Brighton and Sussex University Hospitals NHS Trust

Annual Audit Letter for the year ended 31 March 2015

July 2015

Ernst & Young LLP
Members of the Board
Brighton and Sussex University Hospitals NHS Trust
Trust Headquarters
Royal Sussex County Hospital
Eastern Road
Brighton
BN2 5BE

31 July 2015

Dear Members

Annual Audit Letter 2014/15

The purpose of this annual audit letter is to communicate to the Members of the Board 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 Brighton and Sussex University Hospitals NHS Trust (the Trust).

We have already reported the detailed findings from our audit work in our 2014/15 annual results report to the Audit Committee, representing those charged with governance. We do not repeat those in this letter and the matters reported here are the most significant for the Trust.

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

Yours faithfully

Paul King
Director
For and on behalf of Ernst & Young LLP
Enc.

The Audit Commission’s ‘Statement of responsibilities of auditors and audited bodies’ (Statement of responsibilities). It is available from the accountable officer of each audited body and via the Audit Commission’s website.

The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission’s 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 Standing Guidance serves as our terms of appointment as auditors appointed by the Audit Commission. The Standing Guidance sets out additional requirements that auditors must comply with, over and above those set out in the Code of Audit Practice 2010 (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 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.
1. **Executive summary**

Our 2014/15 audit work has been undertaken in accordance with the Audit Plan that we issued in March 2015 and is conducted in accordance with the Audit Commission’s Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

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.

As auditors we are responsible for:

- **Expressing an opinion:**
  - on the 2014/15 financial statements;
  - on the parts of the remuneration report to be audited;
  - on the consistency of other information published with the financial statements, including the annual report; and
  - on whether the summarisation 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 Department of Health 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 on an exception basis any significant issues or outstanding matters arising from our work which is relevant to the NAO as group auditor.**

Summarised below are the results of our work across all these areas:

<table>
<thead>
<tr>
<th>Area of work</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opinion on the:</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 2015 and of its expenditure and income for the year then ended. The Trust adjusted its reported surplus of £102,000 in the draft financial statements to a deficit of £450,000 as a result of our work</td>
</tr>
<tr>
<td>Parts of remuneration report to be audited</td>
<td>No matters to report – the remuneration report was prepared properly within the rules set.</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>
</tr>
<tr>
<td>Reports by exception:</td>
<td></td>
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<tr>
<td>► Consistency of Governance Statement</td>
<td>The Governance Statement was consistent with our understanding of the Trust. Amendments were made to the Trust’s Annual Governance Statement to reflect the qualification of the 2014/15 value for money conclusion.</td>
</tr>
<tr>
<td>► Referrals to the Secretary of State</td>
<td>See further details in section 2 of this report.</td>
</tr>
<tr>
<td>► Public interest report</td>
<td>No matters to report in the public interest.</td>
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</table>
| Value for money conclusion | We qualified the value for money conclusion. We reported on:  
- the Trust’s performance against its financial targets for the year; and  
- the planned deficit for 2015/16 and the challenge of delivering the level of savings required to allow the Trust to return to a cumulative surplus by 31 March 2018. |
| Reporting to the Trust on its summarisation schedules | We identified a small number of prior year inconsistencies between the Trust's statutory financial statements and summarisation schedules which we have reported to the National Audit Office. |
| Reporting to the National Audit Office (NAO) in line with group instructions | As above. |
| **As a result of the above we have also:** |
| Issued a report to those charged with governance of the Trust communicating significant findings resulting from our audit. | An initial audit results report was presented to the 4 June 2015 meeting of the Audit Committee. An updated final version of our audit results report was shared with Audit Committee members on 11 June 2015. |
| Issue a certificate that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Practice issued by the Audit Commission. | Issued 15 June 2015 |
2. Key findings

2.1 Financial statement audit

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 Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission and issued an unqualified audit report on 15 June 2015.

Our detailed findings were reported to the 4 June 2015 Audit Committee meeting. The main issues identified as part of our audit were:

Significant risk 1: Risk of manipulation of the financial statements to achieve financial targets

We concluded that there was a significant risk of the Trust misreporting financial performance in the financial statements to achieve financial targets. We believed that this would be most likely achieved by the misreporting of accruals and other key accounting estimates of income and expenditure.

We identified no evidence of material manipulation of financial performance reported in the financial statements. However, as part of our work we identified material mismatches in income and receivable balances between the Trust and NHS counter parties in the year-end NHS Agreement of Balances exercise. The Trust substantiated the majority of these differences, but there remained an unsubstantiated balance of £2.2 million. The Trust increased its bad debt provision by approximately £1.4 million to provide against these differences. We were satisfied that the remaining unsubstantiated difference of approximately £790,000 was not material.

The Trust also identified approximately £850,000 of deferred income on its balance sheet where there was no continuing liability to deliver related services or incur related expenditure. We were therefore not minded to challenge the Trust’s conclusion to recognise this income in the period of account. As a result of our findings the Trust adjusted its reported surplus of £102,000 in the draft financial statements to a deficit of £450,000.

We raised a number of recommendations for improvement which have been accepted by the Trust. In particular arrangements to reconcile the Trust’s Agreement of Balances submission to its ledger, and to investigate and resolve material differences with counter-parties.

Significant risk 2: Risk of management override

We identified no material misstatement due to fraudulent financial reporting or evidence of material fraud.

Other key findings:

We raised a number of recommendations for improvement as part of our audit which have been accepted by the Trust. The recommendations were made to address weaknesses in accounts production processes and accounting practice arising from our audit. In particular arrangements to reconcile the Trust’s Agreement of Balances submission to its ledger, and to investigate and resolve material differences with counter-parties, need to be improved for the 2015/16 financial statements.

We will work with officers in your finance team to follow up on the implementation of recommendations.
2.2 **Value for money conclusion**

We carry out sufficient and relevant work to conclude whether the Trust has put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources. This is known as our value for money conclusion.

In accordance with guidance issued by the Audit Commission, our 2014/15 value for money conclusion was based on two criteria. We consider whether the Trust had proper arrangements in place for:

- securing financial resilience; and,
- challenging how it secures economy, efficiency and effectiveness

We issued a qualified value for money conclusion on 15 June 2015. Overall we concluded that there was significant uncertainty over the Trust’s ability to deliver a financial position in 2015/16 or subsequent years where the cumulative reported deficit does not trigger a breach of its statutory duty to breakeven taking one year with another.

As part of our audit plan we raised a significant risk that the Trust would fail to deliver financial targets and secure long term financial balance. Our findings in response to the key areas of focus we considered as part of that risk are set out below.

**Area of focus 1: Delivery of 2014/15 financial targets including both the delivery of statutory targets, a progress made with achieving the planned cost improvement programme (CIP), and the balance of recurrent to non-recurrent savings plans**

Based on the audited financial statements the Trust:

- did not deliver its planned target surplus;
- did not deliver breakeven for the period; and
- slightly reduced its cumulative breakeven position.

The Trust reported that it delivered £29.858 million of cost improvements against its planned Cost Improvement Programme (CIP) target of £32.449 million. The main cause of the Trust’s failure to achieve its target surplus in 2014/15 was operating costs being overspent by £16 million. Most of this overspend related to pay which were overspent by £11.9 million. The Trust also benefitted from approximately £7.6 million of non-recurrent income during the year.

We concluded that the Trust did not deliver its financial targets or planned cost improvements during the period.

**Area of focus 2: The reasonableness and robustness of long term planning assumptions**

The Trust revised its budget forecast for 2015/16 from a surplus of £5.2 million, set at 1 per cent of turnover, initially to a breakeven position, and then to a deficit of £19 million. The £19 million budgeted deficit incorporates a CIP requirement of approximately £25 million. CIP delivery rates over the last two years would suggest that this could be achieved but the £19 million budgeted deficit would fully exhaust the Trust’s closing 2014/15 cumulative retained surplus of approximately £5 million. This would result in a carried forward cumulative deficit at the end of 2015/16 of approximately £14 million.

The most recent update of the Trust’s Long Term Financial Model (LTFM) is likely to model a ‘downside’ projection that the Trust’s commissioners (CCGs) will remove up to £70 million of activity and funding from the Trust over the next five years. The Trust is seeking to address pressures on its pay cost budget, which was the main driver of overspending in 2014/15, through an ongoing programme of overseas recruitment. It also believes there is sufficient staffing capacity in the organisation, but that it needs to be better utilised.

We concluded that it is not yet clear that based on either 2014/15 outturn or 2015/16 budget, the Trust is able to contain its pay costs at a level that would allow it to achieve sustainable financial balance.
Area of focus 3: Progress made on the development of a Full Business Case for the 3Ts project and the impact of this on the financial planning of the Trust

The Trust has a significant planned estate modernisation programme, notably the 3Ts project. This is major capital re-provision to redevelop the Trust’s main Royal Sussex County Hospital site in Brighton, where buildings are up to 200 years old. An announcement was made at the end of February by the Health Secretary that the Government had in principle approved an extra £60 million of funding required to progress the redevelopment. A decision on final approval of the scheme is expected by July 2015 and is subject to the Trust securing a ‘guaranteed maximum price’ for the development. The proposed mitigations for potential financial downsides modelled in the Trust’s latest financial plans would require some downsizing of the proposed scale of the 3Ts development.

2.3 Department of Health group instructions

We identified a small number of prior year inconsistencies between the Trust’s statutory financial statements and summarisation schedules which we have reported to the National Audit Office.

2.4 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 identified a small number of areas where further disclosure was required to comply with requirements and to provide a fair and balanced reflection of the Trust’s position. The Trust amended the annual governance statement to address these areas.

2.5 Breach of statutory break-even duty and referral to Secretary of State

We are considering the need to make a referral under Secretary of State under section 30 of the Local Audit and Accountability Act 2014 in respect of the Trust’s planned deficit for 2015/16 of £19 million, which would place the Trust in a position of a cumulative deficit, and the likelihood that this cumulative deficit would not be recovered over a three year period.

2.6 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.

As part of our audit results report we commented on the need for the Trust to be able to fully support and evidence its reported financial position with its major commissioners at the start of the audit. We raised associated recommendations for improvement which were accepted by the Trust. This was the key area of difficulty in delivering the 2014/15 audit and needs to be addressed for 2015/16.

We raised a number of detailed issues arising and associated recommendations from the prior year audit in our 2013/14 management letter. We were in general satisfied they were addressed, apart from issues relating to weaknesses in the Trust’s arrangements to support
deferred income accounted for on its balance sheet. We raised an associated recommendation for improvement based on 2014/15 programme of work as part of the audit results report. This was accepted by the Trust.
3. Fees

Our indicative final fee for 2014/15 was higher than the planned fee as reported in our March 2015 Audit Plan which was set at the scale fee determined by the Audit Commission. This reflects both the significantly higher than expected level of audit risk, the difficulties encountered during the course of the audit and the additional time needed to gain the assurance we needed to support an unqualified audit opinion. This additional fee is subject to agreement with the Trust and also approval by Public Sector Audit Appointments (PSAA) Ltd.

<table>
<thead>
<tr>
<th>Total Audit Fee – Code work</th>
<th>Indicative final fee 2014/15</th>
<th>Planned fee 2014/15</th>
<th>Scale fee 2014/15</th>
<th>Final fee 2013/14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality Account 2014/15*</td>
<td>£10,000</td>
<td>£0</td>
<td>N/A</td>
<td>£10,000</td>
</tr>
<tr>
<td>Other Non-audit work**</td>
<td>£46,323</td>
<td>Estimated as a maximum of £41,725</td>
<td>N/A</td>
<td>£7,381</td>
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</tbody>
</table>

* We undertook a limited assurance review engagement for the Trust on its Quality Account 2014/15 as reporting accountants in accordance with guidance issued by NHS England.
** The non-audit undertaken in 2014/15 involved two separate engagements. The first was to update the analysis supporting the quantitative evaluation of value for money at OBC for the 3Ts project to reflect minor changes in the scope of the project and movements in market assumptions since OBC. The second was a high level review of the arrangements with Sussex MSK partnership. The variance between the planned fee 2014/15 and the indicative final fee 2014/15 relates to a cost overrun on the Sussex MSK partnership review. This has been agreed with the Trust and approved by PSAA Ltd.
*** The indicative final fee is subject to discussion with the Trust and subsequently to consideration and determination by PSAA Ltd.