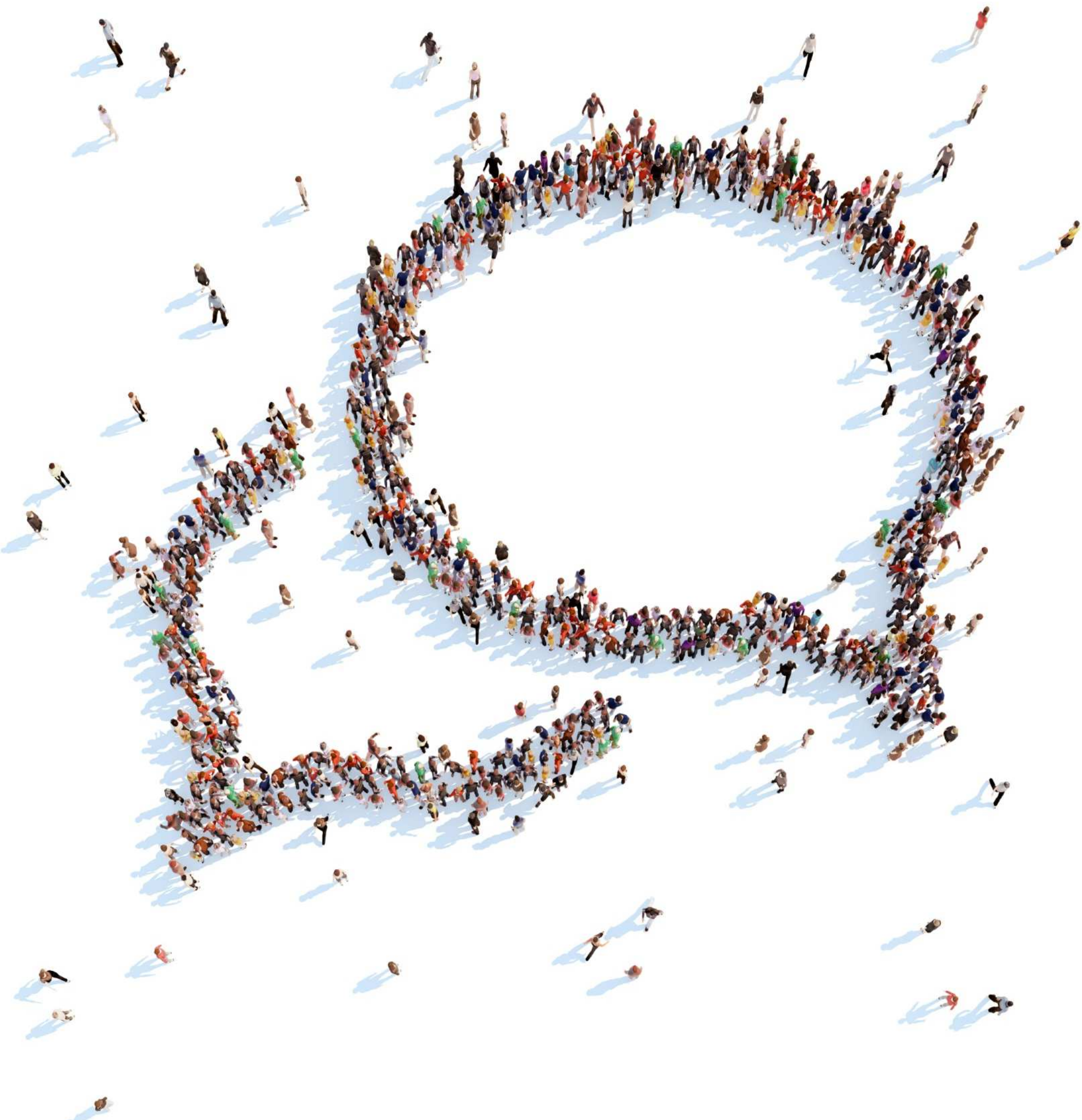
Annual Audit Letter

Southport and Ormskirk Hospital NHS Trust

Year ending 31 March 2018



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Reports and letters prepared by the auditor and addressed to the Trust are prepared for the sole use of the Trust and we take no responsibility to any member or officer in their individual capacity or to any third party.

1. EXECUTIVE SUMMARY

Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Southport and Ormskirk Hospital NHS Trust (the Trust) for the year ended 31 March 2018. Although this letter is addressed to the Trust, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of responsibility	Summary
Audit of the financial statements	Our auditor's report issued on the 25 May 2018 included our opinion that the financial statements give a true and fair view of the Trust's financial position as at 31 March 2018 and of its financial performance for the year then ended. However, given the financial performance of the Trust and the financial challenges going forward, we have highlighted, within our opinion, the material uncertainty related to Going Concern and our referral to the Secretary of State under section 30 of the Local Audit and Accountability Act 2014 (see below for further details).
Value for Money conclusion	On 25 May 2018 we issued an adverse Value for Money Conclusion opinion in respect of the Trust's arrangements to secure economy, efficiency and effectiveness in its use of resources. This was due to significant weaknesses in the Trust's arrangements for planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.
Reporting to the group auditor	In line with group audit instructions issued by the NAO, on 25 May 2018 we reported that the Trust's consolidation schedules were consistent with the audited financial statements.
Statutory reporting	**Referral to the Secretary of State under section 30 of the Local Audit and Accountability Act 2014** We have a duty under the Local Audit and Accountability Act 2014 to refer the matter to the Secretary of State if we have a reason to believe that the Trust, or an officer of the Trust, is about to make, or has made, a decision involving unlawful expenditure, or is about to take, or has taken, unlawful action likely to cause a loss or deficiency. On 25 May 2018, we issued a report to the Secretary of State for Health under section 30(b) of the Local Audit and Accountability Act 2014, as the Trust breached its statutory financial duty to breakeven over the three year period ending 31 March 2018. Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Trust.

2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements	**Unqualified**

The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Trust and whether they give a true and fair view of the Trust's financial position as at 31 March 2018 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Trust's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2018:

Financial statement materiality	Our financial statement materiality is based on 1.5% of Gross Operating Expenditure.	£2.783m
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£83k
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts: - Remuneration of Senior Managers	£10k

2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Trust's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit Committee within our Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Identified significant risk	Our response	Our findings and conclusions
Management override of controls In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits	We addressed this risk through performing audit work over: • accounting estimates impacting on amounts included in the financial statements; • consideration of identified significant transactions outside the normal course of business; and • journals recorded in the general ledger and other adjustments made in preparation of the financial statements.	There were no significant findings arising from our work on management override of controls.
Revenue Recognition Auditing standards (ISA 240) include a rebuttable presumption that there is a significant risk in relation to the timing of income recognition, and in relation to judgements made by management as to when income has been earned. The pressure to manage income to deliver forecast performance in a challenging economic environment increases the risk of fraudulent financial reporting leading to material misstatement and means that we are unable to rebut the presumption.	We evaluated the design and implementation of controls the Trust has in place which mitigate the risk of income being recognised in the wrong year. In addition we undertook a range of substantive procedures including: • testing of material income and material year end receivables; • testing receipts in the pre and post year end period to ensure they have been recognised in the right year; and • reviewing intra-NHS reconciliations and data matches provided by the Department of Health and if necessary seeking direct confirmation from third parties or their external auditors.	There were no significant findings arising from our work on revenue recognition.

Our response to significant risks (continued)

Identified significant risk	Our response	Our findings and conclusions
Valuation of Property, Plant and Equipment (PPE) Property Plan and Equipment are the Trust's highest value assets. In 2017/18, land, buildings and dwellings accounted for £109 million of the £121 million Property, Plant and Equipment balance. Management engage Cushman and Wakefield as an expert, to assist in determining the fair value of land and buildings to be included in the financial statements. Changes in the value of land and buildings may impact on the Statement of Comprehensive Income depending on the circumstances and the specific accounting requirements of the Department of Health and Social Care Group Accounting Manual (GAM).	We evaluated the design and implementation of controls to mitigate the risk. We also: • assessed the scope and terms of the engagement with Cushman and Wakefield; and • tested how management used the Cushman and Wakefield report to value land and buildings in the financial statements. • assessed and challenged the Cushman and Wakefield's methodology and their procedures to ensure objectivity and quality; and • considered regional valuation trends (provided by our valuation expert) to assess the reasonableness of the movement in valuations.	There were no significant findings arising from our work on the valuation of PPE.

2. AUDIT OF THE FINANCIAL STATEMENTS

Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls. We identified the following deficiencies in internal control as part of our audit.

Description of deficiency	Review of officer's declaration of interests highlighted that the Director of Finance declared that a close family member worked for Ernst and Young (EY). The Trust was involved in transactions in the year with EY however, this declared interest was not included within the original related party note but has been included in the revised financial statements as an agreed audit correction.
Potential effects	Related party relationships and transactions may be difficult to identify and report by an entity. Such transactions are subject to an increased risk of fraud as related parties may operate via an extensive and complex network of relationships and transactions may not be conducted on typical commercial terms. It is therefore crucial that adequate procedures are in place and that appropriate records are maintained and reviewed. The related parties note is considered material by nature due to the commercial sensitivity of such transactions and failure to review records can lead to an increased risk of material misstatement.
Recommendation	We recommend that the Trust maintains an adequate and up to date register of interests and that this is appropriately reviewed each year during the accounts production process to ensure all relevant related parties are appropriately disclosed.
Management response	The review of the register of interests will be built into the accounts preparation timetable in the future

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion	Adverse

Our approach to Value for Money

We are required to consider whether the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider. We are only required to report if we conclude that the Trust has not made proper arrangements.

The overall criterion is that, 'in all significant respects, the Trust had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties

Our auditor's report, issued to the Trust on 25 May 2018, outlined our qualified conclusion on the Trust's arrangements to secure economy, efficiency and effectiveness in its use of resources.

Sub-criteria	Commentary	Matters to report
Informed decision making	Our work has identified the Trust's arrangements include: • established governance structure and systems of internal control; • a risk management policy and arrangements for risk identification, validation, mitigation, monitoring and reporting; and • integrated performance, risk and assurance reporting.	None
Working with partners and other third parties	Our work has identified the Trust's arrangements include: • engagement in the Cheshire and Merseyside Sustainability and Transformation Plan (STP) and Mid Mersey Alliance; • active membership of Sefton Health and Care Partnership, a group of health and care organisations working to secure shared improvements to patient care and efficiency; and • significant research partnerships.	None

3. VALUE FOR MONEY CONCLUSION

Sub-criteria	Commentary	Matters to report
Sustainable resource deployment	In considering the Trust's arrangements for securing sustainable resource deployment, we identified the following matters: • The Trust incurred a deficit of £33.6 million in 2017/18 against an original planned deficit of £18.1 million. In December 2017, the Trust amended its planned deficit to £31.7 million, but due to adverse determinations and financial sanctions the Trust was unable to deliver this revised plan. The final outturn for 2017/18 resulted in an underlying cumulative deficit of £66.2 million as at 31 March 2018 - representing a breach of the Trust's statutory 'break-even' duty. • The Trust did not meet its original Cost Improvement Programme (CIP) target for 2017/18. The target set at the beginning of the year was £5.6m, of which only £3.65m was delivered. • The Trust has yet to develop a service delivery model, and organisational configuration, that is able to deliver sustainable services in the future. These have not yet been formalised into a comprehensive strategy, with accompanying detailed operational plans. • The Trust's 2018/19 Plan, submitted to NHS Improvement in April 2018, shows a deficit of £28.8 million after cost improvement plans of £7m. If the 2018/19 Financial Plan is delivered, it will take the Trust's cumulative deficit to £95m / over 58% of the Trust's operating income. As at April 2018, only 44% of the required £7m CIP / saving schemes have been identified. • The Trust was reliant on significant cash support of £30.8m from the Department of Health in 2017/18, and the 2018/19 plan includes significant further interim revenue support loans from the Department of Health. • The Care Quality Commission 2018 inspection report (issued in March 2018) provided an overall rating of 'Requires Improvement' and 'inadequate' in the Well Led domain. Whilst some improvements were noted from the previous 2015 and 2016 CQC reports, the Trust's overall CQC rating remained Requires Improvement in 2017/18.	These issues are evidence of significant weaknesses in the Trust's arrangements for planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.

3. VALUE FOR MONEY CONCLUSION

Significant Value for Money risks

The NAO's guidance requires us to carry out work to identify whether or not a risk to the Value for Money conclusion exists. Risk, in the context of our Value for Money work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Trust being inadequate. In our Audit Strategy Memorandum, we reported that we had identified one significant Value for Money risk. The work we carried out in relation to the significant risk is outlined below.

Risk	Work undertaken	Conclusion
Achievement of financial plan For 2017/18 the Trust set a financial plan of £18.1 million deficit, which was £3 million short of the control total set by NHS Improvement. The achievement of the planned financial performance is dependent on delivering a significant level of cost improvement plans (CIPs) of (£5.6 million). As at month 5, the Trust is reporting a year to date deficit of £13.64 million against a planned deficit of £9.14 million. The Trust were also reporting achievement of £0.77 million CIPs against a plan of £1.14 million. In October 2017, the Trust submitted a revised recovery plan to NHS Improvement. While the Trust has and continues to deploy significant resources and effort to tackle its financial performance there remains a risk that the Trust's arrangements are insufficient to achieve its financial plan for 2017/18.	To evaluate the Trust's arrangements for securing value for money in its use of resources we: • considered achievement of the 2017/18 financial plan; • reviewed the arrangements for delivering recurrent cost improvement schemes; and • challenged the underlying assumptions and rationale supporting the Trust's 2018/19 financial plan.	We completed our work as planned and found significant weaknesses in the Trust's arrangements for planning finances effectively. As highlighted above, the Trust incurred a deficit of £33.6m in 2017/18 against an original planned deficit of £18.1m. The final outturn for 2017/18 resulted in an underlying cumulative deficit of £66.2m as at 31 March 2018 - representing a breach of the Trust's statutory 'break-even' duty. The Trust did not meet its original Cost Improvement Programme (CIP) target for 2017/18. The target set at the beginning of the year was £5.6m, of which only £3.65m was delivered. The Trust's 2018/19 Plan shows a deficit of £28.8m after cost improvement plans of £7m. If the 2018/19 Financial Plan is delivered, it will take the Trust's cumulative deficit to £95m - over 58% of the Trust's operating income. As at April 2018, only 44% of the required £7m CIP / saving schemes have been identified. The Trust was reliant on significant cash support of £30.8m from the Department of Health in 2017/18, and the 2018/19 plan includes significant further support loans from the Department of Health. The Trust has yet to develop a service delivery model, and organisational configuration, that is able to deliver sustainable services in the future. These have not yet been formalised into a comprehensive strategy, with accompanying detailed operational plans.

4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	Matters to report
Governance Statement	No matters to report
Consistency of consolidation data with the audited financial statements	Consistent
Other information published alongside the audited financial statements	Consistent

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Trust's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

Matters which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- Issue a report in the public interest;
- Make a referral to the Secretary of State where we believe that a decision has led to, or would lead to, unlawful expenditure, or an unlawful action likely to cause a loss or deficiency is about to be taken, or has been taken; and
- Make written recommendations to the Trust which must be responded to publically.

On 25 May 2018, we issued a report to the Secretary of State for Health under section 30(b) of the Local Audit and Accountability Act 2014, as the Trust breached its statutory financial duty to breakeven over the three year period ending 31 March 2018.

We did not use our powers to issue a report in the public interest or to make written recommendations to the Trust.

We are also required to report if, in our opinion, the governance statement does not comply with the guidance issued by NHS England or is inconsistent with our knowledge and understanding of the Trust. We did not identify any matters to report in this regard.

Reporting to the NAO in respect of consolidation data

The NAO, as group auditor, requires us to report to them whether consolidation data that the Trust has submitted is consistent with the audited financial statements. We have concluded and reported that the consolidation data is consistent with the audited financial statements.

Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Trust. In our opinion, the information in the Annual Report is consistent with the audited financial statements.

5. OUR FEES

Fees for work as the Trust's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to audit committee in November 2017.

Having completed our work for the 2017/18 financial year, we can confirm that our final fees are as follows (including VAT):

Area of work	2017/18 proposed fee	2017/18 final fee
Delivery of audit work under the NAO Code of Audit Practice	£47,298	£49,098

The final fee is £1,800 (including VAT) more than planned due to additional audit work in relation to the Trust's managed service contracts which are accounted for as if they were Private Finance Initiative (PFI) schemes.

Fees for other work

We also provided non-audit services as follows (including VAT):

Area of work	2017/18 proposed fee	2017/18 final fee
Quality Accounts – external assurance on the Trust's Quality Account	£8,802	£10,602

The final fee is £1,800 (including VAT) more than planned due to additional audit testing required in relation to the Trust's venous thromboembolism (VTE) indicator.

6. FORWARD LOOK

Financial and operational challenges

The Trust continues to face significant financial pressures for 2018/19 reflecting local challenges and the continued national drive to re-establish financial control over the NHS provider sector.

The current NHS financial regime offers access to Provider Sustainability Funding (PSF) for trusts which agree to meet financial control totals set by NHS Improvement. The Trust did not agreed a control total for 2017/18 and has not agreed a control total 2018/19. As a result, the Trust will not have access to PSF funding in 2018/19 and may suffer other related NHS financial regime sanctions.

The Trust's 2018/19 Financial Plan shows a deficit of £28.8m after cost improvement plans of £7m. If the 2018/19 Financial Plan is delivered, it will take the Trust's cumulative deficit to £95m - over 58% of the Trust's operating income. However, the Trust has a poor track record of delivering it's financial and cost improvement plans and as at April 2018, only 44% of the required £7m saving schemes have been identified. The Trust will continue to be reliant on significant cash support loans from the Department of Health in 2018/19.

The Trust has yet to develop a service delivery model, and organisational configuration, that is able to deliver sustainable services in the future. These have not yet been formalised into a comprehensive strategy, with accompanying detailed operational plans.

The Care Quality Commission 2018 inspection report (issued in March 2018) provided an overall rating of 'Requires Improvement' and 'inadequate' in the Well Led domain. Whilst some improvements were noted from the previous 2015 and 2016 CQC reports, the Trust's overall CQC rating remained Requires Improvement in 2017/18.

All of the above represents significant financial and operational challenges for the Trust in 2018/19 and beyond. We will continue to review the Trust's financial and operational performance as part of our audit for 2018/19.

How we will work with the Trust

In the coming year we will continue to support the Trust by:

- continued liaison with Mersey Internal Audit Agency (the Trust's Internal Auditors) to minimise duplication of work;
- attending Audit Committee meetings and presenting an Audit Progress Report including updates on regional and national developments; and
- hosting events for staff, such as our NHS Accounts workshop.

The Trust has taken a positive and constructive approach to our work in our first year as your external auditors and we wish to thank the Board, Audit Committee, and Trust staff for their support and co-operation during our audit since our appointment.

We are committed to supporting the Trust as its external auditor. We will meet with the Trust to identify any learning from the 2017/18 audit and will continue to share our insights from across the NHS and relevant knowledge from the wider public and private sector.

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