Annual Audit Letter 2015-16

Southport and Ormskirk Hospital NHS Trust

13 July 2016

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 2015-16 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 included a summary of our key recommendations in Appendix A. 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 B.

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.
Use of Resources (UoR)	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 capturing payroll and accounts payable routines; 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 2015-16 was £51,975 excluding VAT (2015-16: £72,618). This fee was in line with that highlighted within our audit plan agreed by the Audit Committee in January 2016 (£50,873), plus an additional fee variation of £1,102 in connection with additional local work required for our conclusion on the Trust's VfM arrangements. Our fees are set nationally by Public Sector Audit Appointments Ltd and reflect significant 25% reductions made nationally to scale fees.

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 2015/16 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.

Headlines

Headlines

This section summarises the key messages from our work during 2015-16.

Overall financial results and other key messages	The trust's outturn position for 2015-16 was a £17.2 million deficit, including CQUIN penalties and other fines by commissioners of £2.7 million. The underlying deficit for 2015/16, excluding these penalties and after adjusting for non-recurrent PDC 'capital to revenue' transfer revenue, is £15.0, which is a significant deterioration compared to the original planned deficit for 2015/16 of £10.7 million. The original plan for 2015/16 did not include any penalties or fines. Following establishment of the FRP in November 2015, and in particular the identification of a range of additional income and cost improvement schemes to reduce the deficit from the 'worst case scenario' position for 2015/16, a significant element of financial grip was restored. This resulted in an underlying variance, after allowing for fines and penalties agreed as not to be included in comparison with the forecast deficit, of c. £250k. The Trust overspent significantly on agency costs during 2015/16. The Trust spent £11.7m on agency staff in 2015/16 as per the March 2016 Board Finance report, against a plan of £1.3m. While the Trust has implemented a number of controls over agency spend as part of is financial recovery plan, the overspend on agency costs has continued to be significant. In January 2016, the overspend on agency staffing in total was £0.8m, in February it was £1.0m and in March the overspend was £1.2m. The Trust has delivered below the original CIP target for 2015/16. The target set at the beginning of the year was £8.6m. The actual performance against this target was £7.2m, which was £1.4m behind plan.
Use of Resources conclusion	We concluded that the Trust has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, except for: ▪ The original planned deficit of £10.7m for 2015/16 was revised in Quarter 3, to a re-forecast position of £14.75 million excluding penalties, which was agreed with the TDA. The deterioration in the trust's financial outturn between the original and revised planned outturn was due to unfavourable variances in commissioner income, unplanned increases in expenditure (particularly around agency staff costs) and delays to the establishment and approval of the cost improvement programme. Whilst the Trust went on the achieve the re-forecast position due to the delivery of agreed CIPs and a financial recovery plan in the second half of the year, the year end deficit is indicative of inadequate arrangements to deploy resources in the first two quarters of 2015/16. ▪ Further, we have concerns regarding the arrangements put in place by the Trust, as at 31 March 2016, to devise a sustainable plan for service delivery in the future. We note that the Trust has established an outline vision in partnership with local stakeholders, including Southport and Formby CCG. However, this has not yet been fully developed into a clear and robust strategy, supported by operational plan and financial forecasts, to which the Trust Board and external stakeholders have committed. ▪ Lastly, the Trust's 2016/17 plan indicates a forecast deficit of £6.6 million. While this represents an improvement on the outturn for 2015/16, the scale of this deficit together with the 2015/16 outturn means that there is a significant risk that the Trust will breach its statutory break-even duty for the period 2015/16 – 2017/18. These issues are evidence of weaknesses in proper arrangements for planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.

Headlines (cont.)

Use of resources 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 - Financial standing and delivery of QEP targets, including recovery plans** At the start of the financial year the Trust planned for a full year deficit of £10.7m, including planned achievement of a Quality and Efficiency Programme of £8.6m. In the year to month 7, the Trust had achieved a deficit of £10.3m, which represented an unfavourable variance against the year to date plan of £3.3m. CIP achievement up to month 7 was also £432k behind plan. In order to address this slippage, we were aware that the Trust had established a detailed recovery plan which includes a reforecast full-year deficit of £14.75m, which was still subject to TDA approval at the time. However, there remained a significant risk to the delivery of this reforecast position given the performance in the first six months, principally around controlling expenditure, with spend on staff agency costs representing a particular challenge. Our response to this Value for Money risk included: ▪ Performing a detailed review of the reasons for the difference between the original planned surplus for 2015/16 and the amount re-forecast; ▪ Reviewing the plans put in place to improve the Trust's financial performance during 2015/16 (financial recovery plan) and assessing whether these plans represented proper arrangements to deliver upon the revised forecast control total; ▪ Analysing the key contributing factors, and understanding the steps taken by management to remedy the financial position; ▪ Reviewing internal reporting regarding the Trust's deficit to gain assurance the Trust Board was able to make informed decisions; ▪ Reviewing the Trust's processes for identification, monitoring and delivery of CIP/QEP schemes during the year; and ▪ Reviewing the Trust's response to agency spending caps introduced during 2015/16, and more generally the implementation of controls in place over agency spending within the Trust, to ensure that these were sufficiently robust and adequate. *Conclusion* Taking into account our findings as a whole in connection with this Value for Money risk, we have concluded that we are required to report by exception on the Trust's limited control over its financial performance and position during 2015/16. While we recognise that a significant element of grip was restored in the second half of the financial year, and acknowledge the achievement of significant additional cost improvement programmes in connection with the Trust's established financial recovery plan, it was evident that there was a lack of financial control in the period from April 2015 – September 2015, which resulted in a significant adjustment to the forecast deficit for 2015/16. Since our VfM conclusion covers the entirety of the 2015/16 period, we have concluded that it is appropriate to report this matter, by exception, as part of this conclusion, as it represents a weakness in the Trust's arrangements for planning finances effectively, to support the sustainable delivery of strategic priorities and maintain statutory functions.

Headlines (cont.)

Use of resources risk areas	

Use of resources risk areas

Risk 2 - Liquidity and overall cash position

The Trust continues to face challenges with regard to its liquidity. The cash-holding target as at 31 October 2015 of £1m was achieved and exceeded, with a month-end cash balance of £2.2m. However, the impact of further operating deficits in the remaining months of 2015/16 indicated that further cash support would be needed in order to meet the Trust's working capital requirements.

The Trust had already taken actions to mitigate this, including engaging with the TDA and negotiating a rescheduling of commissioner payments on more favourable terms for the Trust. The next step was attendance at an 'escalation' meeting with the Department of Health, at which the Trust's detailed cashflow and recovery plans would be subject to further scrutiny. These plans would need to include closer working with other health economy partners, particularly the relevant CCGs, to eliminate deficits in the long term.

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.

Our response to this Value for Money risk included:

- Reviewing the Trust's working capital and cash flow forecasts for the coming 12 months;
- Discussing with management and the Director of Finance the action plans in place to restore the Trust's liquidity; and
- Analysing any applicable correspondence with the Trust Development Authority and the Department of Health regarding the provision of cash support, the expectations of these external stakeholders with regard to the provision of further support in the future, and the Trust's own plans for sustainable liquidity in the future.

Conclusion

The actions taken by the Trust in response to the identified liquidity issues early in 2015/16 demonstrate that it has made arrangements to secure economy, efficiency and effectiveness in its use of resources; and

The temporary resolution of the Trust's immediate liquidity concerns and reinstated ability to meet its capital programme, service the planned deficit in 2015/16, and pay its creditors as its liabilities fall due demonstrate that the Trust has secured adequate financial resilience, in the context of the variety of other challenges it faces.

Risk 3 - Future strategy and financial plans

In addition to the points outlined on the preceding pages with regard to financial performance during 2015/16 and the cash/liquidity position at 31 March 2016, there is a clear risk with regard to the Trust's sustainability in the future. This has already been identified by the Trust in its Corporate Risk Register, which recognises that the Trust does not have a viable medium to long term strategy for sustainable delivery of healthcare services.

There is a clear risk that Trust does not currently have a viable and sustainable plan for the coming 3-5 years which does not involve the significant reliance on cash support from DH. There is therefore a significant risk around the arrangements in place at the Trust 'to achieve planned and sustainable outcomes for taxpayers and local people', regardless of its ability to put in place these arrangements and the various external factors and restrictions with regard to problems in the wider health economy.

Continued overleaf.

Headlines (cont.)

Use of resources risk areas	**Risk 3 - Future strategy and financial plans (continued)** Our response to this Value for Money risk included: ▪ Reviewing the Trust's current medium term financial plan for 2016/17 and beyond; ▪ Discussing with management and the Director of Finance the key factors considered in creating this medium term financial plan; ▪ Analysing the Trust's future plans in terms of the extent to which they represent proper arrangements to deliver sustainably into the future; and ▪ Understanding and documenting the plans of the Trust to respond to changes in community service provision, and how this has been built into these plans. *Conclusion* Taking each key finding in connection with this Value for Money risk together, we have concluded that we are required to report, by exception, on the current limitations in the Trust's arrangements to establish a sustainable long-term strategy and operational plan. While we recognise the significant work ongoing to develop such a strategy, the nascent status of the Trust's vision indicates that the Trust's plans for long term sustainable resource deployment are currently limited.

Headlines (cont.)

Financial Statements audit opinion	— We issued an unqualified opinion on the Trust's accounts on 1 June 2016. This means that 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. — There were no material adjusted or unadjusted audit differences that identified as part of the audit. — There were no significant matters which we were required to report to 'those charged with governance'. — We agreed presentational changes to the accounts with Finance, mainly related to compliance with the Department of Health Group Manual for Accounts (MfA) 2015/16.
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 £3.0m (2014/15: £3.0m). — We identified the following risk of material misstatement in the financial statements as part of our External Audit Plan 2015/16: — **Risk 1 – Valuation of land and buildings** In order to gain assurance over the valuation within the financial statements of the Trust's land and building assets, we have completed the following procedures: ■ assessed the competence, capability, objectivity and independence of the Trust's external valuer and considered the information provided to the Trust in 2015/16, to inform its assessment of market value movements, for consistency with the requirements of the NHS Manual for Accounts 2015/16; ■ critically assessed the calculation of market value indices movements completed by the Trust, including a re-performance of this calculation to confirm that no material movement in the value of land and building assets is indicated; ■ appraised the Trust's formal consideration of impairment indicators within its estate, including the process undertaken and the adequacy of the formal, written decision document arising therefrom; and ■ considered the adequacy of the disclosures about the key judgements and degree of estimation involved in concluding that there has been no material movement in the value of land and buildings since 31 March 2015. We did not identify any issues or errors in connection with this significant risk for 2015/16. — **Risk 2 - Recognition of non-NHS income** In order to gain assurance over the valuation within the financial statements of the Trust's land and building assets, we have completed the following procedures: ■ performing detailed testing of all material non-NHS income categories, including the assumptions used to accrue income at the year end. We performed a predictive analytical review of other income to gain assurance over completeness of non-NHS income; and ■ We will complete thorough cut-off testing of non-NHS income transactions recognised around year-end, to confirm that allocation of income to the appropriate period has been completed correctly. We did not identify any issues or errors in connection with this significant risk for 2015/16.

Headlines (cont.)

Annual Governance Statement	— We have also confirmed that the Trust have complied with the Department of Health requirements in the preparation of the Trust's Annual Governance Statement (AGS). — We provided feedback on the format and content of the AGS, with some amendments made to the final Statement.
Whole of Government Accounts	— We issued an unqualified Group Audit Assurance Certificate to the National Audit Office regarding the Whole of Government accounts submission with no exceptions.
Recommendations	— We have raised one medium risk recommendation as a result of our 2015-16 financial statements and Value for Money audit work. This is summarised in Appendix A. — The management recommendation made in 2014/15 has been implemented at the time of the final audit for 2015/16.
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. We did not issue a report in the public interest or refer any matters to the Secretary of State in 2015-16. The Trust recorded a deficit of £17.2 million in 2015/16, and has submitted a planned deficit plan of £6.6 million to NHS Improvement for 2016/17. Because the Trust began the 2015/16 financial year with a cumulative surplus of £4.7 million, this would result in a cumulative deficit at the end of year two of £19.1 million. To recover this by year three would require a surplus of the same amount in 2017/18. There is therefore a significant risk that the Trust will breach its statutory break-even duty for the period 2015/16 – 2017/18. We are conscious that national support arrangements for trusts in financial difficulty are still being finalised. We will therefore revisit the forecasts after the end of Q1 in 2016/17, when funding arrangements are more clear. If they continue to indicate a cumulative deficit by the end of year three, we will be required write to the Secretary of State outlining these facts in what is referred to as a section 13 referral letter.

Appendices

Appendix A

Key recommendations

Recommendations raised in 2015-16

No.	Risk	Issue, impact and recommendation	Management response /responsible officer/ due date
1	Medium	**Timing of CIP approval: Quality Impact Assessments** We identified during our Value for Money audit work that a contributory factor to the underperformance against the planned deficit in the first six months of 2015/16 was slippage in performance of the Trust's CIP programme. The Quality Impact Assessment (QIA) for the programme as a whole was formally approved in October 2015, which potentially impacted on the in-year delivery, particularly for those schemes with a high Quality Impact risk rating, which cannot progress without this QIA approval. There is a risk that delays in the formal QIA approval for the overall CIP programme limits the ability of the Trust to deliver the planned savings within the relevant financial period, resulting in further underperformance against planned out-turn. *We recommend that appropriate organisational focus and resource is dedicated toward the timely approval of QIAs and commencement of the full CIP programme for 2016/17 onwards, in order to give the Trust the best possible chance of delivering the planned in-year savings.*	The Trust will ensure that sufficient focus and resource is made available to ensure the timely QIA review and sign off of CIP schemes by the Medical Director and Director of Nursing. **Responsible officer and due date** Executive Medical Director and Director of Nursing 30 June 2016

Recommendations from previous years

No.	Risk	Issue, impact and recommendation	Current status
1	High	**CIP governance** We identified several issues in relation to the management of CIP delivery in 2014/15 as part of our work on the use of resources. We recognise the actions taken by the Trust to improve processes in 2015/16. We have identified further actions required to improve CIP management oin the future. The Trust should now consider the steps required to embed the achievement of CIP targets into day to day operations. In doing so the Trust should ensure that CIP governance includes: ▪ Engagement of Trust officers at all levels in the establishment of CIP targets. ▪ A clear approach to the agreement of CIP targets, ensuring that schemes agreed are achievable and understandable. ▪ Processes for monitoring of CIP performance with named officers accountable for the achievement of targets.	Our VfM audit work in connection with the significant risk around financial standing and achievement of CIP indicates that the CIP governance processes have improved markedly in comparison with 2014/15. The process for 2015/16 has engaged effectively with Trust officers at different levels within CBUs. Monitoring of scheme achievement has been a particular strength, as has the reporting at the Trust-wide and divisional levels around CIP performance. **Recommendation implemented.** There is a residual risk around the timing of final approval of the CIP programme, which in 2015/16 took place in October 2015, which impacts on the overall in-year delivery of cost improvement schemes. We have raised a recommendation in the current year in relation to this risk.

Summary of our reports issued

2016

January

February

March

April

May

June

July

August

September

October

November

December

Audit Plan

(January 2016)

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

Audit Highlights Memorandum

(May 2016)

The Audit Highlights Memorandum provides details of the results of our audit for 2015-16 including key issues and recommendations raised as a result of our observations.

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

Audit Report

(June 2016)

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

Report on Quality Accounts

(June 2016)

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

Annual Audit Letter

(July 2016)

This Annual Audit Letter provides a summary of the results of our audit for 2015-16.