Annual Audit Letter

Southport & Ormskirk NHS Trust

Year ending 31 March 2019

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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 & Ormskirk NHS Trust (the Trust) for the year ended 31 March 2019. 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 24th May 2019 included our opinion that the financial statements give a true and fair view of the Trust's financial position as at 31 March 2019 and of its financial performance for the year then ended.
Value for Money conclusion	Our auditor's report included an adverse Value for Money conclusion 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 to effectively 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 24th May 2019 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 outlined that we made a referral to the Secretary of State under s30 of the 2014 Act, in relation to the Trust breaching its statutory break-even duty.
Quality Account	We issued our limited assurance report issue on 28th June 2019. We qualified our conclusion due to errors identified in sample testing of the percentage of patients risk assessed for venous-thromboembolism (VTE) indicator. Our testing of the rate of clostridium difficile infections identified no errors. We did not identify any issues in relation to the consistency of the Quality Account with regulations and other sources of information.

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 2019 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 24th May 2019, stated that, in our view, the financial statements give a true and fair view of the Trust's financial position as at 31 March 2019 and of its financial performance for the year then ended. We highlighted within our opinion the material uncertainty relating to Going Concern and our referral to the Secretary of State under section 30 of the Local Audit and Accountability Act 2014.

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 2019:

Financial statement materiality	Our financial statement materiality is based on 1.5% of gross expenditure.	£2.869m
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£0.086m
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts: • Related Party Transactions • Remuneration Report	£0.010m Disclosures within the correct banding

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 addressed this risk through performing audit work over: • 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 seek direct confirmation from third parties or their external auditors.	There were no significant findings from our work on revenue recognition

2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant risks (continued)

Identified significant risk	Our response	Our findings and conclusions
Going Concern In light of the financial pressures facing the NHS, the Trust's planned deficit, the requirement of cash support from the department and significant savings requirements for 2018/19, there are uncertainties about the appropriateness of the going concern assumption for the Trust's financial statements. There is a risk that the Trust does not adequately disclose uncertainties about the appropriateness of the going concern assumption in preparing its financial statements.	We addressed this risk through performing audit work over: • Management's assessment of going concern, the assumptions underlying the assessment and the evidence supporting these assumptions; and • the completeness and accuracy of the disclosure of material uncertainties relating to going concern in the financial statements.	The draft financial statements contained management's assessment of going concern which highlighted material uncertainties in relation to achieving the planned deficit for 2019/20 and the need for cash support. Following our review management updated the disclosure in line with latest available information. We were satisfied the disclosure was appropriate and made reference to this in our opinion.
Valuation of Property, Plant and Equipment Management engage the Cushman and Wakefield as an expert, to assist in determining the fair value of property to be included in the financial statements. 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. The high level of estimation uncertainty within property valuations gives rise to a significant audit risk.	We addressed this risk through performing audit work over: • reviewing the scope and terms of engagement of the valuer's work; • 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 • 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; • comparing the valuation output with market intelligence to obtain assurance that the valuations are in line with market expectations; and • assess the treatment of the upward and downward revaluations in the Trust's financial statements.	We identified an understatement of depreciation by £0.6m due to the Trust applying updated RICS guidance in relation to asset lives from April 2019. In our view the estimate of depreciation should have been updated in 2018/19 based on the best available information. Our review of the valuer's assumptions identified the application of a 10 year smoothing factor. We have recommended management discuss this approach with the valuer in future years. We also identified an error in the Trust's asset register processing the quarter 4 depreciation charge after applying the revaluation. This led to an understatement of the Trust's PPE balance of £552k. The Trust correct this error in the final version of the accounts.

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	The Trust's valuer has used a smoothing factor in BCIS indices to remove volatility from the valuations of the Trust's estate. Whilst the use of a smoothing factor is not in itself inappropriate, and is a matter for the valuer's judgement, it is a key element of the valuation methodology, Trust management should discuss and challenge such assumptions in order to satisfy themselves that the method applied is appropriate for the Trust.
Potential effects	A change in the number of years applied in the smoothing factor will impact on the valuation of buildings and dwellings at year-end
Recommendation	Management should review the use of the smoothing factor in future valuations with the valuer and confirm these remain appropriate for the Trust's circumstances.
Management response	The Director of Finance will meet and discuss with the Trust's valuers as part of the full revaluation taking place in 2019/20.

Description of deficiency	The Trust's stock counts took place over a number of days either side of year-end, ranging from 25th March to 1st April. As transactions took place between the date of stock counts and the year-end there is a potential for stock counts to become out-of-date. Our review of transactions listings at year-end confirmed there had been no material movements in stock balances.
Potential effects	There is potential for the stock balance to be misstated as stock is bought and consumed between the stock count date and year-end.
Recommendation	The Trust should ensure stock counts take place as close to year-end as possible, preferably on 31 March each year. Where stock counts take place before or after year-end records should be maintained to account for the movements in inventory balances.
Management response	The Director of Finance will set a specific date for stock counts to take place in 2019/20. Any variations to these dates will be subject to Director of Finance approval.

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 24th May 2019, outlined our qualified conclusion on the Trust's arrangements to secure economy, efficiency and effectiveness in its use of resources.

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 on the following page.

We reported our findings to the Audit Committee on 22nd May 2019.

3. VALUE FOR MONEY CONCLUSION

Significant Value for Money risks

Risk	Work undertaken	Conclusion
Achievement of Financial Plan For 2018/19 the Trust set a financial plan of £28.8 million deficit. This is dependent on delivering a significant level of cost improvement plans (CIPs) of £7.541 million. The planned deficit is £15.1 million higher than the control total of £13.7 million deficit set by NHS Improvement. As at month 7, the Trust is reporting a year to date deficit of £17.81 million against a plan of £17.54 million deficit. The Trust were also reporting achievement of £2.19 million CIPs as at Month 7 against a year-to-date plan of £3.93 million. The Trust acknowledges the underperformance of the CIP plan and its contribution to the adverse financial position and has identified a gap of £1.4m 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. 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 2018/19. This links to the Trust's arrangements for planning finances effectively to support the sustainable deployment of its resources.	To evaluate the Trust's arrangements for securing value for money in its use of resources we: • considered achievement of the 2018/19 financial plan; • reviewed the arrangements for delivering recurrent cost improvement schemes; and • challenged the underlying assumptions and rationale supporting the Trust's 2019/20 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 £28.961m in 2018/19. The final outturn for 2018/19 resulted in an underlying cumulative deficit of £95.194m as at 31 March 2019 - representing a breach of the Trust's statutory 'break-even' duty. The Trust did not meet its original Cost Improvement Programme (CIP) target for 2018/19. The target set at the beginning of the year was £7.541m, of which only £6.79m was delivered. For 2019/20 the Trust has agreed to its control total deficit of £8.296m (after receipt of Provider Sustainability Funding and Financial Recovery Funding of £18.271m). This is dependant on the Trust achieving a CIP target of £6.314m. If the 2019/20 Financial Plan is delivered, it will take the Trust's cumulative deficit to £103m - over 52% of the Trust's operating income. In the 2019/20 financial plan, only £0.966m of identified plans were fully developed and £2.280m were categorised as high risk. The Trust was reliant on significant cash support of £32.0m from the Department of Health in 2018/19, and the 2019/20 plan includes significant further support loans from the Department of Health and Social Care. The Trust is working with commissioners and NHSI to submit a five year financial recovery plan by Autumn 2019.

3. VALUE FOR MONEY CONCLUSION

Significant Value for Money risks

Risk	Work undertaken	Conclusion
Response to CQC Report Findings In September 2018 the CQC published the findings from its unannounced inspection of urgent and emergency services at Southport & Formby District General Hospital which took place in March 2018. Whilst this report did not re-rate the services, it raised a number of concerns and areas of improvement. As part of the report, the CQC has issued a Requirement Notice detailing the fundamental standards not being met by the Trust. This requires the Trust to respond to the CQC with an action plan detailing how they are going to meet these standards. This links to the Trust's governance arrangements to ensure safe and effective care through informed decision making.	To evaluate the Trust's arrangements for securing value for money in its use of resources we: • reviewed the arrangements the Trust has put in place to respond to the findings of the report; • considered how the Trust is monitoring the implementation of remedial actions, and reporting this progress to the Board; and • reviewed any further correspondence between the Trust and CQC is respect of the Requirement Notice	We completed our work as planned and found weaknesses in the Trust's arrangements for monitoring progress against the work plan. The Trust has mapped the 'Must Do' and 'Should Do' actions into an action plan. Each Action is assigned an owner who is responsible for delivery and collating evidence to support the reported progress made. In December 2018 the Trust commissioned a Core Service Review undertaken by peer organisations and chaired by NHSI to provide an independent view on the quality of service delivered by the Trust. This highlighted a number of areas of good practice including positive changes to the Trust's culture and compliance with mandatory training. It also highlighted a number of risk areas for the Trust to focus on in preparation for the next CQC visit. Progress against the Action Plan is monitored through the Quality and Safety Committee on a monthly basis, with further reporting to the Board each month. In March 2019, following concerns raised by the Board over the speed of progress made against plan, the Trust undertook 'deep dives' of the progress against actions. This highlighted a number of actions where sufficient evidence was not available to support progress made against plan. Clinical Business Units were asked to develop plans to improve trajectory and as at May 2019 the Trust is projecting all but 3 actions will be on track to deliver by June 2019. This supports the Trust's 'Vision 2020' which aims to achieve a 'Good' CQC rating by 2020.

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 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.

On 17 May 2019, we issued a referral to the Secretary of State under section 30 (1)(b) of the Local Audit and Accountability Act 2014 in relation to the breach of the Trust's statutory financial duty at 31 March 2019 under Paragraph 2(1) of Schedule 5 of the National Health Service 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 January 2019.

Having completed our work for the 2018/19 financial year, we can confirm that our final fees are as follows:

Area of work	2018/19 proposed fee	2018/19 final fee
Delivery of audit work under the NAO Code of Audit Practice	£39,415	£39,415
VAT	£7,883	£7,883
Total	**£47,298**	**£47,298**

Fees for other work

Area of work	2018/19 proposed fee	2018/19 final fee
Quality Accounts Work	£7,335	£7,335
VAT	£1,467	£1,467
Total	**£8,802**	**£8,802**

6. FORWARD LOOK

Financial and operational outlook

The Trust faces another challenging year in terms of its financial position. The Trust has signed up to its deficit control total of £8.296m for 2019/20, which includes non-recurrent funding of £18.271m. The achievement of the control total is dependant on the delivery of a £6.686m Cost Improvement Plan. Delivery of the planned deficit will require careful management, particularly given the increased demand for services and the need to deliver further improvements in patient care. We will keep this under review as part of our audit in 2019/20.

Alongside delivery of the financial plan, the Trust continues to implement its Vision 2020 strategy, one aim of which is to achieve a CQC 'Good' rating by 2020. The Trust is due another inspection over the coming months. We will review the outcome of the CQC inspection as part of our value for money conclusion in 2019/20.

How we will work with the Trust

We will continue to support the Trust through our audit work including:

- liaising with MIAA (the Trust's Internal Auditors) to minimise duplication of work;
- attendance at Audit Committees where we will continue to inform the Committee about progress on the audit, report our key findings and update it about developments in the NHS and the wider environment; and
- hosting events for staff, such as our NHS Accounts workshop.

We are committed to supporting the Trust as your external auditor. We will meet with the Trust to identify any learning from the2018/19 audit and will continue to share our insights from across the NHS and relevant knowledge from the wider public and private sector.

Closing comments

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

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