Annual Audit Letter

Sheffield Teaching Hospitals NHS Foundation Trust

Year ending 31 March 2018

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CONTENTS

1. EXECUTIVE SUMMARY

Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Sheffield Teaching Hospitals NHS Foundation Trust (the Trust) for the year ended 31 March 2018. 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 NHS 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 responsibility	Summary
Audit of the financial statements	Our auditor's report issued on 24 May 2018 included our opinion that: • the financial statements give a true and fair view of the Trust's financial position as at 31 March 2018 and of its financial performance for the year then ended.
Value for Money conclusion	Our auditor's report stated that we had no matters to report in respect of the Trust's arrangements to secure economy, efficiency and effectiveness in its use of resources.
Reporting to the group auditor	In line with group audit instructions issued by the NAO, on 24 May 2018 we reported that the Trust's consolidation schedules were consistent with the audited financial statements.
Statutory reporting	Our auditor's report confirmed that we did not use our powers • under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Trust; or • to make a referral to the Secretary of State under s30 of the 2014 Act.

2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements	**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 2018 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 (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.

The Code of Audit Practice also requires us to form and express an opinion on whether the Trust's expenditure has been, in all material respects, applied for the purposes intended by Parliament (our regularity opinion).

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 2018:

Financial statement materiality	Our financial statement materiality is based on 1.5% of Gross Operating Expenditure.	£15m
Trivial threshold	Our trivial threshold is based on 2% of financial statement materiality.	£300k
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts: - Remuneration of Senior Managers	£156k

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2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant risks and key audit matters

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.

Key audit matters are defined as those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

The table below outlines the identified significant risks and key audit matters, the work we carried out on these, and our conclusions.

Identified significant risk	Key audit matter?	Our response	Our findings and conclusions
Management override of controls 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 override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.	No	We addressed this risk through performing audit work over: • Accounting estimates impacting amounts included in the financial statements; • Consideration of identified significant transactions outside the normal course of business; and • Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.	There were no significant findings arising from our work on management override of controls.
Revenue recognition There is a risk of fraud in the financial reporting relating to revenue recognition due to the potential to inappropriately record revenue in the wrong period. Due to there being a risk of fraud in revenue recognition we consider it to be a significant risk on all audits. The pressure to manage income to deliver forecast performance in a challenging financial environment increases the risk of fraudulent financial reporting such that we consider revenue recognition to be a Key Audit Matter at the Trust. We consider specific risks in relation to revenue recognition to be in the following areas: • Recognition of income and receivables around the year end; • Recognition of Sustainability and Transformation Fund (STF) income during the year.	Yes	We evaluated the design and implementation of controls the Trust has in place to mitigate the risk of income being recognised in the wrong year. In addition, we undertook a range of substantive procedures including: • testing of material income and material year end receivables; • testing receipts in the pre and post year end period to ensure they have been recognised in the right year; • reviewing intra-NHS reconciliations and data matches provided by the Department of Health and if necessary seeking direct confirmation from third parties or their external auditors; and • testing of STF income and agreeing the consistency of the returns made to NHS Improvement during the year and in year financial reporting.	There were no significant findings arising from our work on revenue recognition.

2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant risks and key audit matters (continued)

Identified significant risk	Key audit matter?	Our response	Our findings and conclusions
Valuation of Land and Buildings Land and buildings are the Trust's highest value assets. In 2017/18 the Trust moved to an alternative site valuation method. This reduced the value of these assets significantly and was subject to a significant degree of estimation and judgement. Management engaged the Valuation Office Agency (VOA) as an expert to assist in determining the fair value of these assets to be included in the financial statements. Changes in the value of land and buildings may impact on the Statement of Comprehensive Income depending on the circumstances and the specific accounting requirements of the Group Accounting Manual.	Yes	We evaluated the design and implementation of controls to mitigate the risk. We also: • assessed the scope and terms of engagement with the VOA; • assessed how management used the VOA's report to value land and buildings in the financial statements; • assessed and challenged the VOA's methodology and their procedures to ensure objectivity and quality (including consulted our own expert to assess the VOA's work); and • considered regional valuation trends (provided by our valuation expert) to assess the reasonableness of the movement in valuations. In addition, we: • assessed the Trust's approach to the alternative / single site valuation; and • tested the reasonableness of the data used to derive the model for the alternative site valuation.	There were no significant findings arising from our work on the valuation of land and buildings.

Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls. We identified one low priority deficiency in internal control as part of our audit – as follows – and we are content with Management's proposed response.

Priority ranking	Description	Number of issues
1 (high)	In our view, there is potential for financial loss, damage to reputation or loss of information. This may have implications for the achievement of business strategic objectives. The recommendation should be taken into consideration by management immediately.	None
2 (medium)	In our view, there is a need to strengthen internal control or enhance business efficiency. The recommendations should be actioned in the near future.	None
3 (low)	In our view, internal control should be strengthened in these additional areas when practicable.	One

2. AUDIT OF THE FINANCIAL STATEMENTS

Significant deficiencies in internal control – Level 3

Description of deficiency	In our testing of journals we identified that journals can be self-reviewed and also that there is no control in place that identifies the individual who creates each journal.
Potential effects	Inadequate audit trail for each journal and also the risk of self-review.
Recommendation	The Trust should enhance its journal processes and controls to ensure that the individual who creates a journal is clearly identifiable and that self review is prohibited.
Management response	Regarding journal completion, the Trust will restate the protocol that the names on the journal should be the user Integra logon name. Regarding journal review/authorisation, the Trust currently mitigates risks around self-review of journals by the following actions: • Standard procedure notes provided on induction, • Directorate analytical review work by Directorate Accountants (as a first line), Finance Managers (as second line), and then the Deputy Director of Finance (Financial Management) / Director of Finance (DoF) / Trust Executive Group (as a final line). • DoF/ DDF(FM) and DDF (FA) Trust wide "triangulation reviews" each month end. • Production of an exception report each month end of journals posted to balance sheet codes for Finance Managers review. • All balance sheet codes are reconciled each month end and the reconciliation reviewed by the Assistant Financial Accountant. • Further at year end, journals to balance sheet codes cannot be uploaded by Financial Management staff and are only entered into the ledger following scrutiny by Financial Accounting staff with the appropriate control account reconciliations being undertaken. The Trust intends to review the opportunities for further control enhancements as part of the upgrade of the financial system during the coming year

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion	Unqualified

Our approach to Value for Money

We are required to consider whether the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. 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. We are only required to report if we conclude that the Trust has not made proper arrangements..

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

Our auditor's report, issued to the Trust on 24 May 2018, confirmed that we had no matters to report in respect of the Trust's arrangements to secure economy, efficiency and effectiveness in its use of resources.

Sub-criteria	Commentary	Matters to report
Informed decision making	Our work has identified the Trust's arrangements include: • established strategic and operational plans; • integrated performance, risk and assurance reporting; • an established governance structure and systems of internal control; and • a risk management policy and arrangements for risk identification, validation, mitigation, monitoring and reporting.	None
Sustainable resource deployment	Our work has identified the Trust's arrangements include: • budget setting, monitoring and reporting; • productivity and efficiency plans; • medium term financial modelling linked to service plans.	None
Working with partners and other third parties	Our work has identified the Trust's arrangements include: • strong engagement and lead role in the South Yorkshire and Bassetlaw Accountable Care System and the Sheffield Accountable Care Partnership; • active membership of Working Together Partnership to secure shared improvements to patient care and efficiency across the South Yorkshire & North Derbyshire area; and • significant research partnerships.	None

3. VALUE FOR MONEY CONCLUSION

Significant Value for Money risks

The NAO's guidance requires us to carry out work to identify whether or not a risk to the Value for Money conclusion exists. Risk, in the context of our Value for Money work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Trust being inadequate. In our Audit Strategy Memorandum, we reported that we had identified one significant Value for Money risk. The work we carried out in relation to the significant risk is outlined below.

Risk	Work undertaken	Conclusion
Achievement of planned control total / cost improvement plans (CIPs) For 2017/18 the Trust agreed a control total deficit of £4.2m. As in previous years, the achievement of the planned financial performance is dependent on delivering significant CIPs. In addition the Trust needs to achieve agreed trajectories for operational performance to access £18.6m from the Sustainability and Transformation Fund. As at Month 8 the Trust is reporting a £1m under delivery against CIPs and a year to date deficit of £1.1m after releasing contingencies of £6.6m. While the Trust is highly focused on improving its financial performance there remains a risk that the Trust's arrangements are insufficient to achieve its financial plans for 2017/18 and the medium term.	To evaluate the Trust's arrangements for securing value for money in its use of resources we: • reviewed the arrangements for delivering recurrent cost improvement schemes; • selected a sample of directorates to test the robustness of their CIPs for 2017/18 including seeking to identify the reasons for under and over delivery during the year; and • challenged the underlying assumptions and rationale supporting the Trust's 2018/19 financial plan.	The Trust has faced significant financial challenges during 2017/18 and has managed its resources to achieve a surplus for the year of £7.8m (once technical adjustments are taken into account). This is a £13.8m improvement on the Trust's financial plan due, largely, to additional funding of £9m from the national Sustainability and Transformation Fund (in part in recognition of the Trust's successful achievement of its £4.2m deficit Control Total set by NHS Improvement). The Trust planned to achieve recurrent efficiency savings of £16.4m in 2017/18 and achieved £15.0m (92%). This is against the background of significant service and demand pressures which materialised as increased patient activity levels in the year. Our sample testing of directorates found that whilst most delivered their budgets / CIPs, these demand pressures impacted some directorates ability to deliver their budgets / CIPs as planned. The Trust has comfortably stayed within its overall agency spending cap of £18.4m as set by NHS Improvement. The Trust has agreed contracts with commissioners and agreed a control total with NHS Improvement for 2018/19. To achieve this control total, the Trust will need to deliver further productivity and efficiency gains of £26.8m in 2018/19. The Trust has made good progress in identify plans to deliver these savings through its 2018/19 Financial Plan and continues to plan further efficiency savings for 2019/20 and future years through its Making It Better Programme. The Trust recognises the significant risks and challenges in delivering these savings in 2018/19 and beyond. Through this work, whilst we recognise the challenges going forward, we identified no residual risks that affected our ability to form our VFM conclusion.

4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	**No matters to report**
Governance Statement	**No matters to report**
Consistency of consolidation data with the audited financial statements	**Consistent**
Other information published alongside the audited 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 powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

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

We have not exercised any of these statutory reporting powers.

We are also required to report if, in our opinion, the 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 identify any matters to report in this regard.

Reporting to the NAO in respect of consolidation data

The NAO, as group auditor, requires us to report to them whether consolidation data that the Trust has submitted is consistent with the audited financial statements. We have concluded and reported that the consolidation data is 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 is consistent with the audited financial statements.

5. OUR FEES

Fees for work as the Foundation Trust's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to the audit committee in January 2018.

Having completed our work for the 2017/18 financial year, we can confirm that our final fees are as follows:

Area of work	2017/18 proposed fee	2017/18 final fee
Delivery of audit work under the NAO Code of Audit Practice	£45,130	£45,130

Fees for other work

We also provided non-audit services as follows:

Area of work	2017/18 proposed fee	2017/18 final fee
Quality Report – external assurance on the Trust’s Quality Report	£7,870	£7,870

6. FORWARD LOOK

Financial outlook

The Trust continues to face significant financial pressures for 2018/19 reflecting the continued national drive to re-establish financial control over the NHS provider sector. The current NHS financial regime offers access to Provider Sustainability Funding (PSF) for trusts which agree to meet financial control totals set by NHS Improvement.

The Trust has agreed a control total for 2018/19 which requires it to achieve a surplus for the year of £5.1 million which gives the Trust access to £26.1 million of PSF. Receipt of funding depends on achieving challenging service performance and financial targets during the year.

The Trust needs to achieve savings for 2018/19 of £26.8m through its productivity and efficiency programme. There are significant challenges to achieve the required efficiencies on a recurrent basis to strengthen the Trust's financial sustainability for the long 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.

The Trust has made good progress in identify plans to deliver the required savings through its 2018/19 Financial Plan and continues to plan further efficiency savings for 2019/20 and future years through its Making It Better Programme. The Trust recognises the significant risks and challenges in delivering these savings in 2018/19 and beyond.

We will continue to review the Trust's financial performance as part of our audit for 2018/19.

Operational challenges

The Trust continues to modernise and develop its services and estate to best meet the needs of patients. This includes pursuing the refreshed 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 can adversely impact 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.

How we will work with the Trust

In the coming year we will continue to support the Trust by:

- continued liaison with 360 Assurance (the Trust's Internal Auditors) to minimise duplication of work;
- attending Audit Committee meetings and presenting an Audit Progress Report including updates on regional and national developments;
- attending Council of Governors' meetings to present the findings from our work; and
- hosting events for staff, such as our NHS Accounts workshop.

The Trust has taken a positive and constructive approach to our audit and we wish to thank the Board, Audit Committee, and Trust staff for their support and co-operation during our audit in the past year.

We are committed to supporting the Trust as its external auditor. We will meet with the Trust to identify any learning from the 2017/18 audit and will continue to share our insights from across the NHS and relevant knowledge from the wider public and private sector.

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