Annual governance report

United Lincolnshire Hospitals NHS Trust

June 2011

audit commission

Contents

Traffic light explanation

■ Red ◆ Amber ● Green

Key messages

This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.

	Traffic light
Unqualified audit opinion	
Proper arrangements to secure value for money	

Audit opinion and financial statements

- The arrangements for the production of your financial statements were sound and I plan to issue an audit report including an unqualified opinion on the financial statements.
- The draft financial statements were submitted to the Department of Health in advance of the submission deadline.
- Working papers produced by the Trust in support of the financial statements were good and finance staff have responded promptly to queries raised during the audit.

Value for money

- The Trust has reported a significant deficit this year and as a result, I plan to issue a qualified (adverse) conclusion on the Trust's arrangements to secure financial resilience and economy, efficiency and effectiveness in its use of resources.

Before I complete my audit

I confirm to you:

- **that I have complied with the required ethical standards for auditors**

I ask you to confirm to me:

- **that you have considered the matters raised in the report before approving the financial statements;**
- **that you have taken note of the adjustments to the financial statements which are set out in this report (Appendix 2);**
- **that you have considered the unadjusted misstatements to the financial statements which are set out in this report (Appendix 3);**
- **that you approve the Letter of Representation on behalf of the Trust before I issue my opinion and conclusion;**
- **that you agree the action plan at Appendix 5.**

My report includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

Independence

I can confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence. I can also confirm there were no relationships resulting in a threat to independence, objectivity and integrity.

I ask the Audit Committee to:

- consider the matters raised in this report before approving the financial statements;
- take note of the adjustments to the financial statements which are set out in this report (Appendix 2);
- consider the unadjusted misstatements which are set out in this report (Appendix 3);
- approve the Letter of Representation, provided alongside this report, on behalf of the Trust before I issue my opinion and conclusion; and
- agree the action plan at Appendix 5

Financial statements

Opinion on the financial statements

Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft audit report.

Errors in the financial statements

We identified errors in the financial statements and reported these to management. We report issues where further information since the accounts were produced has proved an original estimate to be incorrect by more than a trivial amount. Most of the errors have been corrected but we have identified four errors (other than those of a trivial nature) that management has declined to correct as follows and as detailed at Appendix 3:

- Whilst the Trust has reviewed its onerous contract position at 31 March 2011 a review of the calculation methodology and assumptions used identified weakness in the approach. A recalculation of this figure identifies the need to reduce the impairment by some £938k, although it is acknowledged that an element of this is in respect of updated information since the accounts were produced;

- The Trust has reduced its income accrual for partially completed spells in respect of Lincolnshire PCT by 70% for selected PODs. This was based on the assumption that as the Trust had exceeded threshold targets for 2010-11 this income should be reduced. This does not meet the requirements of IAS18 which requires that 'revenue shall be measured at the fair value of the consideration received or receivable.' In this case this reduction to income of £1,783k will be received in 2011-12 and count towards the 2011-12 threshold targets;

- The Trust has estimated its payroll enhancement creditors at 31 March 2011, basing them on downloaded data in December 2010. A subsequent review of these to the actual amounts incurred show an under provision of some £91k and again it is acknowledged that the Trust made the estimate using the information available at the time; and

- A review of the Trust's calculation of its holiday pay accrual shows an error in the basis of calculation which results in an over accrual of employee costs of £275k.

Financial statements

The Trust's financial statements and Statement on Internal Control are important means by which the Trust accounts for its stewardship of public funds. As Directors you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the Statement on Internal Control.

In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

Key audit risk and our findings

Key Audit Risk	Finding:
Submission deadlines remain challenging in 2010/11 and there is reduced capacity in the finance department, albeit that this is partly covered by contract staff. This presents a risk that the audit will not proceed as planned.	We had early and regular discussions with the Trust regarding closedown plans to ensure quality and timing of information. We brought forward as much work as possible to the pre-statements stage and provided staff with an early indication of our working paper requirements. The Trust sent staff to the Audit Commission's national Final Accounts Workshop which offered guidance on topical technical accounting issues related to accounts production. We supplemented the workshops with a local discussion of the implications for the audit of the accounts. The accounts were produced to a good standard in accordance with national deadlines and the audit proceeded as planned.
The Trust is forecasting a deficit of over £14 million and will be under pressure to reduce this. This carries the risk of year end management of balances which may not comply with accepted accounting practice.	We monitored the financial position and designed the audit approach to identify areas at risk of financial manipulation. There was no evidence of material manipulation of balances to reduce the in year deficit.
There has been evidence of inappropriate capitalisation of expenditure in previous years along with other issues around the treatment of assets. Although we have agreed a protocol, the complex arrangements in place at the Trust increase the risk of error.	We undertook early work to assess the Trust's approach and to ensure that the treatment of assets was in accordance with the agreed protocol. Our substantive, post statements work has confirmed that, in all material respects, the Trust's treatment of its assets is appropriate.

Key audit risks and our findings *continued*

Key Audit Risks	Finding:
A number of issues were raised as part of the previous year's audit work as follows:	The Trust has addressed the issues identified last year as follows:
■ The Trust had not maintained a memorandum or trading account for its income generation schemes	■ The Trust has produced memorandum accounts for its income generation schemes in this year's statements.
■ The Trust had failed to achieve the BPPC target of 95% of invoices within 30 days of receipt of a valid invoice.	■ The failure to achieve the BPPC target of 95% of invoices within 30 days of receipt of a valid invoice persists.
■ The Trust's property valuations were not in line with those expected by the Audit Commission's call-off valuer.	■ The Trust's property valuations were not materially different to those expected by the Audit Commission's call-off valuer.
■ The Trust's asset register was unable to calculate the difference between the depreciation charge under the historic cost and current cost accounting conventions.	■ The Trust has manually calculated the difference between the depreciation charge under the historic cost and current cost accounting conventions.
■ Some stock returns were missing and the note which shows inventories recognised in expenses was overstated.	■ All stock returns were obtained but the note which shows inventories recognised in expenses was still overstated.
■ The rate of returns from Directorates to enable the calculation of the accrual for leave untaken at the year end was only 56% with no returns being received from one Directorate.	■ The rate of returns from Directorates to enable the calculation of the accrual for leave untaken at the year end was improved from the previous year.

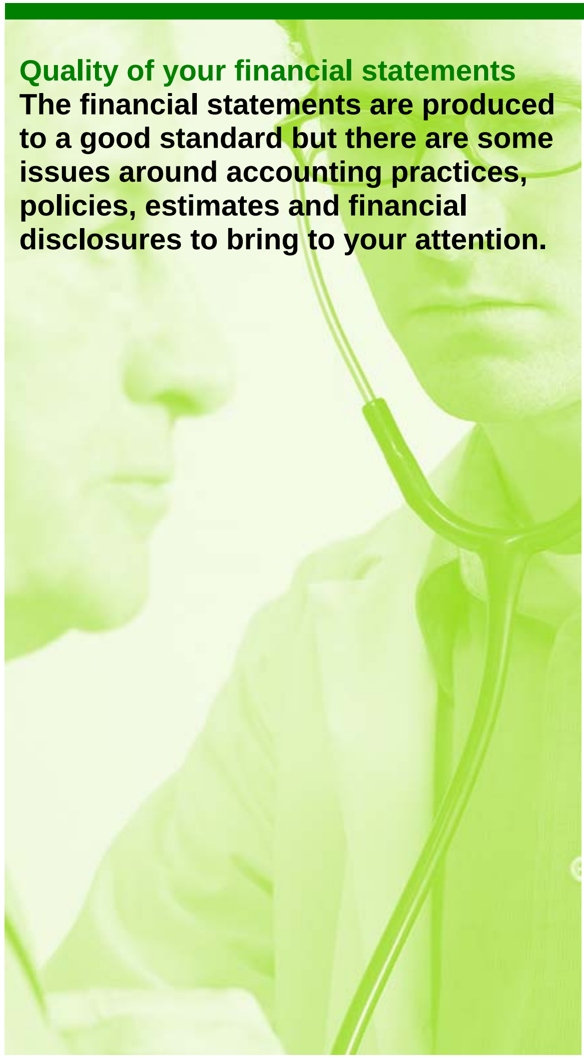
Financial statements

Significant weaknesses in internal control

I have not identified any significant weaknesses in internal control.

Significant weaknesses are only those I identified during the course of the audit that are relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control. I have not identified any significant weaknesses in internal control during the course of the audit.

Financial statements



Quality of your financial statements

The financial statements are produced to a good standard but there are some issues around accounting practices, policies, estimates and financial disclosures to bring to your attention.

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures. These are the issues I want to raise with you.

Accounting practices, policies, estimates and financial disclosures	
Issue	**Findings and recommendations:**
The Trust has failed to achieve the BPPC target of 95% of invoices within 30 days of receipt of a valid invoice. Actual performance is 79% by number and 74% by value for non NHS invoices and 80% by number and 83% by value for non NHS invoices.	Continue to review the reasons for the slow processing of invoices and take appropriate action to improve timeliness of payment in order to improve its performance in relation to the administrative duty under the Better Payment Practice Code.
Note 19 which shows inventories recognised in expenses has been compiled from the total of supplies and services. This is likely to overstate the Note as not all this expenditure will be in relation to stock items but the Trust does not currently have the systems in place to separately identify this expenditure.	Establish systems to separately identify inventories recognised as expenses in year.
In 2008/09 the Trust entered into an arrangement with Progress Housing for the provision of nursing accommodation. This transaction was established in the Trust's books in accordance with section 4.1 of	Establish the correct treatment for the buy out of the contractual arrangement for the provision of nursing accommodation.

the DoH PFI guidance - 'schemes with no unitary payment', as a finance leasing type arrangement, with an asset being recognised and an associated deferred credit being established. The scheme involved the provision of accommodation at 4 distinct sites. The Trust subsequently established an onerous contract against one of the four sites as the scheme incorporated a minimum occupancy guarantee for which the Trust was making considerable payments against as the scheme was over specified at this site. This resulted in the asset being fully impaired by £540,000 to a nil net book value.

The Trust subsequently plans to buy itself out of the contractual arrangement in relation to this site at a cost of £1,146,555. This has been embodied in a legal agreement dated 31 March 2011, although the date the buy-out actually occurs is expected to be late June 2011. In accounting for this transaction the Trust has undertaken the following:

- capitalised the buy out cost of £1,146,555
- fully amortised to revenue the remaining deferred credit in relation to this element of the scheme of £493,000
- subsequently revalued the asset to £850,000 resulting in an impairment charge of £296,555, charged to operating expenses.

This transaction has no material effect on the accounts. However, there remains uncertainty as to the accounting treatment in the following areas:

- whether it is appropriate for the Trust to account for this transaction in 2010/11 using the legal agreement as evidence to support this
- whether it is appropriate for the Trust to capitalise the buy out costs
- whether the accounting transactions as they stand are correct
- whether the Trust should have reversed any part of their original impairment arising from the onerous element of the contract against the asset as part of the accounting treatment.

Financial statements

Letter of representation

Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements.

Value for money

Value for money conclusion

The Trust did not have proper arrangements in place to secure financial resilience.

I am required to conclude whether the Trust has put in place proper corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission. My conclusion on each of the two areas is set out below.

I have identified weaknesses in your arrangements to secure financial resilience and economy, efficiency and effectiveness.

Value for money criteria and our findings

Criterion	Findings:
1. Financial resilience **The organisation has proper arrangements in place to secure financial resilience.**	The Trust's arrangements in 2010/11 did not provide proper arrangements to secure financial resilience. It has been underperforming financially since quarter two when it projected a year end deficit. The outturn is a deficit of £14 million, and the Trust is under SHA led intervention. The deficit is due to a number of factors, including growth in non elective activity and high costs of locum cover and a failure to meet the cost improvement programme, achieving only £9.8 million of the target of £18.3 million. The Trust is planning to achieve break-even during 2011/12, moving to sustainable surplus from 2013/14 onwards albeit with significant risks around the planned recovery

Value for money

Value for money conclusion

The Trust did not have proper arrangements to secure economy, efficiency and effectiveness.

Value for money criteria and our findings *continued*

Criterion	Findings:
2. Securing economy efficiency and effectiveness **The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.**	The Trust has not provided proper arrangements to secure economy, efficiency and effectiveness in 2010/11. Specifically, there was inadequate cost information to support cost improvement plans and there is a history of failure to deliver planned spending reductions. It has made a significant deficit in year and as such, it has failed to prioritise resources within budgets.

Appendix 1 – Draft independent auditor's report

INDEPENDENT AUDITOR'S REPORT TO THE DIRECTORS OF UNITED LINCOLNSHIRE HOSPITALS NHS TRUST

I have audited the financial statements of United Lincolnshire Hospitals NHS Trust for the year ended 31 March 2011 under the Audit Commission Act 1998. The financial statements comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Taxpayers' Equity, the Statement of Cash Flows and the related notes. These financial statements have been prepared under the accounting policies set out in the Statement of Accounting Policies. I have also audited the information in the Remuneration Report that is described as having been audited

This report is made solely to the Board of Directors of United Lincolnshire Hospitals NHS Trust in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 45 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

Respective responsibilities of Directors and auditor

As explained more fully in the Statement of Directors' Responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Trust's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Trust; and the overall presentation of the financial statements. I read all the information in the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view of the state of United Lincolnshire Hospitals NHS Trust's affairs as at 31 March 2011 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the accounting policies directed by the Secretary of State with the consent of the Treasury as relevant to the National Health Service in England.

Opinion on other matters
In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the accounting policies directed by the Secretary of State with the consent of the Treasury as relevant to the National Health Service in England; and
- the information given in the Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception
I have nothing to report in respect of the Statement on Internal Control on which I report to you if, in my opinion the Statement on Internal Control does not reflect compliance with the Department of Health's requirements.

Conclusion on the Trust's arrangements for securing economy, efficiency and effectiveness in the use of resources

Trust's responsibilities
The Trust is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities
I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Trust has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. I am not required to consider, nor have I considered, whether all aspects of the Trust's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Basis for adverse conclusion
I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2010, as to whether the Trust has proper arrangements for:

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

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Trust put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2011.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Trust had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

In considering the Trust's arrangements for securing financial resilience and challenging how it secures economy, efficiency and effectiveness, I identified that the Trust made a deficit of £14 million in year. There was a significant shortfall in its cost improvement programme, with the Trust achieving £9.8 million against a target of £18.3 million. The Trust also experienced higher than expected activity coupled with medical staff vacancies and associated high locum costs, which contributed to an overspend against budget of £14 million on pay costs. Historically the Trust has underperformed significantly against its cost improvement and productivity plans but it has a recovery plan in place which forecasts break even for 2011/12. However, there are risks within this plan since it relies on the delivery of a cost improvement programme of £20.4 million (5.4%) in 2011/12 increasing to 7.6% in 2013/14. A £15 million working capital loan is an integral part of the 2011/12 plan. Achievement of the cost improvement programme requires strong programme management arrangements which the Trust is beginning to develop.

Adverse conclusion

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, the matters reported in the basis for adverse conclusion paragraph above prevent me from being satisfied that in all significant respects United Lincolnshire Hospitals NHS Trust put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011.

Delay in Certification of completion of the audit

I cannot formally conclude the audit and issue an audit certificate until I have completed the work necessary to provide assurance over the Trust’s annual quality accounts. I am satisfied that this work does not have a material effect on the financial statements.

Ian Sadd
Officer of the Audit Commission
Rivermead House
7 Lewis Court
Grove Park
Enderby
Leicestershire
LE19 1SU

7 June 2011

Appendix 2 – Amendments to the draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to aid you in fulfilling your governance responsibilities.

		Statement of comprehensive income		Statement of financial position	
Adjusted misstatement	**Nature of adjustment**	**Dr £'000s**	**Cr £'000s**	**Dr £'000s**	**Cr £'000s**
Foreword to the accounts	Understatement of the reported Capital Resource Limit outturn figure by £1,903k	-	-	-	-
Accounting policies	A number of differences were noted between the pro forma policies of the Department of Health and those disclosed by the Trust	-	-	-	-
Other operating revenue / Operating leases / Finance leases	Incorrect classification of the contingent rent in respect of a single leased property as operating instead of finance	30	30		
Property, plant and equipment	Failure to reset the net book value of land, buildings and dwellings following the revaluation of the Trust's estate			7,661	7,661
Property, plant and equipment / Intangible assets	Incorrect capitalisation of computer software as property, plant and equipment instead of intangibles			54	54
Property, plant and equipment	Failure to report the revaluation gains following the revaluation of the Trust's			4,168	4,168

	estate correctly				
Property, plant and equipment	Incorrect inclusion of intangibles assets of £497k within the textual disclosures of 'gross value of fully depreciated assets still in use'	-	-	-	-
Trade and other receivables	Removal of credit notes totalling £2,382k from the analysis of receivables past their due date but not impaired	-	-	-	-
Trade and other payables	Incorrect classification of accruals as 'other' and ‘non-NHS trade payables – capital’ rather than 'accruals and deferred income'			9,380	9,380
Other liabilities	Incorrect split of balance between ‘current’ and ‘non-current’ elements			14	14
Statement of taxpayers' equity	Failure to eliminate the associated revaluation reserve balances on asset de-recognitions			208	208
Intra-Government balances	Incorrect classification of balances with NHS Injury Costs Recovery Income Unit of £4,446	-	-	-	-

Appendix 3 – Unadjusted misstatements in the financial statements

I identified the following misstatements during my audit, but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities and ask you to correct these misstatements. If you decide not to amend, please tell me why in the representation letter. If you believe the effect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

		Statement of comprehensive income		Statement of financial position	
Unadjusted misstatement	**Nature of required adjustment**	**Dr £'000s**	**Cr £'000s**	**Dr £'000s**	**Cr £'000s**
Operating expenses – Impairments and reversals of property, plant and equipment	The Trust's calculation methodology and assumptions used in its onerous contract provision identified weakness in the approach		938		
Property, plant and equipment – Reversals of impairments				938	
Revenue from patient care activities – Primary care trusts	Incorrect reduction of income due from partially completed spells at the year end by 70%		1,783		
Trade and other receivables – NHS receivables revenue				1,783	
Operating expenses – Employee benefits	Under provision of March payroll enhancement expenditure	91			
Trade and other payables – Accruals and deferred income					91
Operating expenses – Employee benefits	Over provision of holiday pay accrual		275		
Trade and other payables – Accruals and deferred income				275	

Appendix 4 -Glossary

Audit closure certificate

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

Audit opinion

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

Opinion where there is no regularity leg

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

Appendix 4 -Glossary

Materiality and significance

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

‘Significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

Weaknesses in internal control

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

Appendix 4 -Glossary

Value for money conclusion

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

Appendix 5 – Action plan

Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
Continue to review the reasons for the slow processing of invoices and take appropriate action to improve timeliness of payment in order to improve its performance in relation to the administrative duty under the Better Payment Practice Code.	2	Associate Director of Finance - Financial Control	Yes		March 2010
Establish systems to separately identify inventories recognised as expenses in year.	1	Associate Director of Finance - Financial Control	Yes		March 2012
Establish the correct treatment for the buy out of the contractual arrangement for the provision of nursing accommodation.	3	Director of Finance, Procurement and Informatics	Yes	Technical guidance is awaited for the correct treatment of this transaction.	September 2011