Guy's and St Thomas' NHS Foundation Trust

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Report to the Governing Body on the external audit of the Trust's 2014/15 financial statements

Governors' report: 15 July 2015

Contents

"I am delighted to present this report, for your 2014/15 audit, which sets out the focus of our audit and how we addressed the risks we identified.

Sue Barratt ACA

Audit Partner

Executive Summary

We have issued a clean audit report on the Trust's financial statements.

Context

This is a report to you summarising the findings of our external audit of the Trust's 2014/15 financial statements.

We have also reported on the Trust's Quality Report. Our findings from that work are set out in a separate report to you.

	2014/15	2013/14	Increase/ (decrease)	% Increase/ (decrease)
Revenue	£1,289m	£1,241m	£48m	3.9%
Net surplus for the year	£18m	£15m	£3m	20.0%
Land and buildings value	£923m	£885m	£38m	4.3%
Net assets	£1,124m	£1,049m	£75m	7.1%

Approach

We have performed our audit in accordance with Monitor's Audit Code and International Standards on Auditing (UK and Ireland). Details of our approach are set out in section 1 of this report.

The format of our audit report, which is included on page 99 of the Annual Report, has changed this year to include detail on the risks which have had the greatest effect upon our audit approach, and how we responded to those risks. This change reflects new reporting requirements introduced this year for public reporting. We have historically provided this information through this report to the Governors.

The significant audit risks, set out in section 2, were:

- NHS revenue;
- Property valuations;
- Capital additions; and
- Management override of controls.

Our audit report does not contain details of the risk of management override of controls, as the risk did not significantly impact our audit approach compared to other trusts.

Findings

We provided detailed reports to the Trust's Audit Committee and Board on our audit of the Trust's financial statements and a separate report covering our work on the Trust's Quality report on 22 May 2015. On 28 May 2015, we signed our audit opinion on the Trust's financial statements:

- **We issued a clean (unmodified) opinion on the Trust's 2014/15 financial statements.**
- **We did not report on any items 'by exception' in our audit report.**

We have reported control observations and recommendations for improvement to the Audit Committee.

Our approach

We have outlined an overview of our audit approach.

An overview of the scope of the audit

Our audit was scoped by obtaining an understanding of the Trust and the environment it operates in, including internal control, and assessing the risks of material misstatement to the financial statements.

Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team, led by the audit partner, Sue Barratt. The audit team included integrated Deloitte specialists bringing specific skills and experience in property valuations and Information Technology systems.

Data analytic techniques were used as part of audit testing, in particular to support profiling of populations to identify items of audit interest and in journal testing.

We perform work, both on the financial statement audit, and also the work specified by Monitor on the Trust's annual Quality Report. The results of that work are discussed in the accompanying report. The assurance that our work provides to the Council of Governors and Board of Directors, as a body, is not intended to be the only source of assurance for the Council of Governors.

The diagram on the next page illustrates the areas where our work provides assurance, and what other sources of assurance are available to you in respect of other issues.

Materiality

Our work is planned and performed to detect material misstatements. We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Trust to be £9.9m (2014: £9.9m), which is below 1% of revenue and below 3% of taxpayers' equity.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £198k as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also reported to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview our assessment of material account balances, classes of transactions and disclosures

We perform an assessment of risk which includes considering the size, composition and qualitative factors relating to account balances, classes of transactions and disclosures. This enables us to determine the scope of further audit procedures to address the risk of material misstatement.

We performed procedures to review and understand significant movements in all material balances compared to the prior year. We reviewed breakdowns of current year balances to assess whether they contained any unusual items and we considered, based on our prior year audit knowledge, whether there was a history of error in the accounts balance.

Our approach (continued)

Assurance sources for the Trusts

The diagram below illustrates the assurance provided by external audit around finance, quality, controls and systems and the future of the Trust (in the green rows) and how this fits with some of the other assurance available over the Trust's position and performance.

<table>
<tr><th></th><th>Financial
How is the Trust performing financially?</th><th>Quality
How are the Trust's outcomes and quality measured?</th><th>Controls and systems
Does the Trust have adequate processes?</th><th>Future of the trust
Is the Trust's strategy appropriate and sustainable?</th></tr>
<tr><td rowspan="5">Business processes and Board oversight</td><td colspan="4">Is reliable reporting and data being produced through the year, at each level within the Trust, and appropriately reviewed and followed up?</td></tr>
<tr><td colspan="2">Is the Annual Report and Accounts, taken as a whole, fair, balanced and understandable?</td><td>Are the Trust's processes operating effectively?</td><td>Are the Trust's plans realistic and achievable?</td></tr>
<tr><td colspan="4">Is the Trust meeting its legal and regulatory obligations, and are appropriate plans in place to maintain compliance?</td></tr>
<tr><td>Has the Trust delivered on its financial plans?</td><td>Are Quality Priorities selected appropriate for the Trust?</td><td>Does the Trust have efficient systems and processes?</td><td>Are appropriate actions in place to deliver the Trust's plans?</td></tr>
<tr><td>Is the Trust generating sufficient surplus for reinvestment?</td><td>Are quality report metrics accurate and complete (other than 3 tested metrics)?</td><td>Are risks around legacy systems etc appropriately mitigated?</td><td>What are the risks to achievement of the Trust's plans and are appropriate mitigations in place?</td></tr>
<tr><td>Internal audit assurance</td><td colspan="4">Is there a generally sound system of internal control on key financial and management processes?</td></tr>
<tr><td rowspan="3">External Audit assurance on reported performance</td><td>Do the financial statements give a true and fair view?</td><td>Are the 2 tested indicators reasonably stated?</td><td>Is the Annual Governance Statement misleading or inconsistent with information we are aware of from our audit? *</td><td>Is there significant uncertainty over the going concern assumption?</td></tr>
<tr><td>Have the financial statements and remuneration report been properly prepared?</td><td>Does the Quality Report include the required contents?</td><td></td><td></td></tr>
<tr><td>Is the Annual Report consistent with the financial statements? *</td><td>Is the Quality Report consistent with other external and internal reports?</td><td>Has the trust made proper arrangements for securing economy, efficiency and effectiveness in the use of resources? *</td><td></td></tr>
</table>

*Note – the scope of external audit in this area is "negative assurance" of reporting by exception of issues identified.

Our approach (continued)

Procedures for auditing the Trust's financial statements

In summary, our audit of the Trust's financial statements included:

- developing an understanding of the Trust, including its systems, processes, risks, challenges and opportunities and then using this understanding to focus audit procedures on areas where we consider there to be a higher risk of misstatement in the Trust's financial statements;
- interviewing members of the Trust's management team and reviewing documentation to test the design and implementation of the Trust's internal controls in certain key areas relevant to the financial statements; and
- performing sample tests on balances in the Trust's financial statements to supporting documentary evidence, as well as other analytical procedures, to test the validity, accuracy and completeness of those balances.

Approach to audit risks

We focused our work on areas where we considered there to be a higher risk of misstatement. We refer to these areas as significant audit risks.

We provided a detailed audit plan to the Trust's Audit Committee setting out what we considered to be the significant audit risks for the Trust, together with our planned approach to addressing those risks. We have provided a summary of each of the significant audit risks in the following section.

We have made recommendations for the improvement of the Trust's policies, procedures and internal controls from our work. However, we do not consider these recommendations to reflect any material weakness in the Trust's control environment and the Trust is committed to the implementation of our recommendations.

Our approach (continued)

Value for Money

We are required to satisfy ourselves that the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

In contrast to the requirements that apply to NHS Trusts, we are not required to issue a conclusion on value for money. Instead, we report in our audit certificate only significant matters that come to our attention from performing the procedures required by the Audit Code.

In discharging this responsibility, the Code requires that we take into account our work on the Annual Governance Statement and the work of regulators, in particular Monitor and the Care Quality Commission.

We are required to consider the completeness of the disclosures in the Annual Governance Statement in meeting the relevant requirements and identify any inconsistencies between the disclosures and the information that we are aware of from our work on the financial statements and other work.

We have obtained an understanding of the Trust's arrangements for securing "value for money", through a combination of:

- "high level" interviews with key staff including the CFO, Chairman, Chief Executive and Chair of the audit committee;
- review of the Trust's draft Annual Governance Statement;
- consideration of issues identified through our other audit and assurance work;
- consideration of the Trust's results, including benchmarking of actual performance (including on CIP delivery as summarised below) and the 2015/16 Annual Plan;
- review of Monitor's continuity of service and governance risk ratings;
- benchmarking of the Trust's performance.

Through our work we have not identified any specific risks in respect of Value for Money and we have not identified any issues which we need to report in our audit opinion in respect of:

- the Trust's arrangements for securing the economy, efficiency and effectiveness of the use of resources; or
- the Annual Governance Statement.

We did not "report by exception" on any issues in our audit opinion.

Significant Risks: Recognition of NHS revenue and recoverability of receivables

Risk identified

As set out in our Audit Plan, we identified recognition of NHS revenue and associated provisions as a key risk due to the complexity of the payment by results revenue regime, the judgemental nature of provisions for disputes with commissioners and the risk of revenue not being recognised at fair value due to adjustments agreed in settling current year disputes and agreement of future year contracts.

Key judgements

There are significant judgments in the recognition of revenue from care of NHS patients and in provisioning for disputes with commissioners due to:

- the complexity of the Payment by Results regime, in particular in determining the level of overperformance and Commissioning for Quality and Innovation revenue to recognise;
- the judgemental nature of provisions for disputes, including in respect of outstanding overperformance income for quarters 3 and 4; and
- the risk of revenue not being recognised at fair value due to adjustments agreed in settling current year disputes and agreement of future year contracts.

The Trust earns revenue from a wide range of commissioners, increasing the complexity of agreeing a final year-end position.

Details of revenue recognition policies in relation to the operating income of £997.8m are included in note 1.3 to the financial statements. The policy for provisions against NHS receivables (provision of £22.7m) is given in Note 1.23.

Deloitte response

- We evaluated the design and implementation of controls over recognition of Payment by Results income.
- We performed detailed substantive testing of the recoverability of overperformance income and adequacy of provision for underperformance through the year.
- We challenged key judgements around specific areas of dispute and actual or potential challenge from commissioners and the rationale for the accounting treatments adopted. In doing so, we considered the historical accuracy of provisions for disputes and reviewed correspondence with commissioners.
- We tested NHS debtor and revenue balances included in the Intra NHS agreement of balances exercise and investigated significant areas of difference.

Project Diamond

In 2014/15, the Trust recognised £17.9m in respect of Project Diamond out of which £17.9m remained outstanding as at 11 May 2015. We understand that there is no allocation in respect of this project in the 2015/16 forecast. We challenged management's assessment that the income should be recognised in full in 2014/15, rather than adopting the alternative treatment which would be to defer an element of the income into 2015/16. Such a treatment might be considered as that the Trust will not receive any Project Diamond income in 2015/16 and new tariff arrangements, which are expected to better compensate specialist trusts for their higher costs bases, will not begin until 2016/17. The Trust has disclosed the accounting judgement taken, which we consider reasonable in the circumstances. The approach adopted is not an unreasonable approach as the agreement between NHSE and the Trust clearly specifies that this is in respect of 2014/15; the 2015/16 contract negotiation was formally separated by the negotiating Trusts from the 2014/15 settlement, and, while based on lower costs, gives other benefits to the Trust in terms of certainty on income and recovery; and the impact of the principal alternative treatment would not materially affect the result for either 2014/15 or 2015/16.

Property valuations and capital expenditure

Our valuation experts have challenged the key assumptions made by the valuer

Risk Identified

The Trust is required to hold property assets within Property, Plant and Equipment at valuation, which will usually be on a modern equivalent use basis. As detailed in our Audit Plan, valuations are by nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value. The Trust has had an independent valuation carried out for the purposes of the 31 March 2015 financial statements.

The Trust has an extensive £137m capital programme. As detailed in our Audit Plan, accounting for capital expenditure can involve significant judgements.

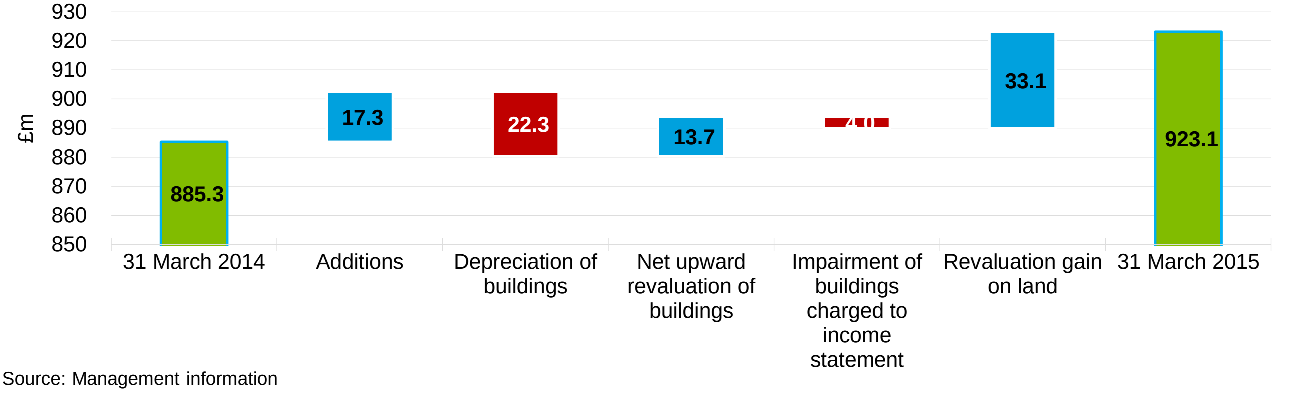
Key judgements

The Trust holds property assets within Property, Plant and Equipment at a modern equivalent use valuation. The valuations are by nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value.

Details of the key policies can be found at note 1.7 in the financial statements.

Note 14.1 shows a year end net book value of fixed assets of £1,153.9m including £112.7m of purchased additions to fixed assets in the year. There are judgments surrounding whether capitalisation criteria, such as timing of commencement of capitalisation and inclusion only of directly attributable costs, have been met in relation to these, and also whether any assets replaced have been appropriately disposed of from the registers.

Movement in property valuations



Source: Management information

Deloitte response

We evaluated the design and implementation of controls over property valuations, and tested the accuracy and completeness of data provided by the Trust to the valuer.

We used internal valuation specialists to review and challenge the appropriateness of the valuation approach and the key assumptions used in the valuation of the Trust's properties, including benchmarking against valuations for other NHS Foundation Trusts as at 31 March 2015.

We assessed whether the valuation and the accounting treatment of the impairment were compliant with the relevant accounting standards, and in particular whether impairments should be recognised in the Income Statement or in Other Comprehensive Income.

We have assessed whether fixed asset additions have been appropriately capitalised by testing whether the capitalisation commenced in the correct period and reviewing the nature of the capitalised costs to verify whether these meet the criteria, and whether any superseded fixed assets have been suitably accounted for including appropriate removal from the fixed asset register. We have reviewed the fixed asset related expense accounts to check for any items which should have been capitalised.

The Trust's valuation assumptions are in line with other Trusts and fall within the expected range highlighted by Deloitte Real Estate. There were two errors (below materiality) relating to prior periods that were identified in the current period. One related to an asset belonging the Trust that was not on the register, and one which was included in the ledger but where there is no value to the Trust.

Management override of controls

We have not identified any instances of management override of controls

Risk Identified

International Standards on Auditing requires auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports.

Key judgements

Our audit work is designed to test for instances of management override of controls. We have summarised above our work on key estimates around revenue recognition, property valuations and accounting for capital projects. We also perform audit work around other estimates, such as provisions.

Deloitte response

We have considered the overall sensitivity of judgements made in preparation of the financial statements, and note that:

- The Trust's reported results were ahead of plan by £11.6m.
- Senior management's remuneration is not tied to particular financial results.
- The final settlement in relation to project diamond has resulted in a comfortable financial position at year end in excess of that in the plan. However, there remain challenges in future budgeting and performance.

We have considered these factors and other potential sensitivities in evaluating the judgements made in the preparation of the financial statements. Specific areas of work are:

Journals

We have made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

We have used Spotlight data analytics tools to test a sample of journals, based upon identification of items of potential audit interest. We reconciled the complete population of journals to the trial balance and performed sampling based on items of audit interest, such as searching for key words, round number journals and journals posted to unusual accounts.

Accounting estimates

In addition to the key estimates discussed above, we have tested the basis for other estimates used in the financial statements such as provisions. We have no additional findings to report.

Significant transactions

We did not identify any significant transactions outside the normal course of business or transactions where the business rationale was not clear.

Deloitte view

We have not identified any significant bias in the key judgements made by management

The control environment is appropriate for the size and complexity of the Trust.

Analysis of audit fees

The professional fees earned by Deloitte in the period from 1 April 2014 to 31 March 2015 were as follows:

	2014/15 £'000	2013/14 £'000
Audit of Trust	100.8	98.3
Audit of subsidiaries*	10.0	11.4
Total audit	**110.8**	**109.7**
Audit related assurance services – Quality report and WGA return	21.0	21.0
Tax advisory services - VAT	28.4	16.5
Total non-audit services	**49.4**	**37.5**
Total fees	**160.2**	**147.2**

* Note that the subsidiaries audits have not yet been finalised. This fee is potentially subject to change. The decrease in the proposed fee for the subsidiaries reflects that only three subsidiaries require audit by Deloitte LLP in the current year, compared with four in the previous year.

Responsibility statement

What we report

Our report is designed to help the Council of Governors, Audit Committee, and the Board discharge their governance duties. Our report includes:

- Details of our audit approach; and
- The significant audit risks we have identified and our responses to those risks.

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What we don’t report

- As you will be aware, our audit was not designed to identify all matters that may be relevant to the Board or Governing body.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

The scope of our work

- Our observations are developed in the context of our audit of the financial statements.
- This report should be read alongside our “Briefing on audit matters” circulated to you previously.

We welcome the opportunity to discuss our report with you and receive your feedback.

Deloitte LLP

Deloitte LLP
Chartered Accountants

Reading
15 July 2015

This report is confidential and prepared solely for the purpose set out in our engagement letter and for the Board of Directors, as a body, and Council of Governors, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent. You should not, without our prior written consent, refer to or use our name on this report for any other purpose, disclose them or refer to them in any prospectus or other document, or make them available or communicate them to any other party.

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