

Health Group Internal Audit

FINAL REPORT
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Health Group Internal Audit provides an objective and independent assurance, analysis and consulting service to the Department of Health and its arm's length bodies, bringing a disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.

Health Group Internal Audit focuses on business priorities and key risks, delivering its service through three core approaches across all corporate and programme activity:

- **Review** and evaluation of internal controls and processes;
- **Advice** to support management in making improvements in risk management, control and governance; and
- **Analysis** of policies, procedures and operations against good practice.

Health Group Internal Audit findings and recommendations:

- Form the basis of an independent opinion to the Accounting Officers and Audit Committees of the Department of Health and its arms length bodies on the degree to which risk management, control and governance support the achievement of objectives; and
- Add value to management by providing a basis and catalyst for improving operations.

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ST GEORGE'S UNIVERSITY HOSPITALS NHS FT - LESSONS LEARNED

Our work has been conducted and our report prepared solely for the benefit of the Department of Health and its arms length bodies and in accordance with a defined and agreed terms of reference. In doing so, we have not taken into account the considerations of any third parties. Accordingly, as our report may not consider issues relevant to such third parties, any use they may choose to make of our report is entirely at their own risk and we accept no responsibility whatsoever in relation to such use. Any third parties, requiring access to the report may be required to sign 'hold harmless' letters.

CONTENTS

PAGE

1. Executive Summary	1
2. Detailed Findings	9
3. Action Plan	19

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1

Executive Summary

1. Introduction

1.1 As part of our role as internal auditors for Monitor, you have requested us to complete a “lessons learned” review following Foundation Trust (“FT”) status being granted to St George’s Healthcare NHS Trust (“the Trust”) on 1 Feb-15. Following authorisation as an FT, the Trust experienced a sudden deterioration in its finances during quarter 4 of 2014/15 which led to it recording a £16.8 million loss for the first financial year.

Background

1.2 The usual decision making process for FT applications can be described as follows. A provider appraisal team comprising an Appraisal Director (“AD”), Senior Manager and Manager and Analyst resource is allocated to each Trusts application. The team reports to the Executive Director of Provider Appraisal (“EDA”) and carries out its work under the guidance set out in Monitor’s publication, “the Guide for Applicants”. The team, including the EDA does not make the decision on each FT application but makes a recommendation to the Provider Appraisal Executive (“PAE”), the decision making body for cases considered to be non-marginal with marginal cases reverting to the Monitor Board. Prior to making a recommendation to the PAE, the team including the EDA meet to discuss the finalisation of the case and the recommendation to be put to the PAE. The EDA will seek a consensus of views so that the PAE is presented

with a united approach from the Provider Appraisal Directorate. In that final discussion process, the EDA may give a steer to the collective decision making. However, where consensus is not forthcoming, the EDA is content for this to be made apparent to the PAE and for the issues to be discussed openly. To preserve independence of decision making, the EDA does not take part in the decision making of the PAE.

1.3 The Trust’s application for FT status was presented to the PAE on 20 Nov-14. At the meeting it was highlighted that the decision was marginal and that key judgements were being taken in relation to the four hour A&E target, quality governance and in light of the Trust’s balance sheet, short to medium term financial viability. PAE reflected on the case for possible deferral in light of the marginal nature of the recommendation. PAE proposed that the Provider Appraisal team should undertake further work and consult NHS England with regard to A&E performance and explore the possibility of additional funding arrangements for the Trust with the Department of Health (“DH”) and the NHS Trust Development Authority (“NHS TDA”). The PAE requested that an update on progress in addressing these points was to be brought to the subsequent PAE meeting to allow further consideration of the authorisation recommendation.

1.4 Subsequent to the follow up by the Provider Appraisal team which extended into early December, the application was reconsidered at the PAE on 11 Dec-14.

1

Executive Summary

At this stage an update was provided on the A&E position and also on the financial position of the Trust. The minutes of the Dec-14 PAE record that PAE was satisfied with the update on A&E performance and that there was a discussion on current trading and the Trust's working capital position. As a result of the discussion the PAE concluded that the Trust's financial position remained an area of risk. They said that further work should be undertaken to determine the level to which the Trust's balance sheet needed to be recapitalised through putting in place appropriate borrowing arrangements to improve the Trust's liquidity position to help protect it against financial pressures in the short term. At the meeting the PAE also agreed that once the funding issue was addressed the case was not considered to be marginal. Therefore, once recapitalisation arrangements including a working capital facility were put in place it was anticipated that the decision could be made by the PAE (rather than the Board). The Trust's application was deferred to enable further work on the nature of the funding facility.

- 1.5 The Provider Appraisal directorate reported to the PAE meeting held on 30 Jan-15 that the Trust had undertaken further work on its funding facility and had secured a £15m working capital loan and £25m working capital facility. PAE members reflected on the Trust's revised downside financial forecast in light of the new funding and concluded that the Trust now demonstrated a reasonable cash position for at least the next two years. In addition, the PAE considered the view of the

NHS TDA on the Trust's A&E performance at this meeting. As a result of these considerations the PAE concluded that the Trust should be authorised as an NHS FT from 1 Feb-15.

- 1.6 Monitor granted the Trust FT status on the basis it would break even in 2014/15 and make a small surplus in 2015/16 in line with the Trust's base case financial forecast. However, a sudden deterioration in the Trust's reported finances led to it recording a £16.8m loss for 2014/15 and the Trust forecasting a £46.2m loss for 2015/16. This led to Monitor undertaking an initial and swift investigation of the reasons for this deterioration which reported in May-15. This internal audit review is subsequent to the Monitor review to consider whether any lessons can be learned from Monitor's Provider Appraisal process adopted on the Trust's assessment.

Our scope and process

- 1.7 This review has assessed the internal processes followed by Monitor's Provider Appraisal Directorate in the authorisation of the Trust as an FT from 1 Feb-15. The aim of this exercise has been to identify any lessons learned from this review and to inform how improvements can be made to the Provider Appraisal process going forward.
- 1.8 Our review has focussed on the following objectives set out in the Terms of Reference agreed with Monitor dated Oct-15:

1

Executive Summary

- a. assess the internal processes followed by Monitor's Provider Appraisal ("PA") Directorate in relation to the Trust's application for foundation trust status; and
- b. consider the work performed by the Reporting Accountants in order to support the working capital and Financial Reporting Procedures ("FRP") opinions provided to Monitor.

Our work was performed over a four week period commencing with a kick-off meeting with the EDA on 9 Oct-15. As part of the fieldwork phase we had access to the following individuals at Monitor and the Reporting Accountants, Ernst & Young LLP:

- David Bennett - Chief Executive Officer;
- Stephen Hay - Managing Director, Provider Regulation;
- Adrian Masters – Managing Director, Sector Development;
- Miranda Carter - Executive Director, Provider Appraisal;
- David Hoppe - Assessment Director, Provider Appraisal;

- Victoria Fairhurst - Senior Manager, Provider Appraisal (on this assessment from 7 May-14 to 19 Dec-14);
- Katherine Golding – Senior Manager, Provider Appraisal (on this assessment from Jan-15 up to date of authorisation);
- Mark Turner - Regional Director – London;
- Hana Katic- Head of Investigations;
- Richard Guest – Partner, Ernst & Young LLP; and
- Michael Barber – Director, Ernst & Young LLP.

We had access to the following information provided to us by Monitor which we have used to gain an insight and understanding of the work undertaken and processes followed over the period up to the initial PAE assessment on 20 Nov-14 and the subsequent period to the authorisation decision taken on 30 Jan-15:

- Papers and minutes for the PAE meetings held on 20 Nov-14, 11 Dec-14 and 30 Jan-15;
- Minutes to the Trust Board to Board ("B2B") meeting held on 25 Sep-14;

1

Executive Summary

- Report prepared by the Monitor Head of Investigations on the 2014/15 Financial Position of the Trust dated May-15;
- The Stage 1, 2 and 3 reports issued by Ernst & Young LLP in their capacity as Reporting Accountants on the St George's NHS FT assessment. These reports were dated 7 Jun-10 (Stage 1 refresh dated 21 Dec-12), 25 Apr-13 and 13 Nov-14, respectively; and
- PwC Forensic review and assessment of St George's addressed to the Trust dated 1 Oct-15.

We also had access to Monitor's "Connect 2" electronic files for the Trust's assessment being:

- Jun-14 file (for assessment up to and including the authorisation deferral in Dec-14); and
- Reactivated Jan-15 file (new file for the work undertaken in Jan-15 up to and including the authorisation of the Trust).

Our work has been limited to one meeting with each of the key individuals noted above and a review of the documents listed earlier. We have not had access nor sought access to any of the working papers and files of the Reporting Accountants supporting their conclusions on FRP and working capital. Our review of the "Connect 2" files has

been limited to a high level review of the file structure and information recorded in the file to support the assessment.

2. Summary of Findings

2.1 The Trust's application was considered at three separate PAE meetings held on 20 Nov-14, 11 Dec-14 and 30 Jan-15 at which the Trust was authorised as a FT. All of the PAE meetings held to consider the Trust's application were supported by detailed papers prepared and presented by the Provider Appraisal team. These papers clearly set out the key judgements made by the Provider Appraisal team in arriving at the conclusions and recommendations. The PAE raised concerns about the Trust's viability as an FT based on both financial and operational performance, demonstrating appropriate involvement and challenge of the authorisation process at a senior level within Monitor.

2.2 A "standard" Monitor FT assessment approach was followed by the Provider Appraisal team on the Trust's assessment, supported by a "Connect 2" electronic file to record the scope of work, details of the work undertaken by the Provider Appraisal team and all information and documentation received and reviewed to support the Trust's assessment up to the formal deferral on 11 Dec-14. A new "Connect 2" electronic file was created to record the work undertaken by the Provider Appraisal team on reactivation of the Trust's application through to authorisation.

1

Executive Summary

2.3 Following the PAE's decision at its Dec-14 meeting, the Provider Appraisal team undertook a limited scope of work focusing on the areas of concern previously identified by the PAE (being working capital requirements and A&E performance of the Trust) and checking whether there had been a material change from the work undertaken in Dec-14 rather than undertake a full re-assessment. The work to review the working capital requirements involved the Trust updating its Board memorandum on working capital requirements including current trading and changes to loan funding. Although the Provider Appraisal papers detailed the approach taken at this stage, there was no evidence of the approach being formally agreed by the PAE.

2.4 Only a high-level assessment of the Trust's current trading performance was undertaken by the Provider Appraisal team leading up to the PAE meeting held on 30 Jan-15. The team received the M9 (to Dec-14) financial information from the Trust on 26 Jan-15 and held a telephone conversation with the Trust's Financial Director to understand the nature of the in-month changes. This was despite the fact that the Trust's M9 management information showed a significant "in-month" deterioration in the Trust's performance which should have warranted a further more detailed review.

2.5 The Reporting Accountants undertook their work over the course of a four year period, with Stage 1 – (Preliminary review of financial reporting procedures)

completed in Jun-10 and the final stage, Stage 3 (Working capital and financial reporting procedures) concluded on 11 Nov-14 with the issue of their final report and signed clean opinions on FRP and working capital on 13 Nov-14 ahead of the initial PAE meeting to consider the Trust's application on 20 Nov-14. Provider Appraisal team expressed concerns over the Reporting Accountants' work and raised these with the Accountants at a meeting on 26 Nov-14 and, therefore, these were not brought to the attention of the PAE on 20 Nov-14.

2.6 Whilst the Trust Board was required to update its Board memorandum to reflect current trading and updated working capital requirements, the Provider Appraisal team did not request the Reporting Accountants to update their work and opinion. This decision was made despite:

- the lapse of time between the date of opinions being issued and subsequent authorisation decision of 30 Jan-15; and
- changes in the Trust's current trading performance, assumptions supporting its base case (and downside scenario) and the Trust preparing an updated Board Memorandum to take account of the revised base case assumptions and new working capital funding arrangements.

1

Executive Summary

EDA explained that the judgement not to request further work by the Reporting Accountants was made because they had signed their opinion in Nov-14 based on a substantially lower level of funding and without a working capital facility. At the time there was a concern about whether any such further work would present value for money in requiring an updated opinion given the substantially increased working capital headroom in the case. The PAE members highlighted that they were not aware of the fact that the Reporting Accountants had not undertaken any work subsequent to the issue of their Stage 3 report and opinions on 13 Nov-14. The paper to PAE did not make it clear that this was the case.

- 2.7 Our work has identified a number of improvements that can be made to the FT assessment process which we have categorised based on the area of the FT assessment process that they relate to. These are summarised below with our key observations and findings supporting our recommendations detailed in Section 2 of this report.

1

Executive Summary

Observation/Recommendation for lessons learned	
1.	<p>Monitor Provider Appraisal process - Although a standard Provider Appraisal approach was followed, there are a small number of areas where the Directorate process could be refined and formalised to ensure risks are appropriately addressed.</p> <p>Recommendation 1: <u>Follow-up on PAE challenge with third parties</u> - Where challenge is provided by the PAE in relation to areas where assurances are sought from third parties including the Reporting Accountants, the reasons for the difference of opinion should be fully explored to ensure that the third party are comfortable with their conclusions and the rationale for their conclusions are fully understood. The outcomes of such discussions should be documented by the Provider Appraisal team ensuring that conclusions reached by the third party are fully understood and reported back to the PAE for consideration as part of their FT authorisation decision process.</p> <p>Recommendation 2: <u>Approval of scope of work</u> – Where significant additional scope for any further work on an assessment is identified, the Provider Appraisal team must ensure that their additional scope of work is agreed and signed-off by the PAE to ensure that the additional work that has been undertaken meets their requirements as part of their FT licensing decision making process.</p> <p>Recommendation 3: <u>Current trading review</u> - Given the current climate of uncertainty and widespread financial deficits within the NHS and FT sector, any work undertaken as part of an FT assessment process should include a detailed review of current financial performance up to and including the date of the PAE and/or Monitor Board meeting at which the authorisation decision is to be made, to ensure that any adverse performance is appropriately reflected in the FT assessment case.</p>
2.	<p>Work of the Reporting Accountants - The Reporting Accountants completed their work with the issue of the Stage 3 report (including opinions) on 13 Nov-14. Concerns were raised by the Provider Appraisal team in relation to their work on a telephone call held on 7 Nov-14 and at a meeting held on 26 Nov-14. It was not clear how (if at all) such concerns had been addressed prior to the opinions being issued and how aware the PAE were of such concerns.</p> <p>Recommendation 4 – <u>Resolution of issues with work of third parties</u> - Where there are instances of any material concerns by the Provider Appraisal team with the work undertaken by the Reporting Accountants and other third parties, all such concerns should be fully raised with the Reporting Accountants and appropriately resolved between all parties with any implications and resolutions reported to the PAE for consideration as part of their overall assessment and decision process for FT authorisation.</p>

1

Executive Summary

Observation/Recommendation for lessons learned	
	<p>Recommendation 5: <u>Update to Reporting Accountants work</u> - Where there has been any lapse of time exceeding one month between the Reporting Accountants opinions being issued and the proposed FT authorisation date, Monitor should inform the Reporting Accountants of any deferral decision and also give them the opportunity, where there is a delay in authorisation, to consider whether their opinions remain valid or need to be rescinded based on their assessment of current circumstances of the aspirant FT. Monitor should also be asking the Reporting Accountants to update their report for the impact of more up to date financial information.</p>
3.	<p><u>Scope of work for FRP and working capital review</u> – There appears to be an expectations gap between what Monitor believe should have been done as part of the Reporting Accountants work on FRP and working capital and what the Reporting Accountants believe is appropriate to address the FT assessment scope of work.</p> <p>Recommendation 6: <u>Scope of work for Reporting Accountants</u> - The current scope of work for both the FRP and working capital reviews should be scrutinised to ensure it remains ‘fit for purpose’ in the current challenging NHS and FT environment and whether the respective scopes need to go into greater depth than they currently do. This review should draw on Monitor’s knowledge of common factors of Trusts that are currently in difficulties. Consideration should also be given as to whether the length of time between the completion of each stage of the FT assessment process (in particular detailed work on FRP) undertaken by the Reporting Accountants is appropriate given the reliance that is placed on the FRP and working capital opinions by Monitor in the overall assessment process. As part of this review, Monitor should engage with the advisers they use as Reporting Accountants to ensure there is a common understanding of the breadth and depth of work required by Monitor from the Reporting Accountants and ensure any ‘expectations gap’ is fully addressed. As part of this engagement, the Reporting Accountants should also give their advice on the nature of the work they think is required in the circumstances.</p>
4.	<p><u>Third party assurance/ confirmations</u> – As part of the initial Provider Appraisal assessment presented to the 20 Nov-14 PAE meeting assurances and confirmations were received from all relevant third parties, which was not the case at the time of the Trust finally being authorised on 30 Jan-15. No assurance/confirmation was request or received by the Provider Appraisal team from the TDA.</p> <p>Recommendation 7: <u>Third party confirmations</u> - Confirmations should be sought from all third parties where there is a lapse of time of at least one month between any prior confirmations provided as part of the FT appraisal process. In particular confirmations should always be sought from the TDA as to their current understanding of the Trust’s financial position.</p>

1

Executive Summary

Observation/Recommendation for lessons learned	
	<p>Recommendation 8: <u>Communication with third parties</u> - Reporting Accountants should be made aware of any delays in authorisation of an aspirant FT and given the opportunity to consider and formally confirm whether any FRP and working capital opinions issued prior to any deferral decision remain valid at the time of an application being reactivated. Where further work has not been undertaken by the Reporting Accountants this should be formally communicated to the PAE as part of informing their decision making process with full explanations and rationale as to why no further update work is deemed appropriate.</p>
5.	<p><u>Knowledge share</u> – Although the senior Monitor team bring to bear broad experience from across the FT sector and knowledge of current pressures and risk areas in the wider NHS and FT sector, the Provider Appraisal team and members of Provider Regulation we met with felt that in general knowledge share and knowledge management was not as good as it should be within Monitor.</p> <p>Recommendation 9: <u>Knowledge share</u> - A formal process for knowledge share should be put in place between Provider Appraisal teams and other parts of Monitor to better inform planning for assessments of aspirant FTs adopting more of a “risk” based approach to the assessment process, identifying any underlying issues at existing FTs that may be prevalent at an aspirant Trust.</p>

2 Detailed Findings

OBSERVATIONS	
1.	<p>Monitor Provider Appraisal process</p> <p>The Trust was referred to Monitor for FT assessment by the TDA in Apr-14. The Monitor Provider Appraisal team were mobilised in May-14 with the detailed fieldwork commencing in Jun-14. An experienced assessment team was assigned to the Trust’s assessment led by an Assessment Director (“AD”) supported by a Senior Manager (“SM”), Manager, Analyst and a Quality Governance Associate. We understand that due to the capacity availability of the PA directorate at the time of this assessment, the team was supported by an additional Manager and Analyst to enable them to gain experience of the FT assessment process. We understand that this appraisal was a standard Monitor FT appraisal with the Provider Appraisal team adopting what they consider to be a “standardised” approach to their assessment work.</p> <p>The Trust’s Board to Board (“B2B”) meeting with Monitor was held on 25 Sept-14. The Monitor panel for the meeting consisted of the then CEO, a non-executive of Monitor’s Board, the EDA and the AD. Although the conclusion of the B2B assessment was that the Trust had a capable Executive Team and Board based on their performance at the B2B meeting, the AD informed us that he did not share this view based on his experience of performance of other aspirant Trusts at B2B he did feel the NED performance was not as convincing to merit this conclusion. The AD stated that he did not believe that sufficient time had been allocated as part of the B2B assessment to challenge the Trust Board on current and future financial plans (e.g. some of the historical financial numbers presented by the Trust’s CEO during his presentation at the B2B were not consistent with the Provider Assessment team’s analysis of the Trust’s underlying position over the corresponding period). Much of the meeting was focussed on the Trust’s future strategy, quality governance and A&E performance. We understand that the Provider Appraisal Directorate has held more detailed finance meetings chaired by the EDA on two assessments of acute Trusts undertaken subsequent to the Trust’s assessment. We understand there is now a formal requirement for the Provider Appraisal team to hold separate financial challenge meetings with applicant Trusts to facilitate specific discussion on financial issues in the current demanding context although we understand that no meetings have yet taken place under this new formal process due to the current nature of the aspirant FT pipeline.</p> <p>The Trust’s assessment was taken to three separate PAE meetings for consideration and approval with the first held on 20 Nov-14. The papers prepared and presented by the Provider Appraisal team set out the key judgements that had been made in arriving at their conclusions on the Trust. We understand that prior to writing the paper for PAE the provider appraisal team and the EDA met to discuss the judgements and marginality of the case. The team and the EDA had a discussion around the sensitivities and mitigations to be applied. As a result, the case was deemed as marginal by the team and EDA, and the EDA recommended that two cases should be presented to PAE to allow a full discussion of the judgements being made. The cases presented were i) authorisation with a side letter on A&E performance or ii) deferral for six months, to enable 2014/15 current trading to be delivered, A&E performance to be observed through winter and quality governance changes to be embedded. We understand from the EDA and AD that the presentation of two cases to PAE had occurred on assessments of aspirant FTs in the past. The PAE reflected on the case for deferral and concluded that possible funding measures</p>

2 Detailed Findings

OBSERVATIONS

to support the financial position should be explored with the DH and TDA and that an update on progress in addressing these point would be brought to the subsequent PAE meeting to allow for further consideration of the authorisation decision.

Following the PAE raising concerns at its meeting on 20 Nov-14 over the Trust's forecast balance sheet position and requirement for the balance sheet to be recapitalised, a meeting was held between the AD and the Reporting Accountants on 26 Nov-14 at which relevant issues were discussed. The Reporting Accountants informed us that three specific points were discussed at this meeting regarding the work undertaken by them to which the Reporting Accountants responded to Monitor via email on 9 Dec-14. We understand that no further discussion or follow-up action was undertaken beyond this point by either party.

Recommendation 1: Follow-up on PAE challenge with third parties – Where challenge is provided by the PAE in relation to areas where assurances are sought from third parties including the Reporting Accountants, the reasons for the difference of opinion should be fully explored to ensure that the third party are comfortable with their conclusions and the rationale for their conclusions are fully understood. The outcomes of such discussions should be documented by the Provider Appraisal team ensuring that conclusions reached by the third party are fully understood and reported back to the PAE for consideration as part of their FT authorisation decision process.

The Trust's application for FT status was next taken to the PAE meeting on 11 Dec-14. The papers to this meeting highlight the work that had been undertaken by the Provider Appraisal team to address the PAE's concerns raised at the previous meeting held on 20 Nov-14 (being A&E performance, quality governance and the Trust's short to medium term financial viability). At this meeting the PAE decided to defer the Trust's application due to continued concern over the Trust's current financial position (in terms of level of liquidity) and to allow the Trust and the Provider Appraisal team to undertake further work on how the Trust's balance sheet could be recapitalised to an acceptable level. The Trust was subsequently informed that the deferral period was for three months.

The papers to this PAE meeting on 11 Dec-14 also stated that if the Trust's application was deferred, the PAE were asked to agree that any reassessment work should be scoped to focus on the areas considered marginal, rather than a "full scale" assessment. A "limited" scope approach was to be worked up by the Provider Appraisal team for agreement at the next PAE meeting (which was scheduled for the middle of Jan-15). From our review of PAE papers and minutes of meeting held subsequent to the 11 Dec-14 meeting along with a review of the Connect 2 "Reactivated Jan-15" file, there is no evidence to support that a "limited scope" of work was formally agreed by the PAE prior to any work being undertaken on the Trust's application during Jan-15. However, the paper from the Provider Appraisal team to the 30 Jan-15 PAE meeting does state that "given the short deferral period, it was agreed that the reassessment work would be scoped to focus on working capital requirements and A&E performance rather than a full assessment". The annex to the paper provided a high level commentary of the most recent financial position, as requested by the EDA of the provider appraisal team. However, the minutes do not confirm whether the PAE formally acknowledged/agreed to this approach. In the absence of a formally agreed scope of work it is not clear whether the level of work undertaken was sufficient to address the areas over which the PAE required assurances prior to a decision on authorisation

2 Detailed Findings

OBSERVATIONS

being taken.

Recommendation 2: Approval of scope of work – Where significant additional scope for any further work on an assessment is identified, the Provider Appraisal team must ensure that their additional scope of work is completed in full and there should be formal agreement and sign-off by the PAE to ensure that the additional work that has been undertaken meets their requirements as part of their FT licensing decision making process.

Immediately following the deferral decision in Dec-14, the Provider Appraisal team met the Trust to explain the requirements of the deferral and the work the Trust needed to do before it could reactivate the case. The EDA stated that she had an understanding of the Trust's desire to progress their application as soon as practically possible from the engagement with the Trust during Dec-14 and Jan-15. In early Jan-15, the Trust contacted the EDA and AD to inform them that the enhanced working capital facility had been put in place and that the Board was due to approve the Board memorandum. The Trust wanted the case to be considered at the January PAE meeting (normally held in the middle of the month). The AD and EDA were concerned about this timing. However, when the Jan-15 PAE meeting was moved back by two weeks to accommodate another provider appraisal matter, the EDA made a judgement that the team should aim to take the application to the meeting at the end of Jan-15. The AD had reservations about this timetable not being sufficient to allow for a more considered approach on the review of the Trust which he considers he made known at the time. The Provider Appraisal team's work was limited to a review of A&E performance, the working capital requirements following the Trust being successful in putting in place revised funding arrangements (including a review of the Trust's revised Working Capital Memorandum prepared by the Trust dated 13 Jan-15) and a review to check for material change since the Dec-14 position.

The Provider Appraisal team used the M8 results to 30 Nov-14 as part of their "limited scope" work (which was the actual reported position on which the Trust's revised base case and updated Board Memorandum were based) ahead of the 30 Jan-15 PAE meeting. The M8 reported position did not indicate any significant downward trend in the Trust's trading performance, with the forecast outturn for 2014/15 being a surplus of £1.8m at M8. The Trust's base case in the updated Board Memorandum showed a surplus of £1.4m for 2014/15 in comparison to an actual deficit of £16.8m over the corresponding period. We understand from our discussion with the Monitor Regional Director for London and the Head of Investigations that the Trust's M9 results to 31 Dec-14 were available and received by Monitor on 26 Jan-15. The M9 position showed an in-month deficit of £3.1m (being £5.7m adverse to Trust's plan per the updated Trust Board Memorandum dated 13 Jan-15). Despite the significant in-month deterioration in trading performance, this does not appear to have been given much consideration as part of the appraisal process and, following a meeting with the EDA on 27 Jan-15, weight was instead placed upon the telephone discussion with the Finance Director on the M9 position which highlighted that the results were distorted by one-off adjustments to income booked in Jan-15.

2 Detailed Findings

OBSERVATIONS	
	<p>Recommendation 3: <u>Current trading review</u> – Given the current climate of uncertainty and widespread financial deficits within the NHS and FT sector, any work undertaken as part of an FT assessment process should include a detailed review of current financial performance up to and including the date of the PAE and/or Monitor Board meeting at which the authorisation decision is to be made, to ensure that any adverse performance is appropriately reflected in the FT assessment case.</p>
2.	<p>Work of the Reporting Accountants</p> <p>We held a meeting with the Reporting Accountants on 23 Oct-15 in their London office. They confirmed that their work had been undertaken over the following four phases resulting in clean FRP and working capital opinions being issued dated 13 Nov-14:</p> <ul style="list-style-type: none"> i. Stage 1 Report - Preliminary review and financial reporting procedures (7 Jun-10); ii. Stage 1 refresh - Preliminary review and financial reporting procedures (21 Dec-12); iii. Stage 2 Report - Historical due diligence (25 Apr-13); and iv. Stage 3 Report - Working capital and financial reporting procedures (13 Nov-14). <p>The Reporting Accountants explained that their engagement was a standard Monitor scope for NHS FT Financial Assessments (“the Scope”) and their approach to the Trust’s review had been no different to their approach on all of the previous FT financial assessments that they have been engaged on as well as others that are currently in progress. The Reporting Accountants stated their engagement on the Trust’s assessment concluded with the issue of the final Stage 3 report (including FRP and working capital opinions) on 13 Nov-14 and confirmed that signed opinions were provided at that time and no further work was undertaken beyond this date by them. They also stated that they were not informed by Monitor of the PAE decision taken at its meeting on 20 Nov-14 of not authorising the Trust due to the issues regarding A&E performance, quality governance and the Trust’s short to medium term financial viability. The Reporting Accountants stated that they were only made aware of the decision not to authorise the Trust through a Monitor press release detailing the decision not to authorise.</p> <p>From our high level review of the Stage 1, 2 and 3 reports issued by the Reporting Accountants against the Scope, we note that the key themes set out in</p>

2 Detailed Findings

OBSERVATIONS

the Scope for each stage of the FT assessment process, have been addressed in full. However, it should be noted that we have not undertaken a review of the actual work undertaken by the Reporting Accountants or working papers supporting their conclusions on which they have issued their FRP and working capital opinions. There was a considerable gap between the time at which the Stage 1 work (including Stage 1 refresh) was undertaken and the FRP opinion being issued in Nov-14.

Financial Reporting Procedures (FRP) – The Reporting Accountants stated that their work on FRP was primarily based on review of documents and interviews with key individuals at the Trust. They stated that they believe that their approach is in line with the requirements of the Scope set by Monitor.

From our review of the “Connect 2” file, it is apparent from a file note of a meeting between the Provider Appraisal team and the Reporting Accountants on 29 Oct-14, that there was a difference of opinion on the level of work that should have been undertaken on reviewing a revised/updated Trust Treasury Management Policy. The file note highlighted that the Reporting Accountants had confirmed that the policy had been recently updated but they had not reviewed it to assess whether it was appropriate for an FT. This was also raised by the SM on the Provider Appraisal team, who stated in our meeting with her that she would have expected more to have been done on this than just confirmation of the existence of the policy. However, the Reporting Accountants stated to us during our review that they did consider the impact of the new policy on the work they conducted and their overall opinions reached. A further call was held between the Provider Appraisal team and the Reporting Accountants on 7 Nov-14 on which issues were discussed. In light of this, the Provider Appraisal team should have pushed back onto the Reporting Accountants to undertake further work or seek clarification to ensure the appropriate level of assurance was being provided from their work.

Working capital – The Reporting Accountants undertook their work over the course of a four year period, with Stage 1 – (Preliminary review of financial reporting procedures) completed in Jun-10 and the final stage, Stage 3 (Working capital and financial reporting procedures) concluded on 11 Nov-14 with the issue of their final report and signed clean opinions on FRP and working capital on 13 Nov-14 ahead of the PAE meeting on 20 Nov-14.

The Reporting Accountants informed us that their detailed fieldwork for Stage 3 commenced on 11 Aug-14 through and concluded with the issue of the Stage 3 report incorporating signed working capital and FRP opinions on 13 Nov-14.

It is evident from individual discussions with the Provider Appraisal AD, SM, EDA and Monitor Chief Executive, that the AD and Provider Appraisal team had raised concerns over the course of the assessment regarding the work undertaken by the Reporting Accountants. In our meeting with the Reporting Accountants they stated that no concerns had been raised by the Monitor team as to the work undertaken by them at any time up to the issue of their opinions (see 1 above regarding subsequent correspondence between Monitor and the Reporting Accountants on the work undertaken by them). There is some evidence of challenge from the Provider Appraisal team to the Reporting Accountants on their findings and conclusions (per the Provider Appraisal team’s file notes of meetings/calls held with the Reporting Accountants on 29 Oct-14 and 7 Nov-14) on the “Connect 2” file, (including lack of sensitivities identified by the Reporting Accountants and not using the most recent actual reported position for their assessment of current performance). This

2 Detailed Findings

OBSERVATIONS

challenge was as part of their routine discussions with the Reporting Accountants over the course of the assessment to gauge progress and discuss any issues identified from their work. The Reporting Accountants stated to us that they believe that they had addressed each of these concerns prior to issuing their Stage 3 report and FRP and working capital opinions on 13 Nov-14 with no outstanding issues. It is not evident from both our discussions with the Provider Appraisal team and review of PAE meeting papers and minutes of how any such concerns were addressed or escalated prior to the Reporting Accountants opinions being issued and the PAE meeting held on 20 Nov-14 to consider the Trust's application. However, we understand that post the conclusion of the Reporting Accountants engagement on the Trust's review and post PAE meeting, the AD met with the Partner from the Reporting Accountants on 26 Nov-14 to raise his concerns over the work undertaken by the Reporting Accountants (in three specific areas as noted earlier). We understand that the EDA did not attend this meeting, however, we understand that the EDA was kept informed of the meeting and points discussed at the meeting by the DA. We note that the view of the Monitor Chief Executive in our meeting was that if there were any concerns from the Provider Appraisal team regarding the work of the Reporting Accountants, he would not have expected the Trust's assessment to have been brought to the PAE until all such concerns and issues had been fully resolved.

Recommendations 4 and 5 –

- i. **Resolution of issues with work of third parties** - *Where there are instances of any material concerns by the Provider Appraisal team with the work undertaken by the Reporting Accountants and other third parties, all such concerns should be fully raised with the Reporting Accountants and appropriately resolved between all parties with any implications and resolutions reported to the PAE for consideration as part of their overall assessment and decision process for FT authorisation.*
- ii. **Update to Reporting Accountants work** - *Where there has been any lapse of time exceeding one month between the Reporting Accountants opinions being issued and the proposed FT authorisation date, Monitor should inform the Reporting Accountants of any deferral decision and also give them the opportunity, where there is a delay in authorisation, to consider whether their opinions remain valid or need to be rescinded based on their assessment of current circumstances of the aspirant FT. Monitor should also be asking the Reporting Accountants to update their report for the impact of more up to date financial information.*

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Detailed Findings

OBSERVATIONS	
3.	<p>Scope of work for FRP and working capital review</p> <p>From meetings with the AD and SM of the Provider Appraisal team, there appears to be an ‘expectations gap’ between Monitor and the Reporting Accountants in terms of the responsibilities of the Reporting Accountants in undertaking the working capital and FRP review., for example on the depth of the FRP review (as noted in 2 above). Both PAE members and the Provider Appraisal team raised concerns in our meetings with them over the level of work undertaken by the Reporting Accountants in forming their judgements and conclusions on the Trust’s FRP. The Trust’s inability to identify and understand its underlying financial position on a timely basis was identified by Monitor’s Regional Director – London (responsible for the Trust post authorisation) as well as the Monitor Head of Investigations who undertook a specific review once the Trust’s financial difficulties had come to light, as a key contributor to the sudden deterioration in the Trust’s reported finances. This may indicate that Monitor’s scope for FRP needs to go further than it currently does in ensuring the robustness of underlying systems and management/Board reporting.</p> <p>Although the PAE and Provider Appraisal team members we spoke to were of the view that the Provider Appraisal team should not be expected to re-perform the work undertaken by the Reporting Accountants, there are a number of questions that Monitor need to address including:</p> <ol style="list-style-type: none">i. what level of assurance is being sought and received by Monitor as part of the FRP and working capital reviews undertaken by the Reporting Accountants and is there a common understanding between the two?;ii. is it appropriate for there being a significant gap between the detailed work on FRP undertaken by the Reporting Accountants and the time at which FRP opinion are provided given the current more challenging environment of the NHS?;iii. should the Monitor Provider Appraisal team be required to undertake additional work on FRP to get their own assurance over key areas (adopting a “risk” based approach) over and above the scope set for the Reporting Accountants; andiv. doe’s the current FRP and working capital scope address the challenging financial and operating environment currently faced by the NHS (e.g. quality of management reporting, operational/clinical sustainability)? <p><i>Recommendation 6: <u>Scope of work for Reporting Accountants</u> – The current scope of work for both the FRP and working capital reviews should be scrutinised to ensure it remains ‘fit for purpose’ in the current challenging NHS and FT environment and whether the respective scopes need to go into greater depth than they currently do. This review should draw on Monitor’s knowledge of common factors of Trusts that are currently in difficulties. Consideration should also be given as to whether the length of time between the completion of each stage of the FT assessment process (in particular detailed work on FRP) undertaken by the Reporting Accountants is appropriate given the reliance that is placed on the</i></p>

2 Detailed Findings

OBSERVATIONS	
	<i>FRP and working capital opinions by Monitor in the overall assessment process. As part of this review, Monitor should engage with the advisers they use as Reporting Accountants to ensure there is a common understanding of the breadth and depth of work required by Monitor from the Reporting Accountants and ensure any 'expectations gap' is fully addressed. As part of this engagement, the Reporting Accountants should also give their advice on the nature of the work they think is required in the circumstances.</i>
4.	<p>Third party assurance/ confirmations</p> <p>As part of the NHS FT Financial Assessment process, Monitor seeks assurances and confirmations from third parties including:</p> <ul style="list-style-type: none"> • TDA; • Care Quality Commission ("CQC"); • Reporting Accountants in the form of FRP and working capital opinions (discussed above); • Board Memorandum; and • Letter of representation from applicant NHS Trust Board. <p>The required assurances were received from all parties as part of the initial formal assessment of the Trust's application taken to the 20 Nov-14 PAE meeting. However, when the Trust's application was taken to the 30 Jan-15 PAE meeting, further assurances do not appear to have been obtained from the TDA. We understand that subsequent to authorisation, it was identified that the Trust had prepared two separate financial plans for 2015/16, one to support the Trust's Board Memorandum submitted to Monitor dated 13 Jan-15 sent to the Provider Appraisal team and a second to the TDA which showed a significantly adverse financial position of £19.5m deficit compared to a £1.7m surplus reflected in the base case in the updated Board Memorandum. We understand that the information provided to the TDA was specific analysis to model the theoretical impact of the 2015/16 tariff proposals under a worst case scenario. We understand that the Provider Appraisal team was not aware of the separate (and different) TDA plan at the time of their assessment and PAE authorisation of the Trust and it was not referred to in the letter of representation provided by the Trust. Even though the plan submitted to the TDA may have been prepared by the Trust on a different basis to the one submitted to support the Trust's updated Board Memorandum, there should still have been some form of discussion between Monitor, TDA and Trust to corroborate and understand the rationale for any differences.</p>

2 Detailed Findings

OBSERVATIONS

Recommendation 7: Third party confirmations – Confirmations should be sought from all third parties where there is a lapse of time of at least one month between any prior confirmations provided as part of the FT appraisal process. In particular confirmations should always be sought from the TDA as to their current understanding of the Trust's financial position.

The Reporting Accountants were not requested to undertake any further work after issuing their Stage 3 report and opinions on 13 Nov-14 despite:

- the lapse in time between the date of the Stage 3 report and the signed FRP and working capital opinions and when the actual PAE decision to authorise the Trust was taken at the PAE meeting on 30 Jan-15; and
- the updated Board Memorandum dated 13 Jan-15 that reflected a revised forecast outturn surplus for 2014/15 of £1.7m compared to forecast surplus of £4.6m in the base case that supported the initial Board Memorandum dated 5 Nov-14 (actual outturn deficit of £16.8m). As well as a revised base case this also included an updated downside scenario prepared by the Trust to reflect their revised view on current trading and the changes in the Trust's liquidity as a result of securing a working capital loan and facility from the Independent Trust Financing Facility ("ITFF").

We understand from our meeting with the Reporting Accountants that they did offer to undertake further work but this had been declined by the Provider Appraisal team. We understand that the PAE were not aware of the fact that the Reporting Accountants had not been asked to undertake any further work to support the revised Board Memorandum (and post the work they completed up to 13 Nov-14). We believe that the Reporting Accountants should have been formally informed of the initial decision to defer the Trust's application and at the point of the Trust's application being reactivated, been given the opportunity to consider any changes in the assumptions supporting the updated Board Memorandum which may have had an impact on their initial conclusions that supported their working capital and FRP opinions. Key changes reflected in the updated Board Memorandum compared to the initial one dated 5 Nov-14 included:

- updated financial modelling to recognise deterioration in trading and cash headroom to M8 of 2014/15 (£2.4m off plan);
- include working capital loan of £15m approved by ITFF;
- updated Trust downside case; and

2 Detailed Findings

OBSERVATIONS	
	<ul style="list-style-type: none"> a consideration of requirement for a working capital facility in light of the changes noted above. <p>Recommendation 8: <u>Communication with third parties</u> – Reporting Accountants should be made aware of any delays in authorisation of an aspirant FT and given the opportunity to consider and formally confirm whether any FRP and working capital opinions issued prior to any deferral decision remain valid at the time of an application being reactivated. Where further work has not been undertaken by the Reporting Accountants this should be formally communicated to the PAE as part of informing their decision making process with full explanations and rationale as to why no further update work is deemed appropriate.</p>
5.	<p>Knowledge share</p> <p>From our meetings with the individuals from Monitor noted earlier, there appears to be a difference of opinion as to the level of “knowledge share” that takes place across the organisation but in particular between the Provider Appraisal teams and Provider Regulation to enable key issues prevalent across the NHS and FT sectors to be shared and factored into the scope of work on an aspirant FTs assessment.</p> <p>Recommendation 9: <u>Knowledge share</u> – A formal process for knowledge share should be put in place between Provider Appraisal teams and other parts of Monitor to better inform planning for assessments of aspirant FTs. Therefore, adopting more of a “risk” based approach to the assessment process, identifying any underlying issues at existing FTs that may be prevalent at an aspirant Trust.</p>

3

Action Plan

Customer to provide details of planned action; owner and implementation date. Action taken will later be assessed by Health Group Internal Audit, and therefore the level of detail provided needs to be sufficient to allow for the assessment of the adequacy of action taken to implement the recommendation to take place.

To be completed by Health Group Internal Audit as part of the recommendation follow-up process

No	RECOMMENDATION	RATING	AGREED ACTION	OWNER & PLANNED IMPLEMENTATION DATE	OBSERVATIONS: RECOMMENDATION / AGREED ACTION IMPLEMENTED?	FURTHER ACTION REQUIRED?
1.	<p><u>Follow-up on PAE challenge with third parties:</u></p> <p>Where challenge is provided by the PAE in relation to areas where assurances are sought from third parties including the Reporting Accountants, the reasons for the difference of opinion should be fully explored to ensure that the third party are comfortable with their conclusions and the rationale for their conclusions are fully understood. The outcomes of such discussions should be documented by the</p>		<p>Agreed</p> <p>Should PAE pick up concerns on an area which is within the third party scope we will ensure these are fed back to the independent party and report back to the PAE on the outcome of the meeting.</p>	<p>Miranda Carter December 2015</p>		

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	Provider Appraisal team ensuring that conclusions reached by the third party are fully understood and reported back to the PAE for consideration as part of their FT authorisation decision process.					
2.	<p><u>Approval of scope of work:</u></p> <p>Where significant additional scope for any further work on an assessment is identified, the Provider Appraisal team must ensure that their additional scope of work is completed in full and there should be formal agreement and sign-off by the PAE to</p>		<p>Partially Agreed</p> <p>Any revisions or limitations in scope will be communicated to the PAE in the decision papers. The EDA will ensure that approval is sought for any material changes in scope (e.g. changes in 3rd party assurance</p>	<p>Miranda Carter</p> <p>December 2015</p>		

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	ensure that the additional work that has been undertaken meets their requirements as part of their FT licensing decision making process.		requirements) This will be actioned via communication at a team brief and also a question included with the PAE board reporting template			
3.	<u>Current trading review:</u> Given the current climate of uncertainty and widespread financial deficits within the NHS and FT sector, any work undertaken as part of an FT assessment process should include a detailed review of current financial performance up to and including the date of the PAE and/or Monitor		Agreed. We will make it clear in guidance and via a team brief that a full review is required of latest current trading prior to decision. As part of the guidance and briefing we will make it clear that if there is a material in month change consideration should	Miranda Carter December 2015		

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	Board meeting at which the authorisation decision is to be made, to ensure that any adverse performance is appropriately reflected in the FT assessment case.		<p>be made to revising the assessment timetable to ensure sufficient work has been undertaken.</p> <p>We will also ensure that the update on current trading and date of the latest information is included in the body of the PAE paper (rather than appendix) to ensure committee members are fully aware prior to decision making.</p>			
4.	<p><u>Resolution of issues with work of third parties:</u> Where there are instances of any material concerns by the Provider Appraisal team with the work undertaken by the</p>		<p>Agreed</p> <p>In future cases we will ensure that the PAE papers reflect</p>			

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	Reporting Accountants and other third parties, all such concerns should be fully raised with the Reporting Accountants and appropriately resolved between all parties with any implications and resolutions reported to the PAE for consideration as part of their overall assessment and decision process for FT authorisation.		whether there have been any material concerns or issues with the independent assurance.			
5.	<u>Update to Reporting Accountants work:</u> Where there has been any lapse of time exceeding one month between the Reporting		Agreed This will be implemented for all assignments going forward where there is a short delay or	Miranda Carter December 2015		

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	Accountants opinions being issued and the proposed FT authorisation date, Monitor should inform the Reporting Accountants of any deferral decision and also give them the opportunity, where there is a delay in authorisation, to consider whether their opinions remain valid or need to be rescinded based on their assessment of current circumstances of the aspirant FT. Monitor should also be asking the Reporting Accountants to update their report for the impact of more up to date financial information.		deferral. Guidance will be issued via a team briefing and we will include the date of the opinions and update work in the cover PAE paper.			

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6.	<p><u>Scope of work for Reporting Accountants:</u></p> <p>The current scope of work for both the FRP and working capital reviews should be scrutinised to ensure it remains 'fit for purpose' in the current challenging NHS and FT environment and whether the respective scopes need to go into greater depth than they currently do. This review should draw on Monitor's knowledge of common factors of Trusts that are currently in difficulties. Consideration should also be given as to whether the length of time between the completion of each stage of the FT assessment</p>		<p>Agreed</p> <p>We will scrutinise the scope of work for the financial reporting procedures in light of the lessons learned from St George's and hold a meeting with the Reporting Accountants, to discuss the requirements going forward.</p>	<p>Miranda Carter</p> <p>January 2016</p>		

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	<p>process (in particular detailed work on FRP) undertaken by the Reporting Accountants is appropriate given the reliance that is placed on the FRP and working capital opinions by Monitor in the overall assessment process. As part of this review, Monitor should engage with the advisers they use as Reporting Accountants to ensure there is a common understanding of the breadth and depth of work required by Monitor from the Reporting Accountants and ensure any 'expectations gap' is fully addressed. As part of this engagement, the Reporting Accountants should also give their advice on the nature of the work they think is</p>					

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	required in the circumstances.					
7.	<p><u>Third party confirmations:</u></p> <p>Confirmations should be sought from all third parties where there is a lapse of time of at least one month between any prior confirmations provided as part of the FT appraisal process. In particular confirmations should always be sought from the TDA as to their current understanding of the Trust's financial position.</p>		<p>Agreed.</p> <p>We will ensure this requirement is reiterated through a team briefing and through the PAE paper template.</p>	<p>Miranda Carter</p> <p>December 2015</p>		

3

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8.	<p><u>Communication with third parties:</u></p> <p>Reporting Accountants should be made aware of any delays in authorisation of an aspirant FT and given the opportunity to consider and formally confirm whether any FRP and working capital opinions issued prior to any deferral decision remain valid at the time of an application being reactivated. Where further work has not been undertaken by the Reporting Accountants</p>		<p>Agreed</p> <p>We will ensure that the Reporting Accountants are informed on deferral decisions given the opportunity to confirm whether their opinions remain valid at reactivation.</p> <p>As noted under recommendation 2 we will inform PAE if the Reporting Accountant's work has not been updated in our</p>	<p>Miranda Carter December 2015</p>		

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Action Plan

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	this should be formally communicated to the PAE as part of informing their decision making process with full explanations and rationale as to why no further update work is deemed appropriate.		decision papers.			
9.	<p><u>Knowledge share:</u></p> <p>A formal process for knowledge share should be put in place between Provider Appraisal teams and other parts of Monitor to better inform planning for assessments of aspirant FTs. Therefore, adopting more of a “risk” based approach to the</p>		<p>Agreed</p> <p>Currently knowledge share is facilitated through</p> <p>(i) PAE decision makers also sitting on the Provider Regulation Committee</p> <p>(ii) PAE team members engage with</p>	<p>Miranda Carter</p> <p>Ongoing from January 2015</p>		

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	assessment process, identifying any underlying issues at existing FTs that may be prevalent at an aspirant Trust.		<p>provider regulation teams as part of the process in particular to discuss the local health economy and operational performance.</p> <p>We recognise that this could be more formalised and plan to implement (i) rotational attendance for Assessment Directors at the Provider Regulation Executive and (ii) quarterly meetings with Provider Regulation (directors/deputy directors) to</p>			

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			<p>consider lessons learned from recent regulation cases and its impact on the assessment process. This will be fed back to PAE via the PAE update.</p>			

4

Report Rating - Definitions

Substantial	In my opinion, the framework of governance, risk management and control is adequate and effective.
Moderate	In my opinion, some improvements are required to enhance the adequacy and effectiveness of the framework of governance, risk management and control.
Limited	In my opinion, there are significant weaknesses in the framework of governance, risk management and control such that it could be or could become inadequate and ineffective.
Unsatisfactory	In my opinion, there are fundamental weaknesses in the framework of governance, risk management and control such that it is inadequate and ineffective or is likely to fail.