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Setting NHS Entities Fees for 2008-09: Acute and Ambulance Trusts, and Local Health Boards

I am writing to you to inform you of the fee arrangements I have put in place to determine your 2008-2009 external audit fee. My Engagement Partners (and where I use a contractor firm, my Liaison Partners) will discuss the necessary details with your Director of Finance.

New factors affecting fees have arisen or are on the horizon: some relate to the proposals for NHS reconfiguration, and others are in response to developments in public audit in the UK. Changes to accounting and auditing standards' requirements are outside my control, but can be expected to have a significant impact this year, and in the future.

In the attachment to this letter I describe how these various factors can be expected to impact on the work required at NHS bodies in Wales now and in the medium-term future. In each case I set out my expectations for how Engagement/Liaison Partners should take these factors into account when setting fees. Due to the changes discussed in the attachment to this letter I am not promulgating a specific percentage fee increase this year. Your body's fee will be bespoke, considering the factors set out in this letter and attachment.

A further change from previous years is that, from 2008 I will conduct data matching exercises under my new statutory powers, inserted into the Public Audit Wales Act 2004 by the Serious Crime Act 2007. My aim will remain that of safeguarding public money against losses from fraud or misappropriation, while making an effective contribution to the wider fight against fraud and, potentially, other crime. Further details on data matching and the National Fraud Initiative (NFI) together with the proposed fees, on which I am required to consult, are also set out in the attachment to this letter.

Finally, I am minded to develop the value for money conclusion (the requirement that I satisfy myself that a body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources) by also providing alongside it an indication of the body's direction of travel, expressed as a brief narrative to reflect progress since the previous year's conclusion was provided. I would require auditors to produce the direction of travel narrative from the information already available to them and without incurring further cost to the body.

I remain very aware of the cost pressures on audited bodies as I seek to improve the value for money of NHS bodies and the efficacy of the audit process. The audit fee, however, must be sufficient to fund the work required considering local circumstances: such as size, the governance environment, risk, complexity, financial and performance management arrangements, and track record on improvement. It will also include (or make appropriate allowance for) the studies I intend to undertake or promote to improve economy, efficiency and effectiveness in services, and must take into account statutory and other requirements. My Compliance Partner will undertake a review of all fees proposed by Engagement/Liaison Partners, before they are confirmed with NHS bodies and challenge those that appear unusual.

I look forward to receiving your comments on my NFI and Value for Money Conclusion proposals, by 5 September 2008 which should be sent to my Chief Operating Officer, Anthony Snow, at the address/email noted above.

Yours sincerely

Jeremy Colman
Auditor General for Wales

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In this attachment the Auditor General for Wales describes a number of important factors that will impact on the work required at NHS bodies in Wales now and in the medium term future. In each case the Auditor General sets out his expectations for how Engagement/Liaison Partners should take these factors into account when setting bespoke fees.

I have reconsidered, and decided to continue, my voluntary adoption of the Welsh Assembly Government's efficiency agenda. Accordingly I have, again this year, instructed that a 1 per cent overall efficiency requirement be included in the fee setting process as part of my response to that agenda.

NHS reconfiguration will impact on the amount of audit work required. The reconfiguration proposals currently being considered envisage considerable change to the number of NHS bodies in Wales. Although such a change would obviously reduce the number of accounts to be audited, it should not be assumed that such a reduction would automatically translate into a pro-rata reduction in the total financial audit fee across Wales, even in the longer term. The smaller number of accounts is likely to lead to an increase in their complexity.

In the short to medium term, however, the number of sets of accounts can be expected to increase as both demising and newly created bodies will need to provide accounts for audit. Bodies in existence for part of a financial year will still need to provide full sets of accounts for audit covering the period up to their demise. Experience suggests that it will be the demising bodies' accounts that will present the greatest challenge for NHS bodies to compile as the tendency is to concentrate accounting resources on the new rather than the demising body.

The timing of the proposed reconfiguration will also coincide with the introduction of International Financial Reporting Standards (IFRS) across the public sector. Further information on IFRS implications is set out below, but IFRS will add a significant additional element of complexity, and inevitably cost, to the audit of demising and newly formed bodies' accounts.

The introduction of International Financial Reporting Standards (IFRS) will have a significant impact on workloads and fees. The Government announced in the 2007 Budget that with effect from 2008-09 the 'Whole of Government Accounts (WGA)' would be compiled on the basis of IFRS. The situation is fluid and developments are continuing to arise, but I outline below my current understanding of the proposals and best estimate of their impact on workload and fees.

In his March 2008 budget report, the Chancellor of the Exchequer announced that following consultations on the technical work needed to implement IFRS based accounts: *"the Government now intends to move to IFRS from 2009-10 to minimise burdens and to ensure a smooth transition. Whole of Government Accounts (WGA) will now also be published for the first time for 2009-10 to allow time to complete the alignment of local and central government accounting policies and to enable WGA to be published on an IFRS basis"*.

In addition the Treasury announced that public bodies whose accounts are based on the Financial Reporting Manual (FRM) would be expected to compile shadow IFRS based accounts for 2008-09 in addition to the United Kingdom Generally Accepted Accounting Principles (UK GAAP) based accounts. For 2008-09 therefore, two complete sets of accounts, as well as restated 2007-08 closing balances will need to be prepared by, and audited for, each body. The introduction of accounts based on IFRS will have a significant impact on workloads and therefore, unavoidably, on fees. I will continue to review the impact on fees of any further requirements issued by the Treasury and Welsh Assembly Government.

The implementation of IFRS is a fundamental change of approach not simply a presentational matter. Work pressure on both compilers of accounts and their auditors will be particularly acute during 2008-09, as bodies restate their opening balances, compile shadow accounts, as well as compiling UK GAAP based accounts. There will also be an ongoing requirement for additional accounting and audit work as a result of the more onerous IFRS accounting and disclosure requirements.

Public sector bodies, and their auditors, cannot be immune from the workload and fee implications of fundamental changes to the accounting requirements applied in the UK. Notwithstanding reports of IFRS having increased financial audit fees by 20 per cent in the commercial sector, and by around 10 per cent elsewhere in the UK public sector, my current estimate is that the introduction of IFRS will add between 6 per cent and 8 per cent to the financial audit fee for NHS bodies in Wales. I will update this estimate as developments arise.

IFRS will also impact on accounting for PFI. The Treasury is introducing the principles of the International Financial Reporting Interpretations Committee's (IFRIC) interpretation, IFRIC 12, into the IFRS based Financial Reporting Manual. IFRIC 12 is an interpretation of IFRS requirements relating to service concessions. It is generally accepted that applying IFRIC 12 principles will result in most PFI schemes appearing 'on' the balance sheets of NHS bodies in contrast to the current position, where most are 'off' balance sheet.

The adoption of IFRIC 12 principles will mean that each PFI arrangement entered into by an NHS body will need to be reviewed against IFRIC 12 requirements and included in the 2009-10 balance sheet and 2008-09 IFRS shadow accounts. Where schemes become 'on' balance sheet, complex prior period adjustments from the inception of the scheme may also be required.

I estimate that the introduction of IFRIC 12 principles will result in one-off additional audit charges:

- Initial review of on/off balance sheet treatment £1,500 to £3,000 per PFI scheme.
- Review of opening balances and prior year adjustment £2,000 to £5,000 per NHS body overall. The costs here will be driven largely by the complexity of the unwinding of the PFI deal(s) at each body. A key factor will be the length of time that a contract has already run, since every year's transactions may need to be unwound.

These estimates will need to be reviewed and refined by auditors in light of developments and any further guidance I issue as and when more information becomes available.

Professional remuneration inflation has for many years exceeded NHS fee increases – a reality that is sometimes not fully appreciated. I estimate that remuneration costs are rising by around 4.8 per cent across the financial and consulting services sectors. However, I consider that this inflationary increase should be capped when agreeing audit fees. Engagement/Liaison Partners should therefore include not more than 3.3 per cent for professional remuneration inflation in calculating fees – a 1.5 per cent saving, on this fee element, for NHS bodies to be found from audit and inspection efficiency gains.

Grant claim certification and other specialist work. In carrying out work in relation to government grant claims and other returns, and in certain other circumstances, Engagement/Liaison Partners may need to use staff with specialist skills in order to review specific local issues. It is essential that appropriate senior and specialist staff are used on the more complex parts of audits. Additional costs will inevitably be incurred. The actual fees charged will be agreed in discussion between the Engagement/Liaison Partner and the body.

Other ongoing developments in accounting and auditing professional standards continue to impact on audit workloads. Aside from the introduction of IFRS across the UK public sector, audit workload continues to increase as auditors are required to comply with changes to professional standards and the introduction of more complex audit and accounting requirements. Barring changes to current implementation timetables, my view is that the level of development applicable during 2008-09 is such that I should absorb any additional work and cost as an efficiency measure. Engagement/Liaison Partners will therefore not include any fee increase due to developments in accounting and auditing standards. The next significant changes to international auditing standards are expected to come through from 2010-11, which I will consider as part of that year's fee scale.

Direction of travel – part of the VFM Conclusion. The Value for Money Conclusion (the requirement that I satisfy myself that a body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources) has become an established part of the Annual Audit Letter.

I am minded to develop this reporting arrangement by also providing an indication of the body's 'direction of travel'. The direction of travel, in respect of its arrangements, would be drawn from the VFM Conclusion taking one year with another, and would be reported in the Annual Audit Letter alongside the VFM Conclusion. I propose a brief narrative to reflect the progress, or direction of travel, by the audited body since the previous year's conclusion was provided. The direction of travel narrative would comment on the body's arrangements in relation to the previous year i.e. whether they have improved, been maintained or deteriorated. Specifically for a body where there has been deterioration or previous weaknesses remain unaddressed the narrative would encourage the body to take action to improve the situation. For demising bodies the narrative would be directed to the successor body. If introduced, I would require auditors to produce the direction of travel narrative from the information already available to them and without incurring further cost to the body.

National Fraud Initiative. I intend that bodies in Wales should continue to take part in the National Fraud Initiative (NFI) – a computerised data-matching exercise. The NFI has shown that data matching is a powerful tool in reviewing local government bodies' arrangements to prevent and detect fraud. For the first time, NFI 2008-09 will be

undertaken under my new statutory data matching powers contained in the Public Audit (Wales) Act 2004, as amended by the Serious Crime 2007.

As I have acquired new powers I am taking the opportunity of this letter to provide an expanded section on the NFI. Under the new legislation, I may:

- carry out data matching exercises for the purpose of assisting in the prevention and detection of fraud, as part of an audit or otherwise;
- require certain bodies to provide data for data matching exercises. These comprise all NHS bodies (and all local government bodies as defined by section 12 of the 2004 Act including among others, unitary authorities, police authorities, fire and civil defence authorities, probation boards and probation trusts); and
- charge a fee to any body participating in a data matching exercise and must set a scale of fees for bodies required to participate.

I am required to prepare and publish a Code of Data Matching Practice. All bodies conducting or participating in my data matching exercises must have regard to the Code, including the Wales Audit Office.

Considerable progress has already been made to prepare for these new powers. Consultation on the new Code of Data Matching Practice is under way. The Audit Commission has also begun discussions, on their own and on my behalf, with stakeholders such as the Pensions Regulator, the Council for Mortgage Lenders and the Insurance Fraud Bureau to develop NFI to help all sectors in the fight against organised fraud.

In addition, in response to the Welfare Reform Act 2007, which gives local authorities powers to investigate and prosecute Income Support (IS)/Job Seeker Allowance (JSA) benefit offences, responsibility for assessing and determining the way forward for housing benefit cases involving IS/JSA will be passed back to local authorities. In order to allow a more effective assessment of NFI matches the Audit Commission is in discussion with the Department for Work and Pensions about integrating key intelligence given by the IS/JSA claimant, for example income declared and student status, into NFI.

The aim under the new arrangements is to ensure that while at all times upholding and protecting individuals' rights in relation to their personal data, the NFI continues to serve the public interest by safeguarding public money against losses from fraud or misappropriation; and making an effective contribution to the wider fight against fraud and, potentially, other crime.

The proposed fees for NFI 2008-09 are based on the number and range of core datasets applicable to each type of body. The proposed fees also reflect inflationary pressures and my proposal to expand the scope of the exercise by making mandatory those data matches which in NFI 2006-07 were optional and consolidating them into the set of core datasets for NFI.

Under these proposals NHS bodies (and local authorities) that have not taken up the optional matches in the past will face higher percentage increases in fees (although the nominal amounts will generally remain small), while most bodies that have taken them up will experience only an inflation uplift. However, for some types of body the minimum percentage increase will be higher (although, again, the nominal amounts are relatively

small) as the opportunity has been taken to realign the relative fees for different types of body. I consider that the fee increases are both reasonable and appropriate.

The report summarising the findings of NFI 2006-07 demonstrates how effective these optional data matches have been in identifying fraud. Fraud is a waste of public money that could otherwise be used to improve public services or reduce the call on taxpayers. The full list of core datasets for NHS Trusts and Local Health Boards is:

- Payroll;
- Pensions payroll;
- Trade creditors payment history and standing data.

The proposed fee is designed to recover the full costs of carrying out the proposed data matching, and to make a reasonable contribution to the overheads. If it appears that the work involved in a data matching exercise is substantially more or less than that envisaged I may charge the body a fee that is larger or smaller.

As noted earlier in this letter, costs are rising by around 4.8 per cent across the financial and consulting services sectors but I consider that this inflationary increase should be capped when agreeing NFI fees. Recognising the specialist nature of data matching work I propose to increase the fees for NFI 2008-09 by 4 per cent.

However, as noted above, it is proposed that the relative fees for different types of body are realigned and other changes will result in real terms increases in fees for some types of body, although the nominal amounts involved are relatively small. Specifically I propose to:

- Consolidate the previously optional modules into core NFI, namely residential care homes, blue badges, insurance and licences, following their highly successful introduction as risk based modules in NFI 2006-07. These extra datasets will incur extra handling and processing costs and these have been reflected in the new fee levels.
- Integrate the fee for the council tax single person discount module into the core NFI fee. In order to balance the workload for NFI participants these matches, which will now form a core NFI matching module, will be run in the year between the main matching exercise within the two yearly NFI cycle.

The NFI process has received significant investment to enhance the service provided to users, for example through:

- Enhanced security arrangements, by integrating a new electronic data file transfer facility into the secure web application, totally eliminating the need to submit CDs.
- Responding to requests from participating bodies for improved functionality of the NFI web application. These developments include improved management information, new facilities to share comments directly with matched bodies, and simplified presentation with key matches more prominent.
- The introduction of a new on line interactive training facility, making relevant material, including demonstrations and tutorial exercises, available for the duration of the initiative. This avoids the cost and environmental impact of audited bodies hosting

and/or sending employees to training events, and allows training to be undertaken at a time and place that is convenient to the user. In addition, unlike group training events, the interactive training software will be available throughout the NFI cycle and will allow all users to select the modules most relevant to them.

The proposed fees for NFI 2008-09 are £1,000 for NHS Trusts and Local Health Board. The NFI is run over a two year period, so the fee covers the two financial years 2008-09 and 2009-10 and will be billed in two equal annual instalments. I envisage that fees for NFI 2010-11 will be increased in line with inflation. However, I may wish to include new modules for the 2010-11 exercise, subject to obtaining Parliamentary approval of Orders to extend my data matching function into new non-fraud related areas and the completion of successful pilot exercises.

VAT. All 2008-09 fees will be subject to VAT which will be charged at the standard rate (currently 17.5 per cent) on all work done.