Management Letter

Sheffield Teaching Hospitals NHS Foundation Trust

For the year ended 31 March 2017

19 June 2017

Contents

Executive summary

Purpose of this report

Our Management Letter summarises the work we have undertaken as the auditor for Sheffield Teaching Hospitals NHS Trust (the Trust) for the year ended 31 March 2017. Although this letter is addressed to the Trust, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the National Health Service Act 2006 (the 2006 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of work	Summary
Financial statements opinion	On 22 May 2017 we issued our opinion that the financial statements gave a true and fair view of the Trust's financial position as at 31 March 2017 and of its financial performance for the year then ended.
Opinions on other matters	On 22 May 2017 we issued our opinion that: • the auditable elements of the Remuneration and Staff Report had been prepared in accordance with requirements; and • the Annual Report published with the financial statements, was consistent with those financial statements.
Value for Money conclusion	We identified no matters to report by exception in respect of the Trust's arrangements to secure economy, efficiency and effectiveness in its use of resources.
Consolidation data	In line with the group audit instructions issued by the NAO, on 22 May 2017 we reported to them that the Trust's consolidation schedules were consistent with the audited financial statements.
Matters that we report by exception	We did not identify any matters to report in relation to: • whether the Annual Governance Statement was in line with our understanding of the Trust; • referrals to the Secretary of State made under Schedule 10 of the 2006 Act; and • reports in the public interest or written recommendations made under Schedule 10 of the 2006 Act.

Audit of the financial statements

Financial statements opinion	Unqualified

The scope of our audit and the results of our work
The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Trust and whether they give a true and fair view of the Trust's financial position as at 31 March 2017 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing for the UK and Ireland (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Trust's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our approach to materiality
We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2017:

Financial statement materiality	£15.602 million
Specific materiality	We have applied a lower level of materiality to the following items of account: • Senior officer remuneration
Trivial threshold	£0.250 million

Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Trust's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit Committee within our Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Significant risk	How we addressed the risk	Audit conclusion
Management override of control In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such overrides could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.	We addressed this risk by performing audit work on: • testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements; • reviewing the key areas within the financial statements where management has used judgement and applied estimation techniques and consider whether there is evidence of unfair bias; and • reviewing significant transactions outside the normal course of business or that otherwise appear to be highly unusual.	We found no evidence of management overriding of controls. We reviewed key areas of management judgement and concluded that, taking account of materiality, our work did not identify any matters to bring to the Trust's attention. We found no significant transactions that we considered outside the normal course of business within the context of the NHS. Our sample testing of journals posted throughout the year and at year end identified no inappropriate or unexplained journals.

<table>
<tr><th>Significant risk</th><th>How we addressed the risk</th><th>Audit conclusion</th></tr>
<tr><td>Revenue and expenditure recognition

Auditing standards include a rebuttable presumption that there is a significant risk in relation to the timing of income recognition, and in relation to judgements made by management as to when income has been earned. For public sector organisations the same risk also applies to the recognition of non-pay expenditure and contractual obligations.

The pressure to manage income and non-pay expenditure to deliver forecast performance in a challenging financial environment increases the risk of fraudulent financial reporting leading to material misstatement and means that we are unable to rebut the presumption.</td><td>We evaluated the design and implementation of any controls the Trust has in place which mitigate the risk of income being recognised in the wrong year. In addition, we addressed this risk by performing audit work on:

• testing a sample of material income and non-pay expenditure including tests to ensure transactions are recognised in the correct year;
• reviewing intra-NHS reconciliations and data matches provided by the Department of Health and if necessary seek direct confirmation from third parties or their external auditors;
• reviewing management oversight of material accounting estimates and changes to accounting policies;
• reviewing judgements about whether the criteria for recognising provisions are satisfied; and
• testing a sample of adjustment journals, selected on the basis of risk characteristics.</td><td>We found no evidence of fraud in revenue or expenditure recognition based on our audit procedures.

There were no significant matters from our work on the intra-NHS data matches.</td></tr>
</table>

Significant risk	How we addressed the risk	Audit conclusion
Property valuation Land, buildings and dwellings account for £358.678 million of the £428.710 million Property, Plant and Equipment balance. Management engage the Valuation Office Agency (VOA), as an expert, to assist in determining the fair value of property to be included in the financial statements. Changes in the value of property may impact on the Statement of Comprehensive Income depending on the circumstances and the specific accounting requirements of the Annual Reporting Manual and the Department of Health Group Accounting Manual.	We evaluated the design and implementation of any controls which mitigate the risk. This includes liaising with management to update our understanding on the approach taken by the Trust in its valuation of land and buildings. In addition, we addressed this risk by performing audit work on: • the scope and terms of the engagement with the VOA; and • how management uses the VOA's report to value land and buildings in the financial statements. We wrote to the VOA to obtain information on the methodology and their procedures to ensure objectivity and quality. We also considered evidence of regional valuation trends, where appropriate.	Our work provided assurance that the Trust had used expert advice from its valuer in preparing its entries for the valuation of Property, Plant and Equipment. Our work provided the assurance we sought and did not highlight any material issues to bring to the Trust's attention.

Value for Money conclusion

Value for Money conclusion	Unqualified

Summary of our work

We are required to satisfy ourselves that the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources, and report by exception. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, 'in all significant respects, the Trust had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- informed decision making;
- sustainable resource deployment;
- working with partners and other third parties.

We are only required to report by exception if we find that that the Trust has not made proper arrangements. We had no matters to report in respect of our Value for Money (VFM) work.

The following table provides commentary of our findings in respect of each of the sub-criteria and an indication as to whether proper arrangements are in place.

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	Our work has identified the Trust's arrangements include: • established governance structures and systems of internal control; • a risk management policy and arrangements for risk identification, validation, mitigation, monitoring and reporting; • integrated risk and assurance reporting.	Yes

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment	Our work has identified the Trust's arrangements include: • long term financial modelling linked to service plans; • budget setting, monitoring and reporting; • efficiency plans.	Yes
Working with partners and other third parties	Our work has identified the Trust's arrangements include: • strong engagement with development of South Yorkshire and Bassetlaw Sustainability and Transformation Plan and Sheffield Place Based Plan; • active membership of Working Together Partnership to secure shared improvements to patient care and efficiency; • significant research partnerships.	Yes

Significant Value for Money risks

As part of our continuous planning processes, we carry out work to identify whether or not a risk to the VFM conclusion exists. In our Audit Strategy Memorandum, we reported that we had identified a significant VFM risk. The work we carried out in relation to significant risks is outlined below.

Value for Money conclusion risk	Work undertaken	Conclusion
Achievement of breakeven financial plan For 2016/17 the Trust has set a revised plan to achieve breakeven. As in previous years, the achievement of the planned financial performance is dependent on delivering a significant level of cost improvements. In addition the Trust needs to achieve agreed trajectories for operational performance to access £19.3 million from the Sustainability and Transformation Fund. As at Month 8 the Trust was reporting a year to date deficit of £2.4 million after contingencies and had identified significant elements of risk to achieving its financial plan. While the Trust has and continues to deploy significant resources and effort to tackle its financial performance there remains a risk that the Trust's arrangements are insufficient to achieve its financial plan for 2016/17.	To evaluate the Trust's arrangements for securing value for money in its use of resources, we performed work on: • reviewing the arrangements for delivering recurrent cost improvement schemes; • considering the arrangements to address residual issues with Lorenzo, the Trust's patient administration system introduced during 2015/16; • assessing the arrangements to ensure compliance with the agency spending cap; • challenging the underlying assumptions and rationale supporting the Trust's 2017/18 financial plan.	The Trust has faced significant financial challenges during 2016/17 and has managed its resources to achieve a surplus for the year of £5.8 million. This is an improvement on the Trust's financial plan which is partly due to additional funding of £4.5 million from the national Sustainability and Transformation Fund in recognition of the Trust's successful achievement of its Control Total set by NHS Improvement. The Trust planned to achieve recurrent efficiency savings of £20 million for 2016/17 and achieved £18 million (90%) at a time of significant service pressures. The Trust continues to plan further efficiency savings through its Making It Better Programme. The Trust has worked hard to resolve the issues relating to the implementation of the Lorenzo. The Trust has stayed within its agency spending cap of £18.4 million as set by NHS Improvement. The Trust met the earlier target for submission of financial plans to NHS Improvement and has agreed control totals for 2017/18 and 2018/19. There were no matters arising from our VFM work that we needed to report.

Other reporting responsibilities

Exercise of statutory reporting powers	**No matters to report**
Annual Governance Statement	**No matters to report**
Consistency of consolidation data with the financial statements	**Consistent**
Other information published alongside the financial statements	**Consistent**

The NAO's Code of Audit Practice and the 2006 Act place wider reporting responsibilities on us, as the Trust's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

Matters which we report by exception
The 2006 Act provides us with specific reporting powers where matters come to our attention that require reporting to parties other than the Trust. We have the power to:

- report in the public interest; and
- make a referral to the Secretary of State where we believe that a decision has led to, or would lead to unlawful expenditure, or an action has been, or would be, unlawful and likely to cause loss or deficiency.

We are also required to report if, in our opinion, the annual governance statement does not comply with the guidance issued by the NHS Improvement or is inconsistent with our knowledge and understanding of the Trust.

We did not exercise any of our reporting powers during our 2016/17 audit and had no matters to report to the Trust in relation to the Annual Governance Statement.

Reporting to the NAO in respect of consolidation data
The NAO requires us to report to them whether consolidation data that the Trust has submitted is consistent with the audited financial statements. We concluded and reported that the consolidation data was consistent with the audited financial statements.

Other information published alongside the financial statements
The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Trust. In our opinion, the information in the Annual Report was consistent with the audited financial statements.

Fees for audit and other services

Fees for work as the Trust's auditor

The final fees for our work for 2016/17 are the same as communicated in our Engagement Letter dated 30 September 2016 (£53,000 plus VAT) and reported to the Audit Committee in our Audit Strategy Memorandum (January 2017). This includes the fee for the audit of the financial statements and the external assurance review of the quality report.

The National Audit Office has clarified that the external assurance of the quality report is now not considered to be part of our work under the Code of Audit Practice. As such, this work should be separately identifiable in our audit fees. The final fees for our work for 2016/17 are as shown below

Area of work	2016/17 final fee	2015/16 predecessor auditor's final fee
Work under the NAO Code of Audit Practice: Accounts, 3Es and Whole of Government Accounts	£45,130	£47,000
External Assurance of the Trust's Quality Report	£7,870	£9,550
Total fees	**£53,000**	**£56,550**

Future challenges

Financial outlook

The Trust continues to face significant financial pressures for 2017/18 reflecting the continued national drive to re-establish financial control over the NHS provider sector. The current NHS financial regime offers access to Sustainability and Transformation Funding (STF) for trusts which agree to meet financial control totals set by NHS Improvement.

The Trust has agreed a control total for 2017/18 which requires the Trust to achieve a deficit for the year of £6 million which gives the Trust access to £18.6 million STF funding. Receipt of funding depends on achieving challenging service performance and financial targets during the year.

The Trust made good progress in achieving planned efficiencies last year although further 2% efficiencies are required to meet the financial plan for 2017/18. There are significant challenges to achieve the required efficiencies on a recurrent basis to strengthen the Trust's financial sustainability for the longer term.

At the same time the Trust must cope with national cost pressures and the impact of the rise in the Retail Price Index which determines the annual price uplift on many external contracts.

We will continue to review the Trust's financial performance as part of our audit for 2017/18.

Operational challenges

The Trust continues to modernise and develop its services and estate to best meet the needs of patients. It has recently refreshed its corporate strategy 'Making a Difference' to respond to the current and potential future challenges in the health and social care sector as new partnerships, structures and accountability arrangements emerge.

The reduction in central government funding to local authorities creates significant challenges for the provision of robust social care services and adversely impacts on the NHS. The Trust is working hard with social care sector partners to ensure that vulnerable patients can be discharged to appropriate care settings on a timely basis.

Cameron Waddell
Partner
For and on behalf of Mazars LLP
June 2017