



# Annual Audit Letter

Southport and Ormskirk Hospital NHS Trust

Year ending 31 March 2020



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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 2020. 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 25 June 2020 included our opinion that: <ul style="list-style-type: none"><li>the financial statements give a true and fair view of the Trust's financial position as at 31 March 2020 and of its financial performance for the year then ended.</li></ul>
Value for Money conclusion	Our auditor's report stated that we were not satisfied that the Trust had proper arrangements to secure economy, efficiency and effectiveness in its use of resources. As detailed in the report, we qualified (adverse) the Value for Money conclusion as we had concluded that there were 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 June 2020 we reported that the Trust's consolidation schedules were consistent with the audited financial statements.
Statutory reporting	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. The report also outlined that we made a referral to the Secretary of State under s30 of the 2014 Act, in relation to the Trust's failure to achieve a rolling three-year break even position.

# 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 2020 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 auditor's report, issued to the Trust on 25 June 2020, stated that, in our view, the financial statements give a true and fair view of the Trust's financial position as at 31 March 2020 and of its financial performance for the year then ended. Within our auditor's report, we drew attention to a material uncertainty relating to going concern and the Trust's disclosures in respect of this matter. Our report was not modified with regards to this material uncertainty.

## 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 2020:

Financial statement materiality	Our financial statement materiality is based on 2% of gross expenditure at the total operating costs level.	£3.257m
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£0.098m
Specific materiality	We applied a lower level of materiality to the following areas of the accounts: <ul style="list-style-type: none"><li>• Remuneration Report</li><li>• Related Parties</li></ul>	Correct Bandings £0.100m

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# 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
<p><b>Management override of controls</b> 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</p>	<p><b>How we addressed this risk</b> We addressed this risk through performing audit work over:</p> <ul style="list-style-type: none"> <li>Accounting estimates impacting on amounts included in the financial statements;</li> <li>Consideration of identified significant transactions outside the normal course of business; and</li> <li>Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.</li> </ul>	<p><b>Audit conclusion</b> There were no significant findings arising from our work on management override of controls.</p>
<p><b>Revenue Recognition</b> 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.</p> <p>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.</p>	<p><b>How we addressed this risk</b> We addressed this risk through performing audit work over:</p> <ul style="list-style-type: none"> <li>Testing of material income and material year end receivables;</li> <li>Reviewing the claim in relation to Covid-19 expenditure to ensure that the Trust included the correct expenditure and the corresponding income;</li> <li>Testing receipts in the pre and post year end period to ensure they have been recognised in the right year; and</li> <li>Reviewing intra-NHS reconciliations and data matches provided by the Department of Health &amp; Social Care (DHSC) and if necessary seek direct confirmation from third parties or their external auditors.</li> </ul>	<p><b>Audit conclusion</b> There were no significant findings from our work on revenue recognition.</p>

# 2. AUDIT OF THE FINANCIAL STATEMENTS

## Our response to significant risks

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Identified significant risk	Our response	Our findings and conclusions
<p><b>Valuation of Property, plant, and equipment (PPE)</b> Management engage the Cushman &amp; Wakefield as an expert, to assist in determining the fair value of property to be included in the financial statements.</p> <p>Changes in the value of property may impact on the Statement of Comprehensive Income depending on the circumstances and the specific accounting requirements of the Annual Reporting Manual and the Department of Health Group Accounting Manual.</p> <p>The high level of estimation uncertainty within property valuations gives rise to a significant audit risk.</p>	<p><b>How our audit addressed this area of management judgement</b></p> <p>We planned to address this risk by assessing the Trust's valuer's qualifications, objectivity and independence to carry out such valuations. In addition we completed substantive testing of the 2019/20 valuation including:</p> <ul style="list-style-type: none"> <li>• reviewing the scope and terms of engagement of the valuer's work;</li> <li>• considering whether the overall revaluation methodology used by the Trust's valuer is in line with industry practice, the DH Group Accounting Manual and the Trust's accounting policies;</li> <li>• assessing the appropriateness of the underlying data and the assumptions used in the valuer's calculations, based on our expectations by reference to sector and local knowledge;</li> <li>• comparing the valuation output with market intelligence to obtain assurance that the valuations are in line with market expectations; and</li> <li>• assessing the treatment of the upward and downward revaluations in the Trust's financial statements.</li> </ul>	<p><b>Audit conclusion</b></p> <p>As part of our work on the valuation, and following liaison with the Trust's valuer by ourselves and the finance team, Cushman &amp; Wakefield identified an error in the summary valuation reported to the Trust. Their error meant the value of land included in the financial statements was overstated by £4m. This error has been corrected my management.</p> <p>We are satisfied that the revised balances for PPE and associated accounting entries are appropriate.</p>

# 3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

Qualified - 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 June 2020, outlined our qualified conclusion on the Trust's arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31st March 2020.

Sub-criteria	Commentary	Matters to report
Informed decision making	<p>Our work focussed on the Trust's progress in delivery the required actions arising from CQC reports issued in 2019. From this we noted:</p> <ul style="list-style-type: none"> <li>• the Trust has processes in place to monitor progress against the action plan;</li> <li>• the Trust has proactively engaged partner organisations to assess performance against plan;</li> <li>• progress is monitored at Board level on a regular basis; and</li> <li>• a review undertaken in March 2019 identified areas where insufficient evidence was available to support reported action.</li> </ul>	See Page 9
Sustainable resource deployment	<p>Our work has highlighted the following:</p> <ul style="list-style-type: none"> <li>• the Trust delivered a deficit of £23.757m in 2019/20 which resulted in a breach of the Trust's statutory break-even duty;</li> <li>• the Trust had agreed to a control total break-even position for 2020/21 after receipt of financial recovery funding of £25.085m but this was before the changes in financial framework following the covid-19 global pandemic; and</li> <li>• under the revised financial framework, the Trust continues to forecast a breakeven position in 2020/21, however, this remains challenging to deliver although changes in the timing of contract payments and the regime around top up payments may make it unlikely that the Trust will require the level of working capital support it has needed in previous years.</li> </ul>	See Page 8

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Sub-criteria	Commentary	Matters to report
Working with partners and other third parties	<p>Our work has identified the Trust's arrangements include:</p> <ul style="list-style-type: none"><li>• engagement in the Cheshire and Merseyside Sustainability and Transformation Plan (STP) and Mid Mersey Alliance;</li><li>• 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</li><li>• significant research partnerships.</li></ul>	None

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# 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 two significant Value for Money risk(s). The work we carried out in relation to significant risks is outlined below.

Risk	Work undertaken	Conclusion
<p><b>Achievement of Financial Plan</b></p> <p>For 2019/20 the Trust set a financial plan of £26.567m deficit. This was dependent on delivering a significant level of cost improvement plans (CIPs) of £6.314m. The planned deficit is £15.1 million higher than the control total of £13.7 million deficit set by NHS Improvement.</p> <p>As at month 7, the Trust is reporting a year to date deficit (excluding non-recurrent funding) of £16.328 million against a plan of £15.457 million deficit. The Trust were also reporting achievement of £1.938 million CIPs as at Month 7 against a year-to-date plan of £3.288 million. The Trust acknowledges the underperformance of the CIP plan and its contribution to the adverse financial position and has identified a gap of £1.955m from the required CIP level. The late delivery of CIP schemes makes it increasingly unlikely that the Trust will achieve its planned level of savings.</p> <p>The above issues highlighted that the Trust may struggle to deliver the financial plan for 2019/20. This links to the Trust's arrangements for planning finances effectively to support the sustainable deployment of its resources.</p>	<p>To evaluate the Trust's arrangements for securing value for money in its use of resources we:</p> <ul style="list-style-type: none"> <li>considered achievement of the 2019/20 financial plan;</li> <li>reviewed the arrangements for delivering recurrent cost improvement schemes; and</li> <li>challenged the underlying assumptions and rationale supporting the Trust's 2020/21 financial plan.</li> </ul>	<p>We completed our work as planned and found significant weaknesses in the Trust's arrangements for planning finances effectively.</p> <p>The Trust incurred a deficit of £23.757m in 2019/20. The final outturn for 2019/20 resulted in an underlying cumulative deficit of £118.951m as at 31 March 2020 - representing a breach of the Trust's statutory 'break-even' duty. The cumulative deficit represents over 61% of the Trust's operating income.</p> <p>For 2019/20 the Trust agreed to its control total deficit of £8.296m (after receipt of Provider Sustainability Funding and Financial Recovery Funding of £18.271m). This was dependant on the Trust achieving a CIP target of £6.314m.</p> <p>The Trust did not meet its original Cost Improvement Programme (CIP) target for 2019/20. As noted, the target set at the beginning of the year was £6.314m, of which only £3.483m was delivered.</p> <p>The Trust was reliant on significant cash support from the Department of Health in 2018/19 (£32m) and the 2019/20 plan included significant further support loans from the Department of Health and Social Care.</p> <p>While progress has been made within 2019/20, and the deficit in year was reduced from 2018/19, the Trust was unable to meet its financial plan for the year.</p>

# 3. VALUE FOR MONEY CONCLUSION

Risk	Work undertaken	Conclusion
<p><b>Response to CQC Report Findings</b></p> <p>In November 2019 the CQC published the findings from its inspection of the Trust, which was a more comprehensive follow-up to the review of urgent and emergency services at Southport &amp; Formby District General Hospital which took place in March 2018.</p> <p>As part of the 2018 report, the CQC issued a Requirement Notice detailing the fundamental standards not being met by the Trust. This required the Trust to respond to the CQC with an action plan detailing how they are going to meet these standards.</p> <p>This links to the Trust's governance arrangements to ensure safe and effective care through informed decision making.</p>	<p>To evaluate the Trust's arrangements for securing value for money in its use of resources we:</p> <ul style="list-style-type: none"> <li>• reviewed the arrangements the Trust has put in place to respond to the findings of the report;</li> <li>• considered how the Trust is monitoring the implementation of remedial actions, and reporting this progress to the Board; and</li> <li>• reviewed any further correspondence between the Trust and CQC in respect of the Requirement Notice.</li> </ul>	<p>We completed our work as planned. The CQC report issued in November 2019 highlighted significant areas of weakness remaining within the Trust's operational arrangements.</p> <p>In response to the CQC reports issued in previous years, the Trust had mapped the 'Must Do' and 'Should Do' actions into a detailed action plan. Each of the actions identified was assigned an owner at an appropriate level of management who was responsible for the delivery of progress against the required action.</p> <p>Progress against the Action Plan was monitored through the Quality and Safety Committee on a monthly basis, with further reporting to the Board on a regular basis. The Trust also established a process of deep dives in respect of the actions reported to have been on track or delivered to ensure there was sufficient evidence available to support the reported progress and the embedding of the changes required. This was also reported to the Board. Action was taken to address those areas where insufficient evidence was available.</p> <p>Although the Trust has made progress with its action plan, the CQC report issued in November 2019 again concluded that the Trust required improvement. Although CQC acknowledged that the Trust's services in the "caring" domain are good, significant and sustainable improvements are still needed to reach an overall assessment of Good.</p> <p>Following receipt of the report, the Trust moved quickly to respond and submitted its refreshed CQC Improvement Plan to the CQC on 29 December 2019. This revised plan identified the improvement actions to be taken throughout 2020/21 to support the Trust's 'Vision 2020' which aims to achieve a 'Good' CQC rating.</p> <p>However, the delivery of this action plan will be impacted by the changes to the Trust's operations from March 2020 onwards due to the Covid19 pandemic and will require a refresh as the Trust returns to a more "business as usual" operating model over the coming months.</p>



# 4. OTHER REPORTING RESPONSIBILITIES

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

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 action has been, or would be unlawful and likely to cause a loss or deficiency; and
- make written recommendations to the Trust which must be responded to publicly.

### 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.

As at 31 March 2020 the Trust has breached its statutory financial duty under Paragraph 2(1) of Schedule 5 of the NHS Act 2006 that:

'Each NHS trust must ensure that its revenue is not less than sufficient, taking one year with another, to meet outgoings properly chargeable to revenue account'.

We are also required to report if, in our opinion, the governance statement does not comply with the guidance issued by NHS Improvement 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 June 2020.

Having completed our work for the 2019/20 financial year, we can confirm that our final fees are as follows:

Area of work	2019/20 proposed fee	2019/20 final fee
Delivery of audit work under the NAO Code of Audit Practice	£39,415	£39,415
VAT	£7,883	£7,883
<b>TOTAL</b>	<b>£47,298</b>	<b>£47,298</b>

## Fees for other work

Area of work	2019/20 proposed fee	2019/20 final fee
Quality Accounts Work	£7,335	£2,935
VAT	£1,467	£587
<b>Total</b>	<b>£8,802</b>	<b>£3,522</b>

# 6. FORWARD LOOK

## Financial outlook

The Trust continues to face significant financial pressures for 2020/21 reflecting the impact of Covid-19 and the continued national drive to re-establish financial control over the NHS provider sector. The current NHS financial regime provides block contract payments until July 2020 based on the 2019/20 cost base plus inflation. The arrangements after July 2020 are less certain although the existing block contracting arrangements may continue for a further period of time through 2020/21.

The Trust is keenly aware of the challenges it faces at the point at which the current, Covid-19, financial regime ceases, and agreements with NHS Improvement on the control total and available central financial support can recommence. The challenges of managing the increasing national cost pressures and the impact of inflationary rises which determine the annual price uplift on many external contracts add to the Trust's significant pressures in the medium term.

The Trust has made good progress in putting plans in place to help to meet the uncertainty faced through its 2020/21 Financial Plan and continues to recognise the significant risks and challenges in delivering financial sustainability in 2020/21 and beyond.

## Operational challenges

The Trust continues to plan to modernise and develop its services to best meet the needs of patients. This includes a number of operational challenges as follows:

- Successfully responding to the issues raised in the recent CQC inspection report; and
- Improving performance against the other key national targets and standards.

In addition, the COVID-19 outbreak presented significant clinical and operational challenges for the Trust. As the NHS moves into a recovery and reset phase, the Trust faces additional challenges to ensure its estate and infrastructure can continue to meet patient needs.

## How we will work with the Trust

We are committed to supporting the Trust as its external auditor. In the coming year we will:

- Liaise routinely with management and finance staff to stay up to date with developments as they occur through the year, ensuring our audit plan for 2020/21 is formed with full understanding of the Trust's issues and risks;
- Discuss audit timetables early in the year and maintain regular discussions on audit progress through the audit, ensuring we deliver a 'no surprises' audit;
- Attend each Audit Committee meeting and presenting Audit Progress Reports including updates on regional and national developments; and
- Host technical events for staff, such as our NHS Accounts workshop.

In addition we will hold an audit debrief meeting with the Trust to identify any learning points from our 2019/20 audit to ensure the audit in 2020/21 progresses even more smoothly.

The Trust has taken a positive and constructive approach to our audit and we wish to thank the Board, Audit Committee, and Trust staff for their support and co-operation during our audit in the past year.

## CONTACT

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