The Royal Wolverhampton Hospitals NHS Trust

NHS

Trust Board Report

Meeting Date:	25 June 2012
Title:	External Audit - Final ISA 260
Executive Summary:	The Board are asked to note the contents of the final ISA 260 provided by independent auditors Pricewaterhouse Coopers.
Action Requested:	To note the Final ISA 260
Report of:	Chief Financial Officer
Author: **Contact Details:**	Kevin Stringer, Chief Financial Officer Tel 01902 695954 Email kevin.stringer@nhs.net
Resource Implications:	None
Public or Private: **(with reasons if private)**	Public Session
References: **(eg from/to other committees)**	Approved by the Audit Committee
Appendices/ References/ Background Reading	ISA 260
NHS Constitution: **(How it impacts on any decision-making)**	In determining this matter, the Board should have regard to the Core principles contained in the Constitution of: - Equality of treatment and access to services - High standards of excellence and professionalism - Service user preferences - Cross community working - Best Value - Accountability through local influence and scrutiny

Background Details

1	Under International Auditing Standards PricewaterhouseCoopers (PWC) are required to report, (ISA 260), on those charged with governance on any significant findings from their audit. The Board are asked to note the contents of the PWC final ISA 260.

Keith Bryan
Audit Committee Chairman
The Royal Wolverhampton Hospitals NHS Trust
New Cross Hospital
Heath Town
Wolverhampton
WV10 OQP

8 June 2012

Dear Keith,

I am writing to update you on how the outstanding matters referred to in The Royal Wolverhampton Hospitals (the "Trust") ISA (UK&I) 260 report that I presented to the Audit Committee meeting yesterday have been resolved before I signed the audit opinions today.

Outstanding matters

As is often the case when we write our ISA (UK&I) 260 there are a small number of outstanding maters to be resolved. These outstanding matters were set out both in the covering letter to, and page 10 of, the ISA (UK&I) 260 report. I set out below for your information brief details on how each of these outstanding matters has been resolved:

Matter outstanding	Resolution
Approval of the financial statements by the Audit Committee on behalf of the Board.	The Audit Committee approved the financial statements on 7 June 2012.
Receipt and review of the final signed financial statements, Annual Report and Annual Governance Statement.	We have completed our final quality checks on the financial statements, Annual Report and Annual Governance Statement.
Receipt of all relevant signed statements and the management representation letter.	All relevant documents were received today prior to signing our opinion.

Also at the Audit Committee we discussed the possibility that income and expenditure were overstated as a result of the provisions issue reported on pages 10 and 11 of the ISA (UK&I) 260 report. This has been resolved as follows:

Matter outstanding	Resolution
Evidence confirming that income and expenditure were not overstated by £1.6million in respect of monies received from Wolverhampton City Primary Care Trust for patient activity which was not delivered by the Trust in 2011/12.	Evidence was reviewed which confirmed that income and expenditure were not overstated as a result of this issue.

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Impact of unadjusted misstatements

There is one uncorrected misstatement that remains above the agreed reporting level of £50,000 and this is described in Appendix 1. Adjusting for the misstatement would lead to no change in the Trust's reported surplus, or its net asset position as at the 31/3/2012. The Audit Committee decided not to adjust the financial statements for this unadjusted misstatement.

Yours sincerely,

Mark Jones.

Mark Jones
Director
PricewaterhouseCoopers LLP

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	Description of misstatement (factual, judgemental, projected)		Statement of Comprehensive Income		Statement of Financial Position	
			Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
1	**Movement of MRI Fixed Assets into Prepayments** Dr Prepayments – Deferred Assets Cr Fixed Assets Equipment Included within PPE Equipment is £1.024 million in relation to PFI additions which should be shown as deferred assets. This relates to the MRI scanner which was originally scheduled to be purchased in 2010/11.	F			1,024	1,024
Total uncorrected misstatements					**1,024**	**1,024**

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Government and Public Sector

The Royal Wolverhampton Hospitals NHS Trust

June 2012

Report to those charged with governance

2011/12 Audit

Members of the Audit Committee
The Royal Wolverhampton Hospitals NHS Trust
New Cross Hospital
Heath Town
Wolverhampton
WV10 OQP

1 June 2012

Members of the Audit Committee

We are pleased to enclose our report to the Audit Committee in respect of our audit of The Royal Wolverhampton Hospitals NHS Trust ("the Trust") for the year ended 31 March 2012, the primary purpose of which is to communicate the significant findings arising from our audit.

The scope and proposed focus of our audit work was summarised in our audit plan, which we presented to the Audit Committee in December 2011. We have subsequently reviewed our audit plan and concluded that our original risk assessment remains appropriate. A summary of the significant risks together with our responses is included in Appendix 1 to this report.

We have completed our audit subject to the outstanding matters set out below. We expect to be able to issue an unqualified audit opinion on the financial statements and an unqualified conclusion on the Trust's use of resources. At the time of writing, the key outstanding matters are:

- approval of the financial statements by the Audit Committee, in accordance with the delegated authority of the Trust Board;
- receipt and review of the final signed financial statements, Annual Report and Annual Governance Statement; and
- receipt of all relevant signed statements and the management representation letter.

We look forward to discussing our report with you at your meeting on 7 June 2012; at the meeting we will provide an oral update on the outstanding matters referred to above. Attending the meeting from PwC will be Mark Jones and David Patterson.

Yours faithfully

PricewaterhouseCoopers LLP

Mark Jones, Director
PricewaterhouseCoopers LLP

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Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

In April 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to directors or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any director or officer in their individual capacity or to any third party.

Executive summary

The purpose of this report

Under the Auditing Practices Board's International Auditing Standard (UK and Ireland) 260 (ISA (UK&I) 260) - "Communication of audit matters with those charged with governance" we are required to report to those charged with governance on the significant findings from our audit before giving our audit opinion on the accounts of The Royal Wolverhampton Hospitals NHS Trust ('the Trust'). As agreed with you previously, "those charged with governance" at the Trust are considered to be the members of the Audit Committee.

This letter contains the significant matters we wish to report to you arising from all aspects of our audit programme of work in accordance with ISA (UK&I) 260.

Our audit work during the year was performed in accordance with the plan that we presented to you in December 2011. We have issued a number of reports during the audit year, detailing the findings from our work and making recommendations for improvement, where appropriate.

We have set out in the rest of this report what we consider to be the most significant matters arising from our audit. The scorecard below summarises our view of your accounts and audit performance:

Key issues

Key

R Red – significant improvements required

A Amber – some improvements required

G Green – no or some minor improvements required

		Comments
Quality of accounts and working papers	Amber	Your accounts were submitted to the Department of Health on time. Our audit identified no material issues with respect to the quality of the accounts presented for audit. A number of minor disclosure issues were identified which have been amended appropriately. These were due principally to a lack of sufficient tailoring of the original financial statements' template to the circumstances of the Trust. However, the Finance Team recognizes this issue and plans to make improvements in this area for 2012/13.
	Green	Supporting working papers were provided to us on time, and in advance where requested, and were of high quality. Papers were provided electronically which helped the smooth running of the audit.
	Green	Last year we commented that the Finance Team were planning to make improvements to income and expenditure related working papers for 2011/12 and we are pleased to report that this has been the case.

Readiness for start of audit	●	Working papers were ready at the start of the audit and key staff were available so that we could make a prompt and efficient start to our work on the first day we arrived.
Availability and responsiveness of staff	●	The Finance Team were available to us during the audit and responded promptly to our audit questions and requests for information. In light of the other pressures on the Finance Team, including the need to account for the impact of the Transforming Community Services transaction and the Foundation Trust authorisation assessment, the Trust's accounting performance is to be commended.
Significant audit and accounting issues	●	We identified some audit and accounting issues during the audit which are explained later in this report. None of these matters are material to the financial statements, either individually or in aggregate. However, the most significant of these had been raised by, and discussed with, the Trust during the year and in advance of the audit. We are satisfied that these are appropriately reflected and disclosed in the financial statements. We expect to give an unqualified opinion on the Trust's 2011/12 financial statements.
Deficiencies in internal control systems	●	We have not identified any significant deficiencies in Internal Control.
Follow up of prior year recommendations	●	Recommendations from prior years have been implemented, in particular procedures are now in place to ensure the Trust has up to date information from the PFI provider in relation to lifecycle events and costs.
Use of resources (Value for Money) conclusion	●	We expect to issue an unqualified use of resources/value for money conclusion. We report in more detail a summary of our work and findings that we wish to bring to your attention later in this report.

An audit of financial statements is not designed to identify all matters that may be relevant to you and does not ordinarily identify all such matters.

Significant matters

We identified the following significant matters during the audit:

- Provisions – the Trust's financial statements contain provisions totalling £3.7 million. Of these £1.6 million relates to income which has been received from Wolverhampton City PCT for services which have not been delivered in 2011/12. In previous years the Trust would have deferred this income as at the year-end (in this case as at 31 March 2012). However, due to the release of late guidance in respect of the NHS agreement of balance exercise by the Department of Health, it was not possible for the Trust to defer the income without resulting in NHS agreement of balance differences. The Trust has therefore recognised the income in year but provided in full for its return to the PCT should the Trust fail to deliver the activity associated with the income;

- Deferred income – the Trust has released £500,000 of deferred income in the year against expenditure which has been incurred on the Acumentive project. Expenditure incurred in 2011/12 was £1.8 million out of a total projected cost over the life of the project of £3.8 million. The total deferred income balance at the start of the 2011/12 financial year was £2.5 million. Our challenge to the Trust has been should income be released to match the expenditure which has been incurred in 2011/12 and the remainder carried forward as deferred income. The Trust believes that due to the current economic climate it is more prudent to self fund the majority of expenditure which has been incurred in 2011/12 rather than release deferred income to match expenditure incurred. This is because the Trust believes that over the coming years the funding environment for the Trust will become more challenging and so self funding of the costs to complete the project in future years may not be possible; and

- Transforming Community Services (TCS) – the Community Services previously provided by Wolverhampton City PCT were transferred to the Trust as part of the national TCS initiative on 1 April 2011. We have audited the impact of this transaction and identified no significant issues. A minor control weakness was identified around the records held of the equipment that was received by the Trust for nil consideration, which has been discussed with management and is discussed in further detail later in the report.

Please note that copies of this report will be sent to the Audit Commission in accordance with its requirements, to the Department of Health as part of the audited accounts submission and to the National Audit Office as auditors of the Department of Health's Resource Accounts.

We would like to take this opportunity to express our thanks for the co-operation and assistance we have received from the management and staff of the Trust throughout our work.

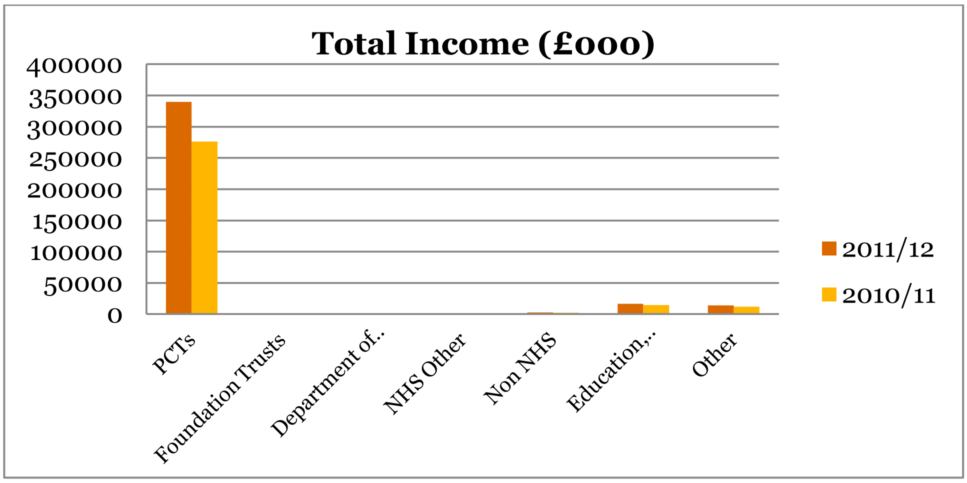
Review of 2011/12 financial statements

Statement of Comprehensive Income

The Trust's financial position remains positive. The implementation of Transforming Community Services has significantly increased your operating income and expenses from the prior period. You have recorded a retained surplus of £8.7 million for 2011/12, an increase of £0.6 million or 7% from 2010/11:

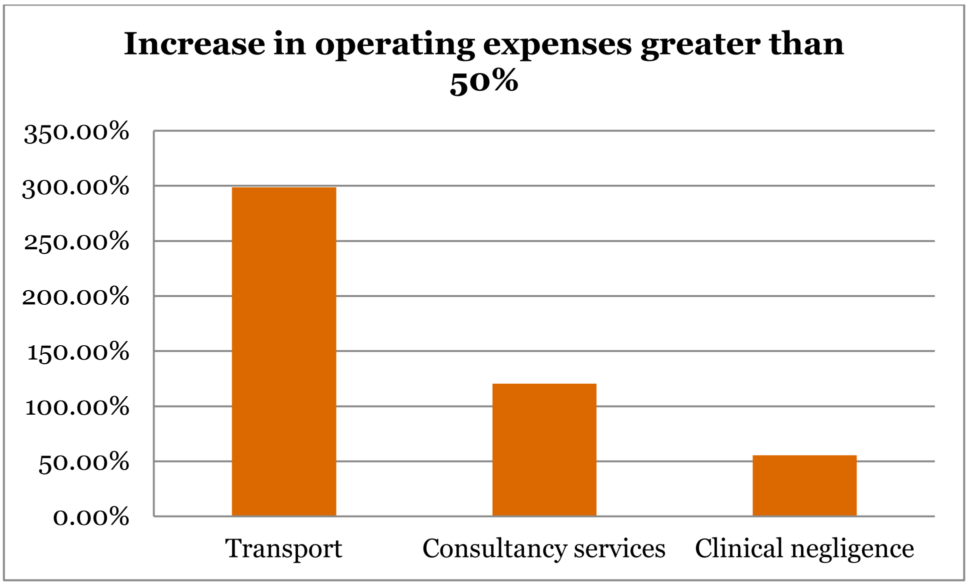
Statement of Comprehensive Income	**2011/12 '£000**	**2010/11 '£000**
Operating income	374,417	305,840
Operating expenses	356,053	289,395
Operating surplus/(deficit) for the year	**18,364**	16,445
Finance income	**106**	67
Other gains / losses	**(37)**	4
Finance costs	**(1,792)**	(928)
Surplus/(Deficit) for the year	**16,641**	15,588
PDC dividends payable	**(7,900)**	(7,407)
Retained surplus / (Deficit) for the year	**8,741**	8,181
Other comprehensive income/(expenditure)	2,073	9,556
Total comprehensive income for the year	10,814	17,737

Your total income has moved significantly since the prior period by around 22%. This is primarily as a result of your TCS transaction with Wolverhampton City PCT. The changes in most categories, other than income from PCTs, have been small.



Your total operating expenses have increased by approximately £66.7 million from the prior year, an increase of 23%. This compares to an increase in income from the prior year of 22%.

Nevertheless, some expenditure categories have increased significantly in excess of 50% compared with the prior period - these are summarised below:



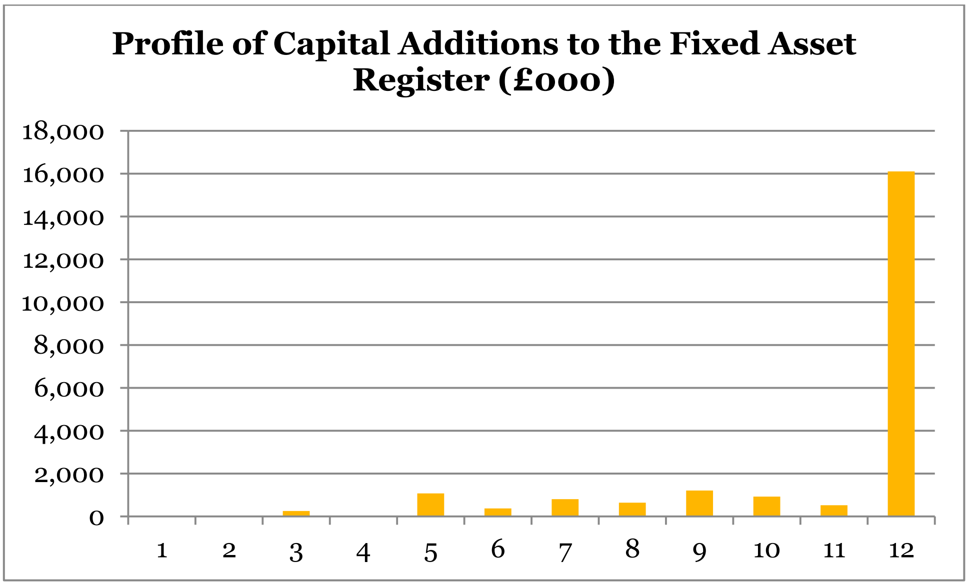
The increase in transport represents the incorrect inclusion of the operating leases in respect of TCS from Wolverhampton City PCT of £4.3 million; these have been reclassified by management to be included within Premises which has subsequently increased to 56% with transport showing a revised increase of 48%.

Statement of Financial Position

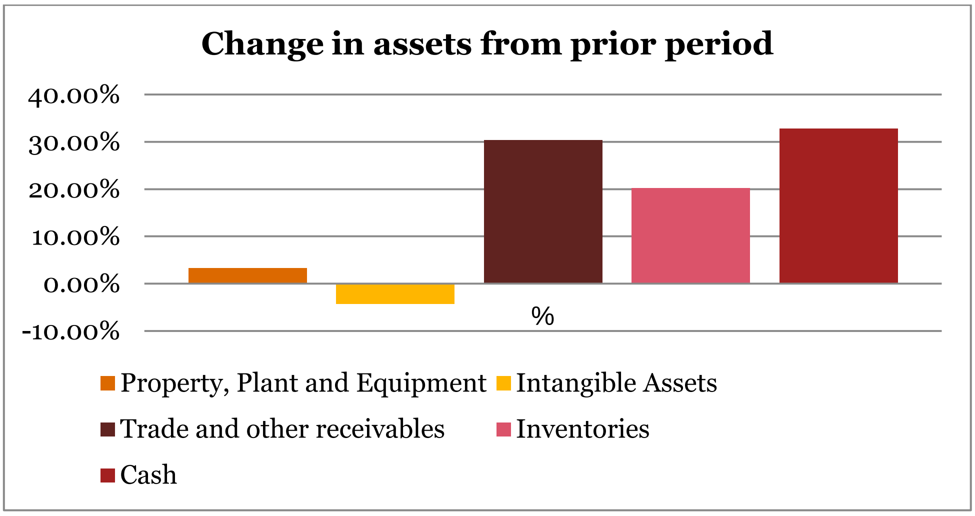
Your Statement of Financial Position illustrates an increase in total assets employed of £11.5 million or 4.9% from 31 March 2011:

	31 March 2012 £'000	31 March 2011 £'000
Non-current assets	**253,851**	244,515
Current assets	**41,220**	32,859
Current liabilities	**(39,327)**	(33,737)
Total non-current liabilities	**(8,542)**	(7,886)
Total assets employed	**247,202**	235,751
Total Taxpayers' Equity	**247,202**	235,751

The non-current asset position in particular has increased from the prior period by £9.3 million. This is primarily as a result of an increased property, plant and equipment position of £8.0 million due to the recognition of assets which have transferred from Wolverhampton City PCT under TCS of £0.8 million, the upwards revaluation of assets of £2.4 million and £19.8 million of fixed asset additions in line with the capital programme (less the depreciation charge of £14.1 million). An analysis has been performed below to compare the profile of additions to the fixed asset register throughout the year where it has been identified that the majority of additions were included in the last month of the year.



The current asset position has increased from the prior period by £8.4 million. This is primarily as a result of an increased inventory position of £1.0 million due to the purchase of new storage facilities within cardiology and pharmacy, an increased trade and receivables position of £3.5 million, and the increase in your cash balance of £3.9 as a result of your increased retained surplus position which has generated higher levels of cash.



The current liabilities position has increased from the prior period by £5.6 million. The main change has been the increase in trade and other payables of £4.4 million and an increase in current provisions of £1.5 million, which is commented upon later in the report.

Significant audit and accounting matters

ISA (UK&I) 260 requires us to communicate to you relevant matters relating to the audit of the financial statements sufficiently promptly to enable you to take appropriate action.

Accounts

We have completed our audit, subject to the following outstanding matters:

- approval of the financial statements by the Audit Committee , in accordance with the delegated authority of the Trust Board;
- receipt and review of the final signed financial statements, Annual Report and Annual Governance Statement; and
- receipt of all relevant signed statements and the management representation letter.

Subject to the satisfactory resolution of these matters, we expect to issue an unqualified audit opinion.

Accounts preparation

Preparing draft accounts by 23 April and audited accounts by 11 June is challenging, particularly against a background of significant change. Your accounts were submitted to the Department of Health on time. Our audit identified no material issues with respect to the quality of the accounts presented for audit although a number of minor disclosure issues were identified which have been amended appropriately; these were due principally to a lack of sufficient tailoring of the original financial statements' template to the circumstances of the Trust. However, the Finance Team recognizes this issue and plans to make improvements in this area for 2012/13.

We agreed in advance what we would need for our audit and this was ready for us when we arrived, and in some cases, where we requested, in advance of the audit. The working papers were sent through to us electronically on the Friday prior to commencement of the audit in order for us to confirm we had what we were expecting, which helped the smooth running of the audit.

The finance team worked hard to meet the timescales and were very helpful in resolving our queries in light of the other pressures on the Finance Team, including the continued Foundation Trust assessment; the Trust's accounting performance is to be commended. We would like to thank the finance team for their support and assistance during the audit. We would like to continue to work with you to help further improve and strengthen this process going forward and have already had initial discussions with the Trust during the audit as to how further improvements could made to the initial draft version of the accounts that are submitted in future.

Accounting issues

Provisions

The financial statements include provisions totalling £3.3 million, which represents an increase of £1.0 million from the prior period. The significant movement in the balance is due to provisions of £1.6 million that have been raised for income which was received in 2011/12 for which the service had not been delivered by the financial yearend and there is potential that these monies will be required to be repaid.

The £1.6 million is further broken down into two separate elements. The first £1.2 million was to be used to reduce Referral to Treatment Times (RTT), however, the Trust was unable to provide any of the services during 2011/12 due to the income being received late in the 2011/12 financial year. The second being for £400,000 for the delivery of post discharge re-enablement and community PbR tariff, where the Trust received the income during the year with the intention of the service being fully delivered in 2011/12; however, due to timing issues this was not delivered as planned, with the Trust providing for the difference between the income received and the expenditure which had been incurred in year.

In previous years the Trust would have deferred this income as at the year-end (in this case as at 31 March 2012). However, due to the release of late guidance in respect of the NHS agreement of balance exercise by the Department of Health, it was not possible for the Trust to defer the income without this resulting in NHS agreement of balance differences. The Trust has therefore recognised the income in year but provided in full for its return to the PCT should the Trust fail to deliver the activity associated with the income. The circumstances under which the Trust would need to return monies to the PCT, should it fail to deliver the activity associated with the income, were set out in letters from the PCT to the Trust dated 23 March 2012 and 13 March 2012 for the £1.6 million and £400,000 respectively. There is also an unintended consequence of this change in accounting treatment, which is that income and expenditure are both overstated by £1.6 million.

We have reviewed your provisions for supporting evidence against the requirements of International Accounting Standard (IAS) 37: 'Provisions, contingent liabilities and contingent assets'. This requires a provision to be raised for liabilities of an uncertain timing or amount. A provision should be recognised when:

- an entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount.

For each provision we have focused on establishing whether the key requirements in the standard have been fulfilled. We have satisfied ourselves that for both of the provisions described above you have met the requirements of IAS 37; our audit of these provisions has included review of communications that have been received by the Trust which confirm that there is potential for these monies to be required to be repaid should the Trust fail to deliver the associated services.

This is a judgemental area and the amounts involved with respect to both provisions and the consequent overstatement of income and expenditure are not material to the financial statements. We will be seeking specific representations from management that there is a valid expectation at as 31 March 2012.

Deferred income in relation to the Acumentive project

The Trust was approached by the Department of Health back in 2009/10 to pilot the so-called Acumentive project, which was intended to be rolled out to other NHS organisations upon completion at the Trust.

In 2009/10 the Trust received a payment of £1.0 million from the West Midlands SHA relating to the Acumentive project, the total amount of which was deferred at the year-end (31 March 2010). A subsequent amount of £1.5 million was received from the Department of Health in 2010/11; both the £1 million and the £1.5 million were deferred as at 31 March 2011. As part of the 2010/11 audit, we reviewed the contract that had been entered into by the Trust with Acumentive which was for £2.1 million excluding VAT.

The Trust has continued to account for £2.0 million of the monies received as deferred income as at 31 March 2012, with the Trust recognising a £0.5 million release of income in 2011/12. During our interim audit we understood that the Trust was planning on releasing income in 2011/12 to match the expenditure that had been incurred during the year. However, as the project has developed during 2011/12 it has became apparent to the Trust that additional expenditure will be required in order to complete the project which was not included within the original contract. During 2011/12 the Trust has reforecast the expenditure to be incurred during the lifetime of the project; this has been based on the actual spend incurred in 2011/12 and the forecast spend going forward to complete the project.

During 2011/12 the Trust has incurred actual expenditure of £1.8 million against a total reforecast spend for the lifetime of the project of £3.8 million. Whilst it is entirely reasonable that the Trust should carry forward some part of the deferred income balance into 2012/13 in order to fund the expenditure that is to be incurred in future years, the question is how much of the deferred income should be released in 2011/12 and how much should be carried forward. Our challenge to the Trust has been should income be released to match the expenditure which has been incurred in 2011/12 and the remainder carried forward as deferred income.

We have undertaken some sensitivity analysis to compare the release to income had the Trust released income in line with the expenditure which has been incurred in 2011/12 to the Trust's proposed accounting treatment as follows:

	£'000
Forecast expenditure to be incurred from 1 April 2012 onwards	1,997
Total project expenditure from 1 April 2011 onwards	3,764
Percentage of costs to be incurred post 1 April 2012	53%
Deferred income balance to be carried forward into 2012/13 if the income is matched in proportion with project expenditure	1,325
Deferred income release in 2011/12	1,175

The release of income in 2011/12 based upon the analysis in the table above would be £1.175 million compared to the £0.5 million that the Trust has released. This demonstrates that even when different judgements are used on how the deferred income could or should be released the difference is not material.

We have discussed with the Chief Financial Officer the assumptions and judgements applied by the Trust in the release of deferred income in 2011/12 and the fact that at the time of the audit the end date of the project is not certain. The Trust believes that due to the current economic climate it is more prudent to self fund the majority of expenditure which has been incurred in 2011/12 rather than release deferred income to match expenditure incurred. This is because the Trust believes that over the coming years the funding environment for the Trust will become more challenging and so self funding of the costs to complete the project in future years may not be possible.

Again, this is another judgemental area and the amounts involved are not material to the financial statements. We have concluded that the release of £0.5 million has been based on reasonable underlying assumptions in line with generally accepted practice and relevant guidance and that the accounting treatment is not materially misstated in the financial statements. We will be seeking specific representations from management that there is a valid expectation that expenditure will be incurred against the deferred income in future years.

Transforming Community Services 'TCS'

The Community Services previously provided by Wolverhampton City PCT were transferred to the Trust as part of the national Transforming Community Services initiative on 1 April 2011.

As part of our audit work we undertook the following steps:

- reviewing the transfer agreements in place with Wolverhampton City PCT which govern the transfer of services;
- assessing the control environment in the Community Services parts of the Trust after the transfer. This included understanding, assessing and validating relevant financial controls in place. We relied upon the work of Internal Audit as part of doing this work;
- reviewing the entries in your Opening Statement of Financial Position and verifying these to supporting evidence;
- reviewing the accounting entries proposed by the Trust for the 2011/12 financial year to ensure they are compliant with Department of Health guidance and are supported by appropriate evidence/documentation, in particular how the Trust has accounted for the initial income receipt of £2.1 million and the resulting repayment of £0.8 million to the PCT as a consequence of the final working capital balance agreement;
- assessing the assets which the Trust is using to deliver the transferred community services and establishing which assets (if any) should be recognised in the Trust's Statement of Financial Position when considering IFRS requirements; and
- physical verification of a sample of equipment assets which were transferred to the Trust from the PCT as part of the transfer agreement.

Our key findings from this work can be summarised as follows:

- we reviewed the transfer agreement with the Wolverhampton City PCT and were able to understand and evaluate the nature of the agreement;
- we assessed the control environment in the Community Services parts of the Trust. We identified some minor areas for improvement, such as the need to maintain a register of assets which are requested and replaced for individuals who use low value equipment;
- we reviewed the TCS-related entries in your opening Statement of Financial Position. We satisfied ourselves that your proposed accounting entries are materially correct;
- we reviewed the entries in the Statement of Comprehensive Income as part of our wider audit work;
- the assets being used for the delivery of the transferred community services have been classified appropriately as finance leases;
- the equipment assets which transferred to the Trust were agreed to a corresponding supporting schedule from the PCT and confirmed to be accurately recorded in the Trust's fixed asset register and depreciated in accordance with the Trust's existing accounting policies;
- for the sample of assets selected for physical verification all were found to be in existence; and
- we made some recommendations for improving the disclosures in the draft financial statements in relation to the TCS transaction. These were agreed and implemented by the Trust.

We are satisfied that the financial statements are materially correct in relation to the Transforming Community Services transactions.

Radiology PFI

The Trust has one PFI scheme in relation to the provision of radiology services. In the prior year audit we identified issues within the Trust's PFI accounting model which resulted in inaccurate values for interest payable, operating expenditure and contingent rentals. None of the misstatements were material.

At the request of the Trust, we undertook an early review of the Trust's updated PFI accounting model for 2011/12 and we are satisfied that its underpinning assumptions are consistent with accounting standards. The accounting entries of the Trust's model have been compared to the outputs of a model prepared by PwC's PFI accounting experts and they have found to be consistent.

In the prior year audit, in addition to the issue mentioned above, we also identified that capital spend included in the 2010/11 accounts had been overstated by £1.024 million. This was due to the purchase of an MRI scanner having been delayed. The Trust has advised us that the proposed purchase of an MRI scanner is now unlikely to occur until 2012/13. The Trust has proposed the following accounting treatment:

- reverse all depreciation charged to I&E for the MRI scanner in 2011/12;
- reverse all depreciation charged for the MRI scanner in 2010/11, as a 2011/12 adjustment; and
- reclassify the asset from fixed assets to a deferred asset (within current assets).

The Trust has reversed all depreciation charged relating to the MRI scanner in respect of both 2010/11 and 2011/12. However, the reclassification of the asset from fixed assets to deferred assets was not performed. The Trust attempted to make this adjustment after it had been identified during the audit. However, this would have resulted in differences between the summarisation schedules and the accounts. Therefore, the Trust decided not to make the change and leave the item as an unadjusted misstatement; hence it is included as an unadjusted misstatement in Appendix 2.

Misstatements and significant audit adjustments

We are required to report to you all unadjusted misstatements that we have identified during the course of our audit, other than those of a trivial nature. A reporting level of £50,000 was agreed with the Audit Committee on presentation and approval of the 2011/12 Audit Plan in December 2011.

One unadjusted misstatement was identified which relates to the reclassification of a PFI asset from property, plant and equipment to prepayments. This proposed adjustment has no Income and Expenditure impact. The Trust was willing to make the adjustment but did not do so because it resulted in validation errors in the summarisation schedules. The unadjusted misstatement, which is not material, is detailed in Appendix 2.

We are also required to bring to your attention misstatements that have been corrected by management but which we consider you should be aware of in fulfilling your governance responsibilities. Details of the adjustments that have been corrected by management but exceed the £50,000 reporting threshold agreed with the Audit Committee are included within Appendix 3.

Significant accounting principles and policies

Significant accounting principles and policies are disclosed in the notes to the financial statements. We will ask the Audit Committee to represent to us that it has considered the selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements.

Judgements and accounting estimates

The following significant judgements or accounting estimates were used in the preparation of the financial statements.

Property, Plant and Equipment - Depreciation and Valuation

You charge depreciation based on an estimate of the Useful Economic Lives of your Property, Plant and Equipment (PPE). This involves a degree of estimation. You also value your PPE in accordance with your accounting policies to ensure that the carrying value is true and fair. This involves some judgement for specialised buildings, where the value is based on a modern equivalent replacement were you to build these again now. The Trust applied property indices to update the valuation of its property. This resulted in an increase in property net book values of £2.4 million during 2011/12. The Trust also valued those assets that were coming into use after significant construction work and wrote off the net book value of assets which were demolished in 2011/12. This resulted in impairments of £400,000 and £300,000 respectively.

For the most significant items, such as your land and buildings, you rely upon an expert in property valuation methodology. We reviewed the valuation assumptions used by the Trust and did not find any issues with the Trust's valuation methodology or assumptions.

Accruals

You raise accruals for expenditure where an invoice has not been raised or received at the year end, but you know there is a liability to be met which relates to the current year. This involves a degree of estimation. The level of accruals raised as at 31 March 2012 is £15.1 million, compared with £7.5 million as at 31 March 2011. Testing was performed on significant accruals as well as on a sample of low value accruals. A small number of accrual misstatements were identified which were below the agreed reporting level of £50,000. In aggregate these errors had a net impact of increasing expenditure by approximately £26,000. In addition to these, we identified three accruals misstatements; these had a net impact of increasing expenditure by £6,000 and resulted in an overstatement of accruals and accounts receivables of £122,000, the details of which are contained in Appendix 3.

Provisions

Provisions at 31 March 2012 totalled £3.3 million (£2.2 million as at 31 March 2011). Because provisions are liabilities of an uncertain timing or amount, there is an inherent level of judgement to be applied. Testing was performed on significant provisions. We did not find any issues with the Trust's judgement in relation to provisions as outlined previously within the Accounting Issues section of the report. We have requested that the Trust refers to a small number of items provided for within its management representations to us.

Deferred income

Deferred income at 31 March 2012 totalled £2.7 million (£3.9 million as at 31 March 2011). Because deferred income is income that the Trust has received for services to be provided in the future, the amount should be accounted for as deferred income if the Trust has the right to do so. Testing was performed on significant deferred income. We did not find any issues with the Trust's judgement in relation to deferred income as outlined within the Accounting Issues section of the report. We have requested that the Trust refers to the Acumentive income it has deferred within its management representations to us.

Disagreements with management

There have been no disagreements with management during the course of the audit, individually or in aggregate, which could be significant to the entity's financial statements or our audit report.

Management representations

A draft of the representation letter that we are requesting management and those charged with governance to sign is included as a separate agenda item to this Audit Committee meeting. In addition to the standard representations we have requested specific representations regarding:

- the validity of the provisions raised in the 2011/12 accounts for income received from Wolverhampton City PCT for services which have not been delivered in 2011/12; and
- the assumptions regarding the release of £0.5 million deferred income regarding the Acumentive project.

More detail is contained in the draft representation letter included in the papers to the Audit Committee for this meeting.

Going concern

There were no material uncertainties related to events and conditions that may cast significant doubt on the Trust's ability to continue as a going concern. In particular, we have noted that:

- during 2011/12 you achieved £13.3 million of your £14.1 million Cost Improvement Plan (CIP) target;
- you reported a retained surplus of £8.7 million in 2011/12;
- your plan for 2012/13 includes a CIP target of approximately £15.3 million to achieve a surplus of £4.5 million. This is going to be a significant challenge but given your previous CIP delivery history we are confident that you are taking action to ensure that your plan is realistic and that measures are in place so that this is managed and monitored appropriately; and
- as at 31 March 2012 you had available cash balances of £15.7 million, and your net current asset position was £1.9 million.

We have concluded that in overall terms you have sufficient resources available to meet your commitments for at least a 12-month period after the projected date of our audit opinion. We do not think there are any material uncertainties related to events and conditions that may cast significant doubt on the Trust's ability to continue as a going concern.

The use of the going concern assumption is appropriate in the preparation and presentation of the financial statements.

Related parties

There are no significant related party matters to be communicated.

Audit independence

We confirm that, in our professional judgment, as at the date of this report, we are independent auditors with respect to the Trust and its related entities, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit engagement leader and the audit staff is not impaired.

PwC has a partnership arrangement with Coventry and Warwickshire Audit Services (CWAS), who also provide your counter fraud service. We have put in place arrangements to ensure that our independence as external auditors is not impaired. We do not provide input to the routine internal audit or counter fraud work in bodies for which we are the external auditors.

Annual Governance Statement

You are required to produce an Annual Governance Statement (AGS) for inclusion in the Annual Report and Accounts. The aim of the AGS is to give a sense of how successfully the Trust has coped with the challenges it faces and of how vulnerable the organisation's performance is or might be, drawing on evidence on governance, risk management and controls.

We reviewed the AGS and considered whether it complied with relevant guidance and whether it was misleading or inconsistent with what we know about the Trust. We found no areas of concern to report in this context.

Annual report

As part of our final audit we reviewed your draft Annual Report. We identified a number of instances where the draft presented for our review was not fully compliant with the requirements of Chapter 2 of the NHS Manual for Accounts.

The NHS Trust Manual for Accounts requires NHS trusts to include a Directors' Report in their Annual Reports. The Audit Code requires auditors to read the Directors' Report and assess whether it is consistent with the financial statements. We are then required to report on this assessment in our audit opinion.

We have reviewed the draft Directors' Report to assess whether it is consistent with the financial statements. We found no areas of inconsistency to report in this context. However, as noted above we have highlighted a number of requirements which were not addressed fully in the Annual Report.

Before we issue our audit opinion we will need to review an updated Annual Report and check whether it is consistent with the financial statements.

Our use of resources/value for money conclusion

Our Use of Resources Code responsibility requires us to carry out sufficient and relevant work in order to conclude on whether you have put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources.

In accordance with guidance issued by the Audit Commission, in 2011/12 our conclusion is based on two criteria:

- the organisation has proper arrangements in place for securing financial resilience; and
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

We have not been required to reach a scored judgement in relation to these criteria and the Audit Commission has not developed 'key lines of enquiry' for each criterion. Instead, we have determined a local programme of audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities.

We anticipate issuing an unqualified value for money conclusion. In forming our judgement we have identified the following matters which we wish to bring to your attention as the most significant and relevant for the Trust going forward:

Transforming Community Services 'TCS'

From 1 April 2011 the Trust took on Community and Dental Services that were previously provided by Wolverhampton City PCT.

In fulfilling our Use of Resources responsibility, and as part of a risk based approach, we have considered the impact of the transfer of community services on the Trust from 1 April 2011. In line with guidance issued to us by the Audit Commission we have considered the steps taken by the Trust to manage this transfer, post 1 April 2011. We have focused in particular upon the steps taken by the Trust to secure financial resilience and value for money in respect of the transfer. In undertaking our work we have:

- maintained an ongoing dialogue with the Chief Financial Officer;
- met with the Trust's Chief Operating Officer and Director of Planning and Contracting to discuss community services; and
- reviewed supporting evidence, key reports and relevant minutes of meetings.

Our work has identified no issues regarding the Trust's arrangements to secure economy, efficiency and effectiveness in the use of resources with regard to the transfer of community services. In reaching this conclusion we have considered the steps taken by the Trust to manage risks associated with the TCS transfer effectively during the financial year. In particular, our review noted that:

- our previous review of the Trust's arrangements for planning the transfer (undertaken as part of our 2010/11 audit work) identified no concerns. The project was found to be supported by robust governance structures and risks were being managed;
- the Trust took the decision not to 'bolt on' community services. Instead the Trust revised its management and service grouping structure in order to integrate community services within existing divisions. This approach has worked well;
- governance arrangements have been in place during 2011/12 which have monitored how in practice community services have been integrated into the Trust. These arrangements have evolved and developed to ensure that they remain fit for purpose;
- CIP schemes relating to services transferred under TCS were delivered during the 2011/12 financial year and services were delivered within budget; and
- performance management arrangements (including the Board Performance Report and Quality and Safety Report) were updated for 2011/12 to include key performance indicators relating to those services transferred under TCS.

Other planned risk based use of resources/value for money work

We have considered the views expressed by regulators in order to identify any issues which may have an impact on our use of resources/value for money conclusion. We have identified no significant issues that would have an adverse impact upon our use of resources/value for money conclusion.

We have also maintained a watching brief on the impact of the night time closure of the Accident and Emergency at Mid-Staffordshire Hospital NHS Foundation Trust on the Trust's performance. We have identified no significant issues for our audit in this context.

Quality accounts

All NHS bodies which provide healthcare are required by the Health Act 2009 and associated regulations to publish an annual quality account. The Department of Health (DH) has determined that the quality accounts published by NHS trusts in 2011/12 should be subject to external audit review. DH agreed with the Audit Commission that Trust auditors would carry out work on the Quality Account in 2011/12 and issue:

- a "limited assurance" conclusion which says that nothing has come to our attention to suggest that your Quality Accounts have not been prepared in line with the regulations; and
- a report which:
  - follows up the recommendations we made in respect of one of the indicators we reviewed in 2010/11;
  - sets out our recommendations following testing of one of the indicators that DH has said you will have to include in your 2012/13 Quality Accounts; and
  - reports on the work undertaken in relation to one local indicator.

The work that we are required to undertake in relation to quality accounts is set out in guidance published by the Audit Commission. In 2011/12 we are required to complete this work before the publication of the Quality Account on the NHS Choices website. The deadline for publication is 30 June 2012. We are currently undertaking this work and expect to report our findings to management during the latter part of June 2012 at a Management Team meeting (date to be agreed). We will report back to the Audit Committee our findings following completion of our work and presentation of our report to management. Due to the deadlines for the completion of this work, it will not be complete by the time we issue our audit opinion on the financial statements and our use of resources/value for money conclusion; therefore our audit report will not include our audit completion certificate. We will issue our audit completion certificate as soon as we have completed and reported upon our work on your Quality Account.

Internal Controls

Accounting systems and systems of internal control

It is the responsibility of the Trust to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. As auditors, we review these arrangements for the purposes of our audit of the financial statements and our review of the annual governance statement.

We are required to report to you any significant deficiencies in internal control we found during the audit. No such matters were identified. However, in our professional judgment we believe the following matters should be brought to your attention:

Deficiency and impact	Recommendation
Disposals There has been a significant increase in the number of disposals recorded in the financial year compared to previous years. The majority of these disposals relate to assets that were held at nil net book value in the asset register. We understand that, during the year, a cleansing exercise was undertaken on the fixed asset register to identify whether assets that were held at nil net book value were still in existence and being utilised. Our testing identified that in a number of instances the authorisation for the disposal occurred in previous years, with one authorised for disposal in 2002/03; however, Finance had not been notified of the disposal and so the asset remained on the fixed asset register. We understand that on an annual basis, the Finance team performs a fixed asset verification exercise where individual wards and departments are required to confirm that assets are in existence and are being utilised, with the results being used to update the fixed asset register. The results of this exercise had previously not identified that such assets had been referred for disposal and therefore would indicate that the exercise is not operating as designed.	We recommend that management communicate to the Clinical Engineering Department and/or the Medical Physics Department that where authorisation for a disposal is obtained a copy is sent at the same time to the Finance team so that the fixed asset register can be updated. Whilst it is acknowledged that the Trust has a verification exercise in place whereby wards confirm the existence and use of assets, on a sample basis a physical verification of such assets should be undertaken to confirm the responses received.

Deficiency and impact	Recommendation
Transforming Community Services – Nil consideration equipment assets As part of our review of the transfer agreement with Wolverhampton City PCT, it was identified that a number of assets were transferred to the Trust for nil consideration which are being used in the community, such as items of kit which are held with district nurses. It was agreed that any items that were associated with staff members who were transferring to the Trust would transfer to the Trust with the staff member concerned and therefore records were not held of what assets had been transferred to the Trust due to the fact that the PCT did not hold such records. As part of our audit procedures we performed physical verification of a sample of equipment assets that had transferred to the Trust under the agreement, which are recognised in the Trust's fixed asset register. Our testing confirmed all assets to be in existence, however it was noted that for one asset the person who was said to be in possession of this asset did not hold the asset and that this was held elsewhere.	Going forward we recommend that the Trust should maintain an itemised schedule of assets that have been subject to a request for replacement so that it is possible to identify who holds such assets and so that when subsequent requests for replacements are made the Trust can confirm that this is appropriate.
Goods Received Notes The Trust has a year-end accrual in the financial statements for goods received notes of £6.8 million, which has increased from the prior year by £1.9 million. Review of the balance identified that approximately £650,000 relates to goods received notes which are more than 6 months old of which approximately £460,000 are more than 12 months old.	We recommend the Trust reviews the items which are aged over 6 months to identify whether invoices have been received but have been unable to be matched to the goods received note in order to confirm that a liability still exists.

Risk of fraud

As part of our work on fraud, we enquire with management as to whether there have been any actual, suspected or alleged frauds affecting the Trust which as auditors we should be made aware of.

Investigations at the Trust are reported by your counter-fraud specialist to the Audit Committee. Reports presented to the Audit Committee to date have not indicated any instances of fraud that would impact on our audit opinion. If this status changes between the date of this report and the signing of our audit opinion, we will be required to consider the impact on our audit opinion.

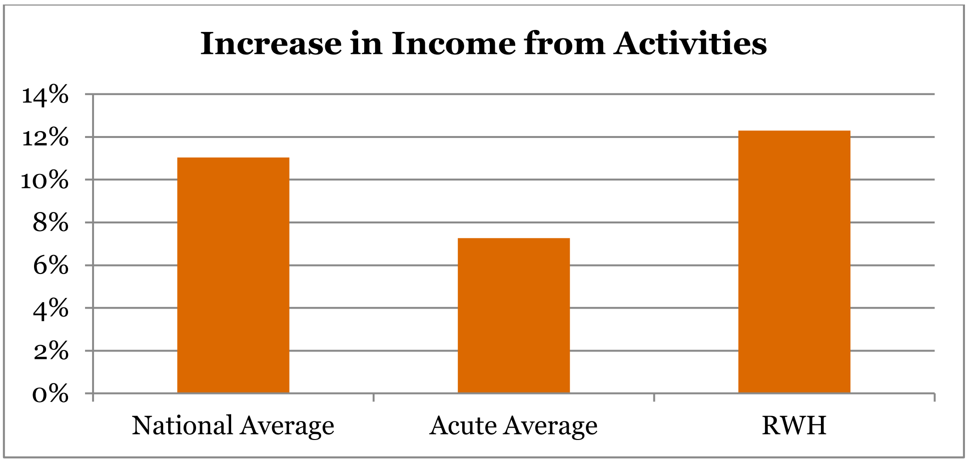
We are also required to make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.

2011/12 performance compared with others

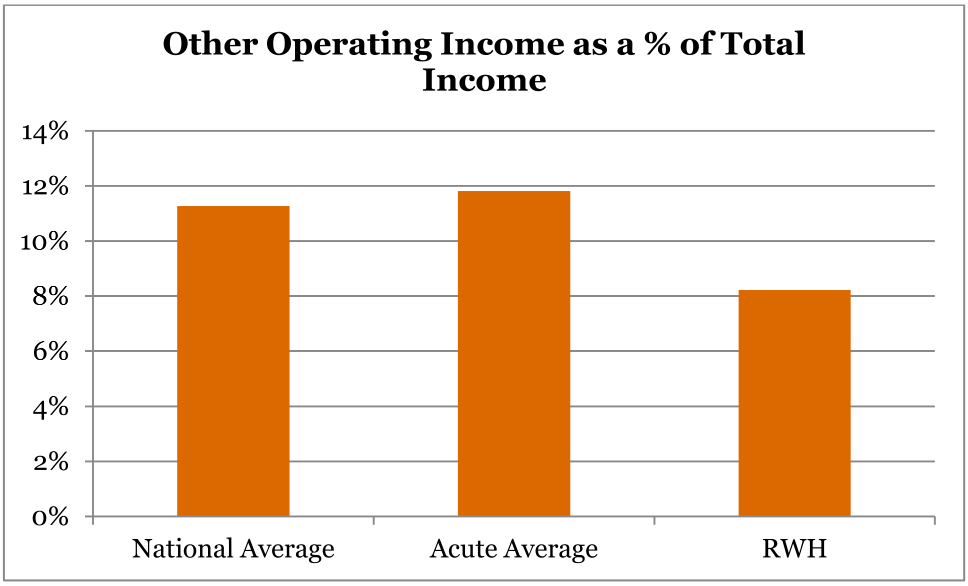
The graphs and tables in this section provide a comparison between you and 17 NHS Foundation Trusts from around the country. The data was taken from the draft accounts which were made available to us and where comparative data was available. We have compared you with the average figures from the other Trusts included in the sample and highlighted possible areas of interest.

Income

Your increase in income from activities between 2010/11 and 2011/12 has been higher than the average for our benchmark group. This was primarily as a result of the impact of TCS. Your increase is more in line with our benchmark for the NHS average rather than the acute trusts' average. It was more common for non-acute trusts to participate in TCS transactions:

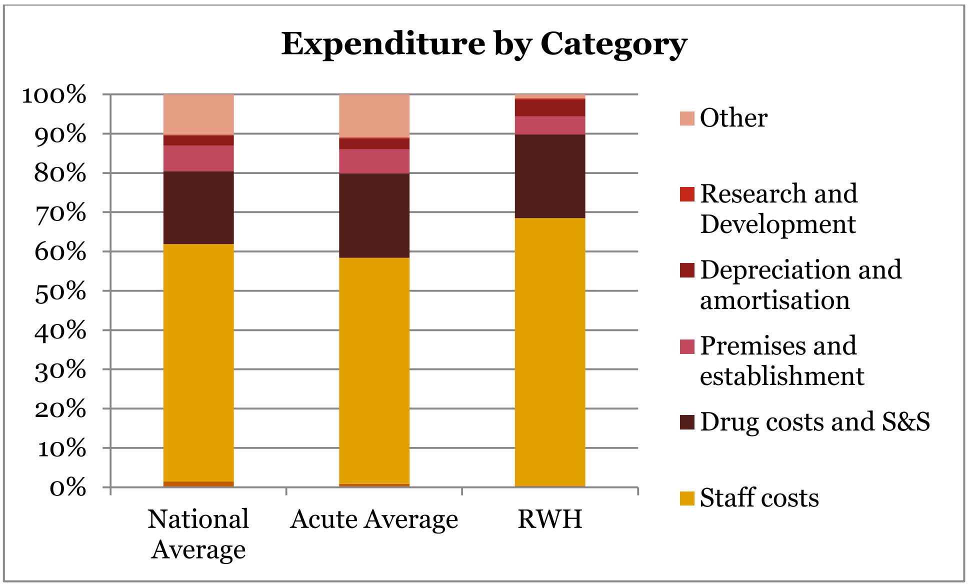


However, the percentage of your income which is derived from other operating activities continues to be lower than for our benchmark group. Your other operating income is only 8% of your total income, compared with 12% for other acute trusts and 11% for the national average. This indicates that you are comparatively more reliant on your core commissioning contracts than others:

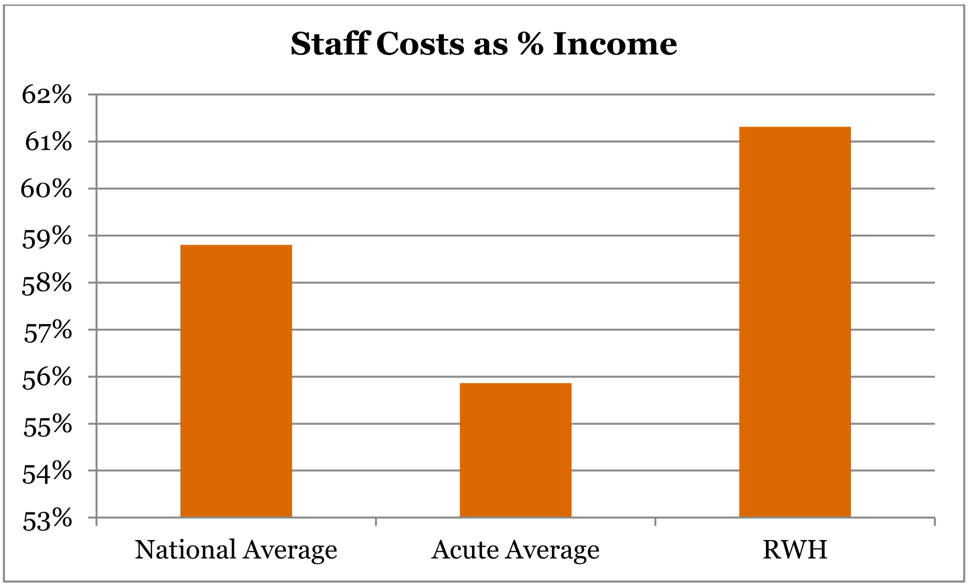


Expenditure

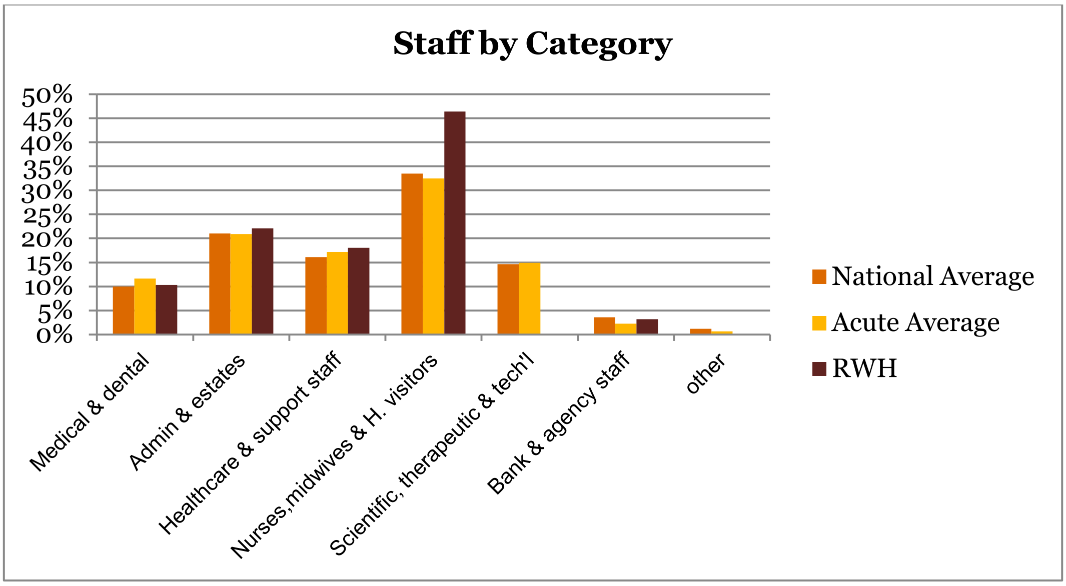
We analysed your expenditure as a proportion of your overall income for 2011/12. This identified that you generally have a higher percentage of your income which pays for staff costs, and a lower proportion for other types of expenditure, as shown below:



As a proportion of total expenditure, your staff costs are above that of the national average and significantly above those of other acute trusts.

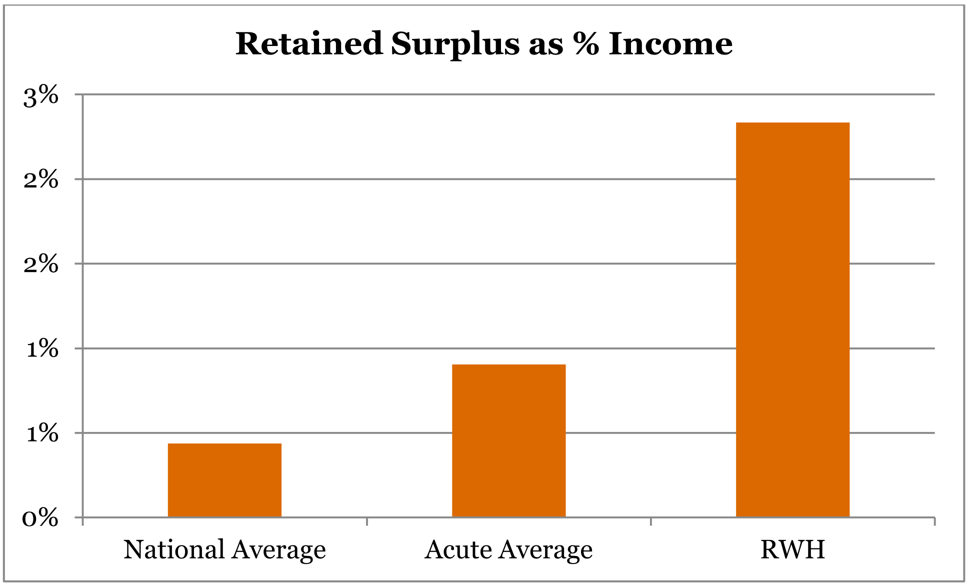


We also looked at your staff numbers classified by type of employee to see if there were any patterns. You tend to have a higher proportion of nurses, midwives and health visitors than other trusts in our benchmark group. This is probably driven by the significant number of community services that the Trust now provides:



Retained Surplus

We have benchmarked your retained surplus as a % of income. This identified that the Trust has a significantly higher level than both the national average and the acute average in our benchmark group:



Fees update

Fees update for 2011/12

Our original fee proposals were included in our Audit Plan which was approved by the Audit Committee in December 2011. We updated our fee proposals as a result of the guidance issued by the Department of Health regarding the restatement of TCS transactions and communicated the reduction of our audit fee to you in our Progress Report to the Audit Committee in April 2012. An update against this revised fee has been provided below:

	2011/12 Forecast Outturn £	**2011/12 Revised Audit Plan Fee £**
Accounts	90,000	90,000
Locally targeted work to address audit risks identified	10,000	10,000
Use of Resources	15,000	15,000
Sub-total before quality accounts	**115,000**	**115,000**
Quality Accounts	12,500	12,500
Sub-total including quality accounts	**127,500**	**127,500**
Transforming Community Services	22,500	22,500
Total	**150,000**	**150,000**

Non-audit work – Provision of Board to Board Support

We have also performed work which falls outside of the Code of Audit Practice requirements. At the request of the Trust, we agreed that we would provide support for a mock 'Board to Board' event on 14 May 2012.

The scope of this work was to provide support and challenge to the Trust in the form of a panel of senior professionals who undertook a mock Board to Board challenge. The fees for the work were £5,100 plus out of pocket expenses incurred for travel and subsistence costs up to a maximum of 5% of the fee charged for the services plus VAT. Based on the agreed scope of work we did not believe that our independence as auditors to the Trust would be impaired by PwC undertaking this additional work. We assessed the threats to our independence and identified appropriate safeguards. This was done in accordance with the provisions of the ICAEW's Ethical Standards.

Recent developments

Accounting developments

We do not at the moment expect any significant changes in financial reporting requirements for 2012/13. There is a small change to the disclosure requirements for auditors' remuneration.

A number of new international accounting standards have been issued in the last year on the topics of consolidated accounts and fair values, however these do not apply for next year, and in any event they have not yet been endorsed by the European Union.

Quality Account

DH and Monitor are proposing for 2012/13 to require that you and other trusts also include in your Quality Accounts:

- your performance against quality indicators specified by DH, which will be aligned to the NHS Outcomes Framework;
- how you compare with the national average performance for these indicators, where the data is available and meaningful; and
- a commentary explaining your performance against these national averages, including any steps you are taking to improve your performance.

We expect that the Audit Commission and DH will determine the audit work to be undertaken on the Quality Accounts of NHS trusts for 2012/13 once they have assessed the results of the 2011/12 audit work.

Appendices

Appendix 1 - Audit approach

Risk Assessment

We reported our planned audit approach to you in December 2011 as part of our 2011/12 Audit Plan; the Audit Plan included the risks to be addressed as part of the audit and the work we planned to do in response.

We have summarised the significant risks and our actual responses in the table below:

Significant Risk	Our Response
Revenue and Expenditure Recognition Accounting policies or the treatment of income and expenditure may lead to material misstatements in the reported revenue position. Financial pressure is increased by challenging savings requirements, potential reductions in activity, and limitations in funding to Primary Care Trusts. *This is a mandatory risk required by auditing standards. We discussed your views on fraud risk at the Audit Committee meeting in December 2011.*	We have considered the accounting policies adopted by the Trust and subjected income and expenditure to the appropriate level of testing to identify any material misstatement. In particular, we examined the existence and completeness of amounts recognised to ensure the accounts are fairly stated.
Management Override of Controls In any organisation, management may be in a position to override the financial controls that you have in place. A control breach of this nature may result in a material misstatement. For all of our audits, we are required to consider this significant risk and adapt our audit procedures accordingly. *This is a mandatory risk required by auditing standards. We discussed your views on fraud risk at the Audit Committee meeting in November 2011.*	We reviewed the work performed by Internal Audit and the level of assurance that they provided regarding management's ability to override controls. We reviewed the appropriateness of journals processed during the year. We assessed management estimations and considered if they were subject to bias, reporting back to you on our findings. We tested the Trust's bank account and other reconciliations and reviewed the year end suspense accounts. Our audit procedures also included an unpredictable element that varies year on year.
Transforming Community Services The Community and Dental Services previously provided by Wolverhampton City PCT were transferred to the Trust as part of the national Transforming Community Services initiative on 1 April 2011. The transactions and subsequent integration of these services into the Trust involve a degree of risk for the Trust with respect to the financial statements in the year of the transfer and impact on our responsibilities as your auditors.	We reviewed the transfer agreement in place with Wolverhampton City PCT which govern the transfer of services. We also reviewed the entries in your Statement of Financial Position and Statement of Comprehensive Income relating to TCS, verifying these to supporting evidence. We also considered the disclosures in your draft accounts and made recommendations for improvement as appropriate. We performed physical verification on a sample of the equipment assets which transferred and were able to confirm their existence.

Appendix 2 – Summary of unadjusted misstatements

We have identified the following misstatement during our audit of the financial statements that has remained unadjusted by management. The Audit Committee is requested formally to consider the unadjusted misstatement below and determine whether it would wish the accounts to be amended. If the misstatement is not adjusted we will require a written representation from you explaining your reasons for not making the adjustment.

	Description of misstatement (factual, judgemental, projected)		**Statement of Comprehensive Income**		**Statement of Financial Position**	
			Dr (£'000)	**Cr (£'000)**	**Dr (£'000)**	**Cr (£'000)**
1	**Movement of MRI Fixed Assets into Prepayments** Dr Prepayments – Deferred Assets Cr Fixed Assets Equipment Included within PPE Equipment is £1.024 million in relation to PFI additions which should be shown as deferred assets. This relates to the MRI scanner which was originally scheduled to be purchased in 2010/11.	F			1,024	1,024
Total uncorrected misstatements					**1,024**	**1,024**

Appendix 3 – Summary of adjusted misstatements

We have identified the following misstatements during our audit of the financial statements that have been adjusted by management but exceed the £50,000 reporting threshold agreed with the Audit Committee.

	Description of misstatement (factual, judgemental, projected)		Statement of Comprehensive Income		Statement of Financial Position	
			Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
1	**Equal Pay Claims** Dr Non NHS Accruals Cr Operating Expenses Through our audit testing it was identified that the Trust had included a liability for equal pay claims for £361,000 which was based on an estimate provided by the Trust's solicitors at 31 March 2012. Since then 6 claims have been withdrawn and the liability has now been estimated as £289,000.	F		72	72	
2	**Overstatement of Prepayments and Accounts Payable** Dr Non NHS Payables Cr Prepayments Through our audit testing 3 invoices were identified, with an aggregate total of £100,000, that had initially been included within accounts payable but which related to 2012/13 and had therefore been reversed through recording an entry in prepayments. The Trust performed an exercise to identify any further similar instances, which identified a further £181,000 was identified.	F			281	281
3	**NHS Disputed Debtors** Dr Non NHS Accruals Cr Non NHS Debtors Included within non-NHS accruals was an accrual that equated to the value of debtors that had been disputed with Wolverhampton City PCT which the Trust had concluded were not recoverable.	F			122	122

	Description of misstatement (factual, judgemental, projected)		Statement of Comprehensive Income		Statement of Financial Position	
			Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
4	**Unrecorded Liabilities** Dr Operating Expenses Cr Non-NHS Accruals Testing performed on a sample of invoices that were received post year end identified 3 invoices which related to 2011/12 but which had been accounted for in 2012/13; these were isolated to purchases in relation to the new storage facilities for inventory.	F	78			78
Total corrected misstatements			**78**	**72**	**475**	**481**