

# Annual governance report

North Cumbria University Hospitals NHS Trust  
Audit 2010/11

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## Ladies and Gentlemen

### 2010/11 Annual Governance Report

I am pleased to present the results of my audit work for 2010/11.

I discussed and agreed a draft of my report with the Chief Executive and Director of Finance on 3 June 2011 and updated it as issues have been resolved.

My report sets out the key issues that you should consider before I complete the audit.

It asks you to:

- consider the matters raised in the report before approving the financial statements (pages 3 to 14);
- note the adjustments to the financial statements set out in this report (Appendix 2);
- agree to adjust the errors in the financial statements I have identified, which management has declined to amend or set out the reasons for not amending the errors; (Appendix 3);
- approve the letter of representation on behalf of the Trust before I issue my opinion and conclusion (Appendix 4); and
- agree your response to the proposed action plan (Appendix 6).

Yours faithfully

Jackie Bellard  
Engagement Lead

Date 7 June 2011

# Key messages

**This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.**

Table 1: **Key messages - financial statements**

<b>Financial statements</b>	<b>Results</b>	<b>Page</b>
Unqualified audit opinion	Yes	17
Important weaknesses in internal control	Yes	10

Table 2: **Key messages - value for money**

<b>Value for money</b>	<b>Results</b>	<b>Page</b>
Proper arrangements to secure value for money	No	15

## **Audit opinion**

**1** Subject to satisfactory completion of outstanding matters I plan to issue an audit report including an unqualified opinion on the financial statements.

## **Certifying completion of the audit**

**2** I cannot formally conclude the audit and issue an audit certificate until I have completed the work necessary to provide assurance over the Trust's annual quality accounts. I am also considering my responsibilities under Section 19 of the Audit Commission Act 1998. I am satisfied that this work does not have a material effect on the financial statements or on my value for money conclusion.

**3** Appendix 1 contains a draft of my Audit Report.

## Financial statements

4 The Financial Statements contained a large number of errors, many of which were of classification, including items in error in the prior year. In addition, in some areas the Trust's actual accounting practice did not match the accounting policies. Appendix 2 reports the amendments made by management to the draft accounts and Appendix 3 reports the items which management has not amended.

## Value for money

### Financial resilience

5 In considering North Cumbria University Hospitals NHS Trust arrangements for securing financial resilience, I identified that at the start of the 2010/11 financial year the Trust did not have robust plans in place for delivery of a significant part of its required cost improvements of £21 million and had only delivered £12.2 million by the end of the year. In addition it received additional income of £20.6 million from NHS North West to enable it to achieve its statutory breakeven duty.

6 Similarly at the start of the 2011/12 financial year only £7.2 million of the required £15.2 million savings plans were developed, the level of income had not been agreed with NHS Cumbria and to achieve breakeven the Trust will require additional income from NHS North West of £27 million.

### Arrangements for securing value for money

7 In considering the Trust's arrangements for securing economy, efficiency and effectiveness I identified that the Trust does not have a medium term financial plan in place and it has yet to assess the financial viability of its agreed clinical strategy. The Trust has limited costing information to inform decisions on service developments and until the latter part of 2010/11 has had limited clinical engagement in ensuring costing information is accurate.

8 The Trust has acknowledged that it cannot deliver the required services within its current financial resources and is seeking a formal arrangement through a merger or acquisition with an existing NHS Foundation Trust.

9 I plan to issue an adverse Value for Money Conclusion. Appendix 1 contains a draft of my Audit Report.

### Audit fees

10 I had to undertake additional work to review the amended Model for the Trust's PFI scheme and to consider the complex technical accounting issues which arose during the audit therefore it may be necessary to increase the audit fee.

**11** The Department of Health (DofH) has requested that Trusts obtain external assurance on their quality accounts with a 'dry-run' exercise for 2010/11. The DofH has asked for the work to be undertaken by the Trust's external auditors. After consultation, the Audit Commission has agreed a supplementary fee of £15,000. We aim to complete out work by 30 June 2011.

### **Independence**

**12** I can confirm that I have complied with the Auditing Practice Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence. I can also confirm there were no relationships resulting in a threat to independence, objectivity and integrity.

**13** The Audit Commission's Audit Practice has not undertaken any non-audit work for the Trust during 2010/11.

## Next steps

**This report identifies the key messages that you should consider before I issue my financial statements opinion, value for money conclusion and audit closure certificate. It includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.**

I ask the Audit Committee to:

- consider the matters raised in the report before approving the financial statements (pages 3 to 14);
- take note of the adjustments to the financial statements which are set out in this report (Appendix 2);
- agree to adjust the errors in the financial statements I have identified that management has declined to amend or set out the reasons for not amending the errors (Appendix 3);
- approve the letter of representation on behalf of the Trust before I issue my opinion and conclusion (Appendix 4); and
- agree your response to the proposed action plan (Appendix 6).



# Financial statements

**The Trust's financial statements and statement of internal control are important means by which the Trust accounts for its stewardship of public funds. As Board members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the statement of internal control.**

## **Opinion on the financial statements**

**14** Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements.

## **Certifying completion of the Audit**

**15** I cannot formally conclude the audit and issue an audit certificate until I have completed the work necessary to provide assurance over the Trust's annual quality accounts. I am also considering my responsibilities under Section 19 of the Audit Commission Act 1998. I am satisfied that this work does not have a material effect on the financial statements or on my value for money conclusion.

**16** Appendix 1 contains a draft of my Audit Report.

## Key areas of judgement and audit risk

17 In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

Table 3: **Key areas of judgement and audit risk**

Issue or risk	Finding
Meeting Statutory Financial Duties	The Trust has met its statutory financial duties but only after receipt of £20.6 million support from NHS North West. I am considering my responsibilities under Section 19 of the Audit Commission Act 1998.
Judgements on accruals and provisions	The Trust did not provide adequate evidence to support all estimated material accruals and provisions. During the audit we received further supporting information and we are satisfied that they are not materially misstated. Trust officers should ensure that they can demonstrate how they have calculated material estimates and the management controls in operation.
PFI model	The Trust supplied a revised PFI Model on 18 April. I have reviewed it and consider that the £1.35 million of lifecycle replacement costs which have been charged to capital should be charged to expenditure in the year, firstly because there is no evidence to demonstrate that the expenditure meets the Trust's criteria for capital expenditure. Secondly because the Trust changed its method of valuing its assets in 2009/10 to an approach which means that the Trust is not able to comply with the requirements of IAS16 as it is not possible to de-recognise the carrying value of the assets which have been replaced. Also we understand that valuation approach assumes that lifecycle costs are charged as an expense in the year they are incurred. We have agreed that as the amount is not material that no amendment to the accounts is required. However the Trust needs to consider the future treatment of lifecycle costs as these costs will be material in future years as shown in the PFI Model.

Issue or risk	Finding
Re development of West Cumberland Hospital site, in particular inappropriate capitalisation of expenditure, capital commitments and valuation	<p>The Trust has not yet received authorisation for the final business case for the new hospital at West Cumbria and therefore the asset is still recorded on the balance sheet with no adjustment to the remaining useful life.</p> <p>Over £540,000 of project team salary and other costs have been charged to capital in the year and £2.3 million of capital expenditure has been incurred in the year, the total cost of assets under construction at 31 March is now £9.9 million. The trust received an additional £300,000 from the SHA as part of a £2 million package of support to cover the revenue costs of developing the site. However, most of the development costs have been charged to capital.</p>
Revaluation of land and buildings	Based on advice from the Trust's valuer, there has been no revaluation of land and buildings in the year.
Accounting for additional income from the Strategic Health Authority	The Trust received £20.6 million additional 'strategic support' in 2010/11. The Chief Executive of the SHA has confirmed in writing that this sum is not repayable. The income is included within 'revenue from patient care activities'.

### Statement on Internal Control

**18** I have reviewed the Trust's Statement on Internal Control and agree that it now includes all the required elements.

**19** Within the section on Significant Control Issues the Trust has referred to the fact that:

- it did not deliver its planned cost improvement programme in 2010/11 and;
- it is taking action to improve Governance and Clinical Governance.

### Errors in the financial statements

**20** The accounts presented for audit on 23 April 2011 have been amended and the agreed amendments are reported in appendix 2.

**21** Once again there are many amendments relating to classification of expenditure and income or of balance sheet items either because the requirements of the Manual for Accounts had not been followed or because the reported information was not in accordance with the underlying information.

**22** I have reviewed the issues and errors which arose during the 2009/10 audit and am satisfied that in most respects the issues have been addressed as expected.

**23** There continues to be scope for improvement in the quality assurance process in particular the overview of the accounts. For example there were several entries where there was a material difference in the amounts disclosed between years but no explanation of why that should be. Further investigations by my team and Trust staff identified that in some cases:

- the variance identified that the information had been incorrectly classified in 2009/10. Where it has been agreed that it is correct to amend the 2009/10 comparative a note has been added to explain the reason for the amendment to the 2009/10 accounts,
- in others the 2010/11 entry was incorrectly classified and has been amended.

**24** None of the amended errors affected the Trust's reported adjusted retained surplus.

**25** I also identified errors which Trust management has not amended, these are reported in appendix 3. None of these errors is individually material. If they were to be corrected the effect, would be to reduce the retained surplus for the year from £1.408 million to a deficit of £26,000. However the adjusted retained surplus of £1.356 million would be unaffected as the amendment regarding charging lifecycle costs to revenue expenditure would be reversed out through the IFRIC 12 adjustment.

## Recommendations

**R1** The Trust must ensure that the financial statements and related disclosure notes are consistent with the underlying information and compliant with the requirements of the relevant accounting standards and the NHS Manual for Accounts.

**R2** The Trust should improve quality assurance processes to ensure that any errors in the financial statements and the underlying records are identified and corrected prior to the accounts being submitted for audit.

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### Important weaknesses in internal control

**26** In completing the audit I found that there is scope to improve the controls over accounting for the legal and administration costs of the equal pay claims. At present there is no clear mechanism for recovering payments from the PCT and maintaining a record of the current position. At year end the Trust accrued a further £252,000 back provision with the PCT within Receivables but this amount has not been agreed with the PCT.

**27** Within the returns which go to the DoH, NHS bodies agree balances between themselves. The Trust is then able to make adjustments to the balances - such as accruals and also has to identify any disputed amounts. As at 31 March 2011, the Trust had over £2 million of disputed amounts, £1.7 million with the PCT and £300,000 with foundation trusts, mostly Cumbria Partnership Foundation Trust.

**28** These weaknesses are only those I identified during the audit that are relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control.

## Recommendations

**R3** The Trust should ensure that payments associated with back to back equal value claims are recovered promptly from the PCT and that these transactions are properly recorded and accounted for including agreeing the balances with the PCT.

**R4** The Trust must resolve the differences regarding disputed amounts as soon as possible in order to minimise the risk that these monies are not paid and the Trust has an even bigger deficit to cover.

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## Quality of your financial statements

**29** I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statement disclosures.

**30** Table 4 contains the issues I want to raise with you.

Table 4: **Accounting practices, policies and estimates and financial statement disclosures**

Issue	Finding
Accounting Policies	The standard accounting policies provided by the DofH are only to be amended in rare circumstances apart from where it is appropriate to delete them when, for example, the Trust has no pooled budget arrangements. The way in which the Trust is accounting for lifecycle costs as subsequent expenditure is not in accordance with the standard accounting policies nor with International Accounting Standard (IAS) 16.
Risks - Litigation	The Trust still has outstanding claims for equal pay. The estimated liability has been assessed as between £2.2 million and £3 million, the Trust has provided £2.2 million and this is covered by a back-to-back provision with the primary care trust.
Asset lives and valuations	The Trust adopted a change to valuing its assets during 2009/10. The changed approach assumes that subsequent expenditure will be charged to revenue as the asset lives of the whole asset have been extended. The Trust charged the subsequent expenditure to capital, however as it has no information about the actual amounts spent by the PFI provider it is not appropriate to record the lifecycle costs as capital expenditure. The Trust has agreed to consider the accounting treatment in future years.
Misstatement corrections	The comparative figures for 2009/10 in some cases have been amended. For example over £2.5 million of income previously reported revenue from patient care activities is now reported as other operating revenue. The prior year figures have been amended and a disclosure added to the Statement of Comprehensive Income and Expenditure, Note 5 and Note 6 to explain the amendment.

## Significant difficulties encountered during the audit

31 Difficulties encountered during the audit included:

- dealing with the large numbers of errors;
- understanding and clarifying the Trust's accounting for the lifecycle costs within the revised PFI model; and
- obtaining sufficient and timely evidence to support estimated figures in the accounts.

32 Many of the errors could have been avoided had there been closer scrutiny of the accounts before they were released to address the significant variances between years.

33 The PFI model was revised this year and I undertook additional work to ensure that the model was correct so that the entries in the accounts were also correct. I raised concerns that in charging the lifecycle costs to capital the Trust is unable to comply either with its accounting policies or with the requirements of International Accounting Standard (IAS) 16:

34 IAS 16 requires that when subsequent expenditure enhances an asset beyond its original specification the cost is capitalised. If the expenditure restores an asset to original specification then the expenditure is capitalised and the existing carrying value is written off to revenue. The Trust cannot comply because it has no information about the value of lifecycle costs spent by the PFI provider nor what it has been spent on.

35 Trust management is required to ensure that where they include significant estimates within their accounts they can demonstrate how they have made the estimates, that they understand the data on which the estimates are based and can demonstrate the controls in operation.

36 The Trust's accounts include liabilities for equal pay claims and redundancy costs and although we eventually obtained sufficient supporting evidence it should have been available at the beginning of the audit.

### Recommendation

R5 Trust management should ensure that they have sufficient information to support all significant accounting estimates at the beginning of the audit.

## Significant matters that were discussed or subject to correspondence with management

37 The most significant matter discussed with management was the Trust's financial resilience.

- Although the Trust achieved over £12.1 million of cost improvements in the year this was some £8 million short of the planned cost improvement programme (CIP).

- Even if the Trust had achieved its planned CIP it would still have required additional financial support because, in order to achieve break even in the year, £20.6 million of strategic support from the SHA via the PCT was needed. I was concerned that the Trust obtained clarity over whether or not the money was repayable. The Chief Executive of the SHA has written to the Trust to confirm that the £20.6 million is not repayable.
- The Trust's 2011/12 budget assumes receipt of £27 million strategic support from the SHA.
- The Trust, PCT and other local stakeholders have agreed on a clinical strategy for providing healthcare in North Cumbria, however the strategy has yet to be costed and therefore it is not clear whether the strategy can be covered by available funding.

**38** In February 2011 the Trust decided that in order to comply with the requirements for Foundation Trust status it would need to merge with another existing Foundation Trust. Negotiations have started and it is expected that the merger will be completed in October 2012.

#### **Letter of representation**

**39** Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. Appendix 4 contains the draft letter of representation.



# Value for money

**I am required to conclude whether the Trust put in place proper corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.**

**40** I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission. My conclusion on each of the two areas is set out below in table 5.

**41** I intend to issue a qualified conclusion stating that the Trust did not have adequate arrangements to secure economy, efficiency and effectiveness in the use of resources, as set out in Table 5. Appendix 1 contains the wording of my draft report.

Table 5: **Value for money conclusion criteria**

Criterion	Finding
Financial resilience The organisation has proper arrangements in place to secure financial resilience. Focus for 2010/11: The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.	The matters discussed in paragraphs 37 and 38 of this report give rise to significant uncertainties which put at risk the Trust's ability to continue to operate for the foreseeable future.  Given these uncertainties, I am unable to conclude that the Trust has in place robust arrangements to secure financial resilience.
Securing economy efficiency and effectiveness The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.	<ul style="list-style-type: none"><li>■ Whilst the trust has delivered some savings in 2010/11 it did not have a clear plan at the start of the financial year and many of the arrangements to deliver CIPs were not in place until the last three months of the year.</li></ul>

Criterion	Finding
<p>Focus for 2010/11:</p> <p>The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.</p>	<ul style="list-style-type: none"> <li>■ The Trust had cashflow difficulties in December 2010 and had to borrow from the SHA because many of the CIPs were not cash releasing.</li> <li>■ The Trust does not have a clinical strategy that is costed and assessed to see if it is affordable.</li> <li>■ In May 2011 they have engaged Deloittes to develop a turnaround plan and review the whole health economy provision.</li> <li>■ There is an assumption that the SHA will provide strategic support of £27 million but this is not confirmed.</li> <li>■ At the start of 2010/11 the Trust had not identified £8 million of the required £15.2 million CIP.</li> <li>■ The Trust have announced that they are seeking a partner eg an FT to enable them to secure a viable future.</li> <li>■ There has been limited clinical engagement during 2010/11 in identifying and delivering CIPs and SLR.</li> <li>■ SLR has not been developed and is not used to drive service changes.</li> </ul>

# Appendix 1 Draft independent Auditor's report to the Board of Directors of North Cumbria University Hospitals NHS Trust

I have audited the financial statements of North Cumbria University Hospitals NHS Trust for the year ended 31 March 2011 under the Audit Commission Act 1998. The financial statements comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Taxpayers' Equity, the Statement of Cash Flows and the related notes. These financial statements have been prepared under the accounting policies set out in the Statement of Accounting Policies. I have also audited the information in the Remuneration Report that is described as having been audited.

This report is made solely to the Board of Directors of North Cumbria University Hospitals NHS Trust in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 45 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

## **Respective responsibilities of Directors and auditor**

As explained more fully in the Statement of Directors' Responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

## **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Trust's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Trust; and the overall presentation of the financial statements. I read all the information in the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## **Opinion on financial statements**

In my opinion the financial statements:

- give a true and fair view of the state of North Cumbria University Hospitals NHS Trust's affairs as at 31 March 2011 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the accounting policies directed by the Secretary of State with the consent of the Treasury as relevant to the National Health Service in England.

## **Opinion on other matters**

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the accounting policies directed by the Secretary of State with the consent of the Treasury as relevant to the National Health Service in England; and
- the information given in the Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## **Matters on which I report by exception**

I have nothing to report in respect of the Statement on Internal Control on which I report to you if, in my opinion the Statement on Internal Control does not reflect compliance with the Department of Health's requirements.

## **Conclusion on the Trust's arrangements for securing economy, efficiency and effectiveness in the use of resources**

### **Trust's responsibilities**

The Trust is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

### **Auditor's responsibilities**

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Trust has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. I am not required to consider, nor have I considered, whether all aspects of the Trust's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

### **Basis for adverse conclusion**

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2010, as to whether the Trust has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Trust put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2011.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Trust had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

In considering the Trust's arrangements for securing financial resilience, I identified that:

- at the start of 2010/11 the Trust did not have robust plans in place for delivery of a significant part of its required cost improvements of £21 million and had only delivered £12.2 million by the end of the year;
- the Trust received additional income of £20.6 million from NHS North West to enable it to achieve its statutory breakeven duty.
- at the start of 2011/12 only £7.2 million of the required £15.2 million savings plans were developed;
- the level of contract income had not been agreed with NHS Cumbria; and
- to achieve breakeven the Trust will require additional income from NHS North West of £27 million in 2011/12.

In considering the Trusts arrangements for securing efficiency economy and effectiveness I identified that:

- the Trust does not have a medium term financial plan in place and
- it has yet to assess the financial viability of its agreed clinical strategy;
- the Trust has limited costing information to inform decisions on service developments and until the latter part of 2010/11 has had limited clinical engagement in ensuring costing information is accurate.

### **Adverse conclusion**

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, the matters reported in the basis for adverse conclusion paragraph above prevent me from being satisfied that in all significant respects North Cumbria University Hospitals NHS Trust put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011.

### **Delay in certification of completion of the audit**

I cannot formally conclude the audit and issue an audit certificate until I have completed the work necessary to provide assurance over the Trust's annual quality accounts. I am also considering my responsibilities under Section 19 of the Audit Commission Act 1998. I am satisfied that this work does not have a material effect on the financial statements or on my value for money conclusion.

Jackie Bellard,

Officer of the Audit Commission

9 June 2011

Audit Commission

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## Appendix 2 Amendments to the draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities.

I have listed the issues in the order they appear in the accounts.

Item no	Item of account and Note	Description	Value and Impact
1	Statement of Comprehensive Income	As a result of various amendments to supporting notes listed in detail below some of the SOCI disclosures have been amended in both 2010/11 and 2009/10. However, none of these items has resulted in a change to the reported retained adjusted surplus/(deficit) for either year.	
2	Statement of Comprehensive Income and Statement in Changes in Taxpayers' Equity	Within my Annual Governance Report for 2009/10 I recommended that errors made on the disclosures relating to impairments should be corrected in 2010/11. Because there has been a change in accounting policy in 2010/11 the adjustment was not correct. The impairment should be taken in full to the revenue account, whatever the state of the revaluation reserve on that asset. A transfer is then made from the revaluation reserve to retained earnings.	<p>The error has been corrected which reduced the surplus by £156,000. However, as this is reversed as an adjustment to the Trust's financial performance position there is no impact on the break-even position.</p> <p>The Statement of Changes in Taxpayers' Equity was also amended to transfer £156,000 from the revaluation reserve to retained earnings.</p> <p>There was no impact on the Trust's retained earnings.</p>



Item no	Item of account and Note	Description	Value and Impact
3	Statement of Financial Position	The Trust raised an invoice on 1 April 2011 to the PCT for a £1.1m contribution towards the revenue costs of the WCH development. This was included as a receivable in the SOFP. The Trust subsequently took the view that this income did not relate to 2010/11 so treated it as deferred income with a £1.1m balance in payables. The statements were amended to remove this £1.1m from both receivables and payables in both the SOFP and Notes 21.1 and 26.	Payables and receivables both reduced by £1.1m. No impact on surplus.
4	Statement of Financial Position	Accrued expenditure relating to an accommodation rebate of £187,000 was included as a negative NHS receivable It should have been a Non-NHS payable. The SOFP was amended and also the supporting notes 21.1 and 26 for receivables and payables.	Current receivables and payables were both increased by £187,000. This has no impact on the Trust's surplus.
5	Statement of Financial Position	A late adjustment was made to the ledger to transfer an incorrect posting of £21,000 from provisions to accruals. This adjustment was not reflected in the statements. Note 26 and the SoFP were amended.	Provisions were overstated by £21,000 and payables were understated by the same amount. This has no impact on the surplus.
6	Statement of Financial Position	Current provisions included £107,000 in respect of public and employers' liability claims. The equivalent figure last year was £149,000 and was disclosed as a non-current provision. The schedule from NHSLA does not distinguish between the current and non-current element of the provision. The Trust's treatment is inconsistent between years. The statements were amended to show this as a non-current provision.	Current provisions reduced by £107,000 and non-current provisions increased by £107,000. This has no impact on the surplus.
7	Cash Flow Statement	The Trust has amended the prior year other capital receipt in respect of £307,000 of donated assets.	Prior year amendment only
8	Note 1.1 Accounting Convention	The note on the going concern basis for preparing the accounts was expanded to provide more detail of the financial challenges faced by the Trust.	No financial impact.

Item no	Item of account and Note	Description	Value and Impact
9	Note 3 Operating segments	The figures quoted as income from external organisations for patient care were amended to agree with the figures in Note 6.	Narrative amendment only. No financial impact.
10	Note 6 Other operating revenue	<p>The accounts submitted for audit originally showed that income from 'non patient care services to other bodies' within other operating income had increased by over £2.8m. As I was unaware that the Trust had taken on additional services for other bodies further checks were made and identified that both the 2009/10 and 2010/11 disclosures were overstated.</p> <p>£300,000 of income from the PCT for revenue costs of the WCH redevelopment was transferred from the 'non patient care services line to other bodies' line to the 'other' line in Note 6 as it does not relate to non patient care services to other bodies.</p> <p>£533,000 was received in 2009/10 in respect of the revenue costs of developing WCH but was incorrectly shown as revenue from patient care activities in Note 5. The prior year comparatives were restated to show this as other operating income.</p>	<p>£300,000 reclassified in Note 6 but no financial impact.</p> <p>Prior year comparatives restated.</p>
11	Note 6 Other operating revenue	<p>We found inconsistency between years in the way that the Trust was treating certain funding received from the PCT, notably NPfIT and Information for Health IT funding streams, and Merit Awards.</p> <p>In 2010/11 all this funding which amounted to £2.1m was shown as 'Non-patient care services to other bodies.' The accounts were amended to transfer £290,000 of Merit Awards and £660,000 of IT funding which had supported Trust developments from the 'non patient care services line to other bodies' line to the 'other' line in Note 6.</p> <p>In the previous year £2.1m equivalent funding was incorrectly shown as revenue from patient care activities. The prior year comparatives were restated to show this as other operating income, split over the 'non patient care services line to other bodies' line and the 'other' line.</p>	<p>£950,000 reclassified in Note 6 but no financial impact.</p> <p>Prior year comparatives restated.</p>

Item no	Item of account and Note	Description	Value and Impact
12	Note 8 Operating expenses	Amendments were made to the classifications of expenditure in Note 8 in order to correctly disclose the audit fee of £191,000 and show the value of services received from foundation trusts of £170,000. The same disclosure in 2009/10 was initially misstated and then amended for the same reasons.	Classification issue only. No financial impact.
4	Note 8 Operating expenses and Note 10.5b	A redundancy provision of £103,000 and MARS provision of £126,000 were charged to "Other" in operating expenses. These costs should be charged to employee benefits. The error also affects the additional note 10.5b which discloses the number and value of Exit Packages.	Other costs overstated by £229,000 and employee benefits understated by £229,000. No impact on surplus.
13	Note 10.3 Staff Sickness Absence	The note was amended to show the days lost and average working days lost in the calendar years 2010 and 2011 in accordance with guidance from the DofH. The reported average working days lost was reduced from 18 to 11 as a result of the amended disclosure.	Disclosure only. No financial impact
14	Note 10.4 Management costs	The narrative in the note was expanded to provide a clearer explanation for the increase in management costs.	No financial impact
15	Note 10.5 Salary and pension entitlements of senior managers.	There were several errors in Note 10.5, Salary and Pension Entitlements of Senior Managers, relating to increase in pensions, increase in lump sums and increase in cash equivalent transfer values. The errors were due to missing information and incorrect calculations.	The note was amended but this has no financial impact.
16	Note 10.5 Salary and pension entitlements of senior managers.	The note did not include a benefit in kind of £100 which had been paid to one of the individuals in the note.	The note was amended. No financial impact.
17	Note 10.5 Salary and pension entitlements of senior managers.	The narrative relating to the accounting treatment of redundancy and other departure costs was incorrect and contradictory. The narrative was redrafted.	The note was amended. No financial impact.
18	Note 16 Property plant and equipment	Guidance from the DH on disclosure of PPE states that where a revaluation has taken place in any year, cumulative depreciation should be zeroed so only the net book value of assets will be carried forward to the subsequent year.	Brought forward cost or valuation figures for buildings and dwellings were reduced by £13.165m

Item no	Item of account and Note	Description	Value and Impact
		NCUHT's assets were revalued in 2009/10 but depreciation was not set to zero in Note 16.	and £3.260m respectively. Brought forward depreciation was set to zero. This had no impact on PPE net book values and no impact on the surplus.
19	Note 16 Property plant and equipment	Adjustments were made to the asset register following a validation exercise to physically confirm the existence of medical equipment. This included a write down of assets which could not be located which had a gross book value of £1,225,000 and accumulated depreciation of £1,100,000. This adjustment was made by reducing the GBV of these assets by £125,000. The accounts were amended to treat these assets as disposed of.	Disposals cost increased by £1,100,000 and depreciation in respect of disposals increased by £1,100,000. There was no impact on the net book value of Property plant and equipment.
20	Note 16 Property plant and equipment	<p>There were some amendments required to the narrative in Note 16 Property, Plant and Equipment.</p> <p>The section on the change to assessing residual lives from 2009/10 was a change introduced last year and was removed.</p> <p>The section on the validation exercise was incorrect and was adjusted in line with the amendments made above</p> <p>Building lives were amended to ensure they were consistent with the prior year.</p>	Narrative amendment only. No financial impact.
21	Note 16.1 Revaluation reserve balance for property, plant and equipment	<p>There was no prior period disclosure made for this note.</p> <p>The statements were amended to include the previous year's figures.</p>	No financial impact.
22	Note 18 Impairments	Note 18 included unnecessary detail relating to a valuation error made in 2009/10. This was removed.	Narrative amendment only. No financial impact.
23	Note 20.1 Inventories	£170,000 was reclassified as Other inventory rather than Consumables.	Classification only. Inventory balance unchanged.

Item no	Item of account and Note	Description	Value and Impact
24	Note 20.2 Inventories recognised in expenses	The original accounts showed that inventories recognised as an expense had reduced by over £3m between years which did not seem reasonable. Following audit queries it became clear that both the 2010/11 and 2009/10 figures had been mis-stated. The statements were amended to reduce the 2010/11 figure by £1m to £24.1m. The prior year figure was reduced from £28.1m to £23.9m Thus showing that inventories recognised in expenses had increased by £200,000 between years.	This is a disclosure figure and does not impact on the statements.
25	Note 21 Trade and other receivables	The note included £1.1m current and £840,000 non-current receivables in respect of injury cost recovery. The Manual for Accounts specifies that these balances should be shown as "Other receivables" but the Trust had shown them as "Non-NHS receivables – revenue". The note was amended and the prior year comparators were also restated.	£1.1m current and £840,000 non-current receivables moved from "Non-NHS receivables – revenue" to "Other receivables". No impact on overall value of receivables.
26	Note 21.2 Receivables past their due date but not impaired	This note showed a large increase in the up to three month category from £730,000 in 2009/10 to £3.04m. The Trust discovered that they had miscalculated the 2009/10 figure but were unable to produce the correct figure. A note was inserted to draw attention to this.	Narrative amendment only. No financial impact.
7	Note 26 Trade and other payables	Other payables within this note include £372,000 current and £1.9m non current liabilities in respect of equal value claims and the associated legal costs. Because these liabilities match the definition of provisions they should be disclosed within provisions Note 34.	The accounts were amended to include the equal value liabilities within Provisions. This had no impact on the surplus.
27	Note 32 Private Finance Initiative	Several amendments were made to Note 32 on PFI. Payments to the consortium were increased by £268,000 to £18.0m (comparative figure also restated). The charge to expenditure in Note 32.2 was increased by the same amount to £9.3m (comparative figure also restated). The wording in Note 32.2 was expanded to make clear that it referred to the service	Narrative amendment only. No financial impact.

Item no	Item of account and Note	Description	Value and Impact
		<p>element of the PFI contract.</p> <p>Comparators were restated in Note 32.2.</p>	
28	Note 34 Provisions	Note 34 on provisions showed a £317,000 redundancy provision. £214,000 of this provision related to clinical excellence awards and should have been disclosed in the 'other' line with the nature of the provision specified.	Redundancy provision overstated by £214,000 and other provisions understated by £214,000. No impact on surplus.
29	Note 34 Provisions	<p>The note was amended to reflect the transfer of £107,000 from current to non-current provisions referred to in the amendments to the SOFP above.</p> <p>In addition -£113,000 was incorrectly disclosed as 'arising during the year' so was transferred to 'reversed unused.'</p> <p>The expected timing of cashflows was also amended.</p>	Current provisions reduced by £107,000 and non-current provisions increased by £107,000. This has no impact on the surplus.
30	Note 34 Provisions	<p>Narrative disclosures in the note incorrectly referred to 31/03/10 rather than 31/03/11.</p> <p>The Note failed to disclose the value of clinical negligence provisions held by the NHS Litigation Authority on behalf of the Trust which were £31.5m (2009/10: £33.3m)</p>	Disclosure issue only. No financial impact.
31	Note 36 Financial instruments	<p>The note included several assets and liabilities which are not financial instruments because there is no contractual obligation in place. These included equal pay assets and liabilities of £2.27m, PDC payable of £292,000, PAYE of £1.4m, NI of £1.2m and pension contributions of £1.6m.</p> <p>The disclosure note was amended</p>	Disclosure issue only.
32	Note 38 Financial performance targets	There was an error in calculating the Trust's original External Financing Limit (EFL). The EFL has now been revised and the note amended to reflect this.	EFL restated from (£2.169m) to £1.031m. This changed the £2.510m overshoot to £690,000 undershoot.
33	Note 38 Financial performance targets	The explanation for the £3.9m underspend against the Capital Resource Limit (CRL) was unclear and was amended.	No financial impact.

Item no	Item of account and Note	Description	Value and Impact
34	Note 39 Related party transactions	<p>The related party transaction note gave incorrect titles to some of the Trust's related parties eg Cumbria Primary Care Trust.</p> <p>It also failed to provide details of transactions with related parties as required by IAS 24.</p>	<p>The note was amended to give the correct titles of related parties and to show the value of transactions and year-end balances.</p>
35	Various	<p>Our review of disclosures within the statements identified several areas which required amendment. These included:</p> <ul style="list-style-type: none"> <li>■ adding a note on accounting standards issued but not yet adopted;</li> <li>■ further detail on income generation activities;</li> <li>■ further disclosure on sickness absence;</li> <li>■ a note on the reduction in pension cash equivalent transfer values; and</li> <li>■ additional disclosure regarding PFI risk within Note 36.3 Financial Risk Management</li> <li>■ inclusion of note on other financial commitments.</li> </ul>	<p>These issues had no financial impact.</p>
36	Various	<p>Our review of additions and cross-referencing within the statement identified several inconsistencies and formatting issues which were corrected by the Trust.</p>	<p>These issues had no financial impact.</p>

## Appendix 3 Unadjusted misstatements in the financial statements

I identified the following misstatements during my audit but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities and ask you to correct these misstatements. If you decide not to amend, please tell me why in the representation letter. If you believe the effect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

	Item of account and Note	Description	Value and Impact
1	Statement of Comprehensive Income	Public Dividend Capital dividends payable for the year is based on 3.5% of the Trust's relevant net assets. The Trust miscalculated this figure and as a result PDC dividends payable was understated by £29,000. No amendment has been made to the statements.	This would have reduced the Trust's surplus by £29,000.
2	Statement of Financial Position	Additions to Property Plant and Equipment include £1.37m in respect of "lifecycle additions" to Cumberland Infirmary under PFI arrangements. The Trust are unaware of what this expenditure relates to and therefore cannot demonstrate that it can be capitalised in line with the Trust's accounting policies. No amendment has been made to the statements	If this were treated as revenue expenditure this Trust's surplus would be reduced by £1.375m. Although there would be no effect on the adjusted retained surplus.
5	Statement of Financial Position	Provisions include £30,000 in respect of an old clinical negligence case. Correspondence on file states that his case is unlikely to proceed although the case is still open. As transfer of economic benefit is not likely this should be written back. No amendment has been made to the statements	This amendment would have increased the Trust's surplus by £30,000.
6	Statement of Financial Position	The Trust has back-to-back arrangements with the PCT for meeting the costs of Equal Value claims. The costs of the claims themselves are held in non-current assets and liabilities. Current assets and liabilities cover administrative and legal costs associated with the claims. Systems for recovering these costs from the PCT have not operated well, and there is a mismatch between the assets and liabilities recorded	Correcting this error would reduce the surplus by up to £60,000.



Item of account and Note	Description	Value and Impact
	<p>in the Trust's SOFP with regard to these costs. The Trust made a late adjustment to the debtor control account and increased the closing receivables balance by £252,000 due from the PCT however this amount has not been agreed with the PCT at year end.</p> <p>The Trust has not accounted for £192,000 additional legal costs arising in the year as revenue expenditure matched by additional income from the PCT, it has only adjusted closing balances.</p> <p>No amendment has been made to the statements.</p>	

## Appendix 4 Draft letter of representation

To:

Mrs J Bellard, Engagement Lead – Trust Practice  
Audit Commission  
Aspinall House  
Aspinall Close  
Middlebrook  
Bolton  
BL6 6QQ

### **North Cumbria University Hospitals NHS Trust - Audit for the year ended 31 March 2011**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other directors of North Cumbria University Hospitals NHS Trust the following representations given to you in connection with your audit of the Trust's financial statements for the year ended 31 March 2011.

#### **Compliance with the statutory authorities**

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the NHS Manual for Accounts which give a true and fair view of the financial position and financial performance of the Trust, for the completeness of the information provided to you, and for making accurate representations to you.

#### **Uncorrected misstatements**

The effects of uncorrected financial statements misstatements summarised in the attached schedule are not material to the financial statements, either individually or in aggregate.

These misstatements have been discussed with those charged with governance within the Trust and the reasons for not correcting these items are as follows;

- reason 1 etc;
- reason 2]

## **Supporting records**

All relevant information and access to persons within the entity has been made available to you for the purpose of your audit, and all the transactions undertaken by the Trust have been properly reflected and recorded in the financial statements.

## **Internal control**

I have communicated to you all deficiencies in internal control of which I am aware

## **Going Concern**

I am satisfied that it is appropriate to adopt the going concern basis in the preparation of the financial statements and that the financial statements include, such disclosures, if any, relating to going concern. North Cumbria University Hospitals NHS Trust has the following plans for future action in relation to the going concern assessment, and the feasibility of the plans

## **Irregularities**

I acknowledge my responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud or error.

### **I also confirm that I have disclosed:**

- my knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements;
- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others; and
- the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

## **Law, regulations, contractual arrangements and codes of practice**

I have disclosed to you all known instances of non-compliance, or suspected non-compliance with laws, regulations and codes of practice, whose effects should be considered when preparing financial statements.

Transactions and events have been carried out in accordance with law, regulation or other authority. The Trust has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance.

All known actual or possible litigation and claims, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

## Accounting estimates including fair values

I confirm the reasonableness of the significant assumptions used in making the accounting estimates, including those measured at fair value.

[Optional - For [xyz] assumption, I confirm:

- the appropriateness of the measurement method, including related assumptions and models, and the consistency in application of the process;
- the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures;
- the completeness and appropriateness under the financial reporting framework; and
- if subsequent events [require/do not require] adjustment to accounting estimates and disclosure included within the financial statements.]

Auditors should use this section and tailor depending on the nature, materiality, and extent of estimation uncertainty regarding the accounting estimates recognised or disclosed in the financial statements.

[Optional - Other representations may include:

Specific representations e.g. The legal claim by ABC Limited has been settled out of court by a payment of £X. No further amounts are expected to be paid and no similar claims have been received or are expected to be received.

Whether the selection, and application, of accounting policies are appropriate.

Whether the following matters have been recognised, measured, presented or disclosed in accordance with the financial reporting framework:

- Plans or intentions that may affect the carrying value or classification of assets and liabilities;
- Liabilities, both actual and contingent; and
- Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral.]

## Related party transactions

I confirm that I have disclosed the identity of North Cumbria University Hospitals NHS Trust's related parties and all the related party relationships and transactions of which I am aware. I have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirement of the framework.

**Subsequent events**

All events subsequent to the date of the financial statements, which would require additional adjustment or disclosure in the financial statements, have been adjusted or disclosed.

**Comparative financial statements**

A restatement of X was made to correct a material misstatement in the prior period financial statements. This affects the comparative information of Y. [Written representations previously made in respect of the prior period remain appropriate.]

Signed on behalf of North Cumbria University Hospitals NHS Trust I confirm that this letter has been discussed and agreed by the Board on 7 June 2011.

Signed

Name

Position

Date

## Appendix 5 Glossary

### **Audit closure certificate**

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

### **Audit opinion**

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

### **Opinion**

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

### **Materiality (and significance)**

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

‘Significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

## **Weaknesses in internal control**

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

## **Value for money conclusion**

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

## Appendix 6 Action plan

### Recommendations

#### Recommendation 1

The Trust must ensure that the financial statements and related disclosure notes are consistent with the underlying information and compliant with the requirements of the relevant accounting standards and the NHS Manual for Accounts.

**Responsibility**

**Priority**

**Date**

**Comments**

#### Recommendation 2

The Trust should improve quality assurance processes to ensure that any errors in the financial statements and the underlying records are identified and corrected prior to the accounts being submitted for audit.

**Responsibility**

**Priority**

**Date**

**Comments**

#### Recommendation 3

The Trust should ensure that payments associated with back to back equal value claims are recovered promptly from the PCT and that these transactions are properly recorded and accounted for including agreeing the balances with the PCT.

**Responsibility**

**Priority**

**Date**

**Comments**



#### Recommendation 4

The Trust must resolve the differences regarding disputed amounts as soon as possible in order to minimise the risk that these monies are not paid and the Trust has an even bigger deficit to cover.

**Responsibility**

**Priority**

**Date**

**Comments**

#### Recommendation 5

Trust management should ensure that they have sufficient information to support all significant accounting estimates at the beginning of the audit.

**Responsibility**

**Priority**

**Date**

**Comments**

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