The Annual Audit Letter for East Sussex Healthcare NHS Trust

Year ended 31 March 2020

30 July 2020

Contents

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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at East Sussex Healthcare NHS Trust (the Trust) for the year ended 31 March 2020.

This Letter is intended to provide a commentary on the results of our work to the Trust and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Trust's Audit Committee as those charged with governance in our Audit Findings Report on 23 June 2020.

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Trust's financial statements (section two);
- assess the Trust's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Trust's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Our work

Materiality	We determined materiality for the audit of the Trust's financial statements to be £9.317m, which is 1.99**%** of the Trust's gross revenue expenditure.
Financial Statements opinion	We gave an unqualified opinion on the Trust's financial statements on 25 June 2020.
NHS Group consolidation template (WGA)	We also reported on the consistency of the financial statements consolidation template provided to the National Audit Office with the audited financial statements. We concluded these were consistent.
Use of statutory powers	We referred a matter to the Secretary of State, as required by section 30 of the Act, on 23 June 2020 because the Trust continues to be in breach of the rolling breakeven requirement.
Value for Money arrangements	We issued a qualified 'except for' value for money conclusion in our audit report to the Directors of the Trust on 25 June 2020. This judgement acknowledges significant improvements in the Trust's financial performance in the 2019/20 year (emergence from NHS Improvement's financial special measures regime in July 2019; achievement of an in year surplus); simultaneously improving quality (the latest CQC inspection improved from "requires improvement" to "good") , tempered this with the recognition that the underlying structural changes have not been proven to be fully embedded for a sufficiently long period for us to conclude fully, that the Trust has proper arrangements in place. The Trust was in financial special measures for the first 4 months of the year, continues to be in contravention of the responsibility to break even over a rolling three year cycle, and also continued to be reliant on borrowing from DHSC during the 2019/20 year.

Executive Summary

Quality Accounts	Due to the Covid-19 pandemic, the Department of Health and Social Care suspended the requirement for the Trust's Quality Accounts to be certified.
Certificate	We certified we have completed the audit of the financial statements of East Sussex Healthcare NHS Trust in accordance with the requirements of the Code of Audit Practice on 25 June 2020.

Working with the Trust

Restrictions for non-essential travel, and remote working during the pandemic, meant both Trust and audit teams had to perform the audit entirely remotely. This required the audit team to use regular video calls to ensure that both teams kept in close contact as we would when carrying out fieldwork on site. We also used alternative approaches to obtaining audit evidence to corroborate transactions, estimates and judgements in the financial statements.

The audit team and the Trust worked together through these unique issues caused by the pandemic, to meet the tight audit timeline.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Trust's staff during these extraordinary times.

Grant Thornton UK LLP
July 2020

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the Trust's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the Trust's financial statements to be £9.317m, which is 1.99**%** of the Trust's gross revenue expenditure. We used this benchmark as, in our view, users of the Trust's financial statements are most interested in where the Trust has spent its revenue in the year.

We set a lower threshold of £0.5m, above which we reported errors to the Audit Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the Annual Report to check it is consistent with our understanding of the Trust and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Trust's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the Financial Statements

Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Covid – 19 The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. These circumstances had an impact on the production and audit of the financial statements for the year ended 31 March 2020, including and not limited to: • Remote working arrangements and redeployment of staff to critical front line duties may impact on the quality and timing of the production of the financial statements, and the evidence we can obtain through physical observation; • Volatility of financial and property markets will increase the uncertainty of assumptions applied by management to asset valuation and receivable recovery estimates, and the reliability of evidence we can obtain to corroborate management estimates; • Financial uncertainty will require management to reconsider financial forecasts supporting their going concern assessment and whether material uncertainties have arisen; and • Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1.	As part of our audit work we have: • worked with management to understand the implications the response to the Covid-19 pandemic has on the organisation's ability to prepare the financial statements and update financial forecasts and assess the implications for our materiality calculations; • liaised with other audit suppliers, regulators and government departments to co-ordinate practical cross sector responses to issues as and when they arise; • evaluated the adequacy of the disclosures in the financial statements that arose in light of the Covid-19 pandemic; • evaluated whether sufficient audit evidence can be obtained in the absence of physical verification of assets through remote technology; • evaluated whether sufficient audit evidence can be obtained to corroborate significant management estimates such as asset valuations and recovery of receivable balances; • evaluated management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment.	The Trust responded to a raft of new guidance from NHS Improvement around the capital, cash and planning regimes in the light of the Covid-19 epidemic and reviewed its current financial governance arrangements and working arrangements. We concluded that the Trust had made appropriate disclosures in respect of Covid-19 in its Annual Report and statement of accounts.

Audit of the Financial Statements (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Revenue recognition Trusts are facing significant external pressure to restrain budget overspends and meet externally set financial targets, coupled with increasing patient demand and cost pressures. In this environment, we have considered the rebuttable presumed risk under ISA (UK) 240 that revenue may be misstated due to the improper recognition of revenue. We rebutted this presumed risk for the revenue streams of the Trust that are principally derived from contracts that are agreed in advance at a fixed price. We determined these to be income from: • Core contracts income for patient care revenues; • Education & training income; • Provider Sustainability Funding (PSF) and Financial Recovery Fund (FRF) funding – additional transformation funding which can be recognised/received based on achievement of the agreed control total. We did not deem it appropriate to rebut this presumed risk for all other material streams of patient care income and other operating revenue. We therefore identified the occurrence and accuracy of these income streams of the Trust and the existence of associated receivable balances as a significant risk, which was one of the most significant assessed risks of material misstatement.	As part of our audit work we have: • evaluated the Trust's accounting policy for recognition income from patient care activities and other operating revenue for appropriateness and compliance with the Department of Health and Social Care Group (DHSC) Accounting Manual 2019/20; • updated our understanding of the Trust's system for accounting for income from patient care activities and other operating revenue, and evaluated the design of the associated controls; <u>Patient Care revenue – contract variations</u> • Utilised the DHSC agreement of balances (AOB) mismatch report, we investigated unmatched revenue and receivable balances, corroborating the unmatched balances to supporting evidence; • Reviewed and sample tested income derived from contract variations and year end receivables to signed contract variations, invoices or other supporting evidence such as correspondence from the Trust's commissioners; and • evaluated and challenged the estimates and the judgments made by management on year end activity and any associated challenges with the Trust's commissioners. <u>Other Operating Revenue</u> • reviewed and sample tested income and year end receivables from other operating revenue to invoices and cash payment or other supporting evidence; and • Tested a sample of income invoices and cash receipts near to the year end to conclude on whether they had been recognised in the correct period.	Our audit work did not identify any issues in respect of revenue recognition.

Audit of the Financial Statements (continued)

<table>
<tr><th>Risks identified in our audit plan</th><th>How we responded to the risk</th><th>Findings and conclusions</th></tr>
<tr><td>Valuation of land and buildings

The Trust revalues its land and buildings annually to ensure that the current value is not materially different from fair value This represents a significant estimate by management in the financial statements.

In valuing the Trust estate, management have made the judgement that for a number of sites, if they needed to be replaced, they would be rebuilt to modern conditions with specialist services valued on an alternative site (Modern Equivalent Asset (MEA)). Management use a valuation expert to value the Trust's estate at 31 March 2020.

We identified the valuation of land and buildings as a significant risk.</td><td>Our audit work included:
• a review of management's processes and assumptions for the calculation of the estimate, including review of instructions issued to the valuation expert and the scope of their work;
• considering the competence, expertise and objectivity of the management expert used;
• testing the revaluations made during the year to ensure they were input correctly into the Trust's asset register;
• challenging valuers assumptions, evaluate and document the relevance and reasonableness of the valuer's findings or conclusions, and their consistency with other audit evidence.
Management have determined the amount of space and location required for ongoing service delivery in the light of their current and projected service needs and have instructed the valuer accordingly. Assumptions have been included around operations which would no longer be delivered from owned land and buildings and would instead be delivered from leased assets under the MEA basis. We have challenge the ongoing reasonableness of these assumptions, and others, which are key to the professional valuation estimate.</td><td>The Trust's land and buildings comprises £189.7m of specialised assets, which are required to be valued at depreciated replacement cost (DRC) at year end, on a modern equivalent asset (MEA) basis. The MEA basis assumptions applied in 2019/20 are the same as those which were first agreed by management with the professional valuer in 2017/18, the first year that the MEA basis was applied.

The valuer declared a 'material valuation uncertainty' in the valuation report issued, due to the Covid-19 pandemic. The Trust disclosed this in its statement of accounts and we reflected this uncertainty in our audit opinion.

The Trust has not made any other assumptions concerning the future or applied any estimations that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.</td></tr>
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Audit of the Financial Statements (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Going concern disclosure We identified the adequacy of disclosures relating to material uncertainties that may cast doubt on the Trust's ability to continue as a going concern in the financial statements as a significant risk. The Trust planned an overall deficit of £10.1m in 2019/20 and expected to continue to require further cash support via revenue loans from NHS Improvement to pay expenses in 2019/20 and 2020/21.	We have : - Reviewed management's cash flow forecast, hybrid budget and outline of anticipated income for the coming 12 months; - Documented and challenged the key assumptions and judgements underlying the cash flow forecast, hybrid budget and outline of anticipated income, to conclude on whether these were reasonable and based on evidence which we were able to corroborate; - Obtained and reviewed communications from NHSE/NHSI which confirmed the block contracting arrangements with Trust's to month 4 of the 2020/21, and their recommendations of how trusts should approach setting assumptions and judgements to come to a reasonable budget for 2020/21 and cash flow forecast through to 12 months after the anticipated date of signing. We confirmed that the Trust's assumptions and judgements underlying the budget and cash flow forecast were in line with this NHSE/NHSI guidance; and - We confirmed the anticipated arrangements around the conversion of borrowing to PDC in September 2020.	Late in the financial year the key circumstances which we expected would require the Trust to continue to disclose material going concern uncertainties, changed significantly resulting in management's conclusion that material uncertainty disclosures were no longer required. The key changes were: - the Trust received additional funding of £10m, delivering a small surplus of £50k; - after the pandemic impact, NHSI agreed a block contract holding arrangement to July which will guarantee the Trust hits breakeven through to that point. The Trust has put in place a hybrid budget that forecasts breakeven to month 4, followed by an anticipated small £1.4m deficit in total for the rest of the year; - Prior to the year end, NHSI announced the Trust's revenue loans (approximately £234m at 31 March 2020) would be converted to Public Dividend Capital during 2020/21 removing the reliance on external revenue loans to pay its liabilities and significantly increasing the Trust's net asset position anticipated at 31 March 2021. We were satisfied with management's assessment of use of going concern basis of accounting. Our audit report was unmodified relating to the going concern basis.

Audit of the Financial Statements

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Management override of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. We identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	As part of our audit work we have: • evaluated the design effectiveness of management controls over journals; • analysed the journals listing and determined the criteria for selecting high risk unusual journals; • tested unusual journals made during the year and the accounts production stage for appropriateness and corroboration; • gained an understanding of the accounting estimates and critical judgements applied by management and considered their reasonableness; and • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work did not identify any issues in respect of management override of controls.

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Trust's financial statements on 25 June 2020.

Preparation of the financial statements

The Trust produced draft statement of accounts for audit on 27 April in accordance with the national deadline and pandemic lockdown restrictions that existed at the time. Restrictions for non-essential travel and home working during the pandemic, has meant both Trust and audit teams have had to perform the audit entirely remotely, and required the audit team to consider alternative approaches to obtaining audit.
This did prove more time consuming than carrying out an audit under normal circumstances. There were challenges for both the audit team and the Trust’s team to conduct the audit virtually during the pandemic as an additional complexity that both teams had to face and address within a short space of time. However, we worked together to overcome these issues to meet a tight audit timeframe

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Trust's Audit Committee on 23 June 2020.

Annual Report, including the Annual Governance Statement

We are also required to review the Trust's Annual Report, including the Annual Governance Statement. It provided these on a timely basis with the draft financial statements with supporting evidence.

Whole of Government Accounts (WGA)

We issued a group return to the National Audit Office in respect of Whole of Government Accounts, which did not identify any issues for the group auditor to consider.

Other statutory powers

We are also required to refer certain matters to the Secretary of State under section 30 of the Local Audit and Accountability Act 2014. We referred a matter to the Secretary of State, as required by section 30 of the Act, on 23 June 2020 because the Trust continues to be in breach of the rolling breakeven requirement.

Certificate of closure of the audit

We certified that we have completed the audit of the financial statements of [name of Trust] in accordance with the requirements of the Code of Audit Practice on 25 June 2020.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in April 2020 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work. The risks we identified and the work we performed are set out overleaf.

As part of our Audit Findings report agreed with the Trust in June 2020, we agreed recommendations to address our findings.

Risks identified in our audit plan

Financial outturn and sustainability: For 2019/20, the control total was initially agreed for a £34m deficit which assumed delivery of £20.6m Cost improvement programme savings (CIPs). Achieving this control total would result in the release of £24m in Provider Sustainability Funding, resulting in a £10.1m deficit result.

At the point of completing our value for money risk assessment, achieving cost improvement targets and securing recurrent financial balance remained a significant challenge and consequently a significant risk under the NAO criteria.

Findings and conclusions

In 2019/20, the Trust's circumstances around financial planning have moved on significantly in terms of financial year end outturn and the forecast position for 2020/21. The Trust achieved a small surplus for the year ended 31 March 2020, and is forecasting a small £1.4m deficit result for the year ended 31 March 2021. The significant improvement in the financial performance from the £44.8m deficit result in 2018/19, has been achieved alongside an improvement in the quality of services provided by the Trust evidenced by the CQC inspection results published in February 2020 – an improvement from "requires improvement" to "good".

The Trust continued to be in special measures for the first four months of the financial year. NHSI confirmed they were satisfied the Trust could exit financial special measures in July 2019, as the Trust had put in place sufficient measures to maintain a firm grip and control on financial performance going forward without external oversight/support.

For 2019/20, the Trust agreed a control total for a £34m deficit result, which was reliant on delivering £20.6m CIPs. The Trust achieved this and secured £24m of Provider Sustainability Funding and Financial Recovery Funding which reduced the annual deficit to £10m. Late in the financial year, having achieved the control total target and successfully emerged from financial special measures, the Trust was granted a further tranche of £10m post-transformation funding by NHSI. This means the Trust has moved from a deficit result of £44.8m in 2018/19 to a small surplus of £50k in 2019/20.

Under its original pre-Covid-19 plans, the Trust had agreed an indicative deficit of £28.5m with NHSI/E for the 2020/21 year, which if achieved, would secure £28.5m of transformation funding and an overall break-even position. A CIP target of 3%, around £15m, was also agreed, following a number of years of annual savings of 4.5%.

Value for Money conclusion (continued)

Findings and conclusions (continued)

However, after the impact of Covid-19 has become clear, the Trust has re-forecast the 2020/21 year to accurately estimate the anticipated level of income and to therefore plan expenditure effectively. This has been carried out under extremely challenging circumstances and simultaneously with redesigning and re-locating some existing services to secure infection control during the pandemic. NHSI have agreed a 4-month block contract holding arrangement under which the Trust will receive an income envelope from April to July 2020 based on the Trust's operating revenue levels during 2019/20.

Additional expenditure incurred due to Covid-19 will also be reimbursed, therefore guaranteeing the Trust will maintain a breakeven position through to July 2020. On this basis, the Trust has put in place a hybrid budget that forecasts breakeven to month 4, followed by use of reasonable assumptions beyond July 2020 to forecast an anticipated small £1.4m deficit in total for the rest of the year. We reviewed the key assumptions and judgements underlying the hybrid budget and anticipated income, to conclude these were reasonable, and in line with our expectations. We also confirmed that the Trust's approach was in line with guidance that has been issued by NHSI/E.

We also note that although the Trust's overall result has improved by a significant margin in the 2019/20 year to a breakeven result, and a breakeven result is forecast for the 2020/21 year, the Trust continues to be in contravention of its responsibility to break even over a rolling three year cycle. The Trust also continued to be reliant on borrowing from DHSC during the 2019/20 year (£236m up from £208m in 2018/19).

On 2nd April 2020, the Department of Health and Social Care (DHSC), NHSE and NHSI announced reforms to the NHS cash regime for the 2020/21 financial year. This confirmed that existing DHSC interim loans as at 31st March 2020 will be extinguished and replaced with the issue of Public Dividend Capital (PDC) to allow the repayment. As yet, it is not clear how these developments may impact the above-mentioned break-even duty in future years.

Overall Value for Money conclusion

We concluded that East Sussex Healthcare NHS Trust has proper arrangements to secure economy, efficiency and effectiveness in its use of resources, except for in relation to planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.

We have reached an except for conclusion as we considered it too early to conclude that the revised arrangements are proven to be established and supporting sustainable delivery over a sufficiently long period to support a unqualified value for money conclusion.

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services.

Reports issued

Report	Date issued
Audit Plan	16 January 2020
Audit Findings Report	23 June 2020
Annual Audit Letter	30 July 2020

Fees

	Planned £	Actual fees £	2018/19 fees £
Statutory audit	72,700	TBC	62500
Charitable fund	1,800	1,800	1,800
Total fees	**74,500**	**TBC**	**64,300**

Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Trust. The table adjacent summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the Trust's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the Trust's policy on the allotment of non-audit work to your auditor.