Annual Audit Letter 2015/16

University Hospitals of Leicester NHS Trust

30 June 2016

Contents

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This report is addressed to University Hospitals of Leicester 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 Jonathan Brown, 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 University Hospitals of Leicester 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 http://www.leicestershospitals.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;
- A review of general IT controls in place at the Trust highlighting any areas for improvement; 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 £132,906 excluding VAT (2014/15: £173,875). This was in line with the fee agreed at the start of the year with the Trust's board. Our fees are set nationally by Public Sector Audit Appointments Ltd and reflect a significant 25% reduction made nationally to scale fees. This fee includes £10,000 for additional audit work relating to the financial standing risk as reported in our Audit Plan and ISA260. This is subject to PSAA approval.

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

Tax Support	Tax support to the Trust in the establishment of a Pharmacy Subsidiary company to provide outpatient, home care and To Take Out services. The fee for this work was £22,000 excluding VAT.

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	— Financially, 2015/16 was another challenging year for the Trust as it recorded a deficit of £34.1 million. As a consequence of the deficit, the Trust was unable to generate sufficient cash to fund their expenditure, and had required external revenue support to facilitate this. Support has also been sought to finance necessary capital expenditure, which is essential to the long-term reconfiguration of the estate to obtain sustainable clinical and financial benefits. The overall financing position has moved from an opening balance of £12 million to a total of £55.6 million, with £1 million incurred in interest charges during 2015/16.
	— At the end of year three the Trust had recorded a cumulative deficit of £114.4 million.
	— The Trust delivered its 2015/16 CIP target of £43 million, which is a continuation of strong delivery against last year's £48 million savings.
	— The Trust did not meet the following performance targets, which additional funding is predicated on the Trust meeting such key targets:
	    — Cancer: 62 day pathway (target 85%) – not met at all during 2015/16, year to date performance is 77.4%
	    — Diagnostics: 6 week wait (target 1%) – achieved 2 months during 2015/16, year to date performance is 1.1%
	    — RTT: 18 week pathway (target 92%) – achieved throughout 2015/16, year to date performance is 92.6%
	    — ED: 4 hour turnaround (target 95%) – not met at all during 2015/16, year to date performance is 86.9%

Use of Resources conclusion	— We concluded that the Trust has not put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the following reasons:
	    — The Trust incurred a deficit for 2015/16 of £34.1 million and as a result experienced significant cash flow restrictions in the year, this had resulted in poor performance against the Better Payment Practice Code (BPPC), with the administrative targets for both NHS and non-NHS payments not met.
	    — The Trust required external revenue support to facilitate the cash flow restrictions incurred.
	    — NHS Trusts have a statutory duty to break even over a three-year period (or a five-year period with the agreement of NHS Improvement). The Trust recorded a deficit of £34.1 million in 2015/16, which as noted above had resulted in a cumulative deficit at the end of year three of £114.4 million. As the Trust had not met this statutory duty, we have written to the Secretary of State outlining these fact.
	    — Additional funding is predicated on the Trust meeting key targets which it is currently underperforming.
	— The Trust had prepared its accounts on a Going Concern Basis as there was no evidence of a prospect of services ceasing altogether at the Trust, however given the cumulative financial deficit of £114.4 million that the Trust had made for the last three financial years, we issued a qualified (except for) conclusion on the Trust's Use of Resources conclusion.

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/Business Planning -** Due to the significant financial challenge in the sector we undertook a detailed consideration of the Trust's financial position and financial sustainability. The Trust prepared its accounts on a Going Concern Basis, however given the cumulative financial deficit of £114.4 million that the Trust has made for the last three financial years, we issued a qualified (except for) conclusion on the Trust's Use of Resources conclusion.
Financial Statements audit opinion	— We issued an unqualified opinion on the Trust's accounts on 3 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. — One significant adjustment was identified as part of the audit due to the treatment of VAT in asset valuations. We identified that the Trust had instructed Gerald Eve to value the estate net of VAT under the assumption that such construction would be completed utilising an estate subsidiary company which would allow the Trust to reclaim related VAT. Our view was that as of 31 March 2016, the Trust was unable to show clear intention or ability to procure through such a route (there was no Special Purpose Vehicle with HMRC approval in place), then it was inappropriate to value net of VAT. — There were no significant matters which we were required to report to those charged with governance.
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 £15 million (2014/15: £15 million). — 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 -** The asset valuation and impairment review processes are both estimates and therefore presented a higher level of risk to the audit. We undertook procedures over the valuation, completeness and accuracy of material fixed asset balances. The Trust amended for a number of adjustments identified. — **Risk 2 - Recognition of NHS and non-NHS income -** Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant audit risk and therefore classified income recognition as a significant audit risk. Our procedures considered the completeness, existence and accuracy of the balances recorded within the financial statements. We have not identified any issues from our work. — **Risk 3 - Fraud risk from revenue recognition -** We classified recognition of NHS and non-NHS income as a significant audit risk for 2015/16 and have outlined above the audit work we have undertaken on this, which fulfils our responsibilities for this objective. — **Risk 4 - Fraud risk from management override of controls -** Professional standards require us to communicate the fraud risk from management override of controls as a significant risk. Our procedures, including testing of journal entries, accounting estimates and significant transaction outside the normal course of business, no instances of fraud were identified.

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. — No significant adjustments were required to the Annual Governance 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 raised one medium risk recommendation as a result of our 2015/16 audit work. — We reiterated one prior year high risk recommendation, which requires further action by management. These are summarised in Appendix A.
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. As the Trust had not met its statutory duty to break even over a three-year period, we wrote to the Secretary of State outlining these fact in what is referred to as a Section 30 referral letter.
Fraud	— No fraud related matters were identified.

Appendices

Appendix A

Key recommendations

Recommendations raised in 2015/16

No.	Risk	Issue, impact and recommendation
1	Medium	**Valuation Assumptions and Methodology** In 2015/16, the Trust changed its approach to valuations. Gerald Eve was instructed as valuer to undertake the valuation using an alternative site basis as part of the assumptions for valuing their specialised properties with a depreciated replacement cost on a modern equivalent asset basis. **Recommendation** The Trust should present a paper to the Audit Committee in advance of applying a new or amended methodology, in order that appropriate discussions can be had, and assurances obtained, over the proposed approach. Such a paper therefore would also allow external auditors sight of such assumptions in advance, ensuring any issues arising could be addressed prior to the final accounts visit.

This appendix summarises all high and medium risk recommendations raised in 2015/16.

Appendix A

Key recommendations

Recommendations from previous years

No.	Risk	Issue, impact and recommendation	Current status
1	High	**Revaluations** The Trust instructed Gerald Eve to undertake two valuations during the year, a full valuation as of 30 September 2014, and another valuation as of 31 March 2015. At the time of our audit, the Trust was unsure what the second valuation entailed and could not provide evidence whether this was another ‘full valuation’ or a ‘top-up valuation’. As a result of this confusion, issues have been raised with regards to the treatment of depreciation in respect of assets further revalued at year end. Additionally, our prior year recommendation in respect of strengthening the quality assurance procedures in relation to valuations have not been fully implemented by the Capital Accountant. Moreover, the Trust instructed Gerald Eve to undertake a full valuation exercise in 2015/16 as of 31 March 2016. The Trust received valuation figures from Gerald Eve during the closedown process in order to process accounting entries required for the financial statements, but did not receive the detailed valuation report nor engagement letter until 25 April 2016. These documents included information regarding the methodology adopted by the valuer and the assumptions feeding into this. Whilst this information was requested in our Prepared By Client document to be reviewed during our interim visit in February 2016, we were not provided with these reports until the end of the first week of our on site final accounts visit. The valuation engagement letter was signed on behalf of the Trust as accepted on 19 May 2016 after the report had been issued. ***Recommendation*** The Trust should ensure that it undertakes the necessary quality assurance procedures in a timely manner, and appropriate evidence to support these is available at the start of the audit. Additionally, the Trust should reassess the approach of having valuations at multiple points in the year, and consider whether the accounting complications arising from this, and the need to provide two sets of audit evidence, outweigh the intended efficiency of the exercise.	The Trust instructed Gerald Eve to undertake a full valuation exercise in 2015/16 as of 31 March 2016. The Trust received valuation figures from Gerald Eve during the closedown process in order to process accounting entries required for the financial statements, but did not receive the detailed valuation report nor engagement letter until 25 April 2016. These documents included information regarding the methodology adopted by the valuer and the assumptions feeding into this. Whilst this information was requested in our Prepared By Client document to be reviewed during our interim visit in February 2016, we were not provided with these reports until the end of the first week of our on site final accounts visit. The valuation engagement letter was signed on behalf of the Trust as accepted on 19 May 2016 after the report had been issued. **Recommendation reiterated**

This appendix summarises outstanding high and medium risk recommendations from previous years.

Summary of our reports issued

2015
December
January
February
March
April
May
June
July
August
September
October
November

Audit Plan (December 2015)	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 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 (July 2016)	This Report confirms the findings of our work in regard to the Trust's Quality Accounts and the indicators selected for review.
Audit Highlights Memorandum (May2016)	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.
Annual Audit Letter (July 2016)	This Annual Audit Letter provides a summary of the results of our audit for 2015/16.