The Annual Audit Letter
for Royal National Orthopaedic Hospital
NHS Trust

Year ended 31 March 2016
26 July 2016

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### Appendices

- Reports issued and fees
Executive summary

Purpose of this letter
Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Royal National Orthopaedic Hospital NHS Trust (the Trust) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Trust and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Trust's Audit Committee as those charged with governance in our Audit Findings Report on 1 June 2016.

Our responsibilities
We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

• give an opinion on the Trust's financial statements (section two)
• assess the Trust's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money (VFM) conclusion) (section three).

In our audit of the Trust's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISA(UK&I)s) and other guidance issued by the NAO.

Our work
Financial statements opinion
We gave an unqualified opinion on the Trust's financial statements on 1 June 2016.

Value for money conclusion
We were satisfied that the Trust had in place for the full year proper arrangements to ensure economy, efficiency and effectiveness in its use of resources.

Consolidation template
We also reported on the consistency of the consolidation schedules submitted to the Department of Health with the audited financial statements. We concluded that these were consistent.

Use of statutory powers
We did not identify any matters which required us to exercise our additional statutory powers.

Certificate
We certify that we have completed the audit of the accounts of Royal National Orthopaedic Hospital NHS Trust in accordance with the requirements of the Code of Audit Practice.

Quality Accounts
We completed a review of the Trust's Quality Account and issued our report on this on 29 June 2016. We concluded that the Quality Account and the indicators we reviewed were prepared in line with the Regulations and guidance.
Working with the Trust

During the year we have delivered a number of successful outcomes with you:

• An efficient audit – we delivered an efficient audit with you in May, delivering the accounts before the deadline, with the sign off taking place on 1 June 2016 following the finalisation of the Annual Report.

• Understanding your operational health – through the value for money conclusion we provided you with an independent review of your operational effectiveness.

• Providing assurance over data quality – we provided assurance over two key indicators in your Quality Account.

• Sharing our insight – we held regular liaison meetings with management, provided regular audit committee updates covering best practice and shared our thought leadership reports.

• Providing training – we provided your teams with training on financial accounts.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Trust’s staff.

Grant Thornton UK LLP
July 2016
Audit of the accounts

Our audit approach

Materiality
In our audit of the Trust's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Trust's accounts to be £2,001k, which is 1.55% of the Trust's gross revenue expenditure. We used this benchmark because we considered users of the Trust's financial statements were most interested in how it has spent the income it has made in the year.

We also set a lower level of specific materiality for certain areas such as cash, senior officer remuneration and auditors remuneration.

We set a lower threshold of £100k, above which we would have reported errors to the Audit Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes assessing whether:
• the Trust's accounting policies are appropriate, have been consistently applied and adequately disclosed;
• significant accounting estimates made by management are reasonable; and
• the overall presentation of the financial statements gives a true and fair view.

We also read the annual report to check it is consistent with our understanding of the Trust and with the accounts on which we give our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Trust's business and is risk based.

We identified key risks and set out in table 1 the work we performed in response to these risks and the results of this work.
Audit of the accounts (continued)

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

<table>
<thead>
<tr>
<th>Risks identified in our audit plan</th>
<th>How we responded to the risk</th>
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</thead>
</table>
| **Financial statement level risk - Going concern**  
Given the Trust's past financial performance and forecast financial outturn, and continuing financial pressures within the provider sector there is a risk that the Trust does not adequately disclose uncertainties about the appropriateness of the going concern assumption for the Trust's financial statements. | As part of our audit work we:  
• Considered management’s assessment of the use of the going concern assumption  
• Considered the adequacy of any disclosures in the accounts and Annual Governance Statement and the impact on our opinion  
• Reviewed written support that you received from NHS Improvements  
• Considered the resilience of your financial plans in our Value for Money work  

We did not identify any issues to report and the Trust produced the accounts on a going concern basis as the Directors have a reasonable expectation that the services provided by the Trust will continue for the foreseeable future. |
| **The revenue cycles include fraudulent transactions**  
Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. For this Trust, we have concluded that the greatest risk of material misstatement relates to the occurrence/ existence of healthcare revenue and receivables. | As part of our audit work we:  
• Reviewed and tested revenue recognition policies  
• Tested material revenue streams including significant income contracts with commissioning bodies  
• Undertook cut-off testing and confirmed transactions are recorded in the correct year  
• Tested accruals and unusual/ unexpected receivables, focussing on receivables raised at year end  
• Reviewed the agreement of balances with other NHS organisations  

We reported that our audit work did not identify any significant issues in relation to the risk identified. |
Audit of the accounts (continued)

<table>
<thead>
<tr>
<th>Risks identified in our audit plan</th>
<th>How we responded to the risk</th>
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<tr>
<td><strong>Management override of controls</strong>&lt;br&gt;Under ISA (UK&amp;I) 240 there is a presumed risk that management will over-ride controls. This risk is present in all entities.</td>
<td>As part of our audit work we;&lt;br&gt;• Documented the control environment around and walkthrough of the systems in respect of journal entries and the property, plant and equipment (PPE) valuation&lt;br&gt;• Reviewed the accounting estimates, judgments and decisions made by management covering:&lt;br&gt;  o Bad debt provision&lt;br&gt;  o Revaluation of PPE&lt;br&gt;  o The useful economic life of PPE&lt;br&gt;  o The value of partially completed spells as at 31st March 2016&lt;br&gt;  o Journal entries/closedown journals; and&lt;br&gt;  o Unusual significant transactions</td>
</tr>
<tr>
<td><strong>Occurrence of healthcare income</strong>&lt;br&gt;The Trust receives 91% of its income from NHS commissioners of healthcare services. The Trust invoices these commissioners throughout the year and accrues for activity in the final quarter of the year. Invoices for this activity are not agreed until after the accounts are produced for audit. There is therefore a risk that income from healthcare may be overstated.</td>
<td>As part of our audit work we have;&lt;br&gt;• Performed walkthrough testing to gain assurance that in-year controls were operating in accordance with our documented understanding&lt;br&gt;• Reviewed and tested revenue recognition policies&lt;br&gt;• Performed testing across healthcare revenues including:&lt;br&gt;  • Review of Service Level Agreement contracts&lt;br&gt;  • Agreement of income to invoices and receipt of payments&lt;br&gt;  • Review of contract variations and year end agreements&lt;br&gt;  • Reviewed the results of the Department of Health agreement of balances exercise&lt;br&gt;  • Considered any significant non-contractual income&lt;br&gt;\We reported that:&lt;br&gt;• Testing of deferred income identified balances at the year end totalling £1,221k where cash had yet to be received as originally planned. This resulted in the Trust overstating its receivables and payables balance within the Statement of Financial Position. The Trust agreed to adjust this within the financial statements.&lt;br&gt;• Our audit work did not identify any further significant issues in relation to the risk identified.\</td>
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Audit of the accounts (continued)

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<tr>
<th>Risks identified in our audit plan</th>
<th>How we responded to the risk</th>
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</table>
| **Valuation of property plant and equipment**  
The Trust's property, plant and equipment, including the main hospital site, represent 89% of the Trust's total assets. Their value is estimated by property valuation experts. | As part of our audit work we have;  
• Performed walkthrough testing to gain assurance that in-year controls were operating in accordance with our documented understanding  
• Reviewed the competence, expertise and objectivity of the valuer as management's expert  
• Reviewed the work carried out by the valuer, including ensuring that any valuations have been undertaken in accordance with the requirements of the appropriate accounting and professional standards and the assumptions and judgements are reasonable  
• Reviewed and challenged the information used by the valuer to ensure it is complete, robust and consistent with our understanding  

We reported that our audit work did not identify any significant issues in relation to the risk identified. |
## Audit of the accounts (continued)

<table>
<thead>
<tr>
<th>Risks identified in our audit plan</th>
<th>How we responded to the risk</th>
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<tr>
<td><strong>Operating expenses</strong></td>
<td>As part of our audit work we have:</td>
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</tbody>
</table>
| Expenditure on goods and services represent 43% of the Trust's total expenditure. Management uses judgement to estimate accruals of expenditure for amounts un-invoiced at the year end. | • Documented and walkthrough the system in respect of Operating expenses  
• Reviewed control account reconciliations  
• Sample tested operating expenditure during the financial year.  
• Tested year end payables.  
• Tested for unrecorded liabilities.  
• Tested manual accruals.  
• Undertaken cut off testing of the supplier invoices of last month of 2015/16 and first month of 2016/17 |
| **Employee remuneration**         | As part of our audit work we have; |
| Expenditure on employee remuneration, comprising salaries and wages, social security costs, pension costs and other related benefits represent 64% of the Trust's total expenditure. | • Documented and walkthrough the system in respect of Employee remuneration  
• Reviewed monthly reconciliations between the Electronic Staff Record payroll system and the General Ledger  
• Undertaken a directional analytical review using trend analysis  
• Sample tested payroll transactions and agreed these to payslips and HR contracts of employment |

We reported that our audit work did not identify any significant issues in relation to the risk identified.
Audit of the accounts (continued)

Audit opinion
We gave an unqualified opinion on the Trust's financial statements on 1 June 2016, in advance of the national deadline.

The Trust made the accounts available for audit in line with the national timetable for submission, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

Issues arising from the audit of the accounts
We reported the key issues from our audit to the Trust's Audit Committee on 31 May 2016.

Annual Governance Statement and Annual Report
We are also required to review the Trust's Annual Governance Statement and Annual Report. No significant issues were noted from the completed reviews.

Whole of Government Accounts (WGA)
We issued a group assurance certificate to the NAO, in respect of Whole of Government Accounts, which did not identify any issues for the group auditor to consider.

Other statutory duties
We are also required to refer certain matters to the Secretary of State under section 30 of the Local Audit and Accountability Act 2014. We were not required to make any other Statutory reporting.
Value for Money conclusion

Background
We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:
In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings
Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work. The risks identified were:

- **Financial outturn:** The Trust reported a deficit for 2015/16 of £6.1m (4.4% of gross expenditure) after PPE valuation adjustments, against a deficit plan of £6.5m. The Trust has also submitted its plan for 2016/17 with a forecast deficit of £6.9m.

- **Liquidity:** In January 2016, the Chief Executive reported to the Board that due to the NHS being short of cash, debtors were not paying their liabilities to the RNOH on time. Similar message was also reported to the Finance and Performance Committee in month 10. The Trust was considering slowing payments in order to deliver the finance targets in March 2016.

- **CQC inspection:** An inspection by the Care Quality Commission in May 2014 rated the Trust as requiring improvement overall, with particular areas of weakness being: Leading of the services required improvement, Safety of the services required improvement, responsiveness of the services required improvement, and the premises at the Stanmore site were not fit for purpose; it does not provide an adequate environment to care and treat patients.

- **Stanmore site redevelopment:** The Trust required the development of the Stanmore site in order to meet the requirements of the CQC inspection and allow it to then progress towards Foundation Trust status. A full Business Case for NHS Phase 1 Stanmore site Redevelopment is planned for submission to the NHS Improvements in April 2016.

In arriving at our conclusion, our main considerations were:

**Financial performance:**
- The Trust's ability to meet financial targets including staff costs
- Review of private patient income against budget
- Review of key financial contracts and CIP performance and deliver plans

**Liquidity:**
- We reviewed the Trust's arrangements for updating, agreeing and monitoring its savings plans, and for communicating key findings to the Finance Committee and Board
- We interviewed key finance personnel to understand challenges faced by the Trust is trying to improve its liquidity including possible solution planning

**CQC inspection:**
- We reviewed the Trusts current plans put in place to achieve the improvements required by the CQC inspection.
- We interviewed key personnel to agree the progress made against the plan and issues that are still yet to be resolved.

**Stanmore site redevelopment:**
- We reviewed the Trust's progress in the site redevelopment
- We will review the assessment by NHS improvements and the financial impact on the Trust should it be agreed, including impact on the Trusts liquidity and financial position.

**Overall VfM conclusion**
We are satisfied that in all significant respects the Trust put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.
Value for Money conclusion

Background
We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:
In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings
Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.
The key risks we identified and the work we performed are set out in the table 2.

As part of our Audit Findings report agreed with the Trust in May 2016, we did not make any recommendation for improvement.

Overall VfM conclusion
We are satisfied that in all significant respects the Trust put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

<table>
<thead>
<tr>
<th>Risk identified</th>
<th>Work carried out</th>
<th>Findings and conclusions</th>
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</thead>
</table>
| **Financial outturn**                | We reviewed the Trust's arrangements for putting together and agreeing its budget, including identification of savings plans; and its arrangements for monitoring and managing delivery of its budget and savings plans for 2015/16, including the impact on service delivery. | The Trust faced significant challenges within the financial year as a result of:
   • Increases in agency staff costs of £1.7m: Similar to other Trusts near to London the Trust struggled to fill its vacant positions and relied on agency staff, which increased its costs
   • Failure to meet its private patient income target of £6.7m by £0.3m

   The Trust has also faced challenges in agreeing its core contracting income with its NHS England and some CCGs. During our work the 2016/17 planned contracting was yet to be agreed for £28.9m of a total of £115.2m expected.

   The Trust's CIP deliver was higher than planned, with a £0.3m favourable variance on the budget of £2.7m. However, compared to other similar sized trusts the CIP target is significantly smaller.

   The Trusts current and future plans are constrained by the current condition of its estate and while the Trust faces significant challenges we concluded that the trust has adequate arrangements for compiling and agreeing its budget, and in its arrangements for monitoring and managing delivery of its budget and savings plans for 2015/16. |
## Value for Money

### Table 2: Value for money risks continued

<table>
<thead>
<tr>
<th>Risk identified</th>
<th>Work carried out</th>
<th>Findings and conclusions</th>
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<tr>
<td><strong>Liquidity</strong></td>
<td>We reviewed the Trust's arrangements for updating, agreeing and monitoring its savings plans, and for communicating key findings to the Finance Committee and Board.</td>
<td>The Trust's liquidity is limited by delays in the payments it receives from its commissioners, most notably NHS England and CCGs in Surrey and Sussex. We reviewed the Trust's processes for managing its cash flows and obtaining payments by commissioners and found that the Trust had taken significant and appropriate actions to get payments from commissioners. The Trust is limited by the options available to it via the intra NHS market.</td>
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<td>We also reviewed the Trust's savings plans and there was evidence of challenge of the robustness of these savings plans by the Finance Committee before they were approved as part of the Trust's medium term financial strategy.</td>
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<td></td>
<td></td>
<td>The Trust has identified a potential savings gap in its projections for 2015/16 onwards and has agreed with the Department of Health a new loan of £4.5m loan to help manage its cash balances. It has started to draw down this balance on a monthly basis since March 2016.</td>
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<tr>
<td></td>
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<td>We concluded that the Trust has adequate arrangements in place for planning finances to support its strategic priorities and in using reliable financial information to support informed decision making, however its cash position is severely limited by external factors.</td>
</tr>
<tr>
<td><strong>Stanmore site redevelopment</strong></td>
<td>We will review the assessment by NHS improvements and the financial impact on the Trust should it be agreed, including impact on the Trusts liquidity and financial position.</td>
<td>We met with the Deputy Director of Finance and Full Business case Finance Manager who are leading on the Trust's Stanmore site redevelopment who provided adequate explanation of the work being done to drive the project forward. We also obtained and reviewed the Full Business Case document submitted to NHS England for approval and reviewed other relevant documents including the sustainability plan. We also reviewed the relevant Board minutes confirming regular monitoring of the application of the approval for the development.</td>
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<td>We concluded that that the Trust's overall arrangements are adequate for putting together and agreeing the planned project, and in its arrangements for monitoring and managing delivery of the project.</td>
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## Value for Money

**Table 2: Value for money risks continued**

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<tr>
<th>Risk identified</th>
<th>Work carried out</th>
<th>Findings and conclusions</th>
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</thead>
<tbody>
<tr>
<td><strong>CQC inspection</strong></td>
<td>We reviewed how the Trust is implementing and monitoring delivery of the action plan agreed to address the findings of the CQC inspection.</td>
<td>We met with the key members of staff who are leading on the Trust's CQC plan and identified that significant actions have been undertaken since the report was finalised. Except for the estate which is awaiting approval by the NHS Improvement, the Trust have completed a response plan and submitted this to CQC in December 2015. The plan has had significant work undertaken by clinical staff and senior management to ensure that the Trust have a viable plan in place. This has included a detailed set of actions, with a specific director associated to the action which includes a timescale, progress and key metric including RAG rating. We recognise the Trust has made progress in addressing the improvement plan and that there is significant process made in implementing a Remedial Action Plan (RAP) to address underperformance in respect of Referral to Treatment (RTT) targets in some specialities. The Trust project compliance with target by September 2016 but in the intervening period commissioners may impose fines and withhold part of contracted payments to you. <strong>On that basis are able to conclude that the Trust has proper arrangements in place to demonstrate and apply the principles of good governance and to deploy workforce to deliver its priorities effectively.</strong></td>
</tr>
<tr>
<td>An inspection by the Care Quality Commission in May 2014 rated the Trust as requiring improvement overall, with particular areas of weakness being: Leading of the services required improvement, Safety of the services required improvement, Responsiveness of the services required improvement, and the premises at the Stanmore location were not fit for purpose; it does not provide an adequate environment to care and treat patients.</td>
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Quality Accounts

The Quality Account

The Quality Account is an annual report to the public from NHS Trusts about the quality of services they deliver. It allows Trust Boards and staff to show their commitment to continuous improvement of service quality, and to explain progress to the public.

Scope of work

We carry out an independent assurance engagement on the Trust's Quality Account, following Department of Health guidance. We give an opinion as to whether we have found anything from our work which leads us to believe that:

• the Quality Account is not prepared in line with the DH criteria;
• the Quality Account is not consistent with other documents specified in the DH guidance; and
• the two indicators in the Quality Account where we carry out detailed work are not compiled in line with the DH regulations and meet expected dimensions of data quality.

Key messages

• We confirmed that the Quality Account had been prepared in line with the requirements of the Regulations
• We confirmed that the Quality Account was consistent with the sources specified in the Guidance
• We confirmed that the commentary on indicators in the Quality Account was consistent with the reported outcomes
• Our testing of two indicators included in the Quality Account found that these were materially reasonably stated in accordance with the Regulations and six dimensions of data quality

Quality Account Indicator testing

We tested the following indicators:

• Percentage of patients risk assessed for venous thromboembolism (VTE)
• Rate of clostridium difficile infections (CDIs)

We reviewed the process used to collect data for these indicators. We checked that the indicators presented in the Quality Report reconciled to the underlying data. We then tested a sample of patients in order to ascertain the accuracy, completeness, timeliness, validity, relevance and reliability of the data, and whether the calculations were in accordance with the definition.

Based on the results of our procedures, nothing came to our attention that causes us to believe that, for the year ended 31 March 2016, the indicators have not been reasonably stated in all material respects.

Conclusion

As a result of this we issued an unqualified conclusion on your Quality Account.
Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and provision of non-audit services.

### Fees

<table>
<thead>
<tr>
<th></th>
<th>Planned £</th>
<th>Actual fees £</th>
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</thead>
<tbody>
<tr>
<td>Statutory audit</td>
<td>50,744</td>
<td>50,744</td>
</tr>
<tr>
<td>Total fees</td>
<td>50,744</td>
<td>50,744</td>
</tr>
</tbody>
</table>

### Fees for other services

<table>
<thead>
<tr>
<th>Audit related services</th>
<th>Fees £</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assurance on your quality report</td>
<td>10,000</td>
</tr>
</tbody>
</table>

### Reports issued

<table>
<thead>
<tr>
<th>Report</th>
<th>Date issued</th>
</tr>
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<tbody>
<tr>
<td>Audit Plan</td>
<td>April 2016</td>
</tr>
<tr>
<td>Audit Findings Report</td>
<td>May 2016</td>
</tr>
<tr>
<td>Annual Audit Letter</td>
<td>July 2016</td>
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