

## TRUST BOARD

<b>Date of Meeting:</b> 05/10/2010		<b>Enclosure:</b> 9
		<b>Agenda Item No:</b> 10.1
<b>Title of Report:</b> Audit Committee Annual Report 2009/10		
<b>Aims:</b> To present to the committee the Audit Committee Annual Report for 2009/10		
<b>Summary:</b>  The purpose of this report is to outline the key activities of the Audit Committee, which have been undertaken during 2009/10. The report also confirms that the committee has achieved the duties and responsibilities set out in its terms of reference.		
<b>Specific implications for consideration (Financial/Workforce/Risk/Legal/Race Equality etc):</b>		
<b>Financial</b>	Contributes to the Trust's system of Corporate Governance	
<b>Workforce</b>	No specific implications.	
<b>Other</b>	Ensures appropriate annual reporting on the key activities of the Trust's Audit Committee.	
<b>Recommendations:</b>  That the Board receives and notes the Audit Committee Annual Report for 2009/10.		
<b>Document previously approved by:</b> Mr M Bonner, Non Executive Director Mr M Evens, Non Executive Director Mr A Mulvey, Director of Finance Ms H Green, Audit Commission Ms C McAdams, Head of Internal Audit		
<b>Prepared by:</b>  Mark Evens/ Michael Bonner Non Executive Directors		<b>Presented by:</b>  Mark Evens Non Executive Director

**TRUST BOARD  
AUDIT COMMITTEE ANNUAL REPORT 2009/10  
OCTOBER 2010**

**1. INTRODUCTION**

The purpose of this report is to set out for the Trust Board how the Audit Committee has helped to maintain and improve organisational governance processes and has met its Terms of Reference during the course of 2009/10. The terms of reference for the Committee and the content of this Report follow the recommendations of the *NHS Audit Committee Handbook* 2005, published by the Department of Health and HFMA.

While this report principally covers the activities of the Committee in the financial year 2009/10, it also includes matters relevant to that year which were discussed in later Committee meetings and updates regarding relevant current developments. In accordance with best practice, this report also draws attention to specific exceptional matters that have arisen during the year and which fall within the Committee's scope.

**2. MEMBERSHIP**

The Committee comprised the following members:

- Michael Bonner (Chair of the Audit Committee)
- Mark Evens
- Judith Cooke
- Philip Day

During the period December 2009 to June 2010, Mr Bonner was acting Chair of the Trust and Mr Evens was acting Chair of the Committee. Subsequently, Mr Evens was appointed Chair of the Committee.

**3. COMMITTEE MEETINGS**

The Committee met on seven occasions during the financial year– in April, June (twice), September, November (twice), and March 2010. The additional meetings in June and November were required to review the annual accounts and IFRS accounts respectively. All Audit Committee meetings were attended by both Internal and External Audit representatives, by the Director of Finance or the acting Director of Finance, and by other trust staff, as appropriate. In addition papers were circulated and commented upon. All Internal Audit reports were circulated to appropriate Trust Senior Management and the Audit Committee Chair. All such reports were summarised, reported and discussed at Audit Committee meetings.

All Committee minutes were provided to the Trust Board.

During the period, in accordance with best practice, a private meeting was held between both Internal and External audit representatives and the Audit Committee members without Trust staff being present. Further such meetings were planned to be (and have been) held on a more regular basis in 2010/11.

#### **4. PRINCIPAL REVIEW AREAS**

These areas are divided into six sections reflecting the key duties of the Committee as set out in its terms of reference.

##### **4.1 Governance, risk management and internal control**

- The Committee reviewed the adequacy of all risk and control related disclosure statements (in particular the Statement on Internal Control and declarations of compliance with the Standards for Better Health), together with the accompanying Head of Internal Audit statement and external audit opinion, prior to endorsement by the Board.
- The Committee reviewed the Assurance Framework and determined that the Framework used during the year was fit for purpose. The Framework is in line with Department of Health expectations and has been reviewed by internal audit and external audit to give additional assurance that this opinion is well founded. The Committee has encouraged more active use of the Framework and better integration with the Trust's risk management processes. Significant progress has been made after the period end in achieving this.
- The Committee has reviewed the completeness of the risk management system and considers the systems to be adequate. There is a continuing effort to better integrate the systems and embed them in the organisation. Subsequent to the period end a new risk management strategy has been approved to help carry through these improvements.

##### **4.2 Internal audit**

Internal Audit services (and supporting Local Counter-Fraud services) are provided under a Service Level Agreement to the Trust by Cumbria Internal Audit and Counter Fraud Consortium.

- The Committee has reviewed and approved the Internal Audit strategy, and was involved in the development of the risk based operational plan and more detailed programme of work, ensuring that this is consistent with the audit needs of the organisation as identified in the Assurance Framework
- The Committee has considered the major findings of internal audit work (and management's response). The Committee considered the number of outstanding audit recommendations to be high. In response, management put in place a programme to review and address the audit recommendations and to ensure that future recommendations are appropriately considered as regards relevance, priority and timeliness of closure.
- The Committee considered that the Head of Internal Audit Report and the SIC properly reflected the findings of internal audit during the year.
- The incidence of fraud at the Trust is relatively low and no significant frauds were reported to the Committee. The programme of counter-fraud awareness continues.

### **4.3 External Audit**

External Audit is carried out by the Audit Commission.

- The Committee reviewed and agreed external audit's annual plan and reviewed and commented on reports prepared by external audit.
- The Committee received briefings from external audit at each meeting which assisted in staying abreast of current developments.
- There was an additional audit to report on the IFRS restatement of the 2008/9 accounts.
- An Annual Governance Letter was received from external audit, containing conclusions from the annual audit and recommendations for improvements. These recommendations were accepted by the Committee. The main issues arising from this are dealt with in section 6 below.

### **4.4 Other assurance functions**

- The Committee maintains strong links with the Governance Committee, through the cross-membership of two non-executive directors, including the Chair of the Governance Committee.
- The Committee has considered other sources of assurance in areas of importance, including that of solicitors in the matter of equal pay claims and of independent accountants in the matter of the PFI refinancing.
- While not of the opinion that gaps exist in current clinical audit processes, the Committee has identified that further assurance would be beneficial in the considering the operation of those processes.

### **4.5 Management**

- The Committee has challenged the assurance process when appropriate and has called managers to account when considered necessary. In particular, the Committee received reports from management addressing a number of outstanding audit recommendations with respect to Private Patients.
- The Committee has identified that it would also be beneficial to request and review reports and to receive positive assurances from directors and managers.

### **4.6 Financial reporting**

- The Committee reviewed the annual financial statements before submission to the Board and recommended that they be approved.
- The Committee noted that the process of financial reporting could be improved and received regular reports against an ALE action plan. Despite the improvements resulting from this, the Trust had significant issues in the implementation of IFRS with a knock-on effect for financial reporting. These matters are dealt with more fully in a separate section below.

## **5. COMMITTEE SELF ASSESSMENT**

The Audit Commission made available its web-based self-assessment system and five members and attendees of the Committee participated in the survey. The Audit

Commission produced a report based on this. The overall results were satisfactory. The main areas of action identified were:

- gaining more robust assurance over financial reporting processes;
- clarifying the assurance over Standards for Better Health (now replaced by CQC registration)
- seeking positive assurances from management and considering the operations of other assurance functions (beyond internal and external audit).

Plans for addressing these areas are set out in section 8 below.

## **6. MAIN ISSUES**

The main areas of concern considered by the Audit Committee in the previous year's report (in italics), updated for developments in the current period, are set out below.

- *The establishment of a structured process under which progress against all recommendations in both Internal and External Audit reports was monitored, and delays in progress challenged.*

Significant progress has been made in this area. A process has now been developed so that all internal and external audit recommendations are brought together within one report which is closely reviewed each month to ensure that agreed recommendations are concluded in a timely way. Where actions are not being completed the Committee intends to request updates from individual management leads as to why actions are off target. In addition to this, a full review of the outstanding internal audit recommendations for 2006/7, 2007/8 and 2008/9 has been undertaken. At the start of the year there were 59 outstanding recommendations from 2006/7, 2007/8 and 2008/9, which have been reduced to 18 outstanding recommendations for 2008/9. To date the 2009/10 position on outstanding recommendations is as follows:

- 97 recommendations complete
- 57 recommendations partially complete
- 33 recommendations outstanding

- *The updating of the Trust's Fixed Asset Register, including the physical verification of assets.* It is disappointing to report that the Trust has continued to have difficulties in embedding the Register into its financial and business processes. While the risk of errors is reduced from those experienced in 2007/8, external audit continued to have concerns in this area, resulting in further attention by management.
- *The preparation for the introduction of International Financial Reporting Standards.* The Trust had some difficulty and delay in restating the 2008/9 accounts in line with IFRS. While some of this was caused by the complexity of the PFI and the late receipt of guidance, it also highlighted some shortfalls in technical capability. The annual accounts for 2009/10 required a material late adjustment to the statutory break even performance, because of an error in accounting for a PFI-related IFRS adjustment. Management have put in place an action plan to address the underlying issues.
- *The improvement process required to deliver a smooth year end process for 2008/09.* An ALE action plan was developed and implemented. While this did deliver some benefits, it is clear that significant issues remain regarding the quality of financial reporting, as illustrated by the specific matters discussed above.

In addition to the action plans to improve the technical quality of accounts, the Trust has recently established a Finance Committee to provide greater assurance over financial management and reporting.

The Committee will continue to monitor these areas in 2010/11.

The principal further concerns arising from the 2009/10 year relate to the financial standing of the Trust. As a result of the material adjustment referred to above, the statutory break-even performance, while positive, was less than required to address the Trust's historic deficit recovery on a straight line basis, although sufficient cash resource was generated to service the Trust's working capital loan repayments. This was considered by the external auditors to be a breach of the "financial recovery plan". Upon further investigation, it became apparent that the Trust does not have a formal financial recovery plan. Such a plan would normally have been put in place in March 2007, when the loan from the Department of Health was agreed, and would require the agreement of the SHA and commissioners as well as being reviewed by the external auditors (and the Audit Committee at that time). In order to remedy this, management have undertaken to draw up a new financial recovery plan to set out the issues facing the Trust, the drivers of these issues, the route to resolving them and the timeframe within which results will be achieved.

The Committee notes that all the events referred to above have occurred during a time of change in the financial leadership of the Trust. During the year the Finance Director resigned and there was a period of six months until the appointment of a substantive replacement..

Looking forward, the need for a robust recovery plan is increased by the significant financial pressures facing the Trust in 2010/11. This is an area of major concern for the Committee. The Committee supports the decision to establish a Finance Committee which, among other responsibilities, will oversee the Recovery Board and the Cost Improvement Programme. The Committee plans to review its role in relation to the Finance Committee and in particular the assurance provided by the Finance Committee.

## **7. FORMAL CONCLUSIONS**

A key requirement of the operation of the Audit Committee is to assess and confirm formally that risk and assurance systems are in place and adequate.

The Audit Committee confirms that:

- the Statement of Internal Control for 2009/10 is consistent with the opinion of the Audit Committee on the organisation's systems of internal control and that the Committee supports the Board's approval of the Statement;
- the overall risk management systems are adequate for the effective governance of the Trust and allow the organisation to understand and manage its key risks;
- there are no significant areas of duplication or omission in the organisation's governance systems that have come to the attention of the Committee that have not been adequately resolved;
- the 2009/10 mid-year self assessment against the Standards of Better Health was consistent with the Audit Committee's understanding of the status of the organisation's governance arrangements.

## **8. AUDIT COMMITTEE FORWARD PLAN**

Based on this review, the key areas of focus for the Audit Committee in 2010/11 are:

- to gain assurance that the Trust has adequate processes for financial management and reporting, particularly with regard to the matters discussed above;
- to improve the clarity of assurance over clinical areas, seek positive assurances from management and consider the operations of other assurance functions.

The specific plans supporting this focus are:

- review of the assurance gained from the Finance Committee;
- follow-up of the specific action plans arising from the 2009/10 external audit and Annual Governance Letter;
- consideration of the sources of assurance, other than audit, in the Assurance Framework and of the effectiveness of these;
- seeking linkage between internal audit activities and the assurance framework;
- consideration of the assurance provided in clinical areas, including by clinical audit;
- inviting attendance by management to discuss assurance in selected areas of the Assurance Framework.

In addition, the Committee plans to continue to monitor existing initiatives, including

- timely closure of audit recommendations, inviting management to attend and explain to the Committee in the event of significant outstanding actions;
- the process of embedding risk management into the organisation;
- the use of the Assurance Framework to inform and guide actions;
- existing action plans for improving financial reporting.

**Michael Bonner**  
**NON-EXECUTIVE DIRECTOR AND**  
**AUDIT COMMITTEE CHAIR, APRIL**  
**2009 – NOVEMBER 2009**

**Mark Evens**  
**NON-EXECUTIVE DIRECTOR AND**  
**AUDIT COMMITTEE ACTING CHAIR,**  
**DECEMBER 2009 - MARCH 2010**