Annual Audit Letter 2016/17

Southport and Ormskirk Hospital NHS Trust

26 July 2017

Contents

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This report is addressed to Southport and Ormskirk Hospital NHS Trust (the Trust) and has been prepared for the sole use of the Trust. We take no responsibility to any member of staff acting in their individual capacities, or to third parties.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Amanda Latham, the engagement lead to the Trust, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers (on 0207 6948981, or by email to andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

Introduction

Introduction

Background

This Annual Audit Letter (the letter) summarises the key issues arising from our 2016/17 audit at Southport and Ormskirk Hospital NHS Trust (the Trust). Although this letter is addressed to the directors of the Trust, it is also intended to communicate these issues to external stakeholders, such as members of the public. It is the responsibility of the Trust to publish the letter on the Trust's website at www.southportandormskirk.nhs.uk.

In the letter we highlight areas of good performance and also provide recommendations to help the Trust improve performance. We have reported all the issues in this letter to the Trust during the year and we have provided a list of our reports in Appendix A.

Scope of our audit

The statutory responsibilities and powers of appointed auditors are set out in the Local Audit and Accountability Act 2014. Our main responsibility is to carry out an audit that meets the requirements of the National Audit Office's Code of Audit Practice (the Code) which requires us to report on:

Financial Statements including the Annual Governance Statement	We provide an opinion on the Trust's accounts. That is whether we believe the accounts give a true and fair view of the financial affairs of the Trust and of the income and expenditure recorded during the year. We also confirm that the Trust has complied with the Department of Health (DoH) requirements in the preparation of its Annual Governance Statement. We also confirm that the balances you have prepared for consolidation into the Whole of Government Accounts (WGA) are not inconsistent with our other work.
Value for Money (VFM) arrangements	We conclude on the arrangements in place for securing economy, efficiency and effectiveness (value for money) in the Trust's use of resources.

Adding value from the External Audit service

We have added value to the Trust from our service throughout the year through our:

- Attendance at meetings with members of the Executive Team and Audit Committee to present our audit findings, broaden our knowledge of the Trust and to provide insight from sector developments and examples of best practice;
- A proactive and pragmatic approach to issues arising in the production of the financial statements to ensure that our opinion is delivered on time;
- Incorporation of data analytics into our programme of work to, for example, identify high risk journals for testing; and
- Building a strong and effective working relationship with Internal Audit to maximise assurance to the Audit Committee, avoid duplication and provide value for money.

Introduction (cont.)

Fees

Our fee for 2016/17 was £50,873 excluding VAT (2015/16: £50,873). This was in line with the fee agreed at the start of the year with the Trust's Audit Committee.

We are currently going through approval with the Trust, and the PSAA, to raise an additional fee of £1,426 in relation to the additional local audit work required for our Value for Money conclusion during 2016/17. This is consistent with the additional fee agreed with PSAA in 2015/16.

We have also completed the following pieces of work at the Trust during the year:

External assurance on the Quality Account	In line with Department of Health guidance, we conducted our external assurance work on the Quality Account in order to provide a signed limited assurance opinion on the content of the Quality Account, in addition to two mandated performance indicators, for inclusion in the Trust's 2016/17 Quality Account. The fee for this work was £9,500.

Acknowledgement

We would like to take this opportunity to thank the officers of the Trust for their continued support throughout the year and over the course of our appointment as the Trust's external auditors, which has concluded with the 2016/17 audit.

Headlines

Headlines

This section summarises the key messages from our work during 2016/17.

Value for Money (VFM) conclusion	We are required to report to you if we are not satisfied that the Trust has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We concluded that the Trust has not put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the following reasons: — The Trust incurred a deficit of £20.7 million in 2016/17 against an original planned deficit of £12.7 million. During 2016/17, the Trust agreed to amend the planned deficit to £20.7 million, which was delivered. This resulted in an underlying cumulative deficit of £33.2 million as at 31 March 2017. — The Trust did not meet its original Cost Improvement Programme (CIP) target for 2016/17. The target set at the beginning of the year was £6.4m, of which only £4.1m was delivered, with over half of this delivery made up of non-recurrent schemes. — The Trust incurred agency expenditure of £11.7 million in 2016/17 against planned expenditure of £7.2 million. This exceeded the agency ceiling set by NHS Improvement. — 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 plan, submitted to NHS Improvement, shows a deficit for 2017/18 of £18.1 million indicating a potential breach of the Trust's statutory 'break-even' duty. — The Trust was reliant on significant cash support of £20.7m from the Department of Health in 2016/17, and the 2017/18 plan includes significant further interim revenue support loans from the Department of Health. — Although some improvements were identified by the Care Quality Commission in its 2016 inspection report in areas rated as Inadequate or Requires Improvement in the previous 2015 CQC report, the Trust's overall CQC rating remained Requires Improvement in 2016/17.
Value for Money conclusion risk areas	We undertook a risk assessment as part of our VFM audit work to identify the key areas impacting on our VFM conclusion and considered the arrangements you have put in place to mitigate these risks. Our work identified the following significant risks: **Risk 1: Management of the Trust's cash position** As at the 31st March 2016, the Trust had £1.0m of cash and cash equivalents. The Trust applied for a new uncommitted revenue support loan during 2016/17, of which a total of £20.7m was drawn down by the end of the year. Failure to effectively manage working capital and liquidity impacts on the Trust's ability to fund itself and ultimately to deliver its services, which means that the cash position remains a VfM risk and area of focus. With regard to our key VfM conclusions, we are satisfied that the actions taken by the Trust in response to the identified liquidity issues early in 2016/17 demonstrate that it has made arrangements to secure the Trust's liquidity during 2016/17. The temporary resolution of the Trust's immediate liquidity concerns ensured its ability to meet its capital programme, service the deficit delivered in 2016/17, and pay its creditors as its liabilities fall due. However, there is a wider issue regarding the long term viability of the Trust, as set out under VFM risk three. *Continued overleaf.*

Headlines

This section summarises the key messages from our work during 2016/17.

<table>
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<td>Value for Money conclusion risk areas</td>
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Risk 2: Trust governance and turnover of key management personnel
The Trust experienced a significant amount of turnover and interim appointments of key management personnel, including in 2016/17 in the positions of Chief Executive, Director of Nursing and Chief Operating Officer, as well as the Trust Chair and Director of HR.
We reviewed the Trust's arrangements for ensuring stable leadership of the Trust during 2015/16 and found these to be satisfactory. However, there remains an ongoing risk around the governance of the Trust, and the ability of the Trust Board to provide stable leadership, during this period of high turnover.
Our work on the VFM risk regarding financial sustainability indicates that the level of turnover at Board level and the number of interim appointments has impacted on the level of Executive challenge over CIP achievement during 2016/17 within the operational CBUs. There has been very limited progress with the implementation of specific CIP programmes, which has been offset partially by over-performance on other programmes. It is anticipated with a largely substantive Executive team going forward, this level of challenge will improve for 2017/18 and beyond.
However, we are satisfied that the Trust put proper arrangements in place during 2016/17 to bring experienced and stable leadership to the Trust, including the introduction of suitable interim appointments through discussion with NHS Improvement. As at 31 March 2017, all Executive Director posts are filled with substantive appointments, with the exception of Chief Executive.
Risk 3: Financial sustainability and delivery of Cost Improvement Programmes
At the start of the financial year the Trust planned for a full year deficit of £12.7m, excluding planned Sustainability and Transformation funding of £6.1m. During the year, the Trust moved away from plan, and by month had delivered a year-to-date deficit of £13.0m, which represented an unfavourable variance against the year to date plan, excluding the impact of STF funding, of £3.2m. Due to the in-year financial and operational performance, the Trust did not receive any STF funding for 2016/17.
From a Value for Money perspective, the Trust faced a challenge to meet its forecast position. Key to this is the ability to make substantial savings whilst maintaining high standards of quality and performance delivery. This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VfM conclusion.
The Trust experienced significant unfavourable variances against the original financial plan throughout 2016/17, resulting in a year-end deficit of £20.7m against an original planned deficit of £12.7m. This year-end deficit was in line with the revised forecast outturn, the approval of which was reached through a formal process during the year, which included sign-off by the Trust Board. No formal financial recovery plan was requested by NHSI during 2016/17, although NHSI undertook a financial investigation in December 2016 and made a series of recommendations to the Trust for improvements to its systems and processes.
We concluded that the Trust failed to exercise adequate financial grip during 2016/17. Unlike in 2015/16, where a financial recovery plan was implemented along with a revised control total – which the Trust met, after adjustments for non-planned penalties imposed by commissioners – the financial position in 2016/17 deteriorated month-on-month, with limited arrangements – aside from the expenditure controls outlined above and achievement of some non-recurrent CIP savings – to recover the Trust's financial position.
The Trust continued to have difficulties in controlling spend on nursing and medical agency staffing. A target spend for 2016/17 of £7.2m was set by NHS Improvement, against which the Trust spent £11.7m. While the Trust put in place arrangements to increase the number of shifts worked by bank staff rather than agency, in addition to a host of other controls, the Trust operated with a significant number of vacancies which needed to be filled in order to maintain safe staffing levels, resulting in this overspend on agency costs, and on pay costs more generally.
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Headlines

This section summarises the key messages from our work during 2016/17.

Value for Money conclusion risk areas	**Risk 3: Financial sustainability and delivery of Cost Improvement Programmes (continued)** As at 31 March 2017, it was clear that the Trust has not put in place proper arrangements to deliver sustainable services to the local population. While progress had been made to decide upon a service delivery model, and organisational configuration, that would deliver sustainable services in the future, this had not yet been formalised into a comprehensive strategy, with accompanying detailed operational plans. The Trust recorded a deficit of £20.7 million in 2016/17, resulting in a cumulative deficit of £33.2m at the end of 2016/17, the second year in which a cumulative deficit has been delivered. The Trust submitted a planned deficit plan of £18.1 million to NHS Improvement for 2017/18. Therefore, all available evidence indicated that the Trust will deliver a deficit over the three-year period from 2015/16 – 2017/18, which is in breach of the Trust's statutory duties to deliver a break-even position over any given three-year period, commencing with the first period in which a cumulative deficit was delivered (in the Trust's case, 2015/16). As we became aware that the Trust had embarked on a course of action that would result in the unlawful making of a cumulative deficit over this three year period, we were required by law to make a referral to the Secretary of State, in what is referred to as a Section 30 referral letter. We made this referral before the issuing of the certificate of completion of the audit. As a result of the conclusions outlined above, we were unable to satisfy ourselves that the Trust had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.
Financial Statements audit opinion	— We issued an unqualified opinion on the Trust's accounts on 31 May 2017. This means that we believed the accounts gave a true and fair view of the financial affairs of the Trust and of the income and expenditure recorded during the year. — There were no significant matters which we were required to report to 'those charged with governance'. — We received complete draft accounts by 24 April 2017 in accordance with the Department of Health's deadline. The working papers provided to support the draft financial statements were generally of a high standard. We would like to commend the Trust's finance staff, who were available throughout the audit visit to answer our queries.
Financial statements audit work undertaken	— We are required to apply the concept of materiality in planning and performing our audit. We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. Our materiality for the audit was £3.0 million (2015/16: £3.0 million). We identified the following risk of material misstatement in the financial statements as part of our External Audit Plan 2016/17: **Risk 1: Valuation of Land and Buildings** As at 31 March 2016, the value of land and buildings in the financial statements was £101.3m. The Trust did not undertake a formal revaluation of its land and building assets during 2015/16. As there is a requirement for the year-end estimate of market valuation to be kept up to date, the Trust commissioned a 'desktop' valuation of its land and building assets as at 1 January 2017. *Continued overleaf*

Headlines (cont.)

Financial statements audit work undertaken (continued)

Risk 1: Valuation of Land and Buildings (continued)

Our audit procedures included:

- **External Valuer:** We assessed the competence, capability, objectivity and independence of the Trust's external valuer and considered the terms of engagement of, and the instructions issued to, the valuer for consistency with the requirements of the Department of Health Group Accounting Manual 2016/17;
- **Valuation basis:** We critically assessed the appropriateness of the valuation bases and assumptions, including the indices utilised by the Trust's external valuers in conducting the 'desktop' valuation.
- **Accounting movements and disclosures:** We undertook work to understand the basis upon which movements in the valuation of land and buildings were identified and treated in the financial statements and determined whether they complied with the requirements of the Department of Health Group Accounting Manual 2016/17.
- **Impairments:** We confirmed the impairment of £393k to the Trust's Fixed Asset Register and to the valuation report provided by Cushman and Wakefield. We also reviewed the Trust's approach to identifying indications of impairments. This included receiving a formal confirmation from the Trust that possible indications of impairment have been considered and no such indications identified, aside from the building assets already impaired.

We completed the above audit procedures and did not identify any audit misstatements or matters which we needed to bring to the attention of 'those charged with governance'. We concluded that the Trust's valuers, Cushman and Wakefield, had the necessary competence and independence to provide a robust estates valuation. We reviewed the assumptions adopted by the valuer and concluded that these were reasonable. The Trust implemented the 'desktop' valuation as at 1 January 2017 in its fixed asset register, and the revaluation gain of £5,455k and the impairment of £393k recorded within the financial statements were consistent with the expert valuation report provided.

Risk 2: Recognition of NHS income and NHS receivables

Contract income is agreed with CCGs and NHS England based on expected activity levels, however billing is based on actual activity. Over or underperformance is agreed with the relevant commissioner at the end of the year based on submitted activity. CQUIN income is based on the delivery of quality targets. At the beginning of 2016/17, The Trust had a Sustainability and Transformation funding envelope of £6.1m, based on the delivery of KPIs – with 70% of the STF based on achievement of the financial control total agreed with NHSI and 30% based on achievement of operational trajectories for key performance indicators agreed with NHSI. Due to non-achievement of the deficit control total for 2016/17, no STF funding has been received during the year.

Our audit procedures included:

- Reviewing the information provided by the Trust as part of the 2016/17 Agreement of Balances (AoB) exercise to ensure it is consistent with the information in the accounts;
- Identifying any mismatches with commissioners and seeking explanations for the mismatches from the Trust;

Continued overleaf.

Headlines (cont.)

Financial statements audit work undertaken (continued)	**Risk 2: Recognition of NHS income and NHS receivables (continued)** — Agreeing any disputed income or receivables to documentation which supports the Trust's estimates, including contract documentation and evidence of the achievement of required activity levels or performance measures; — Ensuring any adjustments to balances agreed with other NHS organisations are reflected in the accounts; and — Agreeing any material accrued or deferred income balances to documentation to confirm they were recorded appropriately. We did not identify any issues from the completion of this work. We reviewed the income and receivable Agreement of Balances mismatches with other NHS organisations. There were no material mismatches or disputes with other organisations. For those which were greater than our reporting threshold and/or that above which we are required to report to the National Audit Office, we obtained sufficient appropriate audit evidence that the income recognised by the Trust (and any accrued income or receivable balance recognised at year end) were reasonable. We are therefore satisfied that the risk of material misstatement associated with recognition of NHS income, including the associated fraud risks, are reduced to an acceptable level.
Annual Governance Statement	— We also confirmed that the Trust complied with the Department of Health requirements in the preparation of the Trust's Annual Governance Statement. We made a number of comments on the draft Annual Governance Statement and worked closely with the Trust to ensure that the final Statement was fully compliant with these requirements.
Recommendations	— We are pleased to report that there were no high-risk recommendations arising from our 2016/17 audit work. — The Trust has been good at implementing agreed audit recommendations from prior years. There were no prior year recommendations which required further actions by management at the time of our final audit in May 2017.
Public Interest Reporting	We have a responsibility to consider whether there is a need to issue a public interest report or whether there are any issues which require referral to the Secretary of State. **Section 30 Referral** The Trust recorded a deficit of £20.7 million in 2016/17, resulting in a cumulative deficit of £33.2m at the end of 2016/17, the second year in which a cumulative deficit has been delivered. The Trust submitted a planned deficit plan of £18.1 million to NHS Improvement for 2017/18. Therefore, all available evidence indicated that the Trust will deliver a deficit over the three-year period from 2015/16 – 2017/18, which is in breach of the Trust's statutory duties to deliver a break-even position over any given three-year period, commencing with the first period in which a cumulative deficit was delivered (in the Trust's case, 2015/16). As we became aware that the Trust had embarked on a course of action that would result in the unlawful making of a cumulative deficit over this three year period, we were required by law to make a referral to the Secretary of State, in what is referred to as a Section 30 referral letter. We made this referral on 30 May 2017.

Appendices

Summary of our reports issued

Audit Plan

(January 2017)

The Audit Plan set out our approach to the audit of the Trust's Value for Money arrangements and Financial Statements (including the Annual Governance Statement).

Audit Report

(May 2017)

The Audit Report provides our audit opinion for the year, the Value for Money conclusion, and our Audit Certificate.

Report on Quality Accounts

(June 2017)

This Report confirms the findings of our work in regard to the Trust's Quality Accounts and the indicators selected for review.

2017

January

February

March

April

May

June

July

August

September

October

November

December

Audit Highlights Memorandum

(May 2017)

The Audit Highlights Memorandum provides details of the results of our audit for 2016/17 including key issues and recommendations raised as a result of our observations.

We also provided the mandatory ISA260 declarations as part of this report.

Annual Audit Letter

(July 2017)

This Annual Audit Letter provides a summary of the results of our audit for 2016/17.