

**Northumberland, Tyne and Wear NHS Foundation Trust**

**Board of Directors Meeting**

Meeting Date: 24<sup>th</sup> May 2017

Title and Author of Paper: Audit Committee Annual Report  
Martin Cocker, Audit Committee Chair

Executive Lead: Audit Committee

Paper for Debate, Decision or Information: Information and Decision

**Key Points to Note:**

The attached paper sets out the role of the Audit Committee and the activity undertaken in relation to the financial year 2106/17.

This report was considered by the Audit Committee on Wednesday 17<sup>th</sup> May and is presented to the Board for inclusion in the Annual Report.

**Risks Highlighted to Board :**

The Audit Committee provides a central means by which the Board of Directors ensures effective internal control arrangements are in place. The Committee also provides a form of independent check upon the executive arm of the Board of Directors.

Does this affect any Board Assurance Framework/Corporate Risks?

No

Equal Opportunities, Legal and Other Implications: None

**Outcome Required:**

Approval for inclusion in the Annual Report

Link to Policies and Strategies: N/A

## Annual Report on the work of the Audit Committee 2016/17

### Overview

The Audit Committee provides a central means by which the Board of Directors ensures effective internal control arrangements are in place. The Committee also provides a form of independent check upon the executive arm of the Board of Directors. It is the job of Executive Directors and the Accountable Officer to establish and maintain processes for governance. The Audit Committee independently monitors, reviews and reports to the Board of Directors on the process of governance, and, where appropriate, facilitates and supports, through its independence, the attainment of effective processes.

### Audit Committee Composition and Attendance:

The Audit Committee comprises three non-executive directors. Each of the members is considered to be independent. The Board is satisfied that the Chairman of the Audit Committee has recent and relevant financial experience.

The Audit Committee met six times during, and twice shortly after the end of, the financial year. Attendance at those meetings was as follows:

Member	Meetings	
	Total	Attended
Martin Cocker	8	8
Alexis Cleveland	4	4
Peter Studd	8	6
Miriam Harte	4	4

Alexis Cleveland was appointed as Acting Chair of the Trust in December 2016 and at that time stood down from the Audit Committee. Miriam Harte was appointed as a non-executive director on January 1, 2017 and joined the Audit Committee from that date.

In addition to the non-executive directors, the Director of Finance, Executive Director of Commissioning and Quality Assurance, External Audit and Internal Audit, including Counter Fraud, were all invited to each meeting during the year. All, or suitable alternates, attended each meeting.

A representative of the Governors attended each Audit Committee meeting as an observer.

External Audit and Internal Audit were given opportunities at the end of each meeting to discuss confidential matters with the Audit Committee without Executive management being present.

## **Programme of Works**

The Audit Committee follows an annual work programme that covers the principal responsibilities set out within its terms of reference. In 2016/17, this included, amongst other matters, the following activities:

- Assessed the integrity of the Trust's financial statements for the year ended March 31, 2017;
- Considered the effectiveness, independence and objectivity of the external auditor throughout the audit cycle;
- Reviewed the Annual Governance Statement in light of the Head of Internal Audit opinion, the External Audit opinion relating to the year end and any reports issued by CQC and Monitor;
- Reviewed External Audit's findings and opinions on the Quality Report, the securing of economy, efficiency and effectiveness, and the areas of the Annual Report subject to audit review;
- Considered whether the Trust's Business Assurance Framework ('BAF') and Corporate Risk Register are complete, fit for purpose and in line with Department of Health expectations;
- Reviewed the arrangements by which staff may raise in confidence concerns about possible improprieties in matters of financial reporting and control, clinical quality, patient safety or other matters;
- Reviewed the process established by the Trust to ensure compliance with Monitor's Code of Governance;
- Challenged and approved the internal audit programme, counter fraud and informatics plan, operational plans and detailed programmes of work for the year. The Audit Committee confirmed the effectiveness of internal audit and counter fraud and the adequacy of their staffing and resources;
- Considered the major findings of internal audit, counter fraud and informatics throughout the year. The Audit Committee agreed that the remedial actions proposed were appropriate and then monitored the timely implementation of those remedial actions by management;
- Reviewed the work of other Board Committees and considered how matters discussed at those committees impacted the work of the Audit Committee;

## **Significant Issues**

Throughout the year, the Audit Committee has debated and concluded on a number of matters. The more significant issues to have come before the Audit Committee, and the actions taken by the Audit Committee to ensure that those issues were dealt with promptly and in an appropriate manner, are noted below.

## **1. Integrity of financial reporting**

The Audit Committee reviewed the integrity of the financial statements of the Trust. This process included reviewing the accounting policies to ensure that they remained appropriate and had been complied with and debating the areas of significance in relation to the integrity of financial reporting. The review and debate took into account the views of the External Auditors, Mazars LLP ('Mazars').

The significant matters considered were:

### *Revaluation of the Trust's Buildings*

The Trust records its specialist NHS buildings initially at cost and subsequently at their fair value. The fair value is calculated using the 'depreciated replacement cost' ('DRC') method.

The DRC method seeks to calculate the cost of an asset that would provide a similar function and equivalent utility to the asset being valued, but which is of a current design, constructed using current materials and techniques and is built on a site of optimal size and location.

Therefore, the valuation of the Trust's specialized NHS buildings is not a valuation of the existing buildings in their current locations. Rather, it is a valuation of the specialist buildings that the Trust could hypothetically build to deliver the services and occupancy levels as at the balance sheet date on a site that was of the optimal size and location.

Application of the DRC method typically results in an asset value that is significantly lower than the actual cost.

In addition, subsequent remedial capital expenditure on assets already revalued under the DRC method and which does not significantly increase either the value or expected life of the asset is unlikely to result in an increase in the fair value of the asset calculated using the DRC method.

Any reduction in value between the original cost and the fair value calculated under the DRC method is reported as an impairment in the financial statements.

Accordingly, the initial use of the DRC typically results in a significant provision for impairment. In addition, subsequent remedial capital expenditure on assets already revalued under the DRC method is likely to result in an additional provision for impairment.

Any increase in the fair value of specialized NHS assets at successive balance sheet dates is reported as a revaluation.

Non-specialist buildings fall outside the DRC valuation methodology and are carried at market value.

As a result of the valuation as at March 31, 2017, net impairment charges of £25.9 million have been made to operating expenses and a further £0.7 million has been charged against the revaluation reserve. Of these totals, £10.6 million relates to a reduction in land values and £12.8 million to large construction schemes where the assets have been brought into use in the year. In particular, the Mitford Unit at Northgate has resulted in an £8.7 million impairment and the Cleadon scheme at Monkwearmouth has resulted in an impairment of £4.1 million.

The valuation at March 31, 2017 has also resulted in a change in lives. The combination of a reduction in land values and the changes to asset lives has resulted in a reduction in

depreciation charges of £1.5m for the year. In turn, this has reduced the amount to be paid in respect of the public dividend capital by £0.3 million.

In respect of these movements in valuation of specialised NHS assets, the Audit Committee has debated and challenged the work performed by Mazars, including their review of the work of the valuer.

Additionally, the Audit Committee has confirmed with management that assumptions made in determining the Trust's services and occupancy levels as at March 31, 2017 and in mapping those services onto an asset of equivalent capacity and function have not changed during the year.

After careful consideration, the Audit Committee has concluded that the adjustments to the level of impairment have been properly calculated and disclosed in the financial statements.

### *Provisions*

The Trust has a number of legal or constructive obligations of uncertain timing or amount. Provision for these obligations is made where it is probable that there will be a future outflow of cash or other resources and where a reliable estimate can be made of the amount.

The Audit Committee has discussed with management the provisions made at March 31, 2017. The Audit Committee also challenged the work performed during the audit by Mazars to determine if the provisions were accurately calculated and complete.

After consideration, the Audit Committee was satisfied that the level of provision made in the financial statements reflects the best estimate of the economic outflow likely to occur.

### *Impairment of Accounts Receivable*

The Trust makes provision against accounts receivables over 3 months past due unless there is a specific reason not to provide. Specific reasons include debts subsequently paid or balances where credible assurances have been received that the debts will be paid. In addition, where disputes are known, the Trust may provide for certain debts less than 3 months old.

The provision at 31 March 2017 was approximately £1.2 million of which £0.7 million is in respect of a receivable from NHS Mansfield and Ashfield CCG. This provision represents approximately 50% of the total outstanding from the CCG and is in respect of one service user that attended NTW.

The Audit Committee considered the methodology for identifying and assessing accounts receivable that may be subject to impairment and concluded that it remained appropriate.

The Audit Committee also discussed with the external auditors the work that they had performed during the audit to satisfy themselves that the provisions being made were complete and appropriate. In particular, the Audit Committee questioned the partial provision against the amount due from Mansfield and Ashfield CCG.

After consideration, the Audit Committee concluded that the provision for impairment of receivables was complete and appropriate.

### *Going Concern*

The Audit Committee formally considered the assumptions relating the going concern basis of reporting of the financial statements. After careful analysis and debate, the Audit Committee recommended to the March 2017 Board meeting that the use of going concern basis for the preparation of the annual financial statements was appropriate.

### *Consolidated Accounts*

On April 1, 2016, the Northumberland, Tyne and Wear NHS Foundation Trust Charity (the 'Charity') was established. The Charity is controlled by the Trust and so its assets, liabilities, incomes and expenditures fall to be consolidated into the balance sheet and income statement of the Trust under the provisions of International Financial Reporting Standard 10 ('IFRS 10').

However, IFRS 10 includes an over-ride to this provision on the grounds of materiality.

Management have assessed the need for the preparation of consolidated accounts to incorporate the Charity. This assessment compared both the statement of comprehensive income and the statement of financial position to provide an overall assessment of quantitative materiality.

Based on this assessment, management have concluded that the impact of the Charity for the current financial year is not material and so consolidated accounts need not be prepared.

The Audit Committee has reviewed the factors being used to make this assessment and has discussed with management's position with Mazars. After careful consideration of the factors and the responses from Mazars, the Audit Committee has concurred with the position of management.

## **2. Board Assurance Framework**

The Audit Committee has a responsibility to ensure that the Trust's system of risk management is adequate in both identifying risks and how those risks are managed.

The Trust's principal risks and the mitigating controls are reflected in the Board Assurance Framework ('BAF'). The BAF is currently maintained by the Trust's Performance and Assurance group and formally reviewed by the Quality and Performance Committee ('Q&P').

The Audit Committee considered the review performed by Q&P. It questioned directly the Director of Commissioning and Quality Assurance as to the system for the regular re-assessment of the principal risks and mitigating controls reflected in the BAF.

The Audit Committee also questioned directly the Head of Internal Audit to determine if the results of audits conducted to date and a comparison of the Trust's BAF to the equivalent documents in other similar organisations indicated any significant duplications or omissions in the Trust's governance systems.

Finally, the Audit Committee reviewed the Head of Internal Audit Opinion, presented to the Audit Committee in May 2017.

After careful scrutiny and consideration, the Audit Committee concluded that:

- The system of risk management is adequate in identifying risks and allowing the Board to understand the appropriate management of those risks; and

- The BAF was comprehensive and fit for purpose; and
- There were no significant omissions or duplications in the Trust's systems of governance.

### **3. Annual Governance Statement**

The Audit Committee is required to consider the Annual Governance Statement and determine whether it is consistent with the Audit Committee's view on the Trust's system of internal control.

During the year, a number of matters have been brought to the attention of the Audit Committee, mainly through the reports of Internal Audit. Therefore, the Audit Committee needed to formally consider these matters in forming its conclusion on the Annual Governance Statement. This was supported by other Audit Committee reviews such as of the Board Assurance Framework, Corporate Risk Register, the Head of Internal Audit Opinion and CQC registration.

After due challenge and debate, the Audit Committee concluded that the matters identified together with the remedial actions taken meant that its view on the Trust's system of internal control was consistent with the Annual Governance Statement. Accordingly, the Audit Committee supported the Board's approval of the Annual Governance Statement.

### **4. Clinical Audit**

Clinical Audit continues to report to the Q&P and not to the Audit Committee. The Audit Committee continues to monitor the issues raised by Clinical Audit through a review of the minutes of the Q&P Meetings.

In addition, the Chair of Q&P brings to the attention of the Audit Committee any matters raised by Clinical Audit, and the proposed remedies, which impact any of the Trust's key risks as recorded in the BAF.

This ensures that the Audit Committee is aware of any key issues raised by Clinical Audit but does not add unnecessary bureaucracy, duplication or contradiction into the process.

### **External Audit**

The Audit Committee places great importance on ensuring that there are high standards of quality and effectiveness in the Trust's external audit process.

Mazars was required to report to the Trust whether:

- The financial statements for the year have been prepared in accordance with directions under Paragraph 25 of Schedule 7 of the National Health Service Act 2006; and
- The financial statements comply with the requirements of all other provisions contained in, or having effect under, any enactment which is applicable to the financial statements; and
- The Trust has made proper arrangements for securing economy, efficiency and effectiveness; and
- The Trust's Quality Report has been prepared in accordance with detailed guidance issued by Monitor.

In September 2016, Mazars presented the audit plan for the year to the Audit Committee. The audit plan was challenged robustly, particularly in terms of timing, resources required, impact on the Trust's day-to-day activities, areas of audit risk, interaction with internal audit and the quality and independence of the Mazars' team.

The cost of the external audit plan was proposed at £40,000 (excluding VAT). The Audit Committee challenged whether Mazars could deliver the audit plan as described for the fee proposed.

Following the challenge and debate, the Audit Committee was satisfied that the audit plan was appropriate for achieving the goals of the audit and that the proposed fee was reasonable for the audit of an entity of the size and complexity of the Trust.

Accordingly, the fee proposal was recommended by the Audit Committee to, and approved by, the Council of Governors in February 2017.

Throughout the audit process, Mazars reported to the Audit Committee, noting any issues of principle or timing identified by the audit, changes in the external auditor's assessment of risk and any significant control weaknesses or errors identified.

Mazars identified no changes in their assessment of risk nor did they identify any significant control weaknesses. The audit did identify some instances of minor misstatement. None of the misstatements identified were assessed above 'trivial'. The Trust's financial statements were adjusted for all the matters identified.

At the conclusion of the audit, the Audit Committee performed a specific evaluation of Mazars' performance with the aid of a comprehensive questionnaire and with input from the Trust's management and internal audit.

Based on the interaction with the auditor throughout the audit process and the feedback from Trust's management and internal audit, the Audit Committee has concluded that the Trust received an effective and cost-efficient audit for the year.

The Trust has a policy in place for non-audit services provided by External Audit, which has been approved by the Council of Governors. During the year, the Trust has conducted a review of mortalities and learning support. External Audit has assisted in that review.

The Audit Committee considered the scope of the work being requested from External Audit and the proposed fee. The Audit Committee also confirmed that the scope of the work had been subject to External Audit's own internal independence review. After careful consideration, the Audit Committee agreed that the proposed scope of work and associated fee would not impair the independence of the External Auditor.

Martin Cocker  
Audit Committee Chair