Scarborough and North East Yorkshire Healthcare NHS Trust

Review of Governance Arrangements

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Introduction

1. The Scarborough and North East Yorkshire Healthcare NHS Trust's (the Trust) external auditors as part of their 2005/06 audit have issued a critical governance report. This is in the context of a Public Interest Report (PIR) being issued in November 2005 and the Trust facing a major financial challenge. As part of the response to these circumstances, the Yorkshire and the Humber Strategic Health Authority in conjunction with the Trust Board commissioned Keith Wright, former Regional Director of Finance supported by Carol Stubley, to review the Trust's governance arrangements, including:

- The Trust's response to the PIR published in November 2005
- The matters raised by the auditors in their 2005/06 Annual Governance Report
- The appropriateness and timeliness of the response to date and any actions that need to be taken to bring about material improvement.

2. Our approach to this task has been to test the Trust's governance arrangements by reviewing relevant documentation and carrying out a series of interviews with Board members, clinicians, senior managers and representatives from the former Strategic Health Authority. We have not had the opportunity to interview the Chief Executive or Director of Finance and as a consequence have ensured that our conclusions are in the main supported by documentary rather than verbal evidence.

3. We would like to acknowledge the openness and professionalism of the Trust's non executive, executive and clinical leaders in responding to our review. This is an uncomfortable time for the Board and senior managers and we detected from the outset a desire to move forward positively in the interests of patients, staff and the local community which the hospital serves.

The report is structured as follows

- Scrutiny reports
- Strategic Issues
- Financial Issues
- Business Processes and Organisational Arrangements
- Relationships
- Integrated Governance Framework
- Conclusion
- Recommendations
- Appendix 1: Public Interest Report :Response and comment
- Appendix 2: Governance Report: Recommendations

SCRUTINY REPORTS

Response to the Public Interest Report

4. The PIR issued in November 2005 (although known about as a possibility from July 2005) set out serious challenges for the Trust. Auditors issue such reports because they believe a public body has failed to address fundamental issues and as such, a wider audience needs to be made aware of the failings. In effect the PIR is designed to force an organisation to take on board auditors concerns.

5. By July 2006 the Trust should have been able to have demonstrated sufficient progress in addressing the Public Interest Report's recommendations to avert further external audit criticism. Unfortunately this has not proved the case with the issuing of a critical governance report, internal audit giving limited assurance on internal controls and the former North and East Yorkshire and Northern Lincolnshire Strategic Health Authority in the Monitor diagnostic raising concerns on governance, strategy and financial position.

6. In our opinion the over-riding reason for the Trust continuing to find itself being criticised is that the Trust's management agenda has been skewed towards operational delivery at the expense of its governance challenges. For example the financial challenge that the Trust faces is of course a major issue but the failure to put in place a robust recovery plan and a sound budgetary control system is a key underlying reason for the continued criticism of it's governance. The response to the PIR has been afforded insufficient prominence within the organisation. This is demonstrated in a number of ways.

7. Firstly, the arrangements for monitoring progress against the action plan although initially appearing sound was not sustained and drifted away from being regarded as the core business with the inevitable result of slippage and lack of progress. The recommendations were not given sustained focus in their own right. Our examination of the Trust Board minutes shows that there has been substantive discussion on progress against the action plan on only one occasion. The Finance sub-committee and Audit committee dealt with issues arising from the report but we can find no evidence of the action plan or PIR going back to these committees for progress reports. We recommend that in order to get the PIR back into core business these matters should be handled directly at the Audit committee with regular updates on progress to the Board .

8. Secondly, no one on the executive team was seen to be accountable for the PIR. In many instances a PIR would result in some degree of Board sanction of its executive and non executive team members. This did not occur although we are informed that there was serious debate amongst the Non Executives in

relation to taking such action. The reasons for adopting this strategy have been explained to us as:

- The Board determined that business continuity was paramount to successful recovery.

- The PIR was seen in some quarters as having a rather personal aspect and this may have detracted some members of the Board from focussing on the underlying issues.

- A letter from the former SHA to the Director of Finance of the NHS refers to the Board having, "confidence in the professional judgement being made by an experienced Director of Finance".

- All of this was in the context of the SHA supporting the Boards decisions in relation to the public interest report.

9. Thirdly, the PIR was not formally distributed to the consultant body and senior managers within the organisation. The majority of senior managers and representatives of the consultant body that we have spoken to were unaware of the report's existence which suggests that making it available on the Trust's website did not communicate it's contents to any effect. We see this as a passive response. It may have been perceived that this was a technical financial issue or perhaps it was part of a deliberate communication strategy to minimise damage to the moral of those delivering front line services in the Trust. Either way we do not agree with this approach as it suggests a lack of ownership and understanding of the seriousness of the agenda.

10. Finally, at one level it would appear that the Trust had put in place business processes to address the challenges posed within the PIR. However, closer examination of the action plan together with discussions with individuals has led us to the conclusion that the plan has not addressed the fundamental criticisms, which produced the PIR. For example one of the recommendations within the PIR was that an effective budgetary control system is maintained so that planned savings can be delivered. Whilst expenditure controls have been introduced, budgets have been rolled forward on a historic basis and in many cases do not reflect reality. Without a realistic budget framework against which to monitor the performance of budget holders the current arrangements cannot be regarded as effective.

11. In addition, the medium term financial plan produced in July 2005 has proved to be unrealistic. An example of how poor financial planning may lead the Trust into further financial deficit is that the decision to approve the business case for the new endoscope suite was based in part on the Trust generating a "£3.2m surplus" by 2008. This will not happen.

12. We detail at Appendix 1 our assessment of action against the PIR recommendations.

2005/06 Governance Report

13. In July 2006, the Trust received a highly critical Governance report from the external auditors covering both its basic financial stewardship and its Auditors Local Evaluation (ALE) in relation to value for money issues. This formed part of the 2005/06 audit which resulted in a £1.6m adjustment to the annual accounts. Placed in the context of a PIR being issued in November 2005 this report poses serious questions in relation to the governance of the Trust. It also raises the prospect of a further PIR being issued if real progress is not made in the coming months to address these issues.

14. Our review forms part of the response to the report but we have noted that the Board have suspended the Chief Executive and Finance Director as it takes time to review its position.

15. The Trust did have time to provide evidence to mitigate the ALE scores but failed to do so. If the evidence does exist then the scores may reflect a harsher view than is the reality. Our discussions with Board members suggest differing levels of understanding regarding the process surrounding the ALE scores and its significance. This suggests there needs to be faster formal reporting links between the Board and the Audit Committee e.g. the January 2006 audit committee minutes were submitted to the Board in April 2006.

16. At Appendix 2 we set out our recommendations against each of the findings in the report. In summary it identifies:

- Errors in the financial statements
- Material weaknesses in internal control
- Failure around strategic and operational objectives
- Failure to manage business risks
- Failure to manage and improve value for money
- Failure to put in place a medium term financial strategy and budgetary control systems linked to strategic objectives
- Failure to match resources with expenditure.

17. Finally, the Board will need to determine how it communicates the findings of the above report when it becomes available within the public domain.

Internal Audit Opinion on the System of Internal Control (SIC) for the Year ending 31 March 2006

18. At the Trust Board of 20th June 2006, a revised SIC was presented and reflected the Head of Internal Audit's revised opinion of "limited assurance" on the Trust's system of internal control for two of the three key elements where an opinion is required. Firstly, a Board approved assurance framework was not in place in the required Department of Health format and secondly, that there was insufficient evidence to substantiate the Trust's self-assessment declaration in respect of the Health Care Standards. The issuing of this limited opinion was after the auditor had withdrawn a previous opinion of assurance based on commitments from the Trust to provide evidential information. The internal auditor maintains that such information did not materialise. Limited assurance of the Trusts internal control systems in the context of a recent PIR suggests significant governance weaknesses.

Feedback on Foundation Trust (FT) Diagnostic- March 2006

19. In March 2006, the Trust received feedback from the North and East Yorkshire and Northern Lincolnshire Strategic Health Authority on the results of the FT diagnostic. The messages were consistent with those of external auditors in relation to the financial challenges, strategy and in particular governance where the SHA note "a series of concerns" and a recommendation for the Trust to reconsider its governance arrangements. The feedback highlights issues around performance management, risk management and the balance between operational and strategic focus of the Board. This is consistent with our own findings.

STRATEGIC ISSUES

20. The FT diagnostic encourages the Trust to match its "bottom up" existing strategy with an effective "top down" view of services offered. This bottom up strategic direction was developed by the Trust in 2004 and is viewed positively by senior managers within the Trust. The process for preparing it engaged a variety of staff across all disciplines and levels and was successful in cementing confidence in top management to achieve change and improvement. In practice the strategic direction does not reflect the real strategic challenges facing the organisation and is not backed up with operational and financial plans. It can only act as a basis for moving the business forward if matched to a top down review of services as described in the FT diagnostic feedback. For example we were looking for strategic analysis of the impact of Payment by Results and clinical viability of each of the Trusts services. The Service Development Strategy produced in January 2006 represents a good start but the feedback from Monitor and the former SHA highlights its high risk nature and need for further work.

21. We have been told that management, in conjunction with the Trust's clinicians have made attempts to engage in service redesign within the community hospitals and with primary care (e.g. an attempt to create an integrated out of hours service). We have detected some frustration within the clinical community that failure to implement such initiatives is attributable to a lack of support from partner organisations and the former strategic health authority.

22. Looking to the future, the size of the financial challenge facing the Trust is of a magnitude that cannot be resolved by the Trust alone. A strategic solution needs to be formulated which will have as its component parts provision of care from acute and primary care settings including the community hospitals. As part of this, forging new clinical alliances with neighbouring Trusts in addition to Hull is essential. This does not mean the downgrading of the Trust. On the contrary it is essential to its survival and the strengthening and sustainability of high quality clinical services.

23. Our impression is that the clinical community are ready to engage this agenda and there is an opportunity with the creation of the new North Yorkshire and York PCT and Yorkshire and the Humber Strategic Health Authority to create fresh momentum. New relationships and a more strategic commissioning footprint will help provide the essential political and planning climate to move forward. The Trust Board need to urgently and enthusiastically grasp the opportunities that these new relationships present as we sense the public are losing confidence in the local health community being able to formulate and effectively communicate a viable and coherent vision for the future.

FINANCIAL ISSUES

Financial Position of the Trust

24. The current financial position of the Trust as reported to the Board on 25th July 2006 shows a forecast deficit for 2006/7 of £5.4m after achieving direct operational savings of £4m and assuming an income (SLA) from the host commissioner of £59.4m (against an offer of £50.9m). Taking account of the difference in the value of the SLA, the in year deficit could be in the range of £5.4m and £13.9m. Added to this the historical debt of £11.8m, the current forecast for the year-end is a deficit of between £17.2m and £25.7m. These figures assume that all the savings plans are delivered which based on past experience and the current budgetary control arrangements appears ambitious.

Financial control

25. We have not undertaken a full review of the financial control procedures within the Trust but in the light of the PIR and Governance report have sought to

establish a view on those aspects of financial control that were identified as issues.

26. We have been informed that budgets have been rolled forward on a historical basis and are not linked to the previous years out-turn, planned levels of activity, operational plans and manpower plans. As a result, budgets are not realistic. Whilst budget review meetings are held, management energy will inevitably be spent focussing on explaining and justifying overspends compared to unrealistic budgets, diverting valuable time away from managing the problem and developing solutions. We would acknowledge that the Trust has made efforts to control expenditure since the publication of the PIR but this is in the context of a significant increase in the Trust's manpower since April 2004.

27. We are aware from our discussions that a number of internal business cases have been developed and approved for improvements in clinical services without any funding streams being identified. This will have inevitably contributed to the Trust's financial problems as has the increase in Whole Time Equivalent staff numbers employed by the Trust since April 2004. The average cost of an employee is circa £30k. Crude financial extrapolation of the table below shows a £4.2m increase in manpower cost between April 2004 and April 2006.This in the context of a reported divisional forecast deficit of £4.0m in July 2004.

MANPOWER WTE	April 2004	April 2005	April 2006
Headquarters	186	230	235
Facilities	345	375	352
Medicine	646	702	672
Surgery	698	787	757
TOTAL	**1875**	**2094**	**2016**

1. During financial year 2004/05 staff numbers increased by 219 (11%)
2. During financial financial year 2005/06 staff numbers decreased by 78 (3.7%) but are still 141(7.5%) above the April 2004 levels.

28. Looking forward, budgets need to be set on a realistic basis having reference to the previous years out-turn expenditure, operational plans and activity targets. This will enable the size of the financial problem to be accurately assessed and cost reductions targets set for budget holders to which they can be held

accountable. In addition, it would focus the organisation on identifying and exploring strategic solutions to its financial problems.

29. One final comment is that the delays in agreeing the service level agreement for 2006/07 has led to the Trust rolling forward budgets. Obviously this lack of certainty in relation to income is not ideal and needs to be addressed. Nevertheless if the Trust is to have ownership of its financial position it needs to cope with these uncertainties by taking a reasonable and informed assessment of these risks and developing initial budgets based on a clear set of assumptions. The associated risks need to be managed on a proactive basis throughout the year and the plan amended in year if this proves necessary.

Finance Department

30. Symptomatic of the Trust's response to the PIR is the failure to recognise the shortfalls in qualified professional capacity within the finance department. No steps have been taken to address this issue following the PIR other than appointing some junior clerical support. It is difficult to reconcile this position, given the seriousness of the PIR and weaknesses in the Trust's budgetary control arrangements. The minutes of the Board of the 23rd May 2006 re-affirmed a recruitment ban on all non patient related staff.

31. Strong and effective financial management support and control is synonymous with effective and sustainable clinical services. A strong and effective finance function should be seen as part of the solution to the Trust's ongoing financial problems. As part of our recommendations the finance department needs to be strengthened with immediate effect.

BUSINESS PROCESSES AND ORGANISATIONAL ARRANGEMENTS

32. The organisation appears to work along parallel lines of activity with little evidence of an integrated approach to planning and finance which links into an organisational strategy. This is evidenced by lack of a corporate business plan for 2005/06 and 2006/07. (Corporate objectives were set for 2003/04 and 2004/05).This agenda may have been subsumed in the FT diagnostic process but the outputs do not represent an annualised corporate business plan.

33. A number of plans do however exist, namely the PIR action plan, the medium term financial recovery plan, the 2004 – 2009 strategic direction and the outputs from the FT diagnostic exercise. From our perspective, there appears to be little or no connection between these documents which casts doubt on the organisation's ability to understand and take informed decisions. In our discussions with the Board, it is evident that some members are relying on these documents as evidence of sound business planning. The Trust needs to develop

a realistic strategic plan which is translated into annualised short and medium term financial and operational plans linked to budgets.

34. We have identified a number of issues in relation to organisational arrangements and business processes.

Organisation

35. In relation to the organisational issues, one of our principal observations is that the balance of the Board and Executive agenda has been focussed very much on the operational delivery of services and achieving national access targets at the expense of strategy, governance and financial control. These latter matters have not been ignored but have been given insufficient priority. The success that the Executive leadership has had in turning round the operational performance of the Trust may have diverted attention from strategy.

36. This is reflected in the organisation's operational structure. Divisional Directors report directly to the Chief Executive and do not attend the Board or the Directors meeting. It appears as if the Chief Executive has been fulfilling a role at Board level that in other organisations would be covered by a Director of Operations. Those responsible for running the clinical operational side of the hospital have only limited connection to the Trusts main managerial decision-making forums i.e. through the Management Executive Committee. In order to address this imbalance we believe there should be an Executive Director with responsibility for all operational issues in the Trust.

37. There appears to be lack of clarity regarding who is responsible for co-ordinating the Board's integrated governance agenda. Executive Director responsibility appears to rest in practice with the Chief Executive, the Medical Director and Director of Finance with Non Executive input from the Trust Chairman and Chair of the Audit committee. A single management focus should be established with an agenda to drive through a development programme as a response to the integrated governance handbook. The response to date appears restricted to some work on the committee cycle, the FT diagnostic and a commitment to address at a future Board development session.

38. In order to achieve more clarity and focus on governance issues we recommend the redefining of the role of company secretary as outlined in the integrated governance handbook. In the interim we believe some external assistance to the Non Executives is required to help them through this difficult period. This will provide a framework for the Board to take on a more challenging role. A review of the Intelligent Board report for acute trusts issued by the Appointments Commission in spring 2006 could also assist in redefining the focus of the Board.

- The Remuneration and Terms of Service sub committee minutes are required under its constitution to be reported to the Board. This does not occur. Further, decisions recorded in the minutes of this committee do not appear to have been actioned or have been subsequently changed without being reported. The minutes of the 24th September 2004 meeting gave a pay award to Directors backdated to April 2004. The payment appears to have been deferred until November 2005
- The audit committee minutes are required to be reported to the Board but this does not occur until they have been ratified at a subsequent meeting. This can take months and thus is of no value in keeping Board members informed in a timely manner. Also, of the 7 meetings between March 2005 and June 2006 only 3 sets of minutes have been reported to the Board.
- Finance sub-committee minutes have not been reported to the Board for the last two meetings
- The changes in the Chairmanship of the Audit Committee have not been reported to the Board.

- Some members of the Board have expressed concern regarding the clarity and relevance of the finance papers submitted to the Board. There is some frustration that the finance function has not been able to respond to requests for changes in the format of the finance information supplied to the Board.

- In order for Boards to operate effectively they need intelligent evidence based information. There does not appear to be an effective corporate business planning process within the Trust which links activity, operational, manpower and financial plans.

- Given the criticism of the Trust's governance arrangements from multiple external agencies we have tried to understand why the Board's Non Executives were unable to ensure the agenda was balanced between operational delivery , financial control, strategy and governance. The reasons for this are complex but we believe:

1. The balance between non-executive's supporting and challenging the executive may have been skewed towards the former.
2. Perceived progress over the last three years by the current executive team on operational delivery and achievement of targets has perhaps inhibited a culture of challenge.
3. The Non Executive Directors have had insufficient information in order to steer corrective action. e.g. there seems to have been no knowledge until recently that the Finance function lacked the capacity to fully undertake its responsibilities.

- There appears to be an ad-hoc approach to creating and agreeing the Public Trust Board agenda.

Committees

45. Given our findings regarding Board operation, we believe that the Trust would benefit from reviewing the operation of its key committees as part of its response to integrated governance. Specifically:

- Agendas should match the priorities of the Trust.

- Action points and follow up arrangements are clear and disciplined.

- They are conducted in a formal and business like manner.

- The Finance sub committee needs more formal Chairmanship arrangements. It is not apparent from examination of the minutes who is in the Chair

- The terms of reference for the finance, audit and risk management committees should be reviewed in order to clarify their respective roles in relation to the financial agenda of the Trust.

46. The constitution of the Audit Committee is correct, however in practice the committee includes Non Executives, officers, and internal and external audit. The Audit Committee exists to enable the Non Executives on behalf of the Board to gain assurance regarding the governance arrangements within the Trust. Our impression from examination of the minutes suggest that historically the meetings have been of an executive working group and are not pre-programmed in the business cycle of the Trust (e.g. the action plan for the PIR was presented to external audit by a non-executive in the absence of the Chief Executive and Director of Finance). We would suggest a review of these arrangements in conjunction with the Audit Handbook.

47. We believe that the recent changes in the Audit Committee will provide a sound basis for addressing the governance challenges facing the Trust in the coming months. The intervention of the Chair of Audit Committee in personally re-establishing relationships with external and internal audit is a significant step.

48. One non-executive member of the Audit Committee has been absent from attendance for the majority of meetings in 2005 and 2006. Further, attendance at the Remuneration and Terms of Service Committee has been poor. Non attendance weakens a committee and should not be tolerated.

Tone of the Trust

49. The Board's leadership and the application of the Trust's governance arrangements set the tone of an organisation which permeates into its key business processes. The perception of the financial position, relationships with stakeholders, ability to influence the strategic agenda and its discipline around business processes all form part of this tone.

50. We have been told that significant progress has been made in recent years in moving the Trust forward, but we believe there remains a challenge in the Trust taking ownership of its problems (rather than externalising them). We have found:

- A perception that the Trust has been under funded for years, is very efficient and has delivered against key activity and access targets. There is a body of opinion that success in operational delivery is as a result of effective leadership.

- A view that the lead commissioner and former Strategic Health Authority (SHA) have inhibited strategic change

- A perception in some quarters that external audit have wished to make an example out of the Trust.

51. Our view is :

- The Trust has a tendency to externalise its problems which inhibits ownership.

- There appears to be evidence of the Trust creating strategic initiatives that have not come to fruition. Given the nature of these proposals and the need for strategic service planning with political support, external partners may have inhibited progress.

- A Trust often in crisis management mode.

- The Trust has made good progress operationally in recent years. We believe this is attributable to the personal leadership of the executive team combined of course with clinical delivery.

- Relationships between external audit and the Trust together with the style of the PIR appears in some quarters to have detracted from the key messages being given to the organisation by its external auditors. The fact is that external audit are an independent body and the findings of their report should be regarded as a statement of fact.

- The Trust does have a low cost base as evidenced by its reference cost position and its potential gain under the payment by results system. This does not mean it is efficient but may be an indication of its efficiency.

- The Trust's business processes often lack discipline and attention to due process.

RELATIONSHIPS

PCT

52. Whilst there are good relationships between the Trust and the main PCT at a service and middle management level, relationships between the respective Finance Directors are poor. This needs resolving. The lack of a coherent health system strategic plan and delays in agreeing the SLA for 2006/07 also suggest an ineffective relationship at Board level. This lack of effective engagement is detrimental to the Trust and the wider community that it serves.

53. The creation of the new North Yorkshire and York Primary Care Trust provides an opportunity for these issues to be resolved. We also believe that the new Yorkshire and the Humber Strategic Health Authority have a role to play in creating the right environment for change.

External Auditors

54. It appears that key relationships between the external auditors and the Trust had, by the early part of 2006, broken down. This may have contributed to the Trust being unresponsive to requests for supporting evidence from the external auditors in respect of the ALE scores which in our view could have been less damaging.

55. We welcome the fact that the Chair of the Audit Committee is proactively working to re-establish positive relationships with the external auditors. It is good practice for the Non Executives to meet privately with the external and internal auditors.

56. There is a perception by some Board members that the handling by the external auditors in terms of the PIR was unfair. In particular it has been put to us that the accounting adjustments of some £3.7m (of a final adjustment of £4.5m) in the 2004/05 accounts were well known to the external auditors and were discussed at the Audit Committee. There is a sense of injustice that the auditors did not make their views on their interpretation known prior to the submission of the accounts.

- Our view is that the auditors would not be in a position to give a final view at this point in the process. The matter is never resolved until the audit partner

has signed the accounts off once the audit has been completed. Our view is that the Trust knew there were risks around these issues and ultimately the preparation and submission of the accounts which give a true and fair view, is the responsibility of the Trust and not external audit.

- Exception has been taken to the tone of the report in respect of it having a rather personal nature. Certainly this has not helped the relationship between the Trust and its external auditors but the tone of the report should not be allowed to divert attention away from the recommendations for action.

Internal Relationships

57. In terms of internal relationships we detect:

- No damaging friction between the Non Executive team.
- Improved links between the Executives and the clinical body over the past three years.
- A strong degree of loyalty from the senior management to the Trust's executive leadership.

INTEGRATED GOVERNANCE FRAMEWORK

58. In the terms of reference for the review we described governance (taken from the Department of Health's "governance handbook") as the systems, processes and behaviours by which trusts lead, direct and control their functions in order to achieve organisational objectives. Governance arrangements set the tone of an organisation permeating the key business processes.

59. As part of our work we have formed a view on the Trust's position against the ten criteria set out in the "governance handbook"

	CRITERIA	COMMENT
1.	Clarity of purpose	Insufficient. Too much emphasis on the operational agenda and no integrated strategy for recovery.
2.	Strategic annual agenda cycle, with all agenda integrated encompassing activity, resources and quality.	The annual cycle has recently been reviewed but the Trusts business planning processes do not link activity, resources and quality.
3.	Integrated assurance systems in place.	Limited assurance given by internal audit for 2005.6. Action is being taken to address this.
4.	Decision making supported by intelligent information	Further work needed. Financial planning information is not robust.
5.	Streamline committee structure; clear terms of reference and delegation; time limited	Needs review
6.	Audit committee covers all governance issues	Terms of reference and new leadership suggest a positive outlook
7.	Adequate board support company secretary and compliance unit	Needs strengthening
8.	Selection, development & review of board members	No comment
9.	Board etiquette	No comment
10.	Development programme for Board members	Exists but perhaps needs to be more responsive to current challenges.

CONCLUSIONS

60. In bringing together the findings of those charged with scrutinising the Trust's governance arrangements we find;

- The 2004/05 and 2005/06 submitted accounts materially changed.
- A Public Interest Report in respect of the 2004/05 audit (issued November 2005).
- A strong message from the SHA in March 2006 for the Trust to reconsider its governance arrangements (as part of the FT diagnostic).
- Limited assurance by the Trust's internal auditors on the organisation's application of its controls assurance framework.
- In July 2006 a critical governance report (in respect of the 2005/06 audit) with a qualified opinion on value for money.
- The Trust has been placed in formal financial turnaround status and a Turnaround Director appointed.

61. These facts in themselves give a clear indication that governance arrangements within the Trust are not robust. The outcome of our review endorses this view.

62. Despite this, there is opinion within the organisation that much progress has been made in the past three years in relation to the operational management and

performance of the Trust. We concur with this view. We do believe there is improved engagement between the Trust leadership and clinical staff and on the back of this the Trust has delivered its access targets in the context of a low operational cost base. This operational success has underpinned a sense of loyalty and commitment to the Trust's leadership particularly from within the senior managerial community.

63. We also believe there have been efforts to engage in some degree of strategic service reconfiguration but such iniatives appear to have floundered because there is no system wide health strategy (which the public and politicians have been engaged in) which could underpin change. Indeed we detect increasing frustration by the public on the lack of direction and leadership by the local health care system to deliver a solution to the financial challenges facing the Trust and the PCT. Further, we detect a recognition and willingness from many within the consultant body to engage in the strategic service agenda. This momentum needs to be built upon by the Board and the new PCT.

64. A different picture emerges on examination of governance within the Trust particularly in relation to its impact on financial control and achieving financial targets. The balance of the Board's energy between considering strategic matters and operational matters needs to be shifted materially to the strategic. Board business processes need to be strengthened and Non Executives need to continue to adopt a more challenging style in holding the Executive to account for its actions (we sense this has moved significantly since the early part of 2006).

65. Committee processes can be improved and the Trusts corporate business planning for 2005/06 and 2006/07 seems to be non existent (or was subsumed in to the FT process). This latter issue married to the fact that the Chief Executive and Finance Director did not appear to have formal detailed objectives (for 2005/06) suggests that the corporate direction of the Trust was undefined and there was no robust and structured mechanism for holding individuals accountable for delivery.

66. Following from the above we have observed a perception that some Board members assessment of risk has not been translated in to action by the executive. A responsive executive could almost certainly have mitigated the extensive criticism propounded in the governance report and internal audit controls assurance report.

67. The tone of the organisation remains one of externalising its problems which needs to be turned around to it taking ownership and responsibility. A good example of this is the failure to agree the 2006/07 service level agreement with the host PCT. This is undoubtedly disabling and creates uncertainty. Nevertheless, this should not prevent the organisation from setting initial budgets based on a reasonable and informed assessment of expected levels of activity. The risk of changes in these assumptions needs to be managed proactively

centrally at executive level and the plan amended in year if this proves necessary.

68. The Trust appears to have some difficult relationships with its external auditors and its host PCT . These need to be repaired. We also believe creating positive managerial and clinical links with neighbouring providers will help the Trust to prosper rather than contribute to its demise.

69. In terms of the financial aspect of the Trust, the current financial position as reported to the Board on 25th July 2006 shows a forecast deficit for 2006/07 of £5.4m after achieving direct operational savings of £4m and assuming an income (SLA) from the host commissioner of £59.4m (against an offer of £50.9m). Taking account of the difference in the value of the SLA, the in-year deficit could be in the range of £5.4m and £13.9m. Adding to this the historical debt of £11.8m, the current forecast for the year-end is a deficit of between £17.2m and £25.7m. These figures assume that all the savings plans are delivered which based on past experience and the current budgetary control arrangements appear ambitious. All this is in the context of the Trust increasing its WTE manpower by 219 in 2004/05 which was subsequently paired back by 78 posts by April 2006 .The Trust at April 2006 had a WTE workforce some 7.6% above the level in April 2004.The average cost of an employee is £30k .Using a crude extrapolation the cost of this increase is some £4.2m .

70. The challenging financial position is made more difficult to resolve because of ineffective financial management arrangements. Budgets have been rolled forward on a historical basis and as a consequence are unrealistic.

71. In relation to the changes and errors in the 2004/05 and 2005/6 submitted accounts, responsibility sits with the Trust and not its external auditors. It is the Trust's responsibility to produce accounts that comply with accounting standards and represent a true view of the financial consequences of its activities.

72. The PIR issued in November 2005 was a major wake-up call in terms of the Trust addressing its core strategic, financial and governance issues. Progress on responding to the central recommendations has been limited. The Board deemed that continuity of leadership was in the best interests of the Trust . As a result, there was no sanction exercised by the Board on any of its members and no expression of individual accountability. The former SHA have, following the issue of the 2005/06 governance report, indicated their extreme disappointment at the failure of the Trust's management to respond to the challenge.

73. The Board appears to have had a genuine belief that they were addressing the recommendations in the PIR and would cite as evidence the action plan, the increased activity around financial control and the creation of the finance committee. However, these initiatives did not start to address the root cause of

the problem which was; insufficient focus on the recommendations; financial capacity and the driving through of a strategic solution.

74. A further perspective relates to the dynamics between executives and non-executives on the Board. We have stated earlier our belief that the energy of the executive of the Board was focussed on delivering the operational agenda to the detriment of the financial, strategic and governance challenges. It does appear that the Non Executives were unable to provide a corrective influence.

75. Our final conclusion is that the Trust Board has now started to seriously engage on the challenges set out in the November 2005 PIR and believe that the issuing of a second highly critical report by the external auditors (the governance report) will act as a real catalyst for change. If it does not, then a second PIR is likely which would lead to further outside intervention.

76. Our recommendations below are designed to promote a rapid turnaround in the Trust's governance arrangements and provide a strong foundation for the future prosperity of the organisation.

RECOMMENDATIONS

Response to the Public Interest Report

- The Audit Committee should monitor progress against the recommendations arising from the, PIR , the 2005/06 governance report and our own review .The Board should receive a full report on progress and actions taken to rectify slippage on a bi-monthly basis.

- Recommendations arising from the governance report and PIR need to be explicitly linked to Executive Directors personal objectives as appropriate. Similar arrangements should be put in place for Non Executive Directors.

System of Internal Control

- Action has already commenced in assessing the issues of limited assurance. The Trust Board needs to be satisfied of its assurance framework throughout 2006/07. The Audit Committee should be charged with linking with internal audit to ensure that any issues are resolved.

Strategic Issues

- The Board need to be proactive in leading strategic change and engaging particularly with the new North Yorkshire and York Primary Care Trust.

- The existing strategic direction needs to be revised by being matched to a top down review of services backed up by operational and financial plans.

- The Trust should be proactive in forging clinical alliances with all neighbouring Trusts and primary care practioners.

Financial Position of the Trust & Finance Department

- During the course of our review the Trust has been put into formal turnaround to address its financial problems. A Turnaround Director has been appointed and Price Waterhouse Coopers have been assigned to work with the Trust on its turnaround plans. The whole organisation must engage in this process as a means to securing viable and sustainable services and the long term future of the organisation.

- The financial arrangements underpinning the community hospitals need to be resolved as soon as possible.

- The medium term recovery programme is unrealistic and a new plan needs to be developed which has two elements:

    - A short term financial plan for 2006/07
    - On the back of a strategic plan (constructed in conjunction with strategic partners) a new medium term financial recovery plan should be formulated.

  This should be addressed by the Turnaround Director as part of the formal turnaround process. All future plans need to be subject to formal acceptance, review and monitoring by the new Strategic Health Authority and the centre as part of the turnaround process. The plans also need to be signed off by the lead commissioner.

- All 2006/07 budgets need to be reset on a realistic basis taking into account activity, operational and manpower plans. The resultant shortfall should form the basis of a revised cost reduction strategy and the development of the recovery programme. Once this is in place individual Directors can be re-assigned individual targets on which relevant financial information is available to monitor performance.

- The 2006/07 disputes on the SLA need to be resolved with immediate effect. The new Strategic Health Authority should be proactive and the Trust's Chief Executive should take personal responsibility for this issue. Work should commence on developing mechanisms for the agreement of the 2007/08 SLA linked to an overall health economy strategy.

- Business cases for all improvements in services should be matched to a real source of funding and be linked to the Trusts corporate business plan. The Finance committee should scrutinise all such decisions.

- The current control mechanisms on expenditure should continue.

- In order to avoid the problems in the past two years regarding the final accounts, three things need to happen.
  - The finance department needs more capacity
  - Relationships with external audit need to be improved and the Finance Director needs to take the lead in all discussions with external audit regarding proposed accounting treatments in advance of the year end.
  - The Chairman of the Audit Committee needs to have a direct input in scrutinising the accounts before submission and linking with external audit.

- Following from the above, we recommend the appointment of two or three qualified accountants. To make these changes effective, it will require the energy, commitment and leadership of the Director of Finance.

Business Processes and Organisational Structure

- The Trust needs to develop a rolling corporate business plan for 2006/07 which brings together its operational, manpower and financial plans. In the future this needs to be in the context of a strategic plan.

- Executive Directors objective setting and appraisal processes should be formalised and linked directly to the corporate business plan. This process should permeate throughout the organisation's management structure.

- Consideration should be given the appointment of an Executive Director with responsibility for all operational issues within the Trust. This will free up the Chief Executive to focus more on the strategic and governance agendas.

- The Board should strengthen its formal communication links to the consultant body.

- The Trust should review the effectiveness of its staff briefing sessions.

- A strategy needs to be developed for communicating the findings of the 2005/06 governance report to the Trust.

Board Operation

- Finance and performance reports should never be tabled at the Board or sub committees of the Board. The format of the financial reports should be revised and it would seem sensible to involve some Non Executive input into this process.

- The Remuneration and Terms of Service Committee minutes should be reported to the Board. Audit Committee and Finance Sub-committee minutes should be reported to the following Board meeting. The Board should formally agree any changes to the Chairmanship of sub-committees.

- It is the Board's responsibility to ensure that the Trust achieves its statutory financial responsibilities. Non Executive Directors should receive specific training to enable them to challenge financial information being presented to them by the Executive. The role of the Non Executive Director is to act as the guardian for the financial stewardship of the organisation in which they serve and as such they need to exercise more robust and proactive challenge.

- The Board needs to address their need for intelligent evidenced based information to assist their decision making processes. We suggest that the Board identifies its information requirements; establishes the extent to which its information needs are currently met, and; formulates a plan to meet the shortfall. A review of the Intelligent Board report for acute trusts issued by the Appointments Commission in spring 2006 could support this discussion

- In order to achieve more clarity and focus on governance issues we recommend the redefining and strengthening of the role of Board secretary (with a similar role as described in the integrated governance handbook). In the interim we believe some external assistance to the Non Executives is required to help them through this difficult period. This will provide the framework and environment for the Board to take a more challenging role.

- A more formalised approach should be adopted to formulating and setting the agenda for the Trust Board which is linked to the annual business cycle.

Committees

- The Trust needs to review the operation of its key committees in accordance with the recommendations in the integrated governance handbook.

- The terms of reference for the finance and risk management committees should be reviewed in order to clarify their respective roles in relation to the financial agenda of the Trust. Chairmanship of these committees should be re-examined as part of this process.

- We believe that the recent changes in the Audit Committee will provide a sound basis for addressing the governance challenges facing the Trust in the coming months. The Audit Committee exists to enable the Non Executive Directors on behalf of the Board to gain assurance regarding the governance arrangements within the Trust and we would suggest the committee re-affirms it is operating within the best practice recommendations of the Audit Handbook.

Relationships

- The Board needs to lead a process of establishing effective relationships with all its external partners. This is the building block for strategic recovery and minimising the risk of a failure in understanding of its external auditors and itself. It will also help in resolving any future issues regarding the service level agreement.

Integrated Governance Framework

- The Board needs to place the integrated governance framework at the core of its development programme and audit its effectiveness. It should use the ten criteria matrix as an annual health check on its progress and effectiveness.

APPENDIX 1

PUBLIC INTEREST REPORT 2004/5 – REVIEW OF AUDIT RECOMMENDED ACTION POINTS

	ACTION REQUIRED BY TRUST BOARD	TRUST RESPONSE / ACTION TAKEN	COMMENT
1.	In discharging its responsibility to ensure that the Trust meets its statutory financial responsibilities the Board needs to provide strong leadership for the recovery process, carry out robust scrutiny and challenge.	Financial performance is discussed at the Board and the Board robustly challenges the financial performance of the organisation. Detailed action is to document unfunded cost pressures, adopt a strategy to get fully paid for the work it undertakes, have more detailed budget analysis and forecasts from Divisional Directors.	Evidence of discussion of financial performance at the Board. However most financial reports are tabled. In such circumstances it is impossible for Non Executives to make a robust judgement and challenge. Little evidence of real challenge e.g. original 2006/7 budget showed balance, 2005.6 accounts changed by £1.6m The detailed actions simply clarify the position and looks for external solutions.
2.	Finance recovery plan agreed with SHA and PCT	A three year recovery programme was submitted and approved by the Trust Board on 21 June 2005. This document was subsequently updated to reflect the movement in the 2004.5 year end position. The revised cost recovery programme was submitted and approved by the Trust Board on 26 July 2005.	The first year of the recovery plan has proved to be unrealistic and does not take account of historic debt. The position for 2005.6 was £8.9m deficit compared to a planned position of a break even position assuming £4.2m of financial support from the SHA. The second year of the recovery programme (2006/7) showed a surplus of £4k without financial support. Current forecasts discussed at the Trust Board on 25 July 2006

	ACTION REQUIRED BY TRUST BOARD	TRUST RESPONSE / ACTION TAKEN	COMMENT
		The plan was discussed and accepted by the Strategic Health Authority.	report a forecast deficit of between £17.2m and £25.7m taking into account historic debt. In terms of future recovery plans, these need to be subject to more formal acceptance, review and monitoring by the SHA.
3.	Action taken to agree a solution for resolving the accountability issues surrounding community hospitals.	Agreement has been reached regarding the management arrangements for the community hospitals between the Trust and the PCT. Discussions are still ongoing regarding the financial aspects relating to the transfer of the facilities to the PCT and the implications under payment by results.	Agreement reached in August 2005 on the management arrangements. As at July 2006, the financial arrangements to underpin this have not yet been finalised. This is a systemic problem which requires intervention to resolve given that it formed part of the medium term recovery programme.
4.	Detailed plans to underpin the finance recovery programme.	A 3 year financial recovery programme was monitored at public board meetings with lead directors assigned responsibility for savings targets.	We can confirm that individual Directors were assigned specific targets. However given the out-turn for 2005/6 coupled with unrealistic budgets it is not possible to track whether the savings have been achieved. We do have evidence that expenditure controls are in place although this did not stop the approval of an endoscopy suite or investment in access targets.
5.	Effective budgetary control arrangements in place.	The Trust will continue to with its budgetary control arrangements. Monthly review meetings are held with Divisional	The meetings with Divisional Managers have taken place and these certainly clarify the financial position and

	ACTION REQUIRED BY TRUST BOARD	TRUST RESPONSE / ACTION TAKEN	COMMENT
		managers with manpower controls being implemented and a specific initiative to reduce the use of agency staff.	maintain control on expenditure. We remain unconvinced of the real effectiveness of the Trusts budgetary control arrangements given that individuals were being asked to make savings on budgets which were unrealistic to begin with. The essence of effective budgetary control is for managers to have control of realistic budgets.
6.	Accurate in year and year end reporting	Financial reports reconciled to the financial ledger and control totals. Internal audit to carry out a review. Any accounting adjustments will be documented and an opinion sought, prior to the completion of the financial year.	We are not aware of any problems regarding the reconciliation of the financial ledger to the financial reports. However there was a movement from the month 12 forecast out-turn position for 2005/6 of £400k and a further movement of £1.6m following the external audit. This highlights continued problems in forecasting and capacity of the finance department.
7.	The draft accounts are approved at a meeting of the Board and detailed checking procedures introduced so that the accounts are free from material error.	Identified the problem as being due to a new financial ledger in 2004.5. Recommended the introduction of a detailed timetable and cross checking and comparison procedures.	The governance report identifies errors in submission and of judgement. A year end accounts timetable was produced. The 2005/6 accounts were, however, submitted late and were not approved by the Board or the audit committee prior to submission.

APPENDIX 2

2005/6 GOVERNANCE REPORT – SUMMARY OF ISSUES

SUMMARY FINDINGS	RECOMMENDED ACTION
Material Weaknesses in Internal Control	
Late submission and poor quality financial statements with a large number of errors.	Immediate appointment of 2- 3 qualified accountants.
Failure to correctly interpret accounting rules.	Improved relationships with external auditors and improved scrutiny by the Board to minimise future risks. Leadership of the finance function needs to be reviewed.
Insufficient qualified and experienced finance staff.	Immediate appointment of 2-3 qualified accountants.
Absence of a realistic recovery plan including the repayment of the deficit and ensuring there is sufficient cash to repay liabilities.	Development of robust recovery plan which takes into account operational and financial plans of the Trust in 2006.7 and beyond.
Value for Money	
No effective process for setting, reviewing and implementing strategic and operational objectives.	Development of corporate and departmental business plans for 2006.7 linked to strategic objectives and underpinned with financial plans and budgets.
Operational performance has over-ridded financial balance.	This balance needs to be addressed by ensuring that no operational decisions with a financial impact are taken without a clear source of funding being identified. The finance committee should scrutinise all such decisions.
The Board does not have strategic objectives or focus sufficiently on actions.	Board business should be linked to the Trusts strategic objectives and decisions made by the Board should reflect the actions that the Trust are going to take rather than clarification of a situation.
Internal Audit has given limited assurance regarding the Trusts control assurance framework. As such the Trust did not have arrangements to	The Board need to adopt the recommendations in the integrated governance framework. The Audit committee should be charged with linking with internal audit to ensure that any issues are resolved.

SUMMARY FINDINGS	RECOMMENDED ACTION
manage its significant business risks.	The Healthcare Standards system needs to operate for the whole of 2006/7.
The Trust does not have a long terms plan to improve efficiency.	Although the Trust is a low cost provider it does not necessarily mean that the Trust is efficient. A financial strategy needs to be developed that is linked to operational efficiency gain. I.e. increased throughput, increased utilisation of theatres.
In 2005.6 the Trust did not have a medium term financial plan linked to medium term strategic objectives.	A three year financial plan was produced in July 2006 however there was no explicit link to strategic objectives and the plan itself has proved flawed. The plan produced in 2005.6 needs to be revised.
The Trust has overspent in 2004.5 and 2005.6.	The Trusts needs to develop a recovery plan taking into account a strategic review of services.
Budget control systems do not predict the final reported position.	Immediate appointment of 2-3 qualified accountants. The budgets for 2006/7 need to be reset taking into account operational plans.
The Trust does not have an estates strategy	An estates strategy needs to be developed which the supports the delivery of the strategic objectives of the organisation.
The Board had not formally adopted the NHS Code of Conduct for Board Members in 2005.6. In addition, the Trust did not have a register of gifts and hospitality for Non Executive Directors.	These policies and processes need to be put in place and formally adopted by the Trust Board.