

The Explanatory Report of the Comptroller and Auditor General to the Houses of Parliament

Introduction

1. In December 2015, I reported on the 'Sustainability and financial performance of acute hospital trusts', which highlighted the severe, and worse than expected, decline in the financial position in provider sector finances. As I have previously reported, this trend is not sustainable. The financial sustainability of the provider sector should be assessed against the wider backdrop of the broader health and social care sector financial position and the need to close the gap between available resources and patient needs.
2. I continue to report on a range of issues in the health sector which examined the financial pressure being faced by the NHS. Most recently, I highlighted that:
 - as well as the negative impact on individuals' health, there is a financial implication to delays in discharging older people from acute care¹;
 - NHS England has reduced tariff prices paid to providers in order to tackle the increasing costs of commissioning specialist services. This may, however, affect the financial sustainability of providers²; and
 - while progress is being made by the Department of Health and NHS England to improve access to mental health services, additional funding is being met from existing clinical commissioning group budgets. This could have impact on the financial sustainability of providers.
3. Having now completed my financial audits of the 2015-16 Department of Health group accounts, including the Consolidated Foundation Trust financial statements, I consider it appropriate to provide an overview of the department's actions to address the challenges. This report focuses on the Foundation Trust sector and is set out in two parts. Part one provides an overview of the foundation trust sector and the financial pressures it faces. Part Two summarises my financial audit approach. I have reported separately on the Department of Health's resource accounts.

Part One

Sector overview

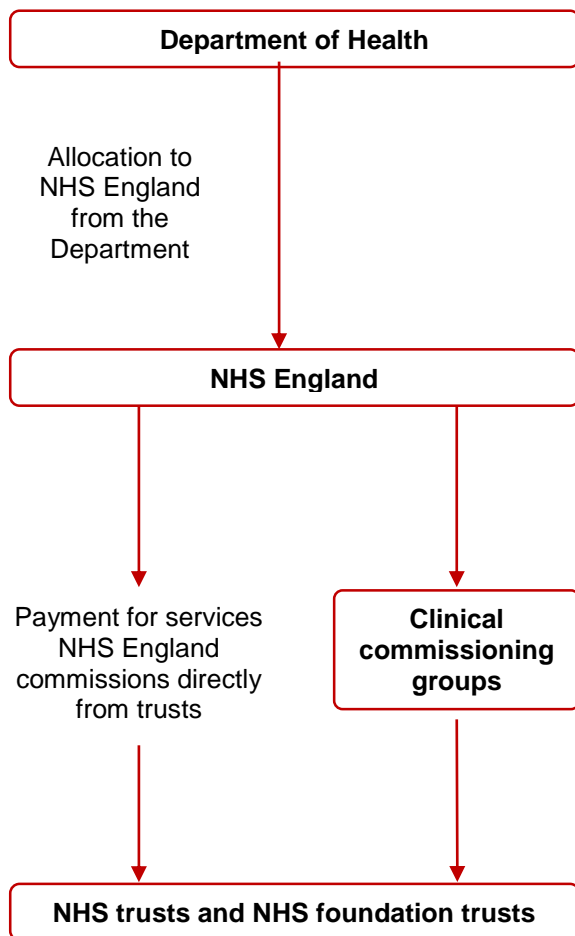
4. NHS foundation trusts make up a significant component of the Department of Health group and are a large part of the provider sector, which also includes NHS trusts, and other providers. NHS foundation trusts are self-governing, have greater financial and operational freedoms from government than NHS trusts, and are directly accountable to Parliament. The NHS foundation trust sector includes five types of trust, providing different services: acute, ambulance, community, mental health and specialist. Most hospitals in England are Foundation Trusts.
5. During the year there were 153 foundation trusts and 85 NHS trusts. Foundation trusts earn most of their operating income from clinical commissioning groups and NHS England, earning £39.9 billion compared to £7.1 billion from other sources. In return, foundation trusts deliver the healthcare they have been commissioned to provide, incurring some £47.6 billion of operating expenditure in doing so.
6. Figure 1 below shows how funding for NHS clinical activity flows through the system from the Department of Health, down to the provider sector³.

¹ <https://www.nao.org.uk/wp-content/uploads/2015/12/Discharging-older-patients-from-hospital-Summary.pdf>

² <https://www.nao.org.uk/report/the-commissioning-of-specialised-services-in-the-nhs/>

³ There is also a funding relationship between the Department of Health and providers, where the Department provides some funding directly

Figure 1.



Foundation Trusts face ongoing financial pressure

7. Foundation trusts began the year in a difficult position. For the first time in 2014-15, they collectively reported a loss before impairments of £345 million, and a post-impairments deficit of £507 million. This represented a continuing decline from 2012-13. This is against a backdrop of continued pressure on the NHS financial position.
8. As the 2015-16 financial statements show, the financial position of foundation trusts continued to deteriorate. The total net deficit is £1.1 billion before impairments and, after impairments, is a deficit of £1.5 billion. This is the second year in which the foundation trust sector has reported a net deficit, and indicates the deepening financial challenge faced by the sector.
9. In 2015-16, the number of foundation trusts reporting a deficit increased again to 101, compared to 78 in the previous year. 29 foundation trusts (19%) received emphasis of matter paragraphs in their audit reports relating to the going concern assumption or financial performance (2013-14: 21 of 153, 14%).
10. The rise in deficit is driven by the increase in operational costs, caused mainly by underlying increases in demand. The majority of foundation trusts' expenditure is made up of staff costs. As I reported in *Managing the supply of NHS clinical staff in England*⁴, between 2012-13 and 2015-16, trusts (including

⁴ <https://www.nao.org.uk/wp-content/uploads/2016/02/Managing-the-supply-of-NHS-clinical-staff-in-England.pdf>

foundation trusts) planned to make recurrent pay savings of around £1 billion each year, although actual savings consistently fell well short of this amount. The financial statements show that, for foundation trusts, staff costs overall have risen to £30.3 billion (£27.9 billion in 2014/15). Agency staff costs have increased to £2.1 billion (£1.8 billion 2014/15). Cost increases will also have an impact on cash flows. Overall, cash balances held by foundation trusts have fallen to £3.5 billion (£4.1bn in 2015/16).

Addressing the immediate financial challenge

11. As stated above, I have continued to examine and highlight the challenges faced by the health sector against the backdrop of broader public sector financial pressures.
12. Health is an area of public spending that the government has protected in recent years compared with most other areas of government spending. However, finances have become increasingly tight, with health funding rising at a historically low rate of 1.8% in real terms between 2010-11 and 2014-15. The NHS Five Year Forward View, published in October 2014, estimated that there would be a £30 billion gap between resources and patient needs by 2020-21 and set out proposed changes to the provision of healthcare services to meet this gap.
13. During 2015-16, there have been measures taken at a national level to tackle the immediate financial challenge faced by providers:
 - the Spending Review published in November 2015 announced an extra £5.4 billion available for NHS provider trusts in 2016-17. £1.8 billion comprises the Sustainability and Transformation Fund, of which £1.6 billion would be passed to NHS trusts and foundation trusts who conduct emergency care, and is conditional on those trusts agreeing and achieving their control totals for resource expenditure in 2016-17, and complying with associated conditions. £3.6 billion to be distributed via commissioning allocations and related budgets, meaning it is reflected in an overall uplift in tariff prices, which should result in higher income for providers.
 - In order to tackle the increasing level of temporary staff costs in the provider sector, NHS Improvement introduced caps on agency staff costs. NHS Improvement estimates that since the introduction of the agency cap, foundation trusts have saved £300 million. I have not validated this estimate and without data to understand the impact on staffing or activity levels, it is too early to evaluate the impact of these new measures.
 - The Department of Health has provided interim cash support to providers during the year. As noted in the “Review of NHS foundation trust financial performance 2015/16” section, the Department of Health has provided interim cash support. This support should normally precede a long term recovery plan.
 - In January 2016, Monitor and the NHS Trust Development Authority (TDA) wrote to all NHS providers instructing them to consider a number of areas in preparing their annual accounts, with a view to improving financial outturn. While some of this focused on identifying genuine savings, much of it focused on looking for one-off accounting adjustments which could improve the bottom line in 2015-16. While these adjustments are in line with accounting standards, the guidance was focused on finding adjustments with a positive impact, rather than a full review of all areas which could result in adjustments which have both a positive and negative impact on their final outturn position.

Addressing the financial challenge over the long term

14. In our December 2015 report, *Sustainability and financial performance of acute hospital trusts*, we found that the deterioration of the financial position of NHS trusts and NHS foundation trusts had been severe and worse than expected.

15. In January 2016, the Committee of Public Accounts (PAC) held a hearing with witnesses from the national bodies including the Department of Health, NHS England and NHS Improvement. The Committee's report, published in March 2016, concluded overall that "There is not yet a convincing plan in place for closing the £22 billion efficiency gap and avoiding a 'black hole' in NHS finances." and recommended "The Department of Health, NHS England and NHS Improvement should report to us jointly in September 2016 on their progress with implementing the NAO's recommendations and the further recommendations we make in this report."
16. I am aware that NHS bodies in England are working on their Sustainability and Transformation Plans, covering the period October 2016 to March 2021. Commissioners and providers of NHS and social care should be working together, across 44 geographical locations, to agree how they will provide healthcare services on a secure and balanced financial footing. In light of the immediate and long term financial challenges, these plans will need to be ambitious yet realistic in order to establish a firmer financial footing.
17. I will return to the issue of financial sustainability in the NHS in England in a report this autumn. This report will build on our previous work and examine whether the NHS is on track to achieve financial sustainability, focusing in particular on: the financial performance of NHS bodies; plans for long-term financial sustainability; and the actions taken by the Department and its arm's length bodies to support local NHS bodies to achieve financial sustainability.

Part two

Overview of my financial audit

18. Monitor, which is now part of NHS Improvement, is the legal entity responsible for authorising, monitoring and regulating NHS foundation trusts and, under the Health and Social Care Act 2012, for preparing the consolidated financial statements for NHS foundation trusts (the Consolidated Accounts). The Consolidated Foundation Trust statements are an aggregation of the 153 NHS foundation trusts which had been licensed during the year to 31 March 2016.
19. Monitor is not a 'parent' entity in the consolidation as defined under International Financial Reporting Standards. The Accounting Officer for Monitor does not have any responsibility for the foundation trust sector either collectively or for any individual foundation trust; this is the responsibility of each foundation trust's chief executive who is also the individual Accounting Officer.
20. Foundation trusts appoint their own external auditors, who are required to report to the foundation trust's council of governors and board of directors on the results of their independent audit of the financial statements. Foundation trust's annual reports and accounts are laid in Parliament. The external auditors for each individual trust are required to provide an opinion on the truth and fairness of the financial statements and to report whether or not they have been able to satisfy themselves that the foundation trust is using its resources economically, efficiently and effectively.
21. The individual external auditors are required to follow the Code of Audit Practice which I have issued under the Local Audit and Accountability Act 2014. Auditors plan and perform their audit in compliance with the requirements of the Code and with relevant professional and quality control standards. The auditor's work is risk-based and proportionate and is designed to meet the auditor's statutory responsibilities, applying the auditor's professional judgement to tailor their work to the circumstances in place at the audited body and the audit risks to which they give rise. The auditor conducts their work economically, efficiently and effectively, and in as timely a way as possible.
22. As the statutory auditor for the Consolidated Foundation Trust financial statements, I am required to report whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework and whether they are true and fair. Unlike the individual

foundation trust auditors, I am not required to provide an opinion on the economic, efficient and effective use of resources on the overall consolidated account. I instead use my reporting reports to report on the health sector. Unlike the foundation trust auditors, I am also required to provide a regularity opinion, to confirm whether or not the income and expenditure has been applied in accordance with Parliamentary intention.

23. I have certified the Consolidated Foundation Trusts with an unqualified opinion. In order to reach my opinion, I take a group audit approach as set out by the International Accounting Standard 600 *Special considerations - audits of group financial statements* and I consider the landscape of opinions across the Foundation Trusts. In particular, I have noted that all of the financial statements received unqualified true and fair audit opinions. There has however been an increase in the number of Emphasis of Matter paragraphs issued by the individual auditors. In 2015-16, 29 foundation trusts received Emphasis of Matters in their opinions compared to 21 in 2014-15. These related to going concern or financial performance whereby individual auditors judged that the disclosures were fundamental to the users' understanding of the financial statements and should therefore be highlighted. Monitor have set out their consideration in respect of going concern in note 1.23.

Conclusion

24. I have noted the focus of the Department of Health and national health bodies on addressing the immediate issue of financial outturn for 2015-16. This is set out in more detail in my report on the Department of Health resource account. As I have reported previously, the NHS faces an unprecedented financial challenge which requires long term strategic measures to address. The Department and its national bodies have taken steps toward developing longer term strategic plans over the period of the current Parliament. I will return to these challenges, reviewing the Department's process in developing and implementing these plans in my next report in the autumn.

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