Agenda Item 165/09

West Hertfordshire Hospitals NHS Trust

Annual Audit Letter 2008/09

August 2009

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1 Introduction and key messages

Purpose of this Letter

1.1 This Annual Audit Letter ('Letter') summarises the key issues arising from the work that we have carried out at West Hertfordshire Hospitals NHS Trust ('the Trust') during our 2008/09 audit. The Letter is written in an accessible style, designed to communicate our key messages to the Trust and external stakeholders, including members of the public. The Letter will be published on the Trust's website.

Responsibilities of the external auditors and the Trust

1.2 This Letter has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).

1.3 We have been appointed as the Trust's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

1.4 Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Trust's key risks when reaching our Code conclusions.

1.5 It is the responsibility of the Trust to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Trust is fulfilling these responsibilities.

What this Letter covers

1.6 This Letter covers our 2008/09 Code audit, including key messages and conclusions from our work in:

- auditing the 2008/09 year end accounts and the arrangements review of the 1 April 2008 opening balance sheet restated under International Financial Reporting Standards (Section 2)
- assessing the Trust's arrangements for securing economy, efficiency and effectiveness in the use of its resources (Section 3).

1.7 We have not repeated recommendations agreed with the Trust during the year in this Letter. A list of the reports that contain these recommendations can be found at Appendix A. Appendix B sets out our actual and budgeted fees for 2008/09.

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Key areas for Trust action

1.8 We highlight the following key areas, where the Trust should take action to further improve its arrangements in 2009/10:

- The Trust should continue the developing alignment of the risk management strategy and the assurance framework to the long term strategic objectives of the Trust.

- The links between the Statement of Internal Control (SIC) and Assurance Framework require strengthening. The improvement of the risk registers to dovetail with the Assurance Framework should aid the process.

- The Trust should regularly report to the Board a set of key estate performance indicators benchmarked with other trusts as appropriate and take action where necessary now the site reconfiguration is largely complete.

1.9 The context for these key messages can be found in this Letter.

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2 Audit of accounts

Introduction

2.1 We issued an unqualified opinion on the Trust's 2008/09 accounts on 9 June 2009, meeting the deadline set by the Department of Health. Our opinion confirms that the accounts give a true and fair view of Trust's financial affairs and of the income and expenditure recorded by the Trust.

2.2 Prior to giving our opinion on the accounts, we are required to report significant matters arising from the audit to "those charged with governance" (defined as the Audit Committee at the Trust). We presented our Annual Report to those Charged with Governance to the Audit Committee on 9 June 2009 and summarise only the key messages in this Letter.

Audit of the accounts

2.3 The Trust performed well in producing a timely and accurate set of accounts against an increasingly tight timetable. The initial set of working papers provided were timely and comprehensive and responses to our audit queries and requests for further working papers and evidence were prompt and effective.

2.4 There were no significant audit adjustments. We raised a small number of other proposed adjustments and suggested improvements, none of which were material in nature.

Financial performance

2.6 The Trust met all of its statutory financial targets for 2008/09, as set out below:

Table 1: Performance against statutory targets

	Target	Actual	Met
Surplus/(Deficit)	£4.4m	£4.405m	✔
Capital Cost absorption	3.5%	4%	✔
External Financing Limit	£24.315m	£19.03m	✔
Capital Resource Limit	£37.752m	£32.886m	✔

2.7 The Trust achieved its planned control total of £4.405m surplus. The 2008/09 financial performance demonstrates the Trust's continued strong financial management.

2.8 The Trust has improved its performance against the non-statutory target in relation to the Better Payment Practice Code but still remains below target. The Code requires the Trust to aim to pay all undisputed invoices within 30 days (or due date if

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later). The Trust paid 67% of non-NHS trade invoices and 63% of NHS trade invoices with the target date. Our understanding is that significant improvement in 2009/10 is already beginning to show.

2.9 The Trust has set a £10.8m savings target in order to achieve a surplus of £4.6m. As at month 3 the Trust has agreed a total of £6.9m savings and has identified £2.8m of provisional schemes. The Trust's surplus currently stands at £0.4m for month 3, which is £0.4m under the target. The reason for the variance is due to the Trust spending £0.5m above budget on pay costs, £0.8m above budget on non pay costs, and £0.6m shortfall due to the delay in implementing the required savings. This was offset by the favourable variance of £1.4m due to over performance on the contract. At month 4 the gap has slightly increased to nearly £0.5m but is currently considered by management to be achievable with appropriate corrective action.

2.10 Therefore, although the Trust has set a balanced budget for 2009/10, the financial position is challenging and management recognises that strong financial controls will need to be in place during the year to meet financial targets, whilst investing in planned service developments. The Trust's track record over the past 2 years is very encouraging and the Trust is well placed to address financial challenges in the next 12 months.

Financial systems

2.11 We undertake sufficient work on key financial controls for the purpose of designing our programme of work for the financial statements audit. Our evaluation of the Trust's key financial control systems did not identify any control issues that present a material risk to the accuracy of the financial statements.

2.12 We reviewed the work of internal audit and concluded that the scope and conduct of internal audit work was appropriate to support our work in auditing the Trust's 2008/09 accounts. We performed a high level review of the general IT control environment as part of the overall review of the internal control system and concluded that there were no material weaknesses within the IT arrangements that could adversely impact our audit of the accounts.

2.13 We also issued a separate IT report to management, in which we highlighted some weaknesses around the strategic direction of IT within the Trust and the need for a complete revision of the business continuity arrangements. We agreed an action plan with management to address all of the control issues identified.

Statement on internal control and annual report

2.14 We examined the Trust's arrangements and process for compiling the Statement on Internal Control (SIC) and read the SIC to consider whether it was in accordance with our knowledge of the Trust. We also reviewed the draft version of the Trust's annual report to confirm that this was consistent with our knowledge and to confirm that the summary financial information presented was consistent with the audited financial information.

2.15 We concluded that the initial draft SIC reflected a broad understanding of the Trust's overall arrangements but there was scope for significant improvement in its presentation and links to the Assurance Framework. We comment further on this

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matter in the Use of Resources section. The annual report was consistent with our knowledge of the Trust.

Restatement of the opening Balance Sheet as at 1 April 2008 under IFRS

2.16 On 22 September 2008 the Department of Health issued guidance for the restatement of the opening balance sheet to an IFRS basis. This requires trusts to submit to the Department of Health pro-forma restated 1 April 2008 Opening Balance Sheet, previously prepared under the NHS Manual for Accounts 2008/09 based on United Kingdom Generally Accepted Accounting Principles, on the basis of the accounting policies contained in the NHS Manual for Accounts 2009/10 based in International Generally Accepted Accounting Principles (referred to as IFRS).

2.17 The Audit Commission determined that auditors will report to the Audit Commission on the restated figures under IFRS.

2.18 Our work consisted primarily of:

- checking whether the unadjusted financial information of the Trust had been accurately extracted from an appropriate source
- assessing whether all adjustments necessary for the purpose of presenting the financial information consistent in all material respects with the accounting policies contained in the IFRS NHS Manual for Accounts 2009/10 had been made
- examination of evidence supporting the adjustments
- checking the arithmetical accuracy of the adjustments.

2.19 On 24 April, we reported our findings to the Audit Commission, the Trust were awarded an Amber rating under the traffic light marking system that was employed by the Department of Health for this exercise. This reflected the fact that the Trust has adequate arrangements in place to restate the opening balance sheet under IFRS but further requires to strengthen arrangements in order to become fully compliant.

2.20 In carrying out our work, we identified some scope for the Trust to improve its accounting under IFRS in particular the adoption of the accounting policies from the IFRS NHS Manual for Accounts 2009/10 and the development of a system to calculate the holiday pay accrual.

Looking ahead

2.21 The 2009/10 financial statements are required to be produced in full under IFRS but before this happens the Trust have to restate the 2008/09 accounts under the IFRS NHS Manual for Accounts. The timing involves the Trust submitting the balance sheet to the DH by 4 September 2009 and external audit providing an opinion by 31 October 2009. We will continue to work with management in preparation for production of IFRS compliant 2009/10 accounts.

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3 Use of resources

Introduction

3.1 We issued our annual VFM conclusion on 9 June 2009, at the same time as our accounts opinion, meeting the deadline set by the Department of Health. We concluded that, for 2008/09, the Trust made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2009.

3.2 Prior to giving our VFM conclusion, we set out the basis of this conclusion and the results of our assessment of the Trust against the new use of resources framework, in our Use of Resources report, which we presented to the Audit Committee on 9 June. In this Letter we summarise the key messages from this work alongside relevant current findings, and look forward to forthcoming challenges for the Trust.

2008/09 VFM conclusion and ALE assessment

3.3 Our VFM conclusion was informed by our use of resources work which, in trusts, is based on the Audit Commission Auditors Local Evaluation (ALE) assessment. In order for us to provide a unqualified conclusion, the Trust needed to achieve an 'adequate' assessment (score of at least 2) for each Key Line of Enquiry (KLoE) area. Failure to achieve an 'adequate' assessment in any one area results in an "except for" conclusion.

3.4 We assessed the Trust as achieving level 3 score representing the Trust is performing consistently above minimum requirements, in all of the areas covered by our ALE assessment except for the Internal Control KLoE, which led to 'adequate' conclusions for the relevant criteria within our overall VFM conclusion.

3.5 The findings from our 2008/09 ALE assessment were reported to the Audit Committee in June and our scores have, subsequently, been confirmed following Audit Commission national quality control. The Trust's ALE scores in the five themes, drawn from the scores above, are summarised in the table overleaf.

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Table 2: ALE scores

Key for KLoE scores:
1 - Below minimum requirements - inadequate performance
2 - Meets minimum requirements – performs adequately
3 - Exceeds minimum requirements – performs well
4 - Significantly exceeds minimum requirements – performing excellently

Theme	2008	2009
Financial Reporting	2	3
Financial Management	2	3
Financial Standing	2	3
Internal Control	2	2
Value for Money	2	3
Overall score	**2**	**3**

3.6 We assessed the Trust as performing well in four of the five KLoE themes, which represents an overall score increase for the second year in succession. The area in which the Trust was assessed as performing adequately was internal control.

3.7 Key actions for the Trust, arising from our assessment, include:

- further work needs to be performed to strengthen the Trust's risk management arrangements and the links with strategic objectives and Assurance Framework. This should form a much sounder base for the development of the Statement on Internal Control;
- developing the quality of risk registers to link effectively with the Assurance Framework. Our initial assessment in 2009/10 suggest that sound progress is being made in this area;
- the need to report to Board against a set of key estate performance indicators and take appropriate action where necessary now that service reconfiguration is largely complete and a baseline can be established.
- the need to embed arrangements regarding the Non-Executive Directors and staff disclosures of gifts, hospitality and pecuniary interests.
- further information to be disclosed with regard to the Trust's environmental footprint.

3.8 We agreed an action plan with management to implement these recommendations, and will follow-up on progress as part of the 2009/10 audit.

Finance Department Review

3.9 The Trust is included within the 'wave 10' tranche of NHS trusts seeking to apply for NHS Foundation Trust (FT) status. As such, the Trust will be required to submit its application to the Foundation Trust Monitor (the Monitor) alongside its Integrated Business Plan (IBP) and Long Term Financial Model (LTFM) during Board to Board inspection by the Strategic Health Authority on 29 September 2009.

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3.10 We performed a 'fitness for purpose' review of the finance service to provide assurance to the Board that the finance function is suitably equipped for operating as a Foundation Trust in the future.

3.11 Overall we found the Trust has established a robust finance team resource, which compares favourably with other FT aspirants that we are familiar with. The new arrangements should provide a firm base from which an effective Foundation Trust finance function can be developed.

3.12 The following key areas were identified which the Trust should consider in order to strengthen systems for the FT application process:

- Finance team members will need to enhance specific skills around appropriate investment strategies, cashflow forecasting, and managing a medium to long term working capital model.
- There will be a shift from the normal requirements of a Finance Manager (FM) from expenditure reporting to become a Business Accountant taking account of activity and income suggesting solutions to adverse variances, identifying and utilising areas of spare capacity in the process.
- The Trust currently has the information department located at the Hemel site and the finance function is located at Royalty House in Watford. The crucial links between finance and information especially in an Service Line Reporting regime and beyond means the Trust should give serious consideration as to how finance and information can integrate in a more effective manner.

3.13 We agreed an action plan with management to implement these recommendations, and will follow-up on progress as part of the 2009/10 audit.

Looking ahead

3.14 We agreed our indicative 2009/10 audit fee with the Trust in March 2009. Our fee letter set out our initial assessment of the local risk based use of resources work we plan to carry out to support our VFM conclusion. This comprised:

- development of the assurance framework
- monitoring of the Healthcare Commission targets
- progress on the Watford Health campus private finance initiative scheme

3.15 We confirm that these risks remain relevant and we will build these into the risk assessment for our 2009/10 plan, along with specific follow up of our 2008/09

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recommendations and any new risks emerging between now and when we agree our final plan in December 2009.

3.16 Further risks relevant to the Trust may be around:

- information management and data security
- medium term financial management in an environment of reducing public spending.

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4 Closing remarks

Introduction

4.1 This Letter was agreed with the Chief Executive and Deputy Director of Finance and presented to Audit Committee on 17 September 2009.

4.2 We would like to take this opportunity to express our appreciation for the assistance and cooperation provided during the course of the audit. Our aim is to deliver a high standard of audit, which makes a positive and practical contribution that supports the Trust's own agenda. We recognise the value of your co-operation and support.

Grant Thornton UK LLP
August 2009

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Appendix A 2008/09 reports issued

Report	Date issued
Audit Plan	May 2008
Finance Department Review	February 2009
Audit Strategy Document	February 2009
Auditors Local Evaluation	June 2009
Annual Report to those Charged with Governance	June 2009
Annual Audit Letter	August 2009

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Appendix B Audit and other fees 2008/09

Audit area	Budget 2008/09	Actual 2008/09
Financial statements	£87,000	£87,000
VFM conclusion / Auditors local evaluation	£152,000	£152,000
Total Code of Practice fee	**£239,000**	**£239,000**
Foundation Trust Support	**£29,000	£38,000
IFRS phase 1 restatement work, mandated by the Audit Commission	£0	£10,457
Total fees	**£268,000**	**£287,457**

**carried forward from the 2007-08 audit plan

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