



A TENDER SUBJECT

Chris Wheal assesses how foundation trusts have used their new freedom to appoint auditors and talks to Michael Scott (above), head of the Audit Commission's Trust Practice, about how the commission has geared up for competition

CHOICE AND COMPETITION have burst into the world of financial audit in the NHS. So far, 19 of the early foundation trusts have taken up their new-found freedom to tender for auditors under the more narrowly defined audit standard they are required to use. And the shake-up has prompted the Audit Commission to revamp and re-organise its audit activities, setting up a new Trust Practice and bringing in a new chief, Michael Scott.

For mainstream NHS trusts, the commission appoints the auditors, handing about 65% of audits to its own direct team and the rest to approved commercial firms. Every decade or so, it considers appointing a fresh face to the audit of each trust, but not on a competitive basis and always with the commission setting the price.

With foundation trusts, all that changed. The audit regime is much narrower and more commercially based and, perhaps most importantly, the foundation trusts (technically their boards of governors) get to choose their own auditor and agree the price through normal commercial tendering arrangements and negotiation. The main condition set by regulator Monitor is that audit contracts last no more than five years.

Guy's and St Thomas' in London is typical of trusts that have tendered. 'The foundation trust audit code is quite a lot narrower than the NHS trust code, so the auditors have less to do,' explains John Dowell, head of internal audit at the foundation trust. 'In the first year, we just stayed with the Audit Commission but on a lower fee. We'd had the same auditors since the two hospitals



were combined into one trust in 1993, so we were probably due for a change anyway, but we achieved significant savings through tendering,' he says.

All the usual suspects made presentations and bids. 'It was very close. There wasn't a lot to choose between any of them, including the Audit Commission,' Mr Dowell says. 'In the end we went with Deloitte, partly because Deloitte already had foundation trust experience. The Audit Commission is still in doing the audit for last year but Deloitte will be in for the 2006/07 accounts.'

The foundation trust's audit committee will monitor the contract and recommend to the members' council (Guy's and St Thomas' name for its board of governors) whether or not to confirm the auditor each year. The

WHO AUDITS THE AUDITORS?

Audits of the first foundation trusts were of a 'sufficient high standard and suitable quality', according to an independent review. However, it did flag up a number of significant findings where errors were made. Foundation trust regulator Monitor called in the Quality Assurance Directorate of the Institute of Chartered Accountants in England and Wales to review a sample of 10 audits at the end of 2005. Its report was published at the end of April. It found that three of the 10 did not fully comply with the audit code and it made a raft of general recommendations to toughen up and clarify best practice. Among the mistakes it identified were:

Foundation trust 1

- A misclassification between fixed asset additions (£92,000 understatement), provisions (£369,000 understatement) and a corresponding misstatement of movement in creditors.
- A £360,000 charge regarding pension benefits to the former chief executive was not disclosed as part of his emoluments.
- The majority of the disclosure of £907,000 under provision for irrecoverable debts (non-NHS trade debtors) was in fact in relation to NHS trade debtors.

Foundation trust 2

- The cash flow statement did not cast by £1,000 (identified).
- The brought forward figures on fixed assets do not cast to the brought forward net book value by £3,000 (identified)
- The sub-analysis of brought forward land and buildings does not agree with the main fixed asset note by £1,000,000 (identified).
- In the notes to the accounts, the net book value of buildings instead of the cost was adjusted to the revalued amount at 31 March 2005, resulting in cost and depreciation both being overstated by £5,700,000. However, there was no effect on reserves in the current year.
- The public dividend capital note correctly disclosed the dividend of £3,311,000 and the effective rate of public dividend capital as a percentage of average relevant net assets as 4.1%. However, the average relevant net assets are incorrectly disclosed in this note as £86,617,000 instead of £80,383,000.
- The financial instruments note wrongly discloses £555,000 as 'other'; it should be 'sterling'.

Foundation trust 3

- The balance sheet incorrectly includes the Donated Asset Reserve of £6,953,000 within Taxpayer's Equity albeit that note 21 entitled Movement in Taxpayer's Equity correctly excludes the Donated Asset Reserve.
- Accounting policy 1.16 refers to the amount of Third Party Assets being disclosed in a separate note but they are not.

The review claimed: 'In some aspects of a few Statements of Auditing Standards (SASs), the documentation fell short of an acceptable level.' It found problems with six statements:

SAS 120 – Consideration of law and regulations

SAS 220 – Materiality of the audit

SAS 230 – Working papers

SAS 410 – Analytical procedures

SAS 500 – Considering the work of internal audit

SAS 610 – Communication of audit matters to those charged with governance.

initial contract is three years, but then Guy's and St Thomas' expects to fully re-tender.

Deloitte is not the only big firm making in-roads. The commercial firms have been picking up business across the country and mainly at the expense of the commission (see table overleaf).

Paul Dillon-Robinson, chair of the HFMA's Corporate Governance and Audit Committee, suggests the private sector experience of many foundation trust non-executives and governors plays into the hands of big-name firms. 'They are much more comfortable with private sector names

and less familiar with the Audit Commission,' he says, something the commission's Michael Scott accepts.

There's also the nature of the audit itself. As ever, foundation trusts find themselves facing a new set of rules when it comes to audit standards. The audit code can either be described as a public sector audit with something taken away, or a private sector audit with some public benefit factors thrown in. Either way, it's different to any other sort of audit that currently exists, which means the private firms are busy poaching staff from the Audit Commission to

WHO'S AUDITING WHO: TENDERS TO DATE

NHS foundation trust	Auditor prior to FT status	Auditor now in place
Basildon and Thurrock University Hospitals NHS Foundation Trust	Audit Commission	Audit Commission
Countess of Chester Hospital NHS Foundation Trust	Audit Commission	KPMG
Homerton University Hospital NHS Foundation Trust	Audit Commission	KPMG
Moorfields Eye Hospital NHS Foundation Trust	Deloitte	Deloitte
Royal Devon and Exeter NHS Foundation Trust	Audit Commission	PwC
The Royal Marsden NHS Foundation Trust	Deloitte	Deloitte
Cambridge University Hospitals NHS Foundation Trust	PwC	KPMG
Gloucestershire Hospitals NHS Foundation Trust	RSMi	RSMi
City Hospitals Sunderland NHS Foundation Trust	Audit Commission	PwC
Derbyshire Hospitals NHS Foundation Trust	Audit Commission	Audit Commission
Guy's and St. Thomas's NHS Foundation Trust	Audit Commission	Deloitte
Papworth Hospital NHS Foundation Trust	PwC	PwC
Sheffield Teaching Hospitals NHS Foundation Trust	Audit Commission	Audit Commission
University College London Hospitals NHS Foundation Trust	Audit Commission	PwC
Gateshead Health NHS FT	Audit Commission	Audit Commission
South Tyneside Healthcare NHS FT	Audit Commission	Audit Commission
Barnsley District Hospital NHS FT	Audit Commission	PwC
Frimley Park Hospital NHS FT	Audit Commission	PwC
Heart of England (formerly Birmingham Heartlands and Solihull) NHS FT	Audit Commission	PwC

Source: Audit Commission

secure the public sector skills they require and the commission is recruiting from the big firms to add a commercial edge.

The commission is making sure that competition between the potential auditors is hotting up. Mr Scott was parachuted in to reinforce the commission's team. A former trust chief executive and star of the NHS Modernisation Agency, Mr Scott arrived when the commission was in retreat.

'In the early days, the Audit Commission didn't win any foundation trust audits. As a result of that, I joined to create the Trust Practice to work with foundation trusts going through the process of becoming foundation trusts and to compete for the audits. We've won five of the last 10,' he says.

To put that in context, the commission has, so far, only retained its audit contracts in those five, suggesting the Trust Practice has made a difference. It has not yet won a contract that was previously with a commercial firm, although tendering has resulted in at least one commercial firm losing out to another. The Audit Commission's Leicester-based Trust Practice is committed to competing for every contract.

'Foundation trusts are achieving value for money in the prices they're getting – they are generally realising real savings of 10%-20% – and it has helped them think through governance issues,' Mr Scott says. 'What we find is that there are as many different styles of foundation trust as there are foundation



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trusts. The thing they have in common is a more businesslike approach. The non-execs are from a more commercial background. They see comparators in the FT top 250 rather than in the NHS. That's why we're augmenting our skills with new staff from the likes of PricewaterhouseCoopers and KPMG.'

It also means the commission has to tout itself around foundation trusts and trusts seeking foundation status to educate those with a purely commercial background about what it is and does. 'Non-execs new to the NHS don't have the exposure to what we can offer. We are an unknown quantity,' Mr Scott admits. In some cases the governors

themselves are driving the audit tendering process and in other cases they are listening to advice from executives.

One factor in Mr Scott's favour is that the Audit Commission is unlikely to face conflict of interest questions because it is unlikely to be bidding for significant commercial work from the foundation trusts it audits. 'A lot of the commercial firms will want to act as consultants and not restrict themselves to audit. With the possibility of foundation trust mergers, firms will be far more interested in merger and acquisition work and in the due diligence consultancy,' says Mr Dillon-Robinson. 'It is going to become an issue and we are unlikely to get involved in mergers and acquisition work,' confirms Mr Scott.

Including the five audit contracts the commission has won in open tender, the Audit Commission has contracts with 12 of the 35 foundation trusts that existed in May. But more foundations are to be announced in June and a further batch in the autumn, potentially swelling their ranks to more than 50 by the end of 2006. A further 25 NHS trusts are asking the secretary of state to support their applications from next year.

As with the early foundation trusts, the newcomers are unlikely to be in a hurry to tender for audit services. But once they have found their feet, they are likely to turn their attention in this direction. The competition for work is only going to get more intense.