

# **The Mid Yorkshire Hospitals NHS Trust**

**Annual Audit Letter 2007/08**

**4 September 2008**

# The Mid Yorkshire Hospitals NHS Trust Annual Audit Letter 2007/08

## Purpose of this Letter and scope of our audit

The purpose of this Annual Audit Letter (letter) is to summarise the key issues arising from the work that we have carried out during the year at The Mid Yorkshire Hospitals NHS Trust (the Trust). Although this letter is addressed to the directors of the Trust, it is also intended to communicate the significant issues we have identified, in an accessible style, to key external stakeholders, including members of the public. The letter will be published on the Audit Commission website at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk) and also on the Trust website.

This letter has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. This is available from [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk).

## Responsibilities of the external auditors and the Trust

We have been appointed as the Trust's independent external auditors by the Audit Commission, the body responsible for appointing auditors to local public bodies in England, including NHS trusts.

As the Trust's external auditors, we have a broad remit covering financial and governance matters. We target our work on areas that involve significant amounts of public money and on the basis of our assessment of the key risks to the Trust achieving its objectives. It is the responsibility of the Trust to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for. We have considered how the Trust is fulfilling these responsibilities.

## The scope of our work

Our responsibility as your external auditors is to plan and carry out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code). Under the Code, we are required to review and report on:

- the Trust's accounts
- whether the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

This letter summarises the significant issues arising from both these areas of work and highlights the key recommendations that we consider should be addressed by the Trust. A list of all reports issued to the Trust in relation to the 2007/08 audit is provided in Appendix A and we have included details of our audit fees in Appendix B.

### Key issues arising from the audit of the accounts

We issued an unqualified opinion on the Trust's accounts in accordance with the deadline set by the Department of Health. Our opinion was that the accounts gave a true and fair view of the Trust's financial affairs and of its income and expenditure for the year.

Before we give our opinion on the accounts, we are required to report significant matters arising from the audit to the Trust's Audit Committee. A detailed report was issued on 12 June 2008 and the key issues are summarised here.

### Accounting issues

We received a complete set of draft accounts, in advance of the accounts submission deadline set by the Department of Health. The Trust's finance team produced a very good set of working papers in support of the draft accounts.

Where appropriate, our work on the financial statements placed reliance on the systems of control operated by the Trust. From the results of our reviews, including a review of work performed by the Trust's internal auditors, we concluded that we could rely on the Trust's systems of internal control to reduce the extent of detailed testing at the final accounts audit in accordance with our planned audit strategy. Our audit of systems, this year, included a review of the Information Systems control environment. We made recommendations for improving procedures for recovering computer systems quickly and effectively in the event of a disaster or catastrophe occurring.

We discussed a number of significant accounting issues with the Trust's finance team prior to the start of our final accounts audit. The early discussion of such issues ensured the smooth running of the final accounts audit. We have, again, recognised the production of Auditor Briefings on specific and complex accounting issues by the Trust as an example of best practice in our Auditor Local Evaluation (ALE) submission to the Audit Commission. Throughout the year we have discussed a number of accounting issues with the Trust, including calculating the impairment provision on those assets which the Trust will no longer use when the new hospitals buildings are completed. From our discussions, we were able to agree with the Trust, appropriate accounting treatments, at the earliest opportunity.

The accounts included a number of areas where management had exercised judgement in relation to the amounts to be included in the accounts. These areas related mainly to estimating provisions for future liabilities and the timing of recognition of certain sources of income received in the year.

All the areas of judgement were carefully considered by members of the Audit Committee who concurred with the judgements made by Management. Following our detailed review of these estimates, we were able to accept the calculations as being reasonable in all the circumstances. We did though make a recommendation to improve the documentation in support of both provisions made and decisions on the deferral of income into the next accounting year. We also requested and the Trust provided, formal confirmation to us of the basis for the judgements made.

We found only one adjustment that was required to the income and expenditure account. The Trust decided not to make the amendment and due to its small size we accepted their decision. We agreed with the Trust some minor narrative disclosures to enhance the understanding of users of the accounts.

### Financial Standing

NHS trusts have a number of key financial duties (summarised below). The Trust's performance in 2007/08 is set out in the table below:

Target	Performance	Target met?
Breakeven in year.	The Trust achieved a surplus of £767,000 in the year.	Yes
Breakeven on income and expenditure, year on year.	Whilst the Trust reported a surplus of £767,000 for 2007/08, it has an accumulated deficit position.	No
Keep within the capital resource limit (CRL) of £12,532,000.	The Trust remained within the CRL with an under spend of £1,885,000.	Yes
Remain within the external financing limit (EFL) of £48,130,000.	The Trust remained within the EFL with an undershoot of £249,000.	Yes
Keep within a Capital Cost Absorption Rate (CCAR) of 3.5%.	The Trust reported a CCAR of 3.2% which is within the Department of Health's materiality range of 3.0% to 4.0%.	Yes

The Trust achieved an in-year surplus. This represents a considerable turnaround of the Trust's financial position from three years ago, which is testament to the focus of the Trust in delivering its financial recovery plans to address the considerable level of cost improvements which were required. However, the accumulated deficits from previous years means that the Trust has not been able to meet its statutory breakeven duty due to its cumulative deficit position.

Last year, we noted that the Trust was seeking to resolve its significant level of temporary funding of £77m which has arisen due to the deficits incurred in previous years. The Trust had been identified by the Department of Health as a financially challenged Trust which is defined as being one not able to repay funding in respect of past deficits without some fundamental restructuring of its repayment arrangements. We have reported, in previous Annual Audit Letters, that the Trust needed to resolve its historical deficit position.

During May 2008, the Trust signed an agreement with the Yorkshire and Humber Strategic Health Authority, (SHA) and its local Primary Care Trusts (PCTs) to resolve its level of historical debt. The agreement provides for this working capital borrowing requirement to be resolved in full. This was achieved by way of £45.6m of public dividend capital that the Trust will not be required to repay and a £31.4m working capital loan, The Wakefield and Kirklees PCTs are providing resources for a three year period equivalent to the loan principal repayments and interest charges.

The agreement also makes a significant contribution towards the reduction of the accumulated deficit (as measured for statutory break-even duty purposes) with any residual balance to be addressed over the medium to long term. We have reviewed the terms of the agreement and the Trust through these discussions, is seeking clarification, from the SHA, of a number of important issues in relation to the implementation of the agreement. We are currently liaising with the Trust on how the transactions referred to in the agreement are to be reflected in the Trust's 2008/09 and subsequent years' accounts. The agreement of the

Audit of Accounts 2007-08  
Annual Audit Letter

accounting treatment for these transactions is crucial to give full effect to this resolution of the historical deficit position of the Trust.

**Looking ahead to 2008/09.**

For 2008/09, the Trust is forecasting a breakeven position requiring the identification and delivery of £13.8m of cost improvements. At the Trust's request, a major firm of accountants has recently reviewed the Trust's medium term financial plans for the five years from 2008/09 to 2012/13. Their report, dated 31 July 2008, suggests that there is a significantly increased financial viability challenge in the medium term requiring average annual cost improvements of 3.9% of the total cost base. This increased level of cost improvements required is primarily due to national efficiency targets being increased in the recent Comprehensive Spending review and also reflects the now finalised costs of the Hospitals Development PFI project.

The report recognises that although challenging cost improvements targets over the last three years have been achieved already, there remains scope for additional cost improvement opportunities over the next five years. However, to achieve these opportunities will require budget holders to improve the delivery of cost improvements identified in 2008/09 and a more strategic review of services. The Trust is planning to implement matters arising from this review as part of its Next Steps process. The independent accountants noted that, only through this process is the Trust going to avoid slipping back into deficit over the next five years.

As at the end of July 2008 the Trust was reporting a financial position in line with plan and a forecast to meet its financial targets for the year. The Trust acknowledges that the achievement of these targets is likely to be reliant on some non recurrent and expedient measures pending the establishment of a complete and sufficient cost improvement programme.

**Key issues arising from the review of the Trust's use of resources**

We are required to issue a conclusion on whether we are satisfied that the Trust has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.

We are also required to assess how well NHS organisations manage and use their financial resources by providing scored judgements on the Trust's arrangements in five specific areas. This is known as the Auditor's Local Evaluation.

**Use of resources conclusion**

The use of resources conclusion for NHS bodies comprises an assessment of the arrangements in 12 Code of Practice areas. These areas are closely linked with the Auditors Local Evaluation (ALE) judgements. In order for an unqualified use of resources conclusion to be provided, an NHS body should achieve the minimum standards at Level 2 under all ALE judgements.

We were able to issue an unqualified use of resources conclusion for the 2007/08 financial year. This means we are satisfied that the Trust put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Audit of Accounts 2007-08  
Annual Audit Letter

Auditor's Local Evaluation

We assessed the Trust's arrangements in five areas using the 1-4 scoring system introduced by the Audit Commission, where:

- 1 = below minimum requirements - inadequate performance
- 2 = at minimum requirements – adequate performance
- 3 = consistently above minimum requirements – performing well
- 4 = well above minimum requirements – performing strongly.

It is important to note that the scores for 2008 are provisional at this stage and may be subject to change. The finalised scores will be formally published by the Audit Commission in late September 2008.

Area	2007/08 Score	2006/07 Score
Financial reporting	4	3
Financial management	3	3
Financial standing	2	1
Internal control	3	2
Value for money	2	2
<b>Overall Score</b>	2	1

From our assessments, and the positive response of the Trust to recommendations we have made in our audit reports, we have been able to conclude that the Trust has improved its scores within financial reporting, financial standing and internal control with financial reporting now being awarded a Level 4 - well above minimum requirements-performing strongly. This score recognises improvement in both the quality of accounts preparation and the presentation of the annual report. Two detailed reports supporting our assessments and highlighting areas for improvement have been issued to the Trust, in May and August 2008.

As a result of financial standing and value for money scores of 2, the Trust's Overall score is Level 2 for 2008, a notable improvement on 2006/07, reflecting the achievement of the Trust in breaking even in the year.

The principal areas we identified for action by the Trust, to help improve its scores next year, are to:

- demonstrate that data quality is sound
- ensure that agreed actions from the Audit Commission's clinical coding audit are implemented
- demonstrate that the Trust is making progress in achieving all key operational and strategic plans
- address capacity issues to ensure achievement of strategic plans
- provide reports on key estates performance indicators to the full Board
- introduce a procurement policy, the use of which and cost/efficiency savings are monitored
- formally test that corporate services are delivering an efficient service for the Trust, evidenced by benchmarking the Trust's 'back office' functions with NHS peers
- use the efficiency and productivity metrics published by the NHS Institute for Innovation and Improvement and develop action plans to address any issues arising

## Audit of Accounts 2007-08 Annual Audit Letter

The Trust has an established ALE action plan and has committed to update this to implement matters arising from our 2007/08 ALE review and to recognise the requirements of the 2008/09 ALE framework published by the Audit Commission. This will provide the overall plan to improve ALE scores.

### Specific risk based work

Our risk analysis and discussions with the Trust identified the following areas where specific risk based work was considered to be necessary:

- review of progress in implementation of Integrated Governance
- review of arrangements for Service Line Reporting and Service Line Management
- review of Trust's preparation for adopting International Financial Reporting Standards

### Integrated governance

We reported last year on the Trust's plans to develop governance arrangements using the principles within the Integrated Governance Handbook 2006. We recommended that, as full implementation of these arrangements is expected to take several years, the Trust should prepare a formal project plan to coordinate this work. Whilst no overall plan has been produced showing how all elements of the Integrated Governance Handbook are being addressed, we have now seen evidence to show that the Trust is working toward implementing these issues.

The Trust produced an initial Project Plan covering the restructuring of existing committees and assurance arrangements. This work was completed during the year with the March Board meeting approving an updated Integrated Governance Strategy and Assurance Framework.

The Integrated Governance Strategy adopted at the March Board meeting included an overall Integrated Governance Framework showing the key linkages between the Assurance Framework, the Trust's principal objectives and the risks. We consider the overall arrangements for providing assurance to the Board to be an example of best practice.

During the year, the Trust revised its committee structures to improve the overall level of assurance. The Trust has reviewed the terms of reference of these committees during the year and is working towards implementing revised terms.

We would suggest that the Trust should consider reviewing its new arrangements against the Monitor Code of Governance areas to assess whether there are further opportunities to strengthen its governance structures as it moves closer to application for Foundation Trust status.

The Trust has performed a self assessment of the Audit Committee involving assessing the Committee against a NAO checklist. In performing this work the Trust has also considered the views of key members of the finance department, internal auditors and us. This process highlighted a number of areas where action is being taken to ensure that the Audit Committee meets best practice.

### Service Line Reporting and Service Line Management

The development of Service Line Reporting (SLR) and Service Line Management (SLM) is widely regarded within the NHS as a key step in improving productivity at the specialty level thereby improving the financial performance of an organisation as a whole. SLR is the reporting of the profit and loss position on distinct service lines or business units, whilst SLM is applying SLR data as the basis for planning strategy, decision making and performance management of a Trust.

Audit of Accounts 2007-08  
Annual Audit Letter

We have discussed aspects of the arrangements at the Trust and compared them to best practice and our knowledge of the progress that other Trusts are making in response to implementing SLR.

We found that the Trust regularly produces information on a SLR basis, which provides regular and timely information on the income, expenditure and contribution after overheads on a speciality basis. This enables the Trust to identify specialities that are making a positive contribution to the Trust's profitability and those areas where action needs to be taken. The quality of information produced is better than we have seen at many other NHS trusts (including Foundation Trusts) and the Trust already meets the Monitor requirements for the introduction of SLR.

The key areas that the Trust will need to work on over the coming 12 months are as follows:

- training key staff and Board Members in the use of SLR data as part of effective SLM
- identification of clinical leads who can be seen as champions for the use of SLM
- ensuring the integrity of underlying activity and cost data
- refining the process for allocation of costs to specialities such as the use of expensive drugs or the use of diagnostic services
- considering the basis of the allocation of overheads
- whether to extend SLR reporting to cover the performance of individual sites or consultants

**International Financial Reporting Standards and "faster accounts close"**

The final accounts timetable has again been brought forward by the Department of Health for 2008/09, with draft accounts to be prepared and submitted by NHS bodies to the Department of Health by 23 April 2009, over a week earlier than in 2007/08. Similarly, audited accounts need to be submitted by 12 June 2009, over a week earlier than in the current year. The Trust is an active participant in national and local NHS groups on effective implementation of faster accounts close. We have agreed a timetable with the Trust for meeting the new deadlines and have commenced meetings on ways in which the audit process can be streamlined.

The move towards implementation of International Financial Reporting Standards (IFRS) will also require the Trust to restate its opening transition balance sheet as at 1 April 2008 for IFRS purposes. The Trust is represented at a national level on a group examining the implications of adopting IFRS. The Trust has a nominated IFRS lead and is working to an internal action plan to identify areas where adjustments will be required under IFRS.

The Trust is required to submit a restated balance sheet by December 2008 with an audited version required by 1 May 2009. We have agreed with the Trust that this audit work will be performed in February 2009 to avoid the final accounts preparation deadline.

A key issue for the Trust is the strong likelihood that the Hospital Development PFI Project will have to be accounted for as "on balance sheet". The Department of Health is working with a number of Trusts to consider the accounting implications of such a treatment across the NHS. We are participating in this DoH lead review and will discuss the implications with the Trust once the outcome of the review is known. In the meantime, the Trust needs to ensure that it continues to plan and resource its preparations for full implementation of IFRS. We will continue working with the Trust to ensure that the deadlines for adopting IFRS are met.

**Key Recommendations**

We have highlighted here our recommendations that we feel need the most urgent attention by the Trust Board over the coming year.

**Recommendation 1**

Ensure that the Trust clarifies the arrangements, including accounting issues, for the implementation of the financially challenged Trust agreement with the SHA and local PCT's.

**Recommendation 2**

Ensure that the identification and delivery of cost improvements required to achieve the 2008/09 budget are closely monitored by the Board.

**Recommendation 3**

Develop plans to ensure that the Trust can deliver medium term financial viability by examining how to generate further income and cost improvement opportunities and to include a review of its business fundamentals.

**Recommendation 4**

Ensure that the ALE Action Plan is implemented.

We also followed-up the recommendations that we made in our Annual Audit Letter for 2006/07 and consider that the Trust has taken appropriate action to implement them.

**Closing Remarks**

This letter was discussed with the Chief Executive and Director of Finance. The letter was presented to the Audit Committee on 15 September 2008 with a copy provided to all Board Members.

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

Grant Thornton UK LLP  
4 September 2008

## A Reports issued in relation to the 2007/08 audit

<b>Report</b>	<b>Date Issued</b>
Audit plan	Final - 3 October 2007
Interim Report	28 May 2008
ISA260 communication of audit matters to those charged with governance	12 June 2008
Use of resources - Auditors Local Evaluation and use of Resources update	22 August 2008
Annual Audit Letter	4 September 2008

## B Audit Fees 2007/08

The table below summarises the planned and actual audit fees charged to the Trust during 2007/08

<b>Audit Area</b>	<b>Plan</b>	<b>Actual</b>
	<b>2007-08</b>	<b>2007-08</b>
Accounts	61,000	61,000
Use of resources	109,000	109,000
<b>Total - Trust</b>	<b>170,000</b>	<b>170,000</b>



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