The Princess Alexandra Hospital NHS Trust

Annual Audit Letter for the year ended 31 March 2016

JULY 2016

Ernst & Young LLP
In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued “Statement of responsibilities of auditors and audited bodies 2015-16”. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk).

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The ‘Terms of Appointment from 1 April 2015’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Directors/Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.
Executive Summary
Executive Summary

We are required to issue an annual audit letter to The Princess Alexandra Hospital NHS Trust (the Trust) following completion of our audit procedures for the year ended 31 March 2016.

Below are the results and conclusions on the significant areas of the audit process.

<table>
<thead>
<tr>
<th>Area of Work</th>
<th>Conclusion</th>
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<tbody>
<tr>
<td>Opinion on the Trust's:</td>
<td></td>
</tr>
<tr>
<td>► Financial statements</td>
<td>Unqualified – the financial statements give a true and fair view of the financial position of the Trust as at 31 March 2016 and of its expenditure and income for the year then ended</td>
</tr>
<tr>
<td>► Parts of the remuneration and staff report to be audited</td>
<td>We had no matters to report.</td>
</tr>
<tr>
<td>► Consistency of the Annual Report and other information published with the financial statements</td>
<td>Financial information in the Annual report and published with the financial statements was consistent with the Annual Accounts</td>
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Reports by exception:

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<table>
<thead>
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<tbody>
<tr>
<td>► Consistency of Governance Statement</td>
<td>The Governance Statement was consistent with our understanding of the Trust. We recommended two changes, which were made.</td>
</tr>
<tr>
<td>► Referrals to the Secretary of State</td>
<td>A report was issued to the Secretary of State in May 2016 under section 30 of the Local Audit and Accountability Act 2014 due to the Trust’s deficit position. Further details are included in the section ‘Other Reporting Issues’</td>
</tr>
<tr>
<td>► Public interest report</td>
<td>We had no matters to report in the public interest.</td>
</tr>
<tr>
<td>► Value for money conclusion</td>
<td>Qualified (adverse) – key issues include:</td>
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<td></td>
<td>► The significant brought forward and in year deficit.</td>
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<td></td>
<td>► The size of the deficit budget for 2016/17.</td>
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<td></td>
<td>► Recommended improvements in financial governance and financial modernisation that are in progress, and remain to be completed.</td>
</tr>
<tr>
<td>Area of Work</td>
<td>Conclusion</td>
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<tr>
<td>Reporting to the Trust on its consolidation schedules</td>
<td>We identified and reported a difference of £1.8 million in the analysis of the financial instruments in the consolidation schedule compared to the audited financial statements. The Trust could not make this amendment in the consolidation schedule due to restrictions on the template provided.</td>
</tr>
<tr>
<td>Reporting to the National Audit Office (NAO) in line with group instructions</td>
<td>We reported the above difference of £1.8 million for the financial instruments disclosure note. The audited financial statements correctly showed £1.8m of financial assets as ‘loans and receivables’ whilst the consolidation schedules showed these as ‘assets held for sale’.</td>
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As a result of the above we have also:

<table>
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<tr>
<th>Area of Work</th>
<th>Conclusion</th>
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<tr>
<td>Issued a report to those charged with governance of the Trust communicating significant findings resulting from our audit.</td>
<td>Our Audit results report was issued on 27 May 2016 and presented to the Audit Committee on 2 June 2016.</td>
</tr>
<tr>
<td>Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.</td>
<td>Our certificate was issued on 2 June 2016.</td>
</tr>
</tbody>
</table>

We would like to take this opportunity to thank the Trust staff for their assistance during the course of our work.

Kevin Suter

Executive Director
For and on behalf of Ernst & Young LLP
Purpose

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Directors and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Trust.

We have already reported the detailed findings from our audit work in our 2015/16 annual results report to the Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Trust.
Responsibilities
Responsibilities

Responsibilities of the Appointed Auditor

Our 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued on 1 March 2016 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

Expressing an opinion:

► On the 2015/16 financial statements;
► On the parts of the remuneration and staff report to be audited;
► On the consistency of other information published with the financial statements, including the annual report; and
► On whether the consolidation schedules are consistent with the Trust’s financial statements for the relevant reporting period.

Reporting by exception:

► If the annual governance statement does not comply with relevant guidance or is not consistent with our understanding of the Trust;
► To the Secretary of State for Health if we have concerns about the legality of transactions of decisions taken by the Trust; and
► Any significant matters that are in the public interest.
► Forming a conclusion on the arrangements the Trust has in place to secure economy, efficiency and effectiveness in its use of resources.

Reporting to the National Audit Office (NAO) any differences over £250,000 between the consolidation schedules and the audited financial statements

Responsibilities of the Trust

The Trust is responsible for preparing and publishing its statement of accounts, annual report and annual governance statement. It is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.
Financial Statement Audit
Financial Statement Audit

Key Issues

The Annual Report and Accounts is an important tool for the Trust to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Trust's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 2 June 2016.

Our detailed findings were reported to the 2 June 2016 Audit Committee.

The key issues identified as part of our audit were as follows:

<table>
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<tr>
<th>Significant Risks</th>
<th>Conclusion</th>
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<tr>
<td><strong>Going concern</strong></td>
<td>The Trust’s going concern assessment was provided within note 1.1 to the draft financial statements. We reviewed a copy of the cashflow forecast, which is consistent to the £42.2m deficit plan submitted to the NHS Improvement for the 2016/17 financial year. This shows the Trust maintaining positive in-year cash balances on a monthly basis, but this is predicated on in-year support equivalent to the deficit of £42.2m. The Trust’s key support for is ongoing ability to pay its operational liabilities is the letter of support dated 19 May 2016 from NHS Improvement, which confirmed management are able to assume the Department of Health will provide cash financing support to fund all essential operational liabilities. This will be through either Interim Revolving Working Capital Support Facility, or Interim Revenue Support Loan. We concluded that the use of the going concern assumption was appropriate for the 2015/16 financial statements.</td>
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Management override of controls | We carried out our programme of work. There were no matters for us to bring to the attention of the Audit Committee. |

As identified in ISA (UK and Ireland) 240, management is in a unique position to | |
perpetrate fraud because of their ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Revenue and expenditure recognition

Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue.

We judged your accounting policies to be consistent with the Department of Health’s Manual for Accounts, and found no material evidence of bias in accounting estimates. Based on our work there were no issues that we needed to bring to the attention of the Audit Committee, other than we agreed with management a classification between provisions and the bad debt provision. This change did not affect the overall deficit figure reported.

Other Key Findings

Electronic patient record
At the end of March 2015 the Trust’s financial statements included intangible assets of £13m. Further costs were incurred in 2015/16 of approximately £1 million. We reviewed management’s rationale for the treatment of the costs incurred against International Accounting Standard 38 ‘Intangible Assets’.

We reviewed the paper provided and were satisfied that the treatment of the expenditure is appropriate under IAS38.

Annual report
The Trust’s draft annual report did not follow the structure and requirements set out in the Manual for Accounts. We flagged up the non-compliance shortly after the submission of the draft, which enabled the Trust to re-structure the report.

We had to undertake unplanned work to review several iterations of the document. There were also multiple changes to the remuneration report section including to prior year figures for pension amounts.
### Legacy systems
The Trust continues to use a number of manual processes within Finance and has an old asset register system which does not hold all the information necessary to enable it to perform calculations required.

**Conclusion**
Senior management within the financial team are aware that there is a need to streamline and update processes. In some areas this is moving forward, for example renewed focus on the contractual management of the general ledger support.

If the Trust can improve its processes, then it should be able to create more efficiency in the basic financial processing and reporting functions. This in turn should then release resources to contribute to the other significant challenges the Trust is facing.

For the purposes of future audits we would want to explore whether it will be feasible to obtain a single consolidated electronic file of working papers. This again would save staff time in printing and collating papers, and facilitate making the working papers comprehensive.

### Aged debt not impaired
We found that there were some old amounts for two debtors that were not being paid.

**Conclusion**
We agreed with management’s judgement these debts should not be impaired, on the basis of the payment of subsequent invoices and administration errors only.

Given the Trust’s cash position and the age of the debt, the Trust needs to prioritise action to recover the outstanding debt.

### Property, plant and equipment verification
The Trust seeks to undertake a fixed asset verification exercise for its plant and equipment assets. Not all departments submitted their returns ahead of the audit. Some indicated that assets were no longer in use, after the draft accounts were prepared.

**Conclusion**
We assessed the impact as being trivial. However the verification is an important control over a material element of the Trust’s asset base. We would suggest that departments are reminded of the requirement to provide information on a timely basis. Alternatively the verification could take place at an earlier point in the year.

### Resolution of audit queries
Some queries took a long time to resolve.

**Conclusion**
We recognise the impact on the Trust’s Finance team of pressures resulting from other reviews that are being undertaken at the Trust. We would hope that a period of stability would enable the Finance team to take forward the modernisation agenda.
Value for Money
Value for Money

We are required to consider whether the Trust has put in place ‘proper arrangements’ to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

![Diagram showing Informed decision making, Proper arrangements for securing value for money, Sustainable resource deployment, and Working with partners and third parties.](image)
We noted the following issues as part of our audit in relation to the Trust’s arrangements. We therefore issued a qualified value for money conclusion on 2 June 2016.

Key Findings

Overall the financial position of the Trust, its 2015/16 outturn and 2016/17 plan remain consistent with the previous Financial Sustainability Review which concluded that it is not financially sustainable in its current form.

We recognise that the Trust is aiming to progress either towards an Integrated Care Organisation (ICO) or Accountable Care Organisation (ACO), working with its commissioners and other partners within the system wider review and Sustainability and Transformation Plans (STP). However, at present there is no defined timetable for the move to either. A plan is required to articulate the financial impacts of the potential future arrangements, and how this may address the cumulative financial deficit.

We reflected that there are improvements at the Trust compared to previous years; in the delivery of savings plans, improving financial management capacity, and taking forward the financial modernisation process. However, the Trust is still faced with a significant financial deficit in relation to its overall organisation size, and an extremely challenging position given its operational pressures to achieve this plan.

We could not conclude that you have made appropriate arrangements to secure economy, efficiency and effectiveness in your use of resources. This is particularly due to:

► the significant brought forward and in year deficit
► the size of the deficit budget for 2016/17
► the challenges that will be faced by the Trust to deliver that deficit budget; and
► the improvements in financial governance and financial modernisation processes that still remain to be completed, despite the start the Trust has made to address them.
Other Reporting Issues
Other Reporting Issues

Department of Health Group Instructions
We are only required to report to the National Audit Office (NAO) on an exception basis if there were significant issues or outstanding matters arising from our work. We reported the following issue to the NAO:

- There was a difference in the classification of financial assets in the financial instruments note of £1.8 million between the audited statement of accounts and the consolidation schedules. The accounts showed £1.8 million correctly as ‘loans and receivables’ whereas the consolidation schedules showed this as ‘available for sale’ assets. This was due to a late change to the accounts.

Annual Governance Statement
We are required to consider the completeness of disclosures in the Trust’s annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it complies with relevant guidance.

We completed this work and recommended two changes be made. The Trust amended the annual governance statement to include these changes.

Referral to Secretary of State
On 17 May 2016 we issued a report under section 30 of the Local Audit & Accountability Act 2014. The Trust has a statutory duty, set out at paragraph 2(1) of Schedule 5 to the National Health Service Act 2006, to ensure that it breaks even taking one financial year with another. Our referral on 17 May 2016 set out that the Trust’s unaudited financial statements reported a deficit of £37.714 million and cumulative deficits over the preceding two financial years of £35.356 million. We therefore had reason to believe that The Princess Alexandra Hospital NHS Trust was, taking into account the NHS Finance Manual “Guidance on Breakeven Duty and Provisions”, in the financial year ended 31 March 2016 in breach of this duty.

Report in the Public Interest
We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the CCG/Trust or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.
Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have not identified significant deficiencies in internal control through our work. However, there are two areas which suggest a need for improvement.

We initially planned to undertake a controls approach and place reliance on the work of Internal Audit for our audit strategy to payroll. The Trust’s payroll internal audit was given an ‘adequate’ rating. However, specifics of their findings, particularly the fact that they were not able to access authorised signatory forms for those people who had authorised starter, leaver or other change forms, meant that we had to revert to a substantive audit approach. Without access to such forms it is not possible to ensure that the people authorising are appropriate to authorise. We support IA’s findings and recommendations, and we note that the Trust is reviewing its authorised signatory forms and, with SERCO the payroll service provider, how their system could be used to manage the process electronically.

Throughout our audit we have also noted that the Trust is currently using manual workflows rather than electronic workflows for key processes, for example raising invoices. It is not achieving the full advantages and efficiencies that modern financial systems can. This was also a finding of the financial governance review carried out early in 2016.
Focused on your future
## Focused on your future

<table>
<thead>
<tr>
<th>Area</th>
<th>Issue</th>
<th>Impact</th>
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<tbody>
<tr>
<td>NHS provider financial pressures</td>
<td>Draft 2015/16 financial statements show NHS providers overspent by a record £2.45 billion for the year. The scale of this overspending is unprecedented. Despite additional funding and significant efforts to reduce deficits, record numbers of trusts overspent and the overall deficit is likely to be three times higher than in 2014/15. Some 48 trusts reported a deficit of more than £20 million, including 11 trusts reporting an individual deficit of more than £50 million. At the same time, performance against key targets is continuing to deteriorate and there are increasing concerns over the quality of services. Providers as a whole missed the Accident and Emergency waiting target of seeing 95 percent of patients within four hours for the final quarter of the year, and waiting lists for routine operations reached 3.34 million. It is not yet clear whether trusts’ financial performance for the year will cause the Department of Health to exceed its spending limit for 2015/16, a serious breach of parliamentary protocol. Whether or not there is a breach, NHS trusts will start 2016/17 with a collective deficit of around £1 billion more than planned. Without change there is the potential for the increasing financial pressure to impact further on levels of patient care.</td>
<td>The scale of the financial challenges faced by NHS providers impacts all aspects of their operations. It is therefore a key driver of audit risk and impacts our approach.</td>
</tr>
<tr>
<td>Sustainability and Transformation Plans</td>
<td>NHS England’s document, Delivering the Forward View: NHS planning guidance 2016/17-2020/21, published in December 2015, asks local health systems, including local government, voluntary and community partners, to work together to secure transformation change in healthcare planning and delivery. For this purpose England has been divided into 44 local health systems, made up of local councils, CCGs and NHS and other providers. Each health system needs to produce, by the end of June 2016, a Sustainability and Transformation Plan covering the next five years. The initial requirement is for CCGs and providers to control</td>
<td>Bodies will need to work together to a far greater extent than ever before to ensure that sustainability and financial plans are viable, and successfully delivered. Failure to do this could have wider adverse financial and service delivery consequences across the whole local area. As your external auditor we need to gain an understanding of your wider approach and plans, and the impact of greater partnership working on your governance, internal control and financial reporting.</td>
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expenditure and stay within budget in 2016-17. Subsequently, spending and performance will need to be managed sustainably over the following four years in order to access the available transformation funding. This is intended to fund changes to service delivery while maintaining and improving patient safety and quality over the years 2017-21. Failure to deliver on targets agreed will result in bodies being unable to access transformation funding, which will from now on be the only additional funds available.

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<tr>
<td>EU referendum</td>
<td>The decision of the UK to begin the process of leaving the EU has introduced a period of significant uncertainty for the UK and indeed the Global economy. The Leave vote will lead to a significant impact for the public sector as it will be the sector that has to deliver the implementation of Brexit.</td>
<td>Many of the issues and challenges that face the UK public sector will continue to exist, not least because continued pressure on public finances will need responding to. Additionally it may well be that the challenges are increased if the expected economic impacts of Brexit and loss of EU grants outweigh the benefits of not having to contribute to the EU and require even more innovative solutions. We are committed to supporting our clients through this period, and help identify the opportunities that will also arise. We will talk with you on the concerns and questions you may have and provide our insight at key points along the path. We will provide our June 2016 paper on the EU Referendum, and the impact of Brexit on the Government and Public Sector market.</td>
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Appendix A

Audit Fees
Appendix A  Audit Fees

We reported on 2 June 2016 to the Audit Committee in our Audit Results Report that our fee for 2015/16 would not be in line with the scale fee set by the Public Sector Audit Appointments Limited (PSAA), our regulator. The factors affecting our fee are set out below the following table. Any change to the planned fee has to be agreed both with the Trust’s Chief Finance Officer and the PSAA.

<table>
<thead>
<tr>
<th>Description</th>
<th>Final Fee 2015/16 GBP</th>
<th>Planned Fee 2015/16 GBP</th>
<th>Scale Fee 2015/16 GBP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Audit Fee - Code work</td>
<td>TBC</td>
<td>55,173</td>
<td>55,173</td>
</tr>
<tr>
<td>Non-audit work Quality Report</td>
<td>10,000</td>
<td>10,000</td>
<td>n/a</td>
</tr>
</tbody>
</table>

We incurred additional time at the 2015/16 audit due to:

► Preparation and submission of the s30 referral to the Secretary of Health
► Preparation and agreement of adverse value for money conclusion
► Checking of Annual Report which was re-structured following initial review
► The manual processes in place.

We confirm that we have undertaken non-audit work outside of the Public Sector Audit Appointment Ltd Code requirements in relation to our work on the Quality Report. We have adopted the necessary safeguards in our completion of this work.

EY were also requested to provide personal taxation services to one of the Trust’s non-executive directors. We are satisfied that we have adopted the necessary safeguards in our completion of this work with separate teams, and that there is no threat to our independence as auditors to the Trust. These services are not paid for by the NHS Trust.

There have been no other changes in our assessment of independence since our confirmation in our Audit Pan dated 1 March 2016. We complied with the Auditing Practices Board’s Ethical Standards for Auditors and the requirements of the PSAA Terms of Appointment: in our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.