

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

Introduction

1. NHS Direct was launched as a pilot in 1998 as a 24 hours a day, 7 days a week service with the aim of the NHS providing easier and faster access to health advice and information to the public. Initially three pilot call handling sites were set up based within individual NHS Trusts. The roll-out of the full service was carried out in four waves between March 1998 and November 2000 with NHS Direct becoming a national telephone service in 2000.
2. During this period NHS Direct was centrally managed by the Department of Health but the service was delivered at a local level by 22 NHS host Trusts. The services were provided through Service Level Agreements between the host Trusts and the Department of Health. The costs of NHS Direct were accounted for as part of the host Trusts expenditure and were therefore included within the accounts of the relevant Trusts. Some additional management costs were incurred by the Department of Health and reported in the Department of Health Resource Account.
3. In 2003 the Department of Health published its three year strategy for NHS Direct. This recommended that, from 2004, a nationally dedicated NHS Direct provider would be established with the responsibility for delivery of the service. As a result NHS Direct was established as a Special Health Authority on 1st April 2004 with its own Board, Chair and Chief Executive.
4. Although NHS Direct became a separate body on 1 April 2004 there was no ledger or payroll system in place at that date and whilst these systems were being established the host Trusts continued to be responsible for providing the accounting and payroll services which NHS Direct paid for through service levels agreements. These arrangements continued for the majority of the financial year until NHS Direct implemented a separate Oracle ledger which resulted in them progressively taking responsibility for purchase ledger transactions and payroll arrangements in the last quarter of the financial year.

My responsibilities as auditor

5. I am required, under Auditing Standards, to obtain sufficient evidence to satisfy myself that in all material aspects, the financial statements give a true and fair view of NHS Direct's state of affairs. In forming my opinion, I examine, on a test basis, evidence supporting the amounts, disclosures and regularity of financial transactions included in the financial statement and assess the significant estimates and judgements made in preparing them. I also consider whether the accounting policies are appropriate, consistently applied and adequately disclosed.
6. I have qualified my opinion on the account for 2004-05 because I have been unable to confirm that NHS Direct has maintained proper accounting records for certain payroll costs and that I have received all the information and explanations I require for my audit. Specifically, no evidence was

available to support amounts recorded in the ledger for a significant number of payroll costs. In addition, no evidence was available to support the prior year comparative figures for all aspects of the account.

Purpose of Report

7. The purpose of my report is to:

- explain why NHS Direct has been unable to provide evidence to support a significant number of payroll costs
- explain why NHS direct has been unable to provide prior year comparative figures; and
- indicate the steps NHS Direct is taking to address the weaknesses in controls that led to this situation and to prevent a recurrence in the future.

Accuracy of Payroll costs

8. In 2004-05 NHS Direct incurred pay related expenditure of £94 million which accounts for 66 per cent of total expenditure. Prior to 1 April 2004 NHS Direct staff were employed by the host Trusts and were therefore paid through the host Trust's payroll system. In the majority of cases the host Trusts used shared service provider organisations to process payroll rather than having an in-house payroll section. As a result the payroll processing was split between 19 different payroll providers.
9. When NHS Direct was established as a Special Health Authority staff who had previously been employed by the host Trusts were transferred over to NHS Direct under the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE) . However, at that date NHS Direct had no centralised ledger or payroll system in place and therefore the host Trusts payroll providers remained responsible under a service level agreement for the processing of payroll relating to NHS Direct staff.
10. As NHS Direct had not implemented a centralised ledger or payroll system and the payroll providers and records were disbursed across the country, there was an absence of central management control over the processing of payroll. My staff were therefore unable to take assurance from management's own monitoring controls. A further complication was the fact that staff across the 22 host Trust sites were on sixty-six different terms and conditions of service. As a result it was not possible for my staff to carry out reliable analytical procedures given the differing pay and staff grades across the country.
11. In addition, NHS Direct did not appoint an Internal Auditor until October 2004 and, due to the lack of any centralised payroll records, the Internal Auditor was not able to complete their assessment of the payroll system during 2004-05. As a result my staff were unable to place reliance on the work of Internal Audit. It was therefore necessary for my staff to carry out sample testing of payroll transactions made in 2004-05 in order to gain assurance that payments had only been made to valid NHS Direct employees and at the correct amounts.

12. The collation of the source documentation to support the sample of payroll payments caused NHS Direct some difficulties. This was due to the fact that, whilst NHS Direct progressively moved to a centralised payroll provider starting in January 2005, Human Resources were still based at the host Trust sites, as were the majority of employee files. Furthermore the TUPE records provided no information on the actual salary being paid on transfer. As a result the source documentation had to be obtained from the host Trust payroll providers located across the country.
13. The results of the testing found that NHS Direct were unable to locate the complete or partial supporting evidence for 66 of the 411 (16 per cent) sample payments examined, by value around £30,000 of £1, 450,000 (2.1 per cent). As a result my staff could not verify that these payments were accurate. On the basis of the results of this exercise in the region of £1.6 million of payments made to staff during 2004-05 may not be accurate.

NHS Direct has been unable to provide auditable prior year comparative figures

14. As a Special Health Authority NHS Direct is required, under S 7(2) of the Government Resources and Accounts Act 2000, to produce accounts which meet the financial reporting requirements specified in HM Treasury's Resource Accounting Manual (RAM). The RAM designates the movement of responsibilities from one reporting entity to another within government as a Machinery of Government change. Such changes are accounted for as 'mergers' rather than 'acquisitions' and therefore should follow the requirements of Financial Reporting Standard 6, Acquisitions and Mergers. To ensure comparability between accounting periods, the Standard requires prior year comparative figures to be restated to incorporate the costs and assets of all the merged organisations.
15. As the expenditure relating to NHS Direct was not segregated from the host Trusts' own expenditure, NHS Direct has only been able to provide an estimate of total income and expenditure for the prior year based on returns provided by the host Trusts to the Department of Health together with an estimate of central departmental costs. However, no information has been provided which would enable this balance to be broken down in the way required by the RAM.
16. Under Section 7(3) of the Resources and Accounts Act 2000, I am required to provide an audit opinion as to whether the financial statements of NHS Direct provide a true and fair view of the state of affairs of the entity. I have limited the scope of my audit opinion on these financial statements because NHS Direct was unable to provide me with sufficient evidence to support the prior year comparative expenditure of £121 million and matching income of £121 million and because of this lack of evidence, I have been unable to audit these figures. There were no other audit procedures I could adopt to confirm that the prior year comparatives were not materially misstated.

Conclusion

17. The purpose of establishing NHS Direct as a Special Health Authority was to ensure that there was a single provider with responsibility for the delivery of NHS Direct services.
18. NHS Direct has encountered a number of difficulties in preparing these financial statements and is still working towards implementing systems and controls throughout the organisation. In particular, we have recommended improvements to the overall financial management controls and, more specifically, to controls over both pay and non pay expenditure. It is vital that NHS Direct continues this work in order to ensure that there is a strong system of internal managerial and accounting controls for the preparation of future financial accounts.
19. NHS Direct has taken steps in year to centralise the disparate systems including payroll and are in the process of recruiting Human Resource staff in order to ensure that there is an appropriate Human Resource capacity in each Region. In addition, NHS Direct is required to implement the Department of Health's Agenda for Change which aims to consolidate the conditions of service and pay for all staff across the NHS. This will assist with the harmonisation of the existing sixty six terms and conditions of service into a reduced number. This provides NHS Direct with an opportunity to centralise the information available on staff pay and conditions in order to ensure that documentation is available to support the amounts paid to staff in all cases. This will also enable NHS Direct to manage its resources more effectively and will allow the Accounting Officer to fulfil one of his key responsibilities of ensuring that proper accounting records are maintained.
20. In terms of providing prior year comparators, as a Special Health Authority NHS Direct is now required to produce its own accounts and going forward comparative figures will be provided.
21. My staff will continue to monitor NHS Direct's progress in developing its internal controls and in particular, the progress being made on ensuring that there are controls in place over the payroll system.

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