

TRUST BOARD		
Date of Meeting: 17/01/2012	Agenda Item No: 9.2	Enclosure: 13
Intended Outcome:		
For noting ✓	For information	For decision
Title of Report: Audit Committee Annual Report		
Aims: To inform 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 2010/11		
Executive Summary: This report principally covers the activities of the Committee in the financial year 2010/11. 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		
Specific implications and links to the Trust's Strategic Aims:		
Ensure we provide high quality, safe and effective care for all our patients including meeting essential standards of safety and quality as set out by the CQC		✓
Develop a viable integrated clinical strategy for secondary care services which is sustainable and affordable		
Develop a new healthcare facility in West Cumbria that is fit for the 21st century		
Achieve sustainable financial balance through the delivery of the Trust's internal Cost Improvement Programme, securing a viable contract income from our GP commissioners and contributing to the system wide cost reductions		
To develop and implement a successful merger or acquisition plan that enables the Trust to become part of an existing NHS Foundation Trust		
Recommendations: The Trust Board to note the Audit Committee Annual Report		
Prepared by: Mark Evens Audit Committee Chairman	Presented by: Mark Evens Audit Committee Chairman	

**AUDIT COMMITTEE
AUDIT COMMITTEE ANNUAL REPORT 2010/11
NOVEMBER 2011**

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 2010/11. The terms of reference for the Committee for the financial year 2010/11 and accordingly the content of this Report follow the recommendations of the *NHS Audit Committee Handbook 2005*, published by the Department of Health and HFMA. Since the end of the year, an updated handbook has been published. The Committee will consider significant changes in the handbook in shaping its activities in 2011/12.

While this report principally covers the activities of the Committee in the financial year 2010/11, 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:

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

During the period April to June 2010, Mr Bonner was acting Chair of the Trust and Mr Evens was acting Chair of the Committee. From June 2010, Mr Evens was appointed Chair of the Committee.

3. COMMITTEE MEETINGS

The Committee met on seven occasions during the financial year– in May, June (twice), July, September and December 2010, and February 2011. The additional meeting in June was required to review the annual accounts. All Audit Committee meetings were attended by both Internal and External Audit representatives, by the Director of Finance or the Deputy 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, private meetings were held between both Internal and External audit representatives and the Audit Committee members without Trust staff being present.

Meeting Date	Attendees
11 May 2010	Mr M Evens, Non-Executive Director Mr M Bonner, Non-Executive Director Ms J Cooke, Non-Executive Director Mr A Mulvey, Director of Finance (in attendance) Mr E Gardiner, Associate Director of Finance (in attendance) Mrs R Duguid, Company Secretary (in attendance) Ms C McAdams, Head of Internal Audit and LCFS (in attendance) Ms H Green, External Audit Representative (in attendance) Mr J Cangley, External Audit Representative (in attendance) Ms C Blunt, External Audit Representative (in attendance) Mr K Clarkson, Chief Operating Officer (agenda item 13/10 only) Apologies Mr M Little, Trust Chairman (in attendance) Mr P Day, Non-Executive Director Ms J Bellard, External Audit Representative (in attendance)
1 June 2010	Mr M Evens, Non-Executive Director Mr M Bonner, Non-Executive Director Ms J Cooke, Non-Executive Director Mr P Day, Non-Executive Director Mr A Mulvey, Director of Finance (in attendance) Mr E Gardiner, Associate Director of Finance (in attendance) Mrs R Duguid, Company Secretary (in attendance) Mr C Birtle, Assistant Director of Finance (in attendance) Mrs C McAdams, Head of Internal Audit and LCFS (in attendance) Ms H Green, External Audit Representative (in attendance) Mr J Cangley, External Audit Representative (in attendance) Ms J Bellard, External Audit Representative (in attendance) Apologies No apologies noted
8 June 2010	Mr M Evens, Non-Executive Director Mr M Bonner, Non-Executive Director Ms J Cooke, Non-Executive Director Mr P Day, Non-Executive Director Ms C Heatly, Chief Executive (in attendance) Mr M Little, Trust Chairman (in attendance) Mr A Mulvey, Director of Finance (in attendance) Mr E Gardiner, Associate Director of Finance (in attendance) Mrs C McAdams, Head of Internal Audit and LCFS (in attendance) Ms J Bellard, External Audit Representative (in attendance) Part B of meeting onwards Ms H Green, External Audit Representative (in attendance) Part B

	<p>of meeting onwards Mr C Birtle, Assistant Director of Finance (in attendance) Part C of meeting onwards. Apologies Mrs R Duguid, Company Secretary (in attendance)</p>
26 July 2010	<p>Mr M Evens, Non-Executive Director Mr M Bonner, Non-Executive Director Mr P Day, Non-Executive Director Mr M Little, Trust Chairman (in attendance) Ms C Heatly, Chief Executive (in attendance) Mr A Mulvey, Director of Finance (in attendance) Mrs R Duguid, Company Secretary (in attendance) Mrs C McAdams, Head of Internal Audit and LCFT (in attendance) Ms J Bellard, External Audit Representative (in attendance) Ms H Green, External Audit Representative (in attendance) Apologies Ms J Cooke, Non-Executive Director Mr E Gardiner, Associate Director of Finance (in attendance)</p>
13 September 2010	<p>Mr M Bonner, Non-Executive Director Mr P Day, Non-Executive Director Ms J Cooke, Non-Executive Director Mr M Little, Trust Chairman (in attendance) Mr E Gardiner, Associate Director of Finance (in attendance) Mrs R Duguid, Company Secretary (in attendance) Mrs C McAdams, Head of Internal Audit and LCFS (in attendance) Ms H Green, External Audit Representative (in attendance) Apologies Mr M Evens, Non-Executive Director Mr A Mulvey, Director of Finance (in attendance) Ms C Heatly, Chief Executive (in attendance) Ms J Bellard, External Audit Representative (in attendance)</p>
2 December 2010	<p>Mr M Evens, Non-Executive Director Mr M Bonner, Non-Executive Director Mr P Day, Non-Executive Director Mr M Little, Trust Chairman (in attendance) Mr A Mulvey, Director of Finance (in attendance) Mr E Gardiner, Associate Director of Finance (in attendance) Mrs R Duguid, Company Secretary (in attendance) Mrs McAdams, Head of Internal Audit and LCFS (in attendance) Mr W Pinkerton, Internal Audit (shadowing Mrs McAdams) Mr H Green, External Audit Representative (in attendance) Apologies Ms J Cooke, Non-Executive Director Ms J Bellard, External Audit Representative (in attendance)</p>
2 February 2011	<p>Mr M Evens, Non-Executive Director Mr M Bonner, Non-Executive Director Mr P Day, Non-Executive Director Mr E Gardiner, Associate Director of Finance (in attendance) Mrs R Duguid, Company Secretary (in attendance) Mrs C McAdams, Head of Internal Audit and LCFS (in attendance) Ms H Green, External Audit Representative (in attendance)</p>

	Ms G Martlew, External Audit Representative (in attendance) Mr J Tollitt, Acting Assistant Director of Finance (in attendance) Mr D Gallagher, Agenda point AC03(4)/11 only Apologies Ms J Cooke, Non-Executive Director Mr A Mulvey, Director of Finance (in attendance) Ms J Bellard, External Audit Representative (in attendance)
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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.

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, 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. With the Committee's encouragement, the Framework has been fully integrated with the Trust's risk management processes and strategic risks are reviewed quarterly by the Trust Board.
- The Committee has reviewed the completeness of the risk management system and considers the systems to be adequate. During the period a new risk management strategy was implemented to better integrate the systems and embed them in the organisation.
- The Trust reported a Breast Screening Serious Untoward Incident (SUI) as a significant control issue in 2010/11. A specific recommendation arising from the incident was that a review of clinical governance should be undertaken across the organisation. The Trust Board ratified specific terms of reference to take forward this important review, which set out eight specific objectives to be achieved. The review, which involved internal audit, was completed after the year end and a number of recommendations are being tracked separately from audit recommendations. Oversight of this is being provided by the Governance Committee, but the Audit Committee is kept informed of progress.

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). In the previous year, 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. While the quality of progress tracking has improved significantly during the year, the pace of implementing recommendations is still slow. The Committee has requested that internal audit and management work together to ensure that recommendations are appropriate and are implemented within agreed timescales.

- 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.

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.
- 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.

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. In its previous annual report, the Committee identified that further assurance would be beneficial in the considering the operation of Clinical Audit. This matter was included in the review of clinical governance referred to above and a number of recommendations were made to strengthen the function.

5. *Management*

- The Committee has challenged the assurance process when appropriate and has called managers to account when considered necessary.
- The Committee has also identified where it would also be beneficial to request and review reports and to receive positive assurances from directors and managers.

6. *Financial reporting*

- The Committee reviewed the annual financial statements before submission to the Board and recommended that they be approved.
- The Committee welcomed the establishment of a Finance Committee, which has provided improved oversight of the financial affairs of the Trust. Nevertheless, the Trust continues to face a number of significant challenges. These matters are dealt with more fully in a separate section below.

- During the year the Trust decided to transfer Finance & Accounting Services to NHS Shared Business Service (SBS). It was envisaged that this would lead to better quality financial reporting and control, as well as resulting in some cost reduction. The change was made successfully, effective April 1 2011.

5. COMMITTEE SELF ASSESSMENT

The Audit Commission made available its web-based self-assessment system and three non-executive members and five attendees of the Committee participated in the survey. The Audit Commission produced a report based on this. The detailed results of this will be considered by the Committee at its meeting in November 2011. A number of areas for the Committee to consider in 2011/12 were identified, including:

Financial

- Financial Stability & Viability
- Systems and processes for delivery of financial targets
- Delivery of CIP
- Budgetary Control & Financial Reporting
- Agreement of a financially viable clinical strategy

Governance

- Clinical assurance
- Implementation of clinical governance review plan
- Integration of clinical governance
- Timely clearing of audit recommendations and holding officers to account for implementing recommendations
- Continuing development of the assurance framework and risk management.

Merger/acquisition

- Risk management of the process.

6. MAIN ISSUES

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

- *The financial standing of the Trust and the need for a robust recovery plan.*

The Committee welcomed the decision to establish a Finance Committee, which took responsibility for overseeing the recovery plan. This resulted in a much improved transparency of financial reporting to Board level. However, the Trust continued to struggle to deliver sufficient cost savings to close the gap between income and expenditure. It was identified that the Cost Improvement Programme was at significant risk and that additional strategic support would be required. This support was made available, as supplementary income, by the SHA. A similar situation faces the Trust in the current financial year, with required savings not being matched by agreed initiatives. The Committee's concern therefore continues: the Committee is satisfied that these matters are fully considered at the

Finance Committee, but there are still substantial unresolved issues. These matters are reflected in the Assurance Framework.

- *Assurance over clinical areas and the operations of other assurance functions, including clinical audit*

Last year the Committee was concerned to gain assurance around the operation of clinical audit. An internal audit review was carried out during the year, which concluded that “Overall there is Limited Assurance that Clinical Audit is embedded within the Governance system or that there is clear evidence of follow up and implementation of recommendations across the Trust”. A number of recommendations have been made which are being addressed as part of the clinical governance review plan. The Committee will continue to monitor this plan.

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

Progress continues to be made in this area, particularly in the quality of reporting. Where actions are not being completed the Committee has requested updates from individual management leads as to why actions are off target. Despite this increased focus, the clearance of audit recommendations is still unsatisfactory. As at September 2011, there were 76 overdue audit recommendations including 55 from 2010/11 and before. The Committee will continue to monitor this area closely and to seek to identify the root causes of failures to implement agreed plans.

- *The updating of the Trust’s Fixed Asset Register, including the physical verification of assets.*

While this matter continues to provide challenges for the Trust, given the nature and mobility of some assets, the Committee is pleased to note that it was addressed to the satisfaction of the external auditors in the 2010/11 accounts.

- *Compliance with International Financial Reporting Standards.*

The Trust’s PFI continues to be a source of difficulty in achieving full compliance with IFRS. The complexity of the calculations is challenging for both the Trust and its external auditors. The 2010/11 accounts process was significantly disrupted by the late resolution of the appropriate accounting for PFI lifecycle costs. The Committee encourages management and auditors to work more closely together, to ensure that such matters of principle are addressed early in the audit process.

- *The improvement process required to deliver a smooth year end process.*

Despite the matter referred to above, the Committee was pleased to note that management had taken steps to strengthen the year end financial reporting process. For the first time, in addition to the audit of the financial accounts, in 2010/11 the Quality Account was subject to a “dry run” audit. This surfaced some matters which the Trust need to address for 2011/12 when there will be a formally reported audit.

The principal new issue which has arisen during the year is that the Trust has found it necessary to seek an acquiring Foundation Trust, as it is considered that this is the only route available to achieve FT status within the stipulated timeframe. This is driven by the Trust's financial position as discussed above. There are significant risks attached to the acquisition route. The Committee will seek assurance that these are identified, documented and managed during 2011/12.

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 2010/11 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;
- except as mentioned above as regards clinical audit, 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 Committee has reviewed the plans to improve clinical audit and is satisfied that, if fully implemented, this exception will be resolved;
- the evidence to demonstrate fitness to register with the Care Quality Commission (CQC) was consistent with the 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 to gain assurance in 2011/12 are:

- financial management and in particular the cost improvement plan;
- clinical audit;
- the acquisition process;
- timely implementation of audit recommendations and, in particular, those arising from the clinical governance review.

Mark Evens
NON-EXECUTIVE DIRECTOR AND
AUDIT COMMITTEE CHAIR