mergers*, 17 October 2013.

1.13 The Department approves Monitor's annual budget and business plan. It has reviewed Monitor's financial performance and risks at a strategic level, but has not systematically monitored how Monitor performs against its objectives. It also has frequent contact with Monitor about the performance of the foundation trust sector. Following the reforms to the health system, the Department is seeking to strengthen its stewardship arrangements. It has set up a sponsorship unit to oversee relationships with its arm's-length bodies.

1.14 Monitor's board comprises three executive and four non-executive members. Between March 2011 and January 2014, the same person was both chair and chief executive. Monitor notes in its annual report that this is not consistent with good practice for corporate governance, as set out in *The NHS Foundation Trust Code of Governance* and *The UK Corporate Governance Code*.⁴ Both documents state that these roles should be carried out by different people and that a chief executive should not go on to be the chair of the same organisation. In October 2013, the Secretary of State proposed a new chair, but the House of Commons Health Committee did not endorse the appointment and the candidate withdrew his application.⁵ The Secretary of State appointed an interim chair in January 2014 and expects to make a permanent appointment in autumn 2014.

1.15 Monitor measures its own performance using a range of indicators including measures of process (such as time taken to assess applicant trusts), some outcomes (such as number of trusts in breach and time they take to recover), and stakeholder perceptions. Unlike some other regulators, Monitor does not seek to quantify the net financial benefit of its work. Monitor is updating its performance metrics, aiming to include more outcome measures and better reflect its new responsibilities.

Resources

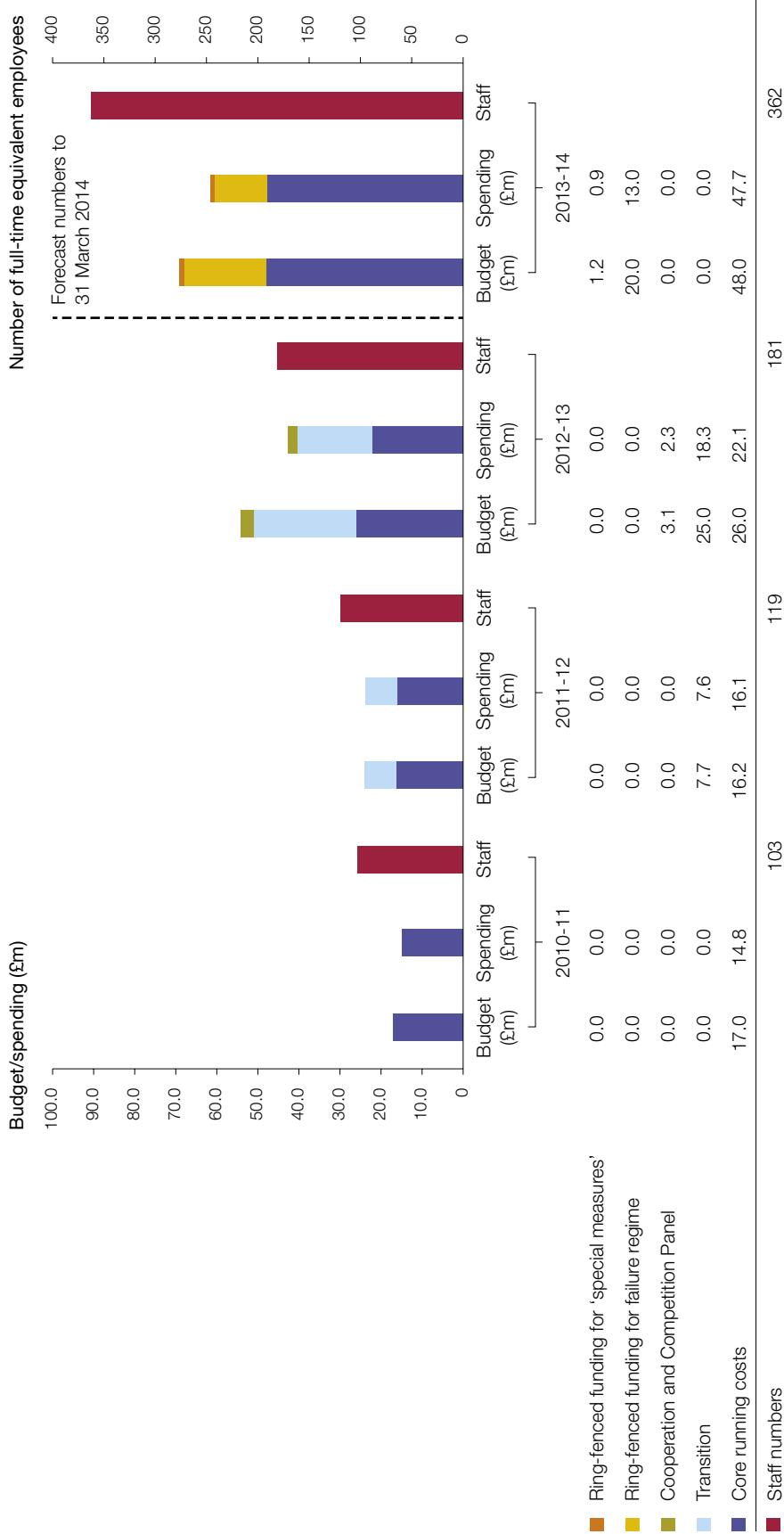
1.16 In recent years, Monitor's spending and staff numbers have increased significantly as it has taken on additional responsibilities and the challenges facing the foundation trust sector have become more complex. Between 2010-11 and 2013-14, Monitor's spending on core running costs more than trebled, from £14.8 million to a forecast £47.7 million (**Figure 2** overleaf). Its total revenue budget for 2013-14 is £69.2 million. This includes £48.0 million for core running costs, and £20.0 million of ring-fenced funding for Monitor to appoint contingency planning teams and trust special administrators as part of the failure regime when NHS foundation trusts face financial failure.⁶

4 Monitor, *The NHS Foundation Trust Code of Governance*, December 2013; and Financial Reporting Council, *The UK Corporate Governance Code*, September 2012.

5 House of Commons Health Committee, *Appointment of the Chair of Monitor*, Fourth Report of Session 2013-14, HC 744, October 2013.

6 Contingency planning teams work to find a system-wide solution to the trust's financial difficulties; trust special administrators take control of the trust's affairs and work with commissioners to ensure that patients continue to have access to essential services.

Figure 2
 Monitor's budget, spending and staff numbers, 2010-11 to 2013-14
 Monitor's budget, spending and staff numbers have increased significantly in recent years



Notes

- 1 In 2012-13, Monitor's core running costs budget was £26.0 million, which comprised £17.7 million for existing functions and £8.3 million for preparations for taking on new responsibilities.
- 2 The transition budget covers development of policy and future organisational design for Monitor's new responsibilities.
- 3 The 'ring-fenced funding for failure regime' is for contingency planning teams and trust special administrators. In 2012-13, this funding was included within core running costs.
- 4 The budget for the Cooperation and Competition Panel was ring-fenced in 2012-13, but was part of core running costs in 2013-14.
- 5 Monitor's spending and staff for 2013-14 are based on numbers forecast at November 2013.
- 6 Staff numbers are based on full-time equivalent employees.

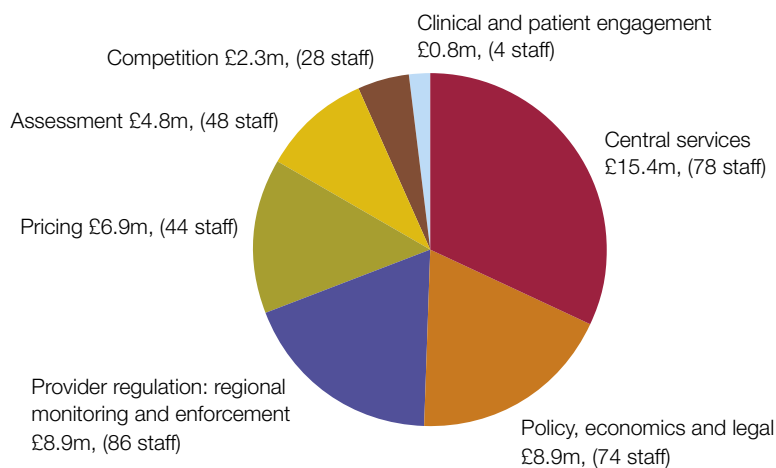
Source: Monitor

1.17 Additional funding for new functions means that the proportion of resources Monitor spends on different activities has changed significantly. Monitor planned that in 2013-14, it would do the following (**Figure 3**):

- Its new responsibilities for pricing and competition would account for 19 per cent of its budget.
- Ten per cent of its budget would be spent on assessing applications from NHS trusts for foundation trust status and reviewing significant transactions involving NHS foundation trusts. The amount spent on this area has increased by 46 per cent since 2010-11, partly because assessments are taking longer.
- Nineteen per cent of its budget would be spent on monitoring NHS foundation trusts and intervening when trusts are in difficulty. The amount spent on this activity has increased by 16 per cent since 2010-11, as the number of trusts in breach of their regulatory conditions has increased.

Figure 3

How Monitor planned to spend its budget in 2013-14



Notes

- 1 Figures are based on Monitor's core running costs budget of £48 million.
- 2 Staffing data is based on the forecast number of staff for March 2014 (estimated at November 2013).
- 3 'Central services' consists of: £9.2 million for Monitor's human resources and corporate services including internal finance, knowledge management, IT and facilities; £2.9 million for other cross-cutting functions including Monitor's communications and corporate office teams; and £3.3 million of residual transition costs, such as office relocation and recruitment fees.
- 4 'Provider regulation: regional monitoring and enforcement' includes financial reporting for the foundation trust sector.

Source: National Audit Office analysis of Monitor data

1.18 Monitor employed 337 staff at 31 December 2013, three times more than in 2010-11 (Figure 2). There is clear consensus among stakeholders that Monitor employs high calibre people, particularly in terms of their financial and business expertise. However, some raised concerns that staff did not have sufficient operational experience or understanding of clinical issues, which risked damaging their credibility and effectiveness. These perceptions are consistent with the results of Monitor's own stakeholder survey. In 2011, 56 per cent of survey respondents considered financial discipline as Monitor's main strength, while 27 per cent said that a main weakness was that Monitor did not understand the NHS at an operational level.

Part Two

Assessing and authorising trusts

2.1 This part of the report covers Monitor's approach to assessing NHS trusts applying for foundation trust status and the quality of its decisions, as indicated by the number of trusts that have got into difficulty shortly after being authorised as NHS foundation trusts.

Approach to assessment

2.2 Monitor assesses NHS trusts that apply for foundation trust status. It tests whether they are financially sustainable, well led (in terms of governance processes and quality of leadership), locally accountable and ready to take on the greater freedoms that foundation trust status allows.

2.3 Monitor assesses each applicant NHS trust by considering:

- the trust's legal constitution, including its level of public membership and draft constitution;
- the effectiveness of governance, including the quality of the board, performance and risk management, and the governance arrangements for ensuring care quality; and
- the trust's financial viability, including its short-term health and long-term sustainability.

2.4 Monitor has set a range of criteria that NHS trusts must meet to be eligible for foundation trust status. These include having the organisational capacity to deliver their business plan, satisfactory care quality, and threshold scores in respect of: financial risk to continuity of services; quality governance impacting on quality of care; and performance against healthcare access and outcomes targets. Ultimately, however, whether or not an NHS trust should be accorded foundation trust status is a matter of judgement for Monitor's board or assessment executive committee, a committee of its board.

Progress in authorising trusts

2.5 The number of NHS trusts applying for foundation trust status has fallen. The NHS Trust Development Authority referred five trusts to Monitor for assessment in the first nine months of 2013-14, compared with 12 referred by the Authority or the Department during 2012-13. At 31 December 2013, of the 98 remaining NHS trusts (excluding NHS Direct), 15 were with Monitor for assessment. The Authority estimates that 11 of the remaining 98 NHS trusts will not apply in their own right but will merge with other bodies, because they are not financially or clinically sustainable in their current form.

2.6 Monitor has made clear that it will not relax the standard it applies in assessing applicant NHS trusts to help meet the government's aim that all trusts should become NHS foundation trusts. If anything, the standard has become more difficult to achieve:

- In July 2010, Monitor introduced additional assessment criteria for quality governance in the light of lessons learned from failings in patient care at Mid Staffordshire NHS Foundation Trust between 2005 and 2008. Applicants must meet a minimum standard against a new framework designed to test the robustness of trusts' governance arrangements for ensuring care quality.
- Monitor has periodically updated its economic assumptions for testing whether trusts are likely to meet the requirement for a net surplus in their third year as an NHS foundation trust. The changes reflect the tighter financial environment and the challenge trusts face in achieving efficiency savings.

2.7 NHS trusts are generally finding it more difficult to meet the standard Monitor applies in assessing applicants for foundation trust status. The number and proportion of applications which are successful has fallen over recent years (**Figure 4**). Just two NHS trusts were authorised in 2012-13, while eight were put on hold to allow the trust to resolve issues identified during the initial phase of the assessment. The drop in successful applications has been caused by a range of factors including the following:

- Many NHS trusts have a tighter financial position as the tariff prices that commissioners pay for healthcare have been reduced as part of the NHS efficiency drive. The reduction is intended to compel trusts to become more efficient to live within their tighter means. However, some trusts are finding it challenging to make the efficiency savings needed for a sustainable financial position. By way of illustration, at 30 September 2013, some 14 per cent of existing NHS foundation trusts did not meet the criteria relating to financial risk that applicant trusts were required to meet.

- There is more emphasis on the quality of care following the failings at Mid Staffordshire NHS Foundation Trust. Since Monitor introduced new criteria for quality governance in July 2010, 35 per cent of applicant NHS trusts have failed to meet these criteria at their first assessment.
- There has been a decline in the quality of the population of remaining NHS trusts, which includes some of the most challenged trusts. We highlighted in our 2011 report *Achievement of foundation trust status by NHS hospital trusts* that some of the challenges these trusts face cannot be resolved within the trust but depend on solving issues in the local health economy.⁷

Figure 4

Monitor's assessment of NHS trusts, 2009-10 to 2013-14

	Number of trusts				
	2009-10	2010-11	2011-12	2012-13	2013-14 (to 31 Dec 2013)
Assessed ¹	20	14	10 ⁵	10	15
Authorised	14	7	7	2	2
Referred ²	7	11	5	12	5
Deferred ³	1	1	1	5	9 ⁶
Postponed ⁴	4	6	1	3	2
Withdrawn	1	0	3	0	2
Rejected	0	0	0	0	0
Total number of NHS foundation trusts	129	136	143	145	147

Notes

- 1 The assessment figure represents the number of trusts for which assessment work was carried out and the decision to authorise, defer, postpone, withdraw or reject was made during that year.
- 2 Number of trusts referred by the Department and, since October 2012, the NHS Trust Development Authority to Monitor for assessment.
- 3 Monitor can defer an application if it considers that outstanding issues can be resolved within 12 months.
- 4 Applications postponed by the trust.
- 5 The number of trusts assessed in 2011-12 (10), does not add up to the number of trusts that were authorised, deferred, postponed, withdrawn or rejected (12). This is because two trusts that withdrew their applications in 2011-12 did not have any assessment work carried out that year, since they were assessed and had applications put on hold in 2010-11.
- 6 Including six trusts whose assessments have been paused until the Care Quality Commission has inspected them under its new regime.

Source: Data for 2009-10 to 2012-13 from Monitor's *Annual Report and Accounts for 2012-13*; data to 31 December 2013 provided by Monitor

⁷ Comptroller and Auditor General, *Achievement of foundation trust status by NHS hospital trusts*, Session 2010-12, HC 1516, National Audit Office, October 2011.

Robustness of the assessment process

2.8 Overall, our view is that Monitor's process for assessing applicants for foundation trust status is rigorous and thorough. For example, it combines evidence from different sources within the trust itself and from third parties, and examines key information from the trust. A consultation exercise conducted for us by the Foundation Trust Network in October 2013 indicated that NHS foundation trusts consider Monitor's assessment process is robust.

2.9 Monitor uses a mix of quantitative and qualitative evidence to assess applicant trusts:

- Monitor reviews financial data on how the trust has performed, as well as the trust's financial projections for the next five years. This review includes analysing how the trust's projections are affected by a more pessimistic set of assumptions, reflecting system-wide pressures as well as risks that are specific to the trust.
- Monitor draws on information from the Care Quality Commission to inform its judgement on whether trusts meet the required standards for the quality of care. It does not authorise trusts until it has received assurance from the Commission. In particular, it requires evidence that the trust is registered with the Commission without enforcement action; and that the impact on patients of any areas of non-compliance with the essential standards of quality and safety is no worse than moderate. Monitor combines evidence from the Commission with other information, including data on the trust's performance and Monitor's own review of the trust's governance arrangements for ensuring care quality.
- Monitor consults healthcare commissioners (previously primary care trusts, now NHS England and clinical commissioning groups) about their commissioning intentions. It questions trusts about their understanding of risks in their local health economy. Monitor's assessment has so far focused on the sustainability of the individual trust in question. However, the viability of local health economies will be increasingly important, in view of the need to ensure services are sustainable. Monitor is therefore considering how to engage better with commissioners, local authorities and other local stakeholders during the assessment process, as well as how to analyse the viability of local health economies.
- Towards the end of the assessment process, Monitor's chief executive and a non-executive member of its board meet the trust's board, including their non-executive members. Monitor uses this discussion to help form a view on whether the trust is aware of the risks it faces, how far the trust is managing these risks, and the board's capability to lead the trust effectively.

Timeliness of assessments

2.10 For NHS trusts now submitting applications to Monitor, the assessment process takes longer than it did – 4.8 months in 2012-13 compared with 3.8 months in 2009-10. This increase is likely to be partly due to the additional checks Monitor introduced in July 2010, the tighter financial environment and the decline in the quality of the population of remaining NHS trusts (paragraph 2.7).

2.11 Monitor has had sufficient capacity to process applications for foundation trust status in a timely way. It has met its target to start all assessments within six months of receiving applications since it set the target in April 2008. It currently has some excess capacity in its assessment team because the volume of applications has declined in 2013-14. Monitor has used some assessment team staff for other work, and expects the volume of assessment work to increase in 2014-15. In planning the resources it needs for assessments, Monitor relies on forecasts from the NHS Trust Development Authority of when NHS trusts will submit applications.

2.12 The timeliness of Monitor's assessment partly depends on it receiving timely information from the Care Quality Commission on care quality. In July 2013, the Commission announced significant changes to how it inspects hospitals to give a more detailed insight into care quality. Monitor has made it clear that it will not authorise any more trusts until the Commission gives updated assurance through its new inspection regime. Both organisations have taken steps to minimise the impact this has on assessments, including the Commission prioritising for inspection those NHS trusts closest to being authorised.

Impact of the assessment process on trusts

2.13 The NHS foundation trusts that responded to a consultation exercise carried out for us by the Foundation Trust Network considered that overall Monitor's assessment process had a beneficial impact on their trust. Specifically, a number of trusts commented that the process had helped them to focus on key strategic issues and improve their governance structures and processes.

2.14 Most of the NHS foundation trusts that we spoke to reported that the assessment process required significant management time, particularly to answer Monitor's questions and prepare evidence. However, given the areas that Monitor focuses on in making its assessment, it is likely that part of this resource commitment will have involved trusts improving their governance and performance to reach the standard required to be authorised.

Quality of assessment decisions

2.15 Few NHS foundation trusts have got into difficulty shortly after being authorised, which suggests that overall Monitor's assessment decisions have been sound. One of Monitor's key performance indicators is that no trust should breach its regulatory conditions⁸ within 12 months of being authorised. Just three of the 147 trusts (2.0 per cent) that Monitor has authorised since it was established in 2004 have done so: Poole Hospital within seven months of being authorised; Bradford Teaching Hospital within nine months of being authorised; and The Queen Elizabeth Hospital, King's Lynn within 12 months of being authorised. An additional seven trusts breached their regulatory conditions within 24 months: University Hospitals of Morecambe Bay; Mid Staffordshire; Dudley Group; Wrightington, Wigan and Leigh; Burton Hospital; Colchester Hospital; Calderdale and Huddersfield.

2.16 In addition, of the 122 NHS foundation trusts authorised since April 2005, Monitor has classified ten trusts (8.2 per cent) as high financial risk and six trusts (4.9 per cent) as high governance risk within 12 months of being authorised. This indicates that these trusts were at increased risk of breaching their regulatory conditions shortly after being authorised. The proportion regarded as high financial risk rose sharply in the second quarter of 2013-14 because very few trusts were authorised in the previous 12 months, and one of the three trusts authorised had a financial risk rating of 2 (**Figure 5**).

2.17 In deciding whether to grant foundation trust status, Monitor sets a standard that it considers good NHS trusts can achieve. This involves accepting an element of risk that some trusts will nonetheless get into difficulty. Monitor aims to identify all material risk while keeping the burden and cost of the assessment proportionate. Some NHS foundation trusts that got into difficulty were recognised as close to the level of risk Monitor accepts when they were authorised. It is likely that some of the underlying issues were there throughout. The circumstances at King's Lynn are outlined in **Figure 6** on page 26.

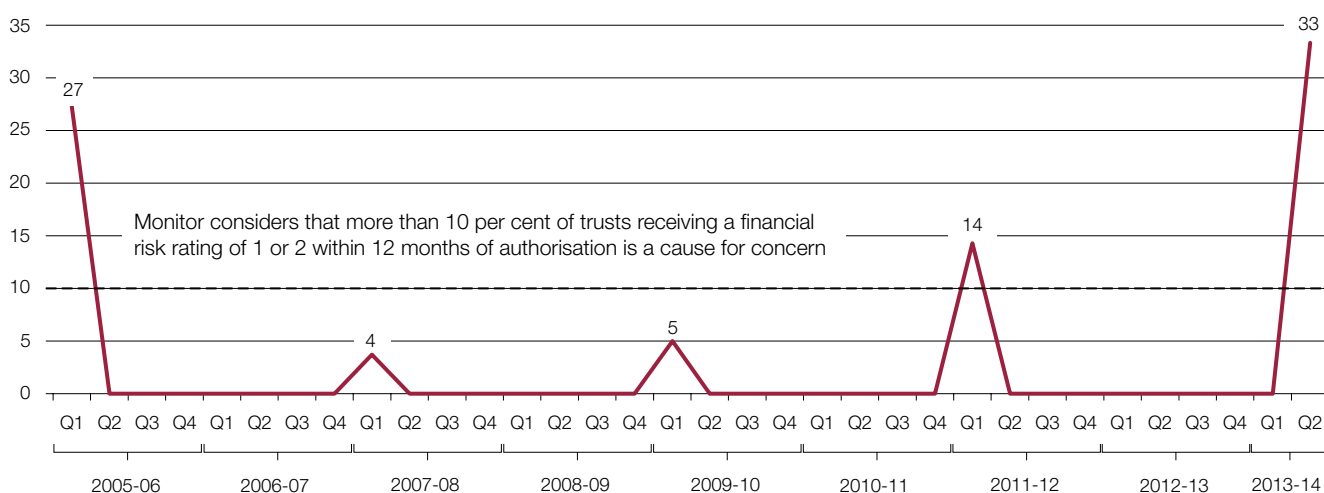
⁸ Monitor regulates NHS foundation trusts against the conditions set out in the provider licence, which is issued to trusts at authorisation. Before introducing the provider licence in April 2013, Monitor regulated NHS foundation trusts against their terms of authorisation which included comparable regulatory conditions.

Figure 5

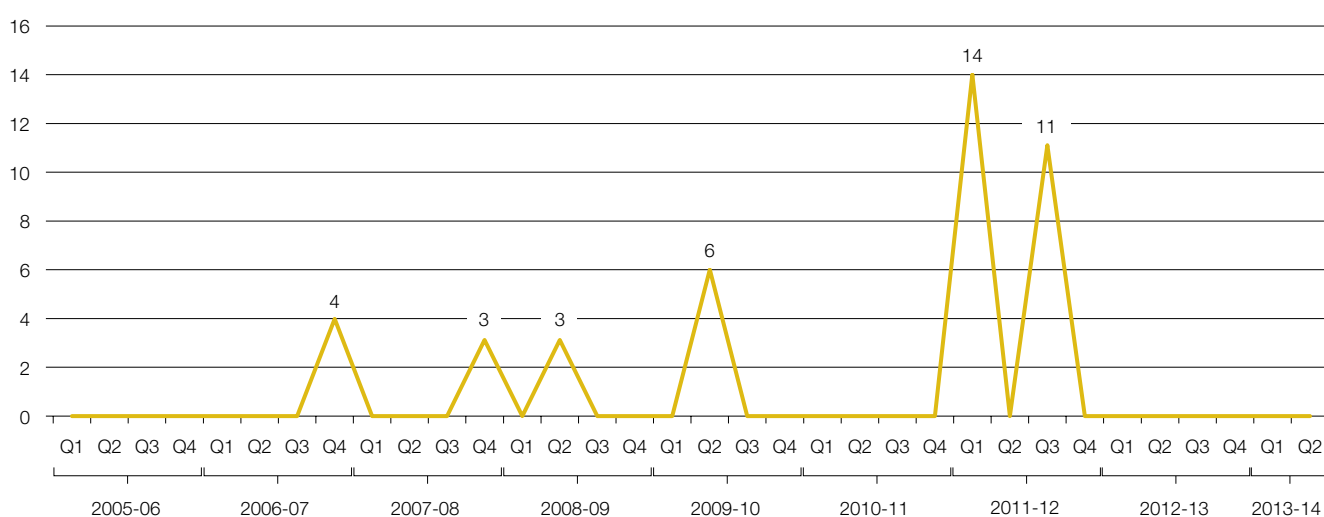
NHS foundation trusts with a financial risk rating of 1 or 2 or a red governance risk rating within 12 months of authorisation, 2005-06 to 2013-14

Except for four quarters, fewer than 10 per cent of trusts were rated high risk (for finance risk, governance risk or both) within 12 months of authorisation, from 2005-06 to 2013-14

Percentage of NHS foundation trusts with a financial risk rating of 1 or 2 within 12 months of authorisation (%)



Percentage of NHS foundation trusts with a red governance risk rating within 12 months of authorisation (%)



- Financial risk rating
- Governance risk rating

Note

1 Monitor has a key performance indicator that only in exceptional circumstances should a newly authorised NHS foundation trust receive a financial risk rating of 1 or 2 or a red governance risk rating.

Source: National Audit Office analysis of Monitor data

Figure 6

Case example: The Queen Elizabeth Hospital NHS Foundation Trust, King's Lynn

Background

The Queen Elizabeth Hospital NHS Foundation Trust is a small district general hospital in King's Lynn.

Authorisation

Monitor authorised the Trust in February 2011, but wrote a letter asking the Trust to improve its financial and clinical reporting and its oversight of its cost improvement programme.

Reason for breach of regulatory conditions

Monitor found the Trust in breach of its regulatory conditions in January 2012, 12 months after it was authorised. The Trust's financial position had deteriorated and Monitor had concerns about the Trust's financial planning and board scrutiny.

It is likely that the underlying cause of the breach was a combination of factors present when the Trust was authorised, as well as subsequent changes. At authorisation, the Trust was considered to be close to the level of risk Monitor accepts. Specifically, it is a small district general hospital similar to other smaller trusts which are finding it more challenging to stay in surplus in a tighter financial climate.

In addition, two key members of the Trust's board, the chief executive and the finance director, left shortly after the Trust was authorised.

The Trust's board now considers that the Trust has limited opportunities to make further savings acting alone and that, to become sustainable, service reconfiguration across the local health economy may be needed.

Source: National Audit Office analysis of Monitor data and interviews with The Queen Elizabeth Hospital NHS Foundation Trust, King's Lynn

2.18 At University Hospitals of Morecambe Bay NHS Foundation Trust, Monitor identified a trend of serious incidents in maternity care during the course of the assessment in 2009. It referred the matter to the Care Quality Commission and put the application on hold. Monitor decided to authorise the Trust after the Commission confirmed that the Trust complied with the essential standards of quality and safety in the areas it had assessed, which included maternity services.

2.19 Monitor found Morecambe Bay in breach of its regulatory conditions 13 months later, in October 2011, after a further review by the Commission found the Trust was not complying with a number of the essential standards. A subsequent review, commissioned by Monitor, found that, as the Commission's initial review had not assessed the Trust against all of the essential standards, a more in-depth evaluation would have been needed to uncover the issues with maternity care.⁹ In January 2013, Monitor changed its guidance for applicants to make clear it can require trusts to commission external reviews of their care quality or governance arrangements as part of their application for foundation trust status.

⁹ Monitor, *Learning and Implications from University Hospitals of Morecambe Bay NHS Foundation Trust*, July 2012.

Part Three

Addressing risk in NHS foundation trusts

3.1 This part of the report covers how Monitor identifies and assesses risk in NHS foundation trusts, the impact of its interventions when trusts get into difficulty and its work to reduce risk in NHS foundation trusts.

Identifying and assessing risk

3.2 Monitor publishes two quarterly risk ratings for each NHS foundation trust. One assesses how well the trust is managed (governance risk), and the other assesses its financial health (financial risk). Monitor also publishes two annual risk ratings based on trusts' annual plans. Trusts send Monitor routine management information including annual plans and financial statements, and standardised quarterly monitoring data. Monitor also draws on evidence from other sources.

3.3 Monitor's aim is to identify in good time significant governance and financial issues in NHS foundation trusts that are of sufficient concern to prompt it to intervene. Between 2010-11 and 2012-13, Monitor's performance was mostly strong against the indicators it set itself, although the number of cases involved is small so performance can be volatile (**Figure 7** overleaf).

3.4 To identify risk in a timely way, Monitor relies heavily on NHS foundation trusts disclosing relevant and accurate information about their performance. Four of our seven case study trusts themselves reported the issues which triggered Monitor's intervention. Participants in our 'sphere of influence' workshop highlighted the reliability of information as an important factor in identifying risk effectively. However, they concluded that Monitor has limited influence over the accuracy and completeness of much of the data it receives.

Figure 7

Monitor's performance in identifying risk, 2010-11 to 2012-13

Monitor's performance was mostly strong against the indicators it set itself for identifying risk

Percentage of material risks to an NHS foundation trust's compliance with regulatory conditions arising from financial performance identified at least six months before a trust's financial risk rating falls below 3

2010-11				2011-12				2012-13			
Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
25%	67%	0%	n/a	83%	n/a	n/a	n/a	n/a	n/a	100%	100%

Percentage of material risks to an NHS foundation trust's compliance with regulatory conditions arising from service performance identified at least six months before a trust is rated red for governance risk

100%	100%	n/a	50%	40%	71%	87%	90%	100%	71%	100%	78%
------	------	-----	-----	-----	-----	-----	-----	------	-----	------	-----

- Less than 60%
- 60–80%
- More than 80%

Notes

- 1 Thresholds are based on few instances per quarter. If, for example, there are four instances, identifying only two in advance is deemed to be poor performance.
- 2 'n/a' means that there were no NHS foundation trusts that were newly rated 1 or 2 for finance or red for governance in the quarter.

Source: National Audit Office analysis of Monitor data

Assessing governance risk

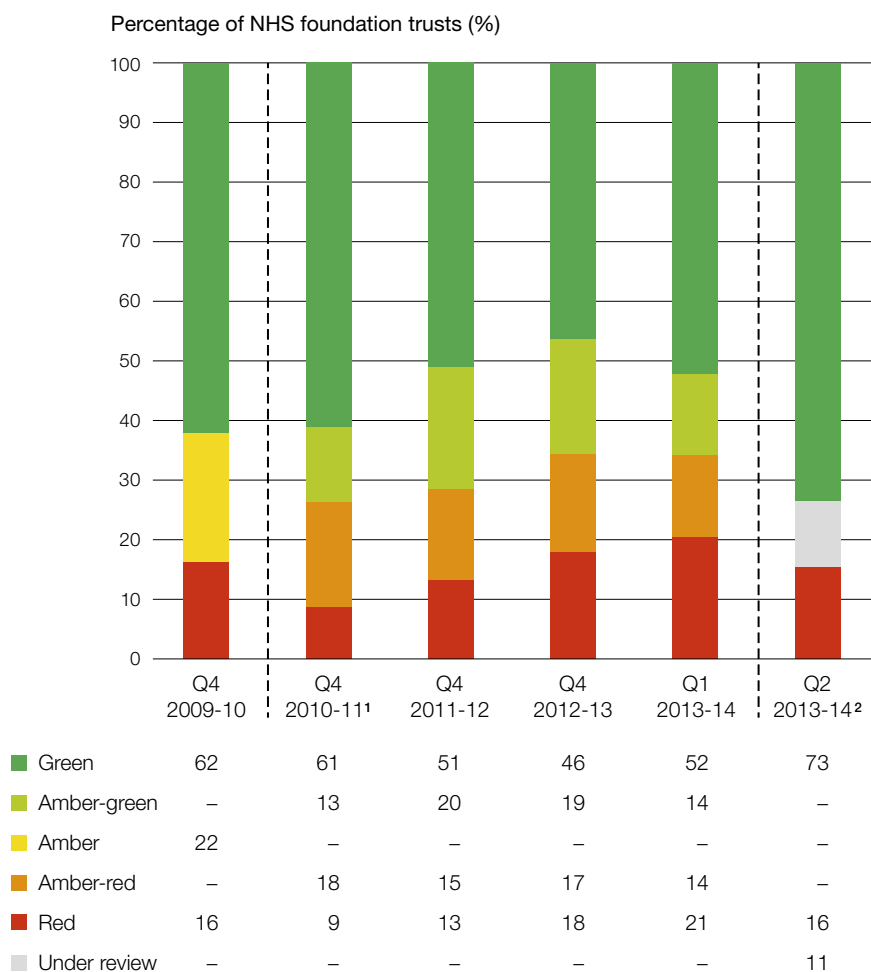
3.5 Monitor assesses governance risk in NHS foundation trusts using red or green ratings. Since July 2013 it has used an 'under review' category for trusts where it is investigating further. The assessment is a matter of judgement. It is based on a combination of: quantitative performance data, such as waiting times and hospital readmission rates as proxy indicators of governance; and qualitative evidence, such as Care Quality Commission inspections and reports to the trust board. There are some trigger points that are likely to lead to Monitor investigating whether a trust is in breach of its regulatory conditions and whether it should take regulatory action. These include the Commission issuing a warning notice, or a trust failing to meet national performance targets for three consecutive quarters.¹⁰

3.6 The way that Monitor has presented its governance risk ratings has changed three times in the last five years, making it more difficult to track trends. The proportion of NHS foundation trusts rated as highest risk for governance increased from 16 per cent at 31 March 2010 to 18 per cent at 31 March 2013 (**Figure 8**). The proportion was 16 per cent at 30 September 2013.

Figure 8

Governance risk ratings for NHS foundation trusts, 2009-10 to 2013-14

The proportion of NHS foundation trusts rated as highest risk for governance increased between 2009-10 and 2012-13



Notes

- 1 In 2010-11, Monitor moved from a three-point scale to a four-point scale, splitting the amber rating into amber-green and amber-red ratings.
- 2 In July 2013, Monitor changed how it assigns governance risk ratings:
 - Monitor assigns a red rating if it is taking regulatory action.
 - Monitor assigns a green rating if no governance concerns are evident.
 - Where it identifies potential material causes for concern with the trust's governance, Monitor will replace the trust's green rating with a description of the action it is taking ('under review').
- 3 Figures may not sum to 100 due to rounding.

Source: National Audit Office analysis of Monitor data

3.7 Monitor recognises that its metrics have not always been effective in identifying poor governance quickly. It has traditionally used retrospective performance measures such as waiting times and infection rates, or has reacted to issues identified by the Care Quality Commission. In practice, however, underlying governance issues may be present well before they become apparent in performance. For example, at one of our case studies, Bolton NHS Foundation Trust, issues about the capability of the board were present for some time before the Trust failed to achieve clinical targets (**Figure 9**).

3.8 In February 2013, the Francis inquiry into Mid Staffordshire NHS Foundation Trust concluded that regulators, including Monitor, had missed warning signs in patient survey data and complaints that there were serious problems at the Trust.¹¹ Participants in our 'sphere of influence' workshop agreed that Monitor had placed less emphasis on data reported by patients as a means of identifying risk, because it had concerns about the quality of the available information.

Figure 9

Case example: Bolton NHS Foundation Trust

Background

Bolton NHS Foundation Trust is a small acute hospital trust, with a sizeable community arm. The Trust was authorised in October 2008.

Reason for breach of regulatory conditions

Monitor found the Trust in breach of its regulatory conditions in April 2012, when it failed to meet its accident and emergency target in the last two quarters of 2011-12, and failed to meet its waiting time targets in three successive quarters in 2010-11 and 2011-12. Monitor also had concerns about performance reporting and assurance to the Trust's board.

At the end of 2011-12, the Trust reported an unexpected trading deficit for the year of £1.9 million, having previously forecast a trading surplus of £1.7 million. The figures were revised after the Trust's auditors found that Trust staff had misreported figures that they had previously reported to Monitor.

There is no evidence to suggest the Trust's board were aware of the misreporting before the Trust's auditors identified it. However, the rapid deterioration in financial performance and the board's failure to identify misreporting of financial data suggest there are likely to have been issues with the Trust's governance for some time before Monitor found the Trust in breach.

Monitor's interventions

Monitor required the Trust to commission an independent review of its governance arrangements. The review highlighted weaknesses in the Trust board's capability and challenge, and in performance reporting to the board.

Monitor required the trust to appoint an interim chair and turnaround director, to develop a recovery plan and improve governance.

At 31 December 2013, the Trust remained in breach of its licence conditions and was reporting regularly to Monitor on its performance, although Monitor considers it has made considerable progress.

Source: National Audit Office analysis of Monitor data and interviews with Bolton NHS Foundation Trust

¹¹ *Final report of the Mid Staffordshire NHS Foundation Trust Public Inquiry*, chaired by Robert Francis QC, Session 2012-13, HC 947, February 2013.

3.9 In October 2013, Monitor updated its regulatory framework to make better use of information from third parties. It now uses staff and patient surveys, and details of complaints and information from whistleblowers, to inform governance risk ratings. Under the new framework, Monitor recommends that NHS foundation trusts should also commission independent reviews of their governance, ideally once every three years.

Assessing financial risk

3.10 Monitor assesses financial risk in NHS foundation trusts, which may affect continuity of services, using numerical scores. In October 2013, Monitor revised how it calculates this score, and now bases it on two key financial measures: the number of days' operating costs the trust can meet from cash reserves ('liquidity'); and the ratio between the trust's available income and annual payments due on its debts, including private finance initiative (PFI) payments ('capital servicing capacity').

3.11 The proportion of NHS foundation trusts rated as highest risk in financial terms increased from 2 per cent assessed on their position at quarter four of 2009-10, to 6 per cent calculated on their position at quarter two of 2013-14 (**Figure 10** overleaf). A declining proportion of trusts received the highest two scores, indicating the increasing financial pressure facing many trusts.

3.12 Until recently Monitor used mostly retrospective indicators to calculate financial risk ratings. We found in our 2012 report on *Peterborough and Stamford Hospitals NHS Foundation Trust* that how Monitor assessed financial risk could not take account of concerns about future events.¹² Monitor therefore rated the Trust as a very low financial risk after the Trust signed the PFI contract for a new hospital building, despite concerns Monitor had already raised about the project's affordability.

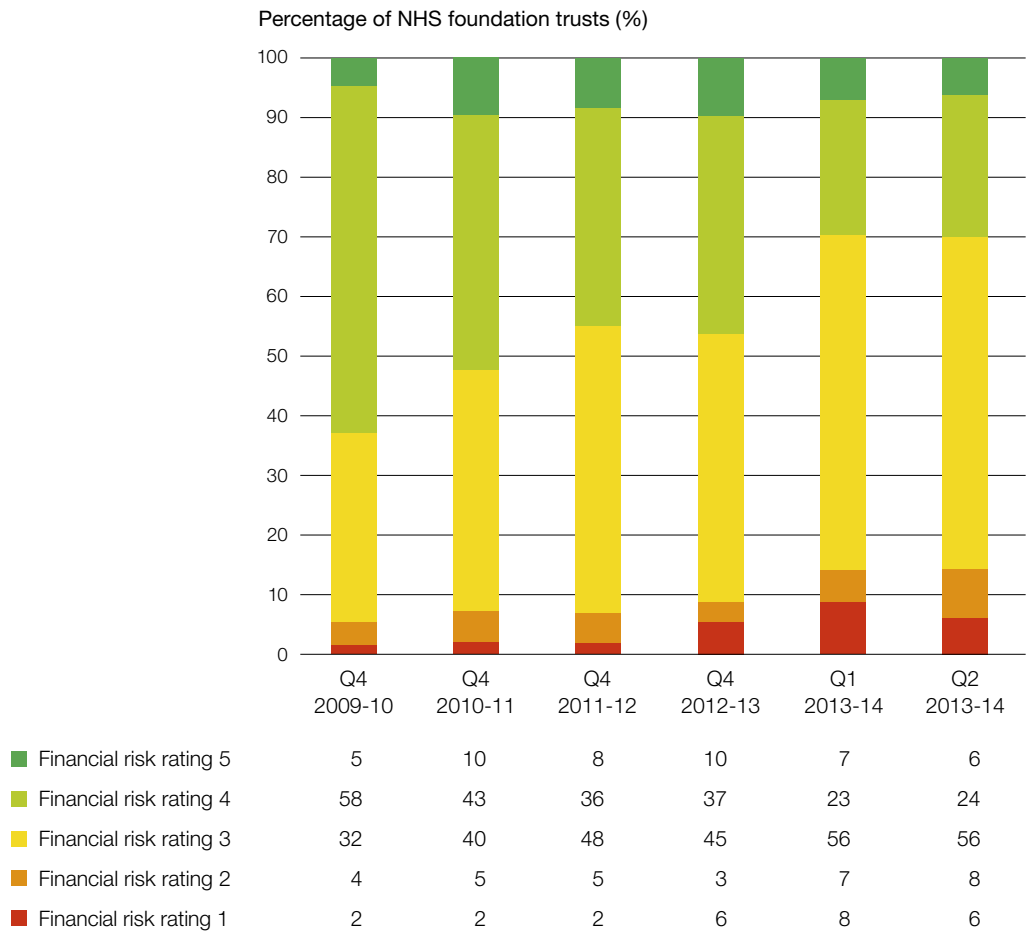
3.13 Monitor is strengthening how it assesses financial risk as part of the changes to its risk assessment framework in October 2013. From summer 2014, Monitor is planning to publish forecast 'continuity of service' risk ratings, based on trusts' financial projections for the next three years to help assess the risk of future financial failure. The ratings will be quarterly for the coming 12 months and annually for the following two years.

¹² Comptroller and Auditor General, *Peterborough and Stamford Hospitals NHS Foundation Trust*, Session 2012-13, HC 658, National Audit Office, November 2012.

Figure 10

Financial risk ratings for NHS foundation trusts, 2009-10 to 2013-14

The proportion of NHS foundation trusts rated as highest risk in financial terms increased between 2009-10 and 2013-14



Note

1 Figures may not sum to 100 due to rounding.

Source: National Audit Office analysis of Monitor data

Trusts breaching their regulatory conditions

3.14 Where risk ratings indicate concerns, Monitor may request further information or open a formal investigation to establish whether the trust has breached its regulatory conditions. At 31 December 2013, 25 NHS foundation trusts (17 per cent) were in breach – one on financial grounds alone, nine on governance grounds alone, and 15 on both financial and governance grounds (**Figure 11** overleaf). Six of the 11 trusts placed in ‘special measures’ after being investigated as part of the Keogh Mortality Review¹³ into the quality of care and treatment were NHS foundation trusts. All were in breach of their regulatory conditions at 31 December 2013.

Impact of interventions

3.15 Responsibility for good governance and financial management lies, in the first instance, with the governors, boards and executive management of NHS foundation trusts themselves. However, Monitor must, among other things, ensure that trusts are financially robust and well governed, and safeguard continuity of essential patient services. It must, therefore, act promptly and effectively if trusts breach, or are at significant risk of breaching, their regulatory conditions to help trusts return to compliance.

Powers of intervention

3.16 Monitor relies mainly on its formal enforcement powers in intervening in NHS foundation trusts. It also has a degree of informal influence with individual trusts and more widely across local health economies. Monitor’s statutory powers to enforce NHS foundation trusts’ compliance with their regulatory conditions were redefined in the Health and Social Care Act 2012:

- Where Monitor has reasonable grounds to suspect a trust is in breach of its regulatory conditions, it can accept a trust’s offer to undertake specific actions to address the issues.
- If a trust has breached its regulatory conditions, Monitor may impose discretionary requirements to ensure the breach is addressed. Monitor may also impose a financial penalty, although it has not used this power to date.
- If Monitor considers that weak governance in a trust means that it is failing, or will fail, to comply with regulatory conditions, Monitor can apply additional conditions relating to governance. If a trust breaches these, Monitor may, for example, remove, suspend or disqualify members of the trust’s board.

¹³ Professor Sir Bruce Keogh, KBE, *Review into the quality of care and treatment provided by 14 hospital trusts in England: overview report*, July 2013.

Figure 11

NHS foundation trusts in breach of their regulatory conditions, 31 December 2013

NHS foundation trust	Reason for regulatory action at 31 December 2013			Date in breach	Months in breach
	Finance	Governance	Finance and governance		
Mid Staffordshire			✓	March 2009	57
Heatherwood and Wexham Park			✓	July 2009	53
Basildon and Thurrock		✓		November 2009	49
Milton Keynes			✓	March 2010	45
Tameside			✓	February 2011	34
Medway			✓	April 2011	32
University Hospitals of Morecambe Bay			✓	October 2011	26
Peterborough and Stamford			✓	October 2011	26
Burton			✓	November 2011	25
Southend		✓		December 2011	24
Derby			✓	January 2012	23
Queen Elizabeth Hospital, King's Lynn			✓	January 2012	23
Bolton			✓	April 2012	20
Royal National Hospital for Rheumatic Diseases	✓			May 2012	19
Sherwood Forest			✓	September 2012	15
Kettering General Hospital			✓	October 2012	14
Cambridgeshire University Hospitals			✓	November 2012	13
Stockport		✓		January 2013	11
Rotherham			✓	February 2013	10
Dorset Healthcare		✓		April 2013	8
North Lincolnshire and Goole		✓		August 2013	4
Aintree University Hospital		✓		November 2013	2
Colchester Hospital		✓		November 2013	2
Calderstones Partnership		✓		December 2013	1
Heart of England		✓		December 2013	1

Source: National Audit Office analysis of Monitor data

3.17 In our 2012 report on *Peterborough and Stamford Hospitals NHS Foundation Trust*, we raised concerns that Monitor's powers were too limited.¹⁴ Monitor had warned that the Trust's new PFI-funded building was likely to be unaffordable, but it lacked the powers and influence to persuade the Trust board or the Department. The Trust subsequently experienced serious financial difficulties, partly because of its PFI commitments, compounded by weak financial management and failure to achieve efficiency savings sufficient to offset rising costs and unfunded increases in activity.

3.18 Monitor's new powers to intervene where it has concerns about particular transactions have not yet been tested. Its view is that it could now impose a licence condition to prevent a transaction of the kind that Peterborough and Stamford entered into, to pre-empt a potential breach of regulatory conditions. There has not been a similar case since Monitor's new powers were introduced to test this view.

Time taken for NHS foundation trusts to comply again with regulatory conditions

3.19 Of the 37 NHS foundation trusts placed in breach of their regulatory conditions since January 2009, 12 now comply again with their regulatory conditions. It usually takes trusts longer to recover from financial breach alone (22 months on average) than from governance breach alone (12 months on average).

3.20 Between 2010-11 and 2012-13, Monitor's performance was variable against the indicators it set itself for returning NHS foundation trusts to compliance with their regulatory conditions (**Figure 12** overleaf). Performance was less good for trusts in breach on financial grounds, although the indicator allows more time for them to return to compliance.

Effectiveness of interventions

3.21 Assessing the impact regulators have on the bodies they regulate is challenging because of the range of influences and the difficulty of attributing change to the regulator's actions. It is therefore difficult to judge conclusively whether Monitor's interventions lead to trusts recovering more quickly than they would otherwise have done.

3.22 External consultants commissioned by Monitor in 2009 concluded that there was some evidence that NHS foundation trusts recovered faster than a comparator group of NHS trusts.¹⁵ We re-performed similar analysis in 2013, but found the results were inconclusive:

- Three of four NHS foundation trusts no longer in financial breach recovered from deficit at a faster rate than a comparator group of similar NHS trusts.
- Conversely, three of four NHS foundation trusts still in financial breach are recovering at a slower rate than a comparator group of similar NHS trusts.

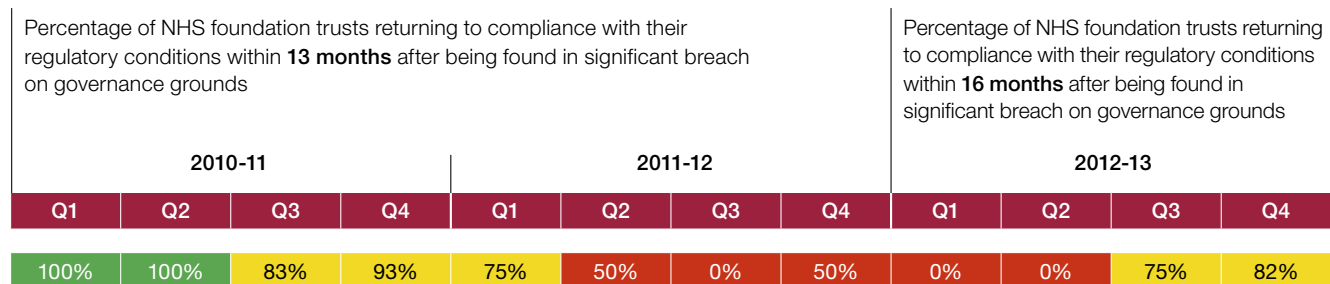
¹⁴ See footnote 12.

¹⁵ Frontier Economics, *Measuring Monitor's impact: economic evaluation report*, September 2009.

Figure 12

Monitor’s performance in returning NHS foundation trusts to compliance, 2010-11 to 2012-13

Monitor’s performance has been variable against indicators for returning NHS foundation trusts to compliance with their regulatory conditions



Percentage of NHS foundation trusts returning to compliance with their regulatory conditions within **25 months** after being found in significant breach on financial grounds



- Less than 75%
- 75–99%
- 100%

Notes

- 1 Thresholds are based on few instances per quarter. Good performance is seen as ensuring that all trusts correct their performance within the required time frame.
- 2 ‘n/a’ means that there were no NHS foundation trusts that returned to compliance in the quarter.

Source: National Audit Office analysis of Monitor data

3.23 It is not possible to draw firm conclusions from this analysis, in part because the group of NHS trusts against which we were able to compare NHS foundation trusts was very small. We selected comparator trusts that were of a similar size, and which had a similar surplus or deficit. However, the variations in outcome may still be explained by factors other than Monitor’s intervention, such as whether trusts had PFI commitments or wider issues within local health economies.

3.24 At the time of our fieldwork in autumn 2013, people we interviewed at our case study trusts considered that Monitor’s interventions were proportionate and this was also the view of the Foundation Trust Network. Four of our case study trusts told us that they took faster or more effective action, or both, because of Monitor than they would otherwise have done. There was consensus that Monitor’s interventions focused minds and led to necessary changes in trusts’ leadership.

Tackling problems within a trust

3.25 Our work indicated that it is easier for Monitor to intervene effectively where the underlying issues are internal to the trust, for example where problems arise from poor leadership or cost control. The case of Dorset County Hospital NHS Foundation Trust is an example of how Monitor's interventions can be effective when a trust's problems can be resolved internally (**Figure 13**). The people we interviewed said that Monitor's interventions had resulted in necessary changes in senior management and that its constructive pressure led members of the Trust board to focus on improving the board's own performance.

3.26 Monitor's interventions regularly lead to NHS foundation trusts in breach of their regulatory conditions taking radical action. In many cases, including in four of our five case study trusts in breach, trusts changed their chair, chief executive or other senior staff following Monitor's intervention. Monitor often identifies individuals, with experience of turning trusts around and whom it holds in high regard, to take up senior posts in trusts in difficulty.

Figure 13

Case example: Dorset County Hospital NHS Foundation Trust

Background

Dorset County Hospital NHS Foundation Trust is a medium sized acute hospital trust. It was authorised in June 2007.

Reason for breach of regulatory conditions

Monitor found the Trust in breach in October 2009, after the Trust's financial performance deteriorated. Monitor gave the Trust a financial risk rating of 1 in August 2009 and forecast that the rating of 1 would remain throughout the rest of 2009-10.

Monitor's interventions

Monitor had concerns about the strategic leadership provided by the Trust's board, and in October 2009 requested the Trust to appoint a new interim chair.

Monitor asked the Trust to develop a financial recovery plan and report its progress to Monitor monthly. It also held monthly progress review meetings with the Trust.

In November 2011, Monitor removed the Trust from breach and in March 2012, the Trust reported a surplus. The people we interviewed at the Trust considered that Monitor's interventions had brought focus and helped the Trust to recover from financial difficulty.

Source: National Audit Office analysis of Monitor data and interviews with Dorset County Hospital NHS Foundation Trust

3.27 In addition, Monitor required all seven of our case study trusts to commission external consultancy support and, in three cases, to employ interim or turnaround directors. The people we interviewed had mixed views about the cost and value of the external consultancy they commissioned. In four trusts, they considered that the consultants had added little to their own understanding of the issues. However, the remaining three trusts said that the cost of consultancy was outweighed by a stronger recovery than there would otherwise have been.

Tackling problems outside a trust

3.28 It has proved much harder for Monitor to intervene effectively when the causes of a trust's difficulties relate to underlying issues in the local health economy. Milton Keynes NHS Foundation Trust, for example, has been in breach for over three years, despite implementing a financial recovery plan and replacing senior managers (**Figure 14**). The people we interviewed at the Trust told us that stand-alone interventions were insufficient to improve the Trust's performance or achieve the necessary pace of recovery. In recent months, however, Monitor has changed its approach. Its aim is to work collaboratively with other stakeholders, including commissioners, the local authority and the NHS Trust Development Authority, to find a solution that will maintain services across Milton Keynes and Bedfordshire. Monitor is also adopting a similar approach at King's Lynn.

Figure 14

Case example: Milton Keynes NHS Foundation Trust

Background

Milton Keynes NHS Foundation Trust is a small acute hospital trust. It was authorised in October 2007.

Reason for breach of regulatory conditions

Monitor found the Trust in breach in March 2010, owing to concerns about the quality of maternity services, board assurance and the Trust's worsening financial position.

Monitor's interventions

Monitor's interventions to date have mostly been within the Trust itself. In 2010, Monitor required the Trust to implement a financial recovery plan and appoint an interim chief executive.

Despite earlier interventions, the Trust had a £9 million deficit in 2012-13. The people we interviewed at the Trust, and staff at Monitor, attributed this to pressures including increases in emergency admissions and demand for elective services growing faster than planned. Nearby Bedford NHS Trust is experiencing similar challenges.

In autumn 2013, Monitor started discussions with the local clinical commissioning groups, NHS England and the NHS Trust Development Authority. Its aim is to work collaboratively with other stakeholders to develop a solution that will maintain services across Milton Keynes and Bedfordshire.

Source: National Audit Office analysis of Monitor data and interviews with Milton Keynes NHS Foundation Trust

Taking early action

3.29 In some cases, where it is concerned that an NHS foundation trust is at increased risk of breaching its regulatory conditions, Monitor may take early informal action and this can be effective. Informal interventions, for example providing support or issuing a warning letter which sets out concerns, can prompt trusts to take action to avoid breach. For example, University Hospitals Bristol took stronger action to tackle its accident and emergency performance in the light of Monitor's closer scrutiny and support (**Figure 15**).

Reducing risk by strengthening NHS foundation trusts' financial management and governance

3.30 The proportion of NHS foundation trusts in breach of their regulatory conditions has increased steadily over the last two years (**Figure 16** overleaf). At 31 December 2013, 17.0 per cent of trusts were in significant breach, up from 10.6 per cent at the same point two years previously.

3.31 The growth in the proportion of NHS foundation trusts in significant difficulty is concerning for the sustainability of the NHS as a whole and for Monitor. The enhanced monitoring and intervention that these trusts require takes an increasing proportion of Monitor's resources. Monitor recognises the pressure that a high proportion of trusts in breach creates for itself and within local health economies. It has started to increase its work to strengthen trusts' governance and financial management, with the aim of reducing the risk of them getting into difficulty.

Figure 15

Case example: University Hospitals Bristol NHS Foundation Trust

Background

University Hospitals Bristol NHS Foundation Trust is an acute teaching hospital. It was authorised in June 2008.

Monitor's early action

The Trust breached its accident and emergency (A&E) target for three of four quarters in 2012-13.

In March 2013, Monitor started reviewing the Trust's A&E performance monthly. It also met with the Trust's board to review the board's oversight of A&E performance. Monitor decided not to place the Trust in breach, and supported the Trust's decision to commission external support to help improve A&E performance.

Actions taken by the Trust

The people we interviewed at the Trust said that the Trust took actions, influenced by Monitor's feedback, which it would not otherwise have done. For example, it commissioned external support to redesign the pathways for transferring patients from the A&E department into other parts of the hospital; and the board also now uses additional data to understand the Trust's performance, as a result of examining the causes of the breach of the A&E target.

The Trust met its A&E target in quarter two of 2013-14.

Source: National Audit Office analysis of Monitor data and interviews with University Hospitals Bristol NHS Foundation Trust

Figure 16
 NHS foundation trusts in breach of their regulatory conditions, 2009-10 to 2013-14

The proportion of NHS foundation trusts in breach of their regulatory conditions has increased steadily over the last two years



Source: National Audit Office analysis of Monitor data

3.32 Monitor seeks to support and develop the foundation trust sector in a variety of ways. For example:

- It provides training to strengthen the capability of boards and non-executive directors, in partnership with other bodies such as business schools and the Foundation Trust Network.
- It publishes guidance and research, including on opportunities to maintain services while under financial pressure and the challenges facing smaller hospitals.
- As part of its regulatory interventions it has recently partnered two NHS foundation trusts in difficulty with high performing trusts to help them develop innovative solutions to the challenges they face.

3.33 To date, however, Monitor has devoted only a very small proportion of its resources to this type of work. It has not assessed the overall impact or reach of this work, although it does collect feedback on its training courses and more recently has started to collect activity data, such as the number of documents downloaded from its website. Monitor plans to expand its sector development team from two to eight staff by early 2014-15.

3.34 The people we interviewed at our case study trusts were not always aware of Monitor's support and development work, and did not always see this as part of Monitor's role as a regulator. Participants in our 'sphere of influence' workshops nonetheless agreed that Monitor might do more, working with other stakeholders, to help trusts reduce risk. This was supported by others we interviewed. They saw scope for Monitor to promote good practice more extensively, for example by sharing the learning from consultancy input in one trust with other trusts, or by supporting collaboration among trusts.

Appendix One

Our audit approach

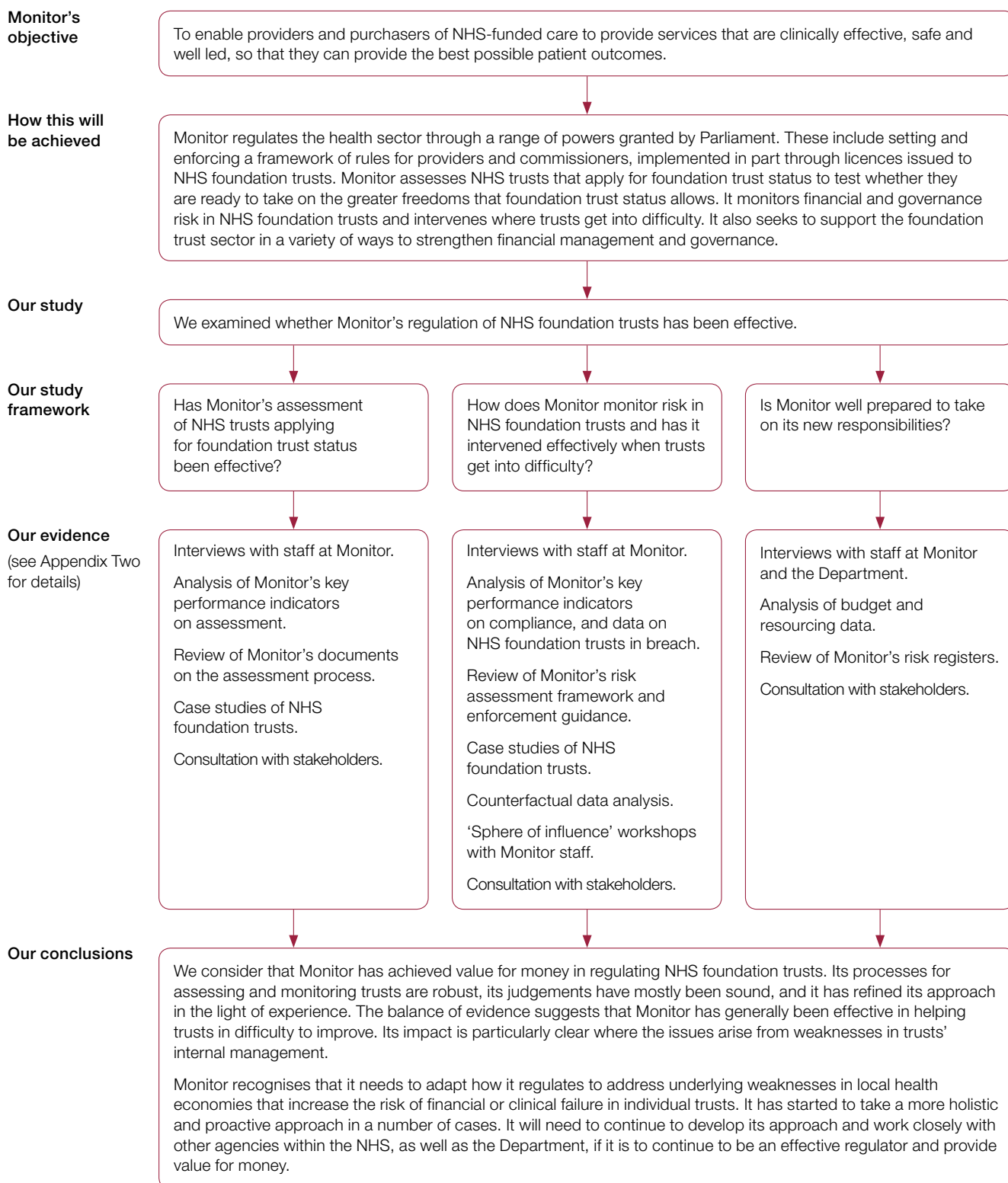
1 This report examines whether Monitor's regulation of NHS foundation trusts has been effective. We reviewed:

- the effectiveness of Monitor's assessment of NHS trusts applying for foundation trust status;
- how Monitor monitors risk in NHS foundation trusts and the effectiveness of its interventions when trusts get into difficulty; and
- whether Monitor is well prepared to take on its new responsibilities.

2 In reviewing these issues, we applied an analytical framework with evaluative criteria, which consider what arrangements would be optimal for effective regulation. We used mainly output-based criteria, for example no NHS foundation trust gets into difficulty soon after it is authorised or NHS foundation trusts recover quickly from difficulty. By 'optimal' we mean the most desirable possible, while acknowledging expressed or implied constraints.

3 Our audit approach is summarised in **Figure 17**. Our evidence base is described in Appendix Two.

Figure 17
Our audit approach



Appendix Two

Our evidence base

1 We reached our independent conclusions on the effectiveness of Monitor's regulation of NHS foundation trusts after analysing evidence that we collected between July and November 2013. Our audit approach is outlined in Appendix One.

2 We conducted seven case studies of NHS foundation trusts that have been, or are currently, in breach of their regulatory conditions, or that have been at risk of breaching those conditions:

- The case studies were designed to collect evidence on a range of issues including: whether the underlying issues were present at the point the trust was authorised; how Monitor intervened to help the trust improve and the impact of its interventions; and the action the trust took and whether the position improved.
- The case study trusts were: Bolton Hospital, Dorset County Hospital, Dudley Group, Milton Keynes Hospital, The Queen Elizabeth Hospital King's Lynn, South Tyneside and University Hospitals Bristol.
- The case studies comprised: interviews with senior people at the trust, such as the chair, chief executive, and finance director; interviews with Monitor staff responsible for overseeing the trusts in question; and reviewing Monitor documents about the trust, such as trust board reporting packs, Monitor board papers, and correspondence between Monitor and the trust.

3 We analysed existing data on Monitor's costs, staffing and performance.

This included time series analysis of Monitor's budget and spending, staffing and recruitment numbers, and key performance data. We also analysed data on NHS foundation trusts, such as financial and governance risk ratings and the number of trusts in breach.

4 We interviewed Monitor's staff and examined Monitor's documents. This work was designed to understand and assess Monitor's assessment and compliance processes, its work to support the foundation trust sector, and its preparations for taking on its new responsibilities. The documents included annual reports, business plans, the risk assessment framework and other guidance, internal audit reports, planning documents relating to Monitor's new role (risk registers, implementation plans, project board papers), and memorandums of understanding between Monitor and other bodies.

5 We consulted a range of stakeholders. This work was designed to obtain views on: the effectiveness of Monitor's assessment and compliance processes and its sector development work; and any key risks, particularly in relation to Monitor's new responsibilities. The organisations included the Department of Health, the Care Quality Commission and the Foundation Trust Network. In addition, the Foundation Trust Network conducted a consultation exercise for us in October 2013 to seek the views of NHS foundation trusts on these issues. We received written responses from 17 NHS foundation trusts.

6 We re-performed some of the counterfactual data analysis carried out for Monitor by Frontier Economics in 2009. This work was designed to examine whether Monitor's interventions have a positive impact, for example whether Monitor's interventions caused NHS foundation trusts to recover from difficulty at a faster rate than they would otherwise have done. We performed two types of counterfactual analysis.

- i The performance of NHS foundation trusts compared with NHS trusts:
 - We compared the recovery of a sample of NHS foundation trusts following a decline in financial performance with a group of NHS trusts with similar characteristics. We conducted the analysis based on year-end surpluses, calculated as a percentage of the trust's annual turnover.¹⁶
 - The sample of NHS foundation trusts consisted of trusts that were in breach within the last three years but have since recovered, and trusts that are currently in breach of their licence conditions. This aimed to illustrate how Monitor has intervened in the process of trusts' recovery, and to examine the interventions that Monitor makes.
 - The comparator group consisted of similar-sized acute NHS trusts with an operating deficit in the same year as the NHS foundation trust's deficit. We selected NHS trusts that had at least broken even in the prior year to remove trusts with deficits for several years. However, this limited the sample of NHS trusts, because in some years there were few NHS trusts in deficit.
- ii The performance of NHS foundation trusts after Monitor's intervention compared with before:
 - We compared the performance of NHS foundation trusts in breach of their regulatory conditions for governance reasons before and after they were placed in breach. We compared performance against key clinical indicators used in Monitor's risk assessment framework, such as A&E waiting times or the particular indicator(s) that caused the trust to be placed in breach. It is difficult to link a trust's clinical performance directly to Monitor's interventions, as there are other variables and bodies involved. However, we analysed whether there was any improvement after Monitor had placed a trust in breach.

¹⁶ We adjusted surplus data to remove impairments.

7 We conducted two ‘sphere of influence’ modelling workshops with Monitor staff. A sphere of influence model assesses the degree of influence a regulator has over the factors needed to achieve beneficial outcomes in the organisations it regulates. Workshop participants included a range of staff from Monitor’s assessment, compliance and sector development teams. The purpose of the workshops was:

- to understand the factors that affect: whether Monitor effectively identifies issues in NHS foundation trusts that have breached or been at risk of breaching their regulatory conditions and how strongly trusts recover (workshop one – provider regulation); and whether NHS foundation trusts have strong financial management and governance (workshop two – sector development);
- to plot these factors according to their importance in relation to: effectively identifying issues in NHS foundation trusts that have breached or been at risk of breaching their regulatory conditions, and how strongly NHS foundation trusts recover; and whether NHS foundation trusts have strong financial management and governance; and
- to plot Monitor’s level of influence over these factors.

This report has been printed on Evolution Digital Satin and contains material sourced from responsibly managed and sustainable forests certified in accordance with the FSC (Forest Stewardship Council).

The wood pulp is totally recyclable and acid-free. Our printers also have full ISO 14001 environmental accreditation, which ensures that they have effective procedures in place to manage waste and practices that may affect the environment.



National Audit Office

Design and Production by NAO Communications
DP Ref: 10357-001

£10.00

ISBN 978-1-904219-03-3



9 781904 219033
