



HEALTHCARE

Annual Audit Letter

2008/09

Sandwell and West
Birmingham Hospitals
NHS Trust

3 September 2009

AUDIT

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This report is addressed to the Trust and has been prepared for the sole use of the Trust. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Michael McDonagh who is the engagement lead to the Trust or Trevor Rees, the national contact partner for all of KPMG's work with the Audit Commission. After this, if you still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure.

You can contact the Complaints Unit by: Phone: 0844 798 3131 [Local rate call] Email: complaints@audit-commission.gov.uk Website: www.audit-commission.gov.uk/aboutus/contactus

Textphone (minicom): 020 7630 042 Post: Complaints Unit Manager, Audit Commission
Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR.

Executive Summary

Purpose

This Annual Audit Letter (the letter) summarises the key issues arising from our 2008/09 audit at Sandwell and West Birmingham Hospitals NHS Trust (the Trust). Although this letter is addressed to the directors of the Trust, it is also intended to communicate these issues to key external stakeholders, including members of the public. The letter will also be published on the Audit Commission website at www.audit-commission.gov.uk. It is the responsibility of the Trust to publish the letter on the Trust website at www.swbh.nhs.uk. In the letter we highlight areas of good performance and also provide recommendations to help you improve performance. Our recommendations are summarised in Appendix 1. We have reported all the issues in this letter to you throughout the year and a list of all reports that we have issued is provided in Appendix 2.

Scope of our audit

The statutory responsibilities and powers of appointed auditors are set out in the Audit Commission Act 1998. Our main responsibility is to carry out an audit that meets the requirements of the Audit Commission's *Code of Audit Practice* (the Code) which requires us to review and report on your:

- *use of resources* - that is whether you have made proper arrangements for securing economy, efficiency and effectiveness ('value for money') in your use of resources. Our work in this area is summarised in section 2;
- *accounts* – that is the Financial Statements and the Statement on Internal Control. This work is summarised in section 3.

Key Messages

The key areas which we draw to your attention to are:

- The Trust achieved its targeted financial position in 2008/09 delivering an in year surplus of £2.5m.
- The Trust's indicative Auditor's Local Evaluation (ALE) scores have shown stability in the overall scores with improvement in several areas since the previous year. Whilst the assessment still needs to go through final national quality assurance, the Trust's indicative overall score is a level 3 for 2008/09 (2007/08: level 3). This means that the Trust is assessed as "consistently above minimum performance, performing well".
- The Trust has been proactive in preparing for the NHS accounts conversion to International Financial Reporting Standards (IFRS) in 2009/10. From our work on the Trust's arrangements for converting its 1 April 2008 balance sheet to IFRS, we assessed that "*adequate arrangements appear to be in place for the balance sheet area to provide not materially misstated amounts for the balance sheet restatement.*"
- We issued unqualified audit opinions on the Trust's financial statements and on its value for money conclusion in 2008/09.

Future Challenges

- The Trust is forecasting a surplus of £2.3m for 2009/10 but to achieve this it will need to deliver a Cost Improvement Plan of £15.1m. The Trust has detailed plans in place to achieve the required savings and has proven its ability to achieve challenging CIPs in the past. However, public expenditure forecasts indicate significant pressure on future NHS funding and the Trust will have to manage the impact of funding pressures with its commissioners and continue to deliver real efficiency and productivity improvements to maintain its financial stability, whilst balancing this with continuing to deliver high quality care to patients.
- The Trust is in the process of applying for Foundation Trust status and is working hard on amendments to its Integrated Business Plan (IBP) and Long Term Financial Model (LTFM), as well as continuing to look at other areas such as Board development, to ensure that the Trust's application is successful. The Trust must look to ensure that it has the capacity to meet the application timetable whilst managing the challenging financial position and continuing to meet its service targets going forward.
- The Trust is progressing with the "Right care, Right Here" (formerly "Towards 2010") programme, the centrepiece of which will be a new hospital replacing the Trust's existing City and Sandwell General Hospitals. The programme may result in additional accounting issues for discussion and resolution in the coming period, particularly in relation to the acquisition of assets and commencement of construction works. The Trust should ensure that the Board continues to be fully informed of any issues as the project progresses.
- NHS financial results for 2009/10 will be reported using IFRS. The Trust is required to re-state its 2008/09 financial statements into IFRS and then produce its 2009/10 accounts in IFRS during the early summer of 2010. The Trust needs to continue to address the challenges of IFRS conversion whilst embedding the principles of IFRS to ensure that it is ready to undertake its financial reporting on an IFRS basis in future.

Executive Summary (continued)

- Through *Saving carbon, improving health* the NHS is aiming to reduce carbon emissions by 10% by 2015. All NHS bodies are going to be monitored and measured on their performance in reducing emissions. The Treasury is developing guidance for 2010/11 which will require all NHS bodies to report publicly on sustainability performance in annual reports. This information will be subject to audit and public scrutiny. NHS organisations need to act now to prepare for sustainability reporting and to realise the huge opportunities that addressing sustainability brings, including cost reduction.

We will liaise with the Trust regarding these and any other issues as they emerge. We will work with you to continue to achieve a smooth accounts and audit process.

Fees

Our audit fee for 2008/09 was £198,000 excluding VAT. This excludes the audit of charitable funds. These fees were in line with those highlighted within our audit plan.

We have undertaken non-audit work during the year in respect of Board Development. This work commenced in 2007/08 following a competitive procurement exercise by the Trust. The agreed fee for this work was £46,000 of which £40,000 was billed in 2008/09.

Use of resources

The main elements of our use of resources work are:

- *Auditor's Local Evaluation (ALE)* - we assess how well you manage and use financial resources by providing scored judgements on arrangements in five areas (Financial Reporting, Financial Management, Financial Standing, Internal Control, and Value For Money). We also follow up prior year recommendations to support this conclusion.
- *Value for money conclusion* – we issue a conclusion on whether we are satisfied that you have put in place proper arrangements for securing economy, efficiency and effectiveness in your use of resources. This is based on the ALE assessment and on the local reviews carried out.

The findings from this work are summarised below.

Element of work	Key findings												
Auditors Local Evaluation	<p>Our assessment of Sandwell and West Birmingham Hospitals NHS Trust against the five specified areas resulted in the following scores on a scale of one (inadequate) to four (performing strongly):</p> <table border="1"> <thead> <tr> <th>Area</th> <th>Score</th> </tr> </thead> <tbody> <tr> <td>Financial reporting</td> <td>3</td> </tr> <tr> <td>Financial management</td> <td>3</td> </tr> <tr> <td>Financial standing</td> <td>4</td> </tr> <tr> <td>Internal control</td> <td>3</td> </tr> <tr> <td>Value for money</td> <td>3</td> </tr> </tbody> </table>	Area	Score	Financial reporting	3	Financial management	3	Financial standing	4	Internal control	3	Value for money	3
	Area	Score											
Financial reporting	3												
Financial management	3												
Financial standing	4												
Internal control	3												
Value for money	3												
	<p>These scores are indicative at present. They were submitted for national quality assurance on 3 July 2009 and the final scores will be released by the Care Quality Commission in September 2009.</p> <p>The 2008/09 ALE assessment has seen the Trust build upon its 2007/08 ALE scores. For Internal Control you progressed from a level two to a level three. For Financial Management, Financial Reporting and Value for Money KLOEs you maintained a level three but improvement was noted on the prior year in several individual KLOE areas which helped to consolidate your position. In addition, fulfilment of the Trust's three year financial recovery plan resulted in a level four being awarded for Financial Standing, an improvement from level three in 2007/08.</p> <p>These scores would suggest an overall ALE score of level three meaning that the Trust is assessed as "consistently above minimum performance, performing well".</p>												
Value for money conclusion	<p>We issued an unqualified value for money conclusion for 2008/09. This means that we are satisfied that you put in place proper arrangements for securing economy, efficiency and effectiveness in your use of resources.</p>												

Based upon our work we concluded that the Trust had made proper arrangements to secure economy, efficiency and effectiveness in its use of resources during 2008/09. We issued our VFM conclusion on 11 June 2009.

The details of our findings and recommendations in relation to ALE will be reported to the Audit Committee in our 2008/09 ALE report which will be issued in September 2009.

The Audit Commission is a signatory to the concordat between bodies inspecting, regulating and auditing healthcare. We provide an annual update of progress against all recommendations arising from our use of resources and accounts work to the Audit Committee in Appendix 1.

Financial statements

Audit opinion

We issued an unqualified opinion on your accounts on 11 June 2009. This means that we believe the accounts give a true and fair view of the financial affairs of the Trust and of the income and expenditure recorded during the year. We have also confirmed that you have complied with the Department of Health requirements in the preparation of your Statement on Internal Control.

Before we give our opinion on the accounts, we are required to report to your Board any significant matters identified. We did this in our report to the Board meeting on the 11 June and the key issues are summarised here.

Accounts production and adjustments to the accounts

- We received a complete set of draft accounts ahead of the Department of Health deadline supported by very good quality working papers.
- We identified a small number of audit differences. There were three significant adjustments that were identified and were not adjusted by management. These were in relation to a Clinical Negligence Scheme for Trusts (CNST) provision, "adjustments to balances" acting as NHS provision for irrecoverable debt and a provision for redundancy. Had these items been adjusted, the effect on the Trust's Income and Expenditure account would have been a £2,861,000 increase in the Trust's surplus. We also identified a number of more minor numerical and presentational errors to the draft accounts which were corrected by management.
- We raised 11 recommendations for performance improvement in our Interim Audit and Auditors Local Evaluation Report (May 2009) and Audit Memorandum (June 2009). A summary of these recommendations, along with the Trust's response, is provided at Appendix 1. No "priority one" (high priority) recommendations were identified during the period.

Financial Standing

NHS bodies are given financial targets every year. One of these, the breakeven duty, is statutory, which means you **must** achieve it. The others are administrative, which means you **should** achieve them. Your performance against the targets is outlined below:

Target name	What it means	Your performance
In-year breakeven	Keeping expenditure payable for the year within the amount of income received for the year	✓ You reported a surplus of £2.5m.
Cumulative breakeven	As above, over a three year period.	✓ You reported a break even over a three year period.
External Financing Limit	Keeping the requirement for cash financing within a limit set by the Strategic Health Authority	✓ You remained within the EFL by £1.138m.
Capital Resource Limit	Keeping net capital expenditure within a limit set by the Strategic Health Authority	✓ You remained within the CRL by £1.413m.

Financial statements (continued)

International Financial Reporting Standards (IFRS)

You have undertaken work on the balance sheet to understand and quantify the impact of IFRS. The Trust has been proactive in discussing any material issues identified as part of this process with us. Our interim report included a summary of our review on the Trust's processes to restate its IFRS opening balance sheet at 1 April 2008. Our assessment was that, overall, "*adequate arrangements appear to be in place for the balance sheet area to provide not materially misstated amounts for the balance sheet restatement*".

We made three recommendations as a result of this work which are detailed in Appendix 1.

Challenges for 2009/10 and beyond

• In 2009/10 NHS Trusts must plan for a minimum 3.0% cost improvement. The Trust is currently planning a Cost Improvement Plan (CIP) of 4.5% (which equates to savings of £15m) and is forecasting a surplus of £2.3m for the year ending 31 March 2010. Key risks to this forecast include:

- achievement of the CIP;
- management of the introduction of the new payment by results tariff, HRG4;
- additional costs incurred by the Trust associated with the "Right Care, Right Here" programme; and
- any impact on the Trust of developments within primary care through provider separation.

The Trust has detailed plans in place to achieve the required savings and has proven its ability to achieve challenging CIPs in the past. However, public expenditure forecasts indicate significant pressure on future NHS funding and the Trust will have to manage the impact of funding pressures with its commissioners and continue to deliver real efficiency and productivity improvements to maintain its financial stability, whilst balancing this with continuing to deliver high quality care to patients.

• The Trust is in the process of applying for Foundation Trust status and is working hard on amendments to its Integrated Business Plan (IBP) and Long Term Financial Model (LTFM), as well as continuing to look at other areas such as Board development, to ensure that the Trust's application is successful. The Trust must look to ensure that it has the capacity to meet the application timetable whilst managing the challenging financial position and continuing to meet its service targets going forward.

• NHS financial results for 2009/10 will be reported using IFRS. The Trust is required to re-state its 2008/09 financial statements into IFRS and then produce its 2009/10 accounts in IFRS during the early summer of 2010. The Trust needs to continue to address the challenges of IFRS conversion whilst embedding the principles of IFRS to ensure that it is ready to undertake its financial reporting on an IFRS basis in future.

• The Trust is progressing with the "Right care, Right Here" (formerly "Towards 2010") programme, the centrepiece of which will be a new hospital replacing the Trust's existing City and Sandwell General Hospitals. The programme may result in additional accounting issues for discussion and resolution in the coming period, particularly in relation to the acquisition of assets and commencement of construction works. The Trust should ensure that the Board continues to be fully informed of any issues as the project progresses.

• Through *Saving carbon, improving health* the NHS is aiming to reduce carbon emissions by 10% by 2015. All NHS bodies are going to be monitored and measured on their performance in reducing emissions. For those Trusts in the Carbon Reduction Commitment scheme there will be implications for cash flow, energy bills, and investment decisions - these could be significant. There are huge opportunities in addressing sustainability with clear cost reduction opportunities from saving energy which will become more and more significant over time.

• The Treasury is developing guidance for 2010-2011 which will require all NHS bodies to report publicly on sustainability performance in annual reports. All reported information will be subject to audit and public scrutiny. Sustainability reporting will be difficult to implement and organisations will need to act now to implement new information gathering processes

We will liaise with the Trust regarding these and any other issues as they emerge. We will work with you to continue to achieve a smooth accounts and audit process.

Appendix 1: Key recommendations

This appendix summarises the recommendations that we have identified during 2008/09, along with your response to them. No “priority one” (high priority) recommendations were made during the year.

Recommendation	Management Response / Timescale for implementation
<p>The following recommendations have been agreed</p>	
<p>Arrangements review on the IFRS opening balance sheet at 1 April 2008</p>	
<p>IFRS: Project Plan</p> <p>The Trust's IFRS project plan and impact assessment should be developed and strengthened by: inclusion of all IFRS, SIC and IFRICs (including those standards with no anticipated impact for the Trust) to demonstrate completeness of the Trust's understanding; the impact assessment and plan should be risk assessed (RAG rated); the plan should cover the second half of the balance sheet restatement and the ongoing convergence processes including systems and process elements e.g. holiday pay accruals, changes to the FAR, review of business case process/ procurement procedures; identification of any training needs (for both finance and non-finance staff) and outlining arrangements for monitoring progress against the plan.</p>	<p>Ongoing.</p> <p>Updates and further details were approved by Audit Committee on 26 March 2009 and process changes are largely embedded within the Finance Department.</p> <p>However, final changes to procedures are being confirmed as a result of lessons learned in the production of restated IFRS accounts for 2008/2009.</p>
<p>IFRS: Accounting Policies</p> <p>The Trust has drafted IFRS accounting policies which identify the need to disclose estimation techniques and accounting judgements relevant to restated balance sheet areas. The Trust needs to complete these details and present the draft IFRS accounting policies to the Audit Committee for consideration and approval.</p>	<p>Implemented.</p> <p>Draft policies were presented to Audit Committee on 26 March 2009 with a finalised version to be presented on 3 September.</p>
<p>IFRS: Working Papers</p> <p>The Trust has working papers in place to justify/ explain the UK GAAP to IFRS balance sheet restatement movements. However working papers need to be developed to clearly evidence consideration of all relevant IFRS, SIC and IFRICs including those standards which the Trust does not has not identified restatement issues in relation to.</p>	<p>Implemented.</p> <p>Consideration of all IFRS related standards was presented to Audit Committee on 26 March 2009.</p>
<p>Interim controls and Auditor's Local Evaluation (ALE) work</p>	
<p>ALE: Improving the ALE process</p> <p>The Trust should continue to improve its methodology for the completion of external assessments (such as ALE), and provide a comprehensive and cross-referenced evidence base supporting the self assessment. This should be built into the Trust's current process and involve the tracking of identified ALE risk areas at Director level. This will allow the Trust to identify any weaknesses and develop timely action plans helping the Trust to achieve improved ratings in future years.</p> <p>We recognise that ALE is not applicable to FTs and that the Trust is in the process of its FT application. However, the need to co-ordinate swift corporate responses to information requests remains a feature of the Monitor performance regime and the Trust should continue the improvements it has made to its corporate processes for dealing with external information requests.</p>	<p>Ongoing.</p> <p>The ALE process is subject to year on year improvements in accountability and co-ordination of evidence. This is an ongoing process lead by the Director of Finance and Performance Management. Consideration of ALE requirements occurs throughout the year, e.g. Board papers ask that consideration is given to ALE implications. The bulk of preparations will occur during the autumn culminating in the yearend submission.</p> <p>The Audit Committee have an opportunity to assess progress at their meeting in December 2009.</p>

Appendix 1: Key recommendations (continued)

Recommendation	Management Response / Timescale for implementation
Interim controls and Auditor’s Local Evaluation (ALE) work (continued)	
<p>Controls: Physical Verification of Assets</p> <p>There is a risk that without a complete annual asset verification exercise redundant or misappropriated assets and inaccuracies or omissions on the fixed asset management system will not be identified in a timely manner, leading to inaccurate reporting of fixed assets.</p> <p>The Capital Accountant should issue on an annual basis lists of assets held by location and require a return from the relevant budget holders to confirm existence and location of assets. The Capital Accountant should ensure that all returns are completed and the process should be performance managed (e.g. through KPIs) to monitor the percentage of the asset base verified by budget holders.</p> <p>The Trust should also consider using members of the Estates team/ internal audit to physically verify a sample of returns once completed to ensure their accuracy. This will provide assurance over the accuracy of the fixed asset register and can be used as part of the Trust’s working papers to support the financial statement audit.</p>	<p>Ongoing.</p> <p>For building and building related assets, the Trust is undertaking a complete MEAV review using external consultants. This will be undertaken in conjunction with Estates staff and will form the basis for the updating of building related information and a platform on which to build future review processes.</p> <p>For equipment, and primarily medical equipment, the Capital Accountant is working closely with Medical Engineering staff both to improve the links between operational and financial records and as part of enabling physical verification of assets. Medical Engineering staff hold primary records for medical equipment (for example maintenance schedules) and are best placed to offer professional advice both in the verification of assets and in the identification of potential impairment or other changes in value.</p> <p>This will continue to be developed as the year progresses with a progress report to Audit Committee this financial year.</p>
<p>Controls: Pharmacy Stock Variances</p> <p>The Trust should ensure that any discrepancies identified between the stock system (JAS) and the physical quantity held are investigated thoroughly at the time of the stock count and before any adjustments to the JAS system are made. The Trust should consider the use of CCTV in pharmacy areas.</p>	<p>Ongoing.</p> <p>Investigation of discrepancies will be undertaken and, where appropriate, reported to Audit Committee. There are established SOPs (Standard Operating Procedure) for dealing with stock variations and these have been sent by the Head of Pharmacy to the DoF. The SOP is current and valid until Feb 2011. If necessary, Internal Audit resources will be used as part of this process when it is considered necessary.</p> <p>The Trust will consider the cost:benefit position of CCTV by December 2009 giving due regard to the risk of loss versus the capital outlay and ongoing revenue costs of monitoring and servicing such a system.</p>
Final accounts work	
<p>Revaluation of assets</p> <p>The Trust must ensure that it is in discussion with the District Valuer to establish the timings for the revaluation of the Trust assets on an MEA value basis. It is recommended that the Trust enter into this dialogue with the District Valuer as soon as possible in order that it can be established what the likely change in asset valuation will be and the potential impairment to be put through the Trust income and expenditure account.</p>	<p>Ongoing.</p> <p>The Trust is not obliged to use the District Valuer. At present a competitive procurement exercise is underway with responses from firms expected 21 August 2009 (approximately 7 or 8 responses expected).</p> <p>When a firm is appointed, the Trust plans to act swiftly in order to establish changes in valuation and any potential impact on the income and expenditure account.</p>

Appendix 1: Key recommendations (continued)

Recommendation	Management Response / Timescale for implementation
Final accounts work (continued)	
<p>NHS debtor recoverability</p> <p>As part of its year end processes the Trust should identify credit notes that are required to be issued to NHS organisations and agree accruals for them as part of the agreement of balances exercise.</p> <p>In addition, the Trust should identify to the Audit Committee those items included within the £755,000 “adjustments to balances” in the 2008/09 accounts and report back to the Committee regarding what values are eventually credited or recovered in 2009/10.</p>	<p>Implemented.</p> <p>A paper has been prepared for the Audit Committee to be discussed at its meeting on 3 September 2009.</p>
<p>Capitalisation of salaries</p> <p>The Trust should allocate the salaries of its Capital Projects team across projects based on the time spent by staff working on each project. This should ideally be evidenced by a staff time record.</p>	<p>Implemented.</p> <p>The Deputy Director of Finance has met with the Head of Capital Planning and a basis for monitoring resource allocation to schemes in is place.</p>
<p>Better Payment Practice Code</p> <p>The Trust should review its performance against the BPPC and establish the reason for the failure to meet the target. This should include a review of the creditors system to consider if the performance is due to a processing or systems issue or if, in fact, the required invoice signatories are not forwarding invoices for processing within the prescribed timescale. We understand that this issue has been raised at the Finance and Performance Committee and the Trust has commenced a response to this.</p>	<p>Ongoing.</p> <p>The finance committee received detailed flowcharts of the processes impacting on payment performance. Some of the solutions to improve performance were discussed and one project (rationalisation of mobile phone accounts) is underway.</p> <p>Further work is needed in the other significant volume area, this being Pharmacy. Patech (the Oracle system maintenance provider) has an established interface written for the pharmacy JACS system. However, it has recently come to light that for this to work the JACS system needs an upgrade. Implementing this solution should have a material effect on payment speed and hence payment performance times.</p> <p>The Director of Finance will liaise with the Chief Operating Officer to determine a timescale for completion.</p>
<p>Reconciliation of fixed asset register</p> <p>The fixed asset register should be fully updated and reconciled to the general ledger by the Capital Accountant on at least a quarterly basis so that any discrepancies are discovered and corrected in a timely manner.</p>	<p>Ongoing.</p> <p>Reconciliation processes are in place. Work is underway to establish a summary presentation of the reconciliation (current output produces all movements in assets) that will compliment the more detailed working papers.</p> <p>This will be presented to auditors during the interim audit in February 2009.</p>

Appendix 2: Reports issued

Report	Date issued
Audit Plan	April 2008
Interim Audit and Auditors Local Evaluation Report	May 2009
Audit Memorandum	June 2009