



NHS EAST SURREY CCG

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2018

19 June 2018

EXECUTIVE SUMMARY

PURPOSE OF THE LETTER

This annual audit letter summarises the key issues arising from the work that we have carried out at NHS East Surrey CCG for the year ended 31 March 2018.

It is addressed to the CCG but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public.

RESPONSIBILITIES OF AUDITORS AND THE CCG

It is the responsibility of the CCG to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

Our responsibility is to plan and carry out an audit that meets the requirements of the National Audit Office's (NAO's) Code of Audit Practice (the Code). Under the Code, we are required to report on:

- Our opinion on the financial statements, regularity of income and expenditure and auditable parts of the remuneration and staff report
- Whether the CCG has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We recognise the value of your co-operation and support and would like to take this opportunity to express our appreciation for the assistance and co-operation provided during the audit.

BDO LLP
19 June 2018

AUDIT CONCLUSIONS

FINANCIAL STATEMENTS AND ANNUAL REPORT

We issued our opinions on the financial statements, regularity and remuneration and staff report on 25 May 2018.

Our opinions on the financial statements and remuneration and staff report were unmodified.

Our regularity opinion was qualified as the CCG recorded an in-year deficit of £24.9 million for the year and thereby breached its statutory financial duties.

We referred a matter to the Secretary of State under section 30 of the Local Audit and Accountability Act 2014 in relation to the CCG's deficit for the year and its planned deficit for 2018/19, which indicate that the CCG has incurred unlawful expenditure and begun a course of action that is unlawful.

USE OF RESOURCES

We were not satisfied that the CCG had proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We issued an adverse use of resources conclusion because we consider the CCG's significant in-year deficit of £24.9 million, and cumulative deficit of £66.9 million at 31 March 2018, is evidence of significant weaknesses in arrangements to achieve planned and sustainable outcomes for taxpayers and local people.

FINANCIAL STATEMENTS AND ANNUAL REPORT

OPINIONS	We issued unmodified opinions on the financial statements and remuneration and staff report and a qualified opinion on regularity.
	<p>This means we consider:</p> <ul style="list-style-type: none">• The financial statements give a true and fair view of the financial position and its net expenditure for the year• In all material respects the expenditure and income had not been applied to the purposes intended by Parliament and the financial transactions did not conform to the authorities which govern them• The parts of the remuneration and staff report to be audited have been properly prepared.

SCOPE OF THE AUDIT

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes an assessment of whether the accounting policies are appropriate to the CCG's circumstances and have been consistently applied and adequately disclosed the reasonableness of significant accounting estimates, and the overall presentation of the financial statements.

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality both in planning and performing our audit and in evaluating the effect of misstatements.

We consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonably knowledgeable users that are taken on the basis of the financial statements.

The materiality for the financial statements as a whole was set at £3.7 million. This was determined with reference to a benchmark of gross expenditure (of which it represents 1.5 per cent) which we consider to be one of the principal considerations for the CCG in assessing the financial performance.

FINANCIAL STATEMENTS AND ANNUAL REPORT

AUDIT DIFFERENCES

Our audit identified three material presentational audit differences, which were corrected in the final financial statements:

- Disclosure misstatement in the financial performance targets note, whereby the target revenue resource limit and deficit for the year were reported on a cumulative basis, consistent with the prior year, instead of the in-year allocation following a change by NHS England in the way in which the revenue resource limit is determined from 2017/18
- Misclassification of £9.841 million (prior year £6.481 million) in the operating expenses note as the purchase of social care was included in 'Purchase of healthcare from non-NHS bodies' instead of in a separate line as required by the Department of Health and Social Care Group Accounting Manual 2017/18
- Re-allocation of £4.165 million (prior year £4.025 million) from revenue to 'Purchase of social care' expenditure to account for contributions from Surrey County Council under the Better Care Fund on a net basis, to better reflect the nature of the underlying joint arrangement.

These had no impact on the reported deficit for the year.

In addition, we found two audit differences that were not corrected in the final financial statements:

- Overstatement of the prescribing accrual by £135,000, based on more up to date information available from NHS Shared Business Services Authority at the time of the audit
- Misclassification of £2.584 million within 'Non-NHS payables' and 'Purchase of healthcare from non-NHS providers' instead of 'NHS payables' and 'Purchase of healthcare from NHS trusts' in the prior year, with the result that non-NHS expenditure was understated and NHS expenditure overstated in 2017/18.

If corrected, these would have decreased the deficit for the year by £135,000.

FINANCIAL STATEMENTS AND ANNUAL REPORT

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

Our audit was scoped by obtaining an understanding of the CCG and its environment, including the system of internal control, and assessing the risks of material misstatement in the financial statements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and the direction of the efforts of the audit team.

RISK	RISK DESCRIPTION AND AUDIT APPROACH	FINDINGS AND CONCLUSION
Management override of controls	<p>Under auditing standards, there is a presumed risk of management override of controls as management is in a unique position to manipulate accounting records to prepare fraudulent financial statements.</p> <p>We responded to this risk by testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.</p> <p>We reviewed the accounting estimates for bias and evaluated whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud.</p> <p>We obtained an understanding of the business rationale for significant transactions that were outside the normal course of business for the CCG or appeared to be unusual.</p>	<p>No issues were identified by our risk-based review of journals and review of accounting estimates for management bias.</p> <p>We found no significant transactions that were outside the normal course of business or otherwise unusual.</p>

FINANCIAL STATEMENTS AND ANNUAL REPORT

RISK	RISK DESCRIPTION AND AUDIT APPROACH	FINDINGS AND CONCLUSION
<p>Completeness and accuracy of NHS provider payables and expenditure</p>	<p>The agreement of balances process is designed to ensure that NHS commissioners and providers agree the outturn expenditure (payables) and income (receivables) under the NHS contracts. However, this process often generates differences between both parties either through misallocated transactions, disputes, cash timing differences or other discrepancies.</p> <p>There was a significant mismatch between the CCG and its key provider, Surrey and Sussex Healthcare NHS Trust (SASH), in the prior year and continuing disputes regarding activity over performance in 2017/18.</p> <p>We responded to this risk by reviewing counter-party mismatches identified through the Department of Health and Social Care's mismatch reports and sought evidence to support the CCG's position. We also reviewed how prior year disputes between the CCG and SASH settled, which informed our assessment of management's judgements in this area in 2017/18.</p>	<p>The CCG had disputed invoices totalling £5.6 million from SASH in 2016/17. It negotiated a settlement of £3.1 million in 2017/18 and included £3.9 million of previously disputed invoices and adjusted out balances in its accounts.</p> <p>Due to the settlement with SASH, there is no significant estimation in the balances at 31 March 2018 and the mismatch in balances between the bodies is now trivial.</p> <p>The mismatch report indicated that the CCG is potentially exposed to additional costs or reduced income of £1.2 million, in the event that the differences are settled fully in the favour of the counter-parties, or to a gain of £0.6 million if the differences are settled fully in the CCG's favour.</p> <p>This includes £0.7 million of long disputed balances with Surrey and Borders Partnership (SABP) NHS Foundation Trust, which the CCG has not accounted for as management does not believe that the amounts are payable.</p> <p>The CCG also recognised £0.3 million of 2016/17 disputed invoices from Sussex Community NHS Foundation Trust in 2017/18.</p> <p>Management had included a general estimated accrual of £2.6 million in its accounts in 2016/17 to recognise that some of these disputed invoices may be payable.</p> <p>The net impact of these transactions was therefore a contribution of £1.6 million to the CCG's deficit in 2017/18.</p> <p>Overall, we were satisfied that management's estimates of final contract outturn costs on NHS activity in 2017/18 were reasonable.</p>

USE OF RESOURCES

CONCLUSION

We were not satisfied that the CCG had proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We consider that the CCG did not have proper arrangements to achieve planned and sustainable outcomes for taxpayers and local people.

SCOPE OF THE AUDIT

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources based on the following reporting criterion:

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

As part of reaching our overall conclusion, we consider the following sub criteria in our work: informed decision making, sustainable resource deployment, and working with partners and other third parties.

OUR ASSESSMENT OF SIGNIFICANT RISKS

Our audit was scoped by our review of predecessor auditor working papers, relevant findings from work undertaken in support of the opinion on financial statements, reports from the CCG including internal audit, information disclosed or available to support the governance statement and annual report, and information available from the risk registers and supporting arrangements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and the direction of the efforts of the audit team.

USE OF RESOURCES

RISK	RISK DESCRIPTION AND AUDIT APPROACH	FINDINGS AND CONCLUSION
<p>The CCG is facing significant financial pressures and remains under legal directions and special measures imposed by NHS England in previous years</p>	<p>During the year management reported significant unmitigated risks to the achievement of its control total deficit due to underperformance on its Quality, Innovation, Productivity and Prevention (QIPP) programme and ongoing issues with acute contract expenditure.</p> <p>The CCG is part of the Sussex and East Surrey Sustainability and Transformation Partnership (STP) footprint with a number of other local partners across health and social care. Work is ongoing at a health economy level to try to close the £11.4 million gap in the CCG's achievement of its control total and to mitigate the additional risks.</p> <p>The legal directions and special measures imposed by NHS England in December 2015 and July 2016 respectively remain in force.</p> <p>We identified a risk that there are continuing weaknesses in the CCG's arrangements in respect of strategic financial planning, financial control and financial governance to support the sustainable delivery of strategic priorities and maintain statutory functions.</p> <p>As a starting point for assessing the effectiveness of the CCG's arrangements, we reviewed 2017/18 outcomes.</p>	<p>The CCG started the year with a financial plan that supported its agreed control deficit of £6.1 million. However, there were significant unmitigated risks in this position by the end of the first quarter.</p> <p>A capped expenditure process review was carried out across the health economy during the year, which resulted in the CCG increasing its planned deficit to £16 million half way through the year.</p> <p>The planned deficit increased further to £23.1 million at the end of the third quarter to reflect additional risks that were materialising.</p> <p>A year-end agreement was reached with the CCG's key provider to settle ongoing disputes. This resulted in additional expenditure of £3.1 million, although this was partly offset by NHS England's release of £1.1 million non-recurrent reserve set aside from the CCG's allocation.</p> <p>The CCG closed the year with an in-year deficit of £24.9 million and a cumulative deficit of £66.9 million.</p> <p>A number of pressures contributed to the CCG's deficit in 2017/18:</p> <ul style="list-style-type: none"> • Higher than planned acute expenditure with the CCG's key provider, as a result of increased activity, built-up contractual disputes which were settled in the year, and increased costs which the provider attributed to a growth in complexity • Under-delivery on planned savings schemes, particularly in respect of acute efficiencies and the Frailty Unit, where the required investment was not made to support transformation schemes, resulting in the CCG delivering only half of its £15.4 million QIPP target before investments • Impact of prior year issues such as the deferring of £3.4 million Local Transformation Investment Fund expenditure into 2017/18.

USE OF RESOURCES

RISK	RISK DESCRIPTION AND AUDIT APPROACH	FINDINGS AND CONCLUSION
<p>The CCG is facing significant financial pressures and remains under legal directions and special measures imposed by NHS England in previous years (continued)</p>	<p>We also reviewed:</p> <ul style="list-style-type: none"> • The CCG's budget setting arrangements and whether its operational and financial plans are aligned with the STP, including underlying assumptions • The CCG's budget monitoring arrangements, including monitoring and delivery of its QIPP programme • Actions taken and progress made in addressing actions required under the legal directions and special measures. 	<p>The CCG's budget for 2017/18 was approved by the Governing Body and NHS England and risks to the achievement of the budget were appropriately monitored and reported during the year.</p> <p>The CCG became a member of the Central Sussex and East Surrey Commissioning Alliance from 1 April 2018, with a permanent Accountable Officer and Chief Finance Officer covering all five CCGs. This was a significant step forward in addressing NHS England's Legal Directions regarding senior appointments. The Alliance presents greater opportunities for joint working across the CCGs in the Alliance and within the Sussex and East Surrey STP going forward.</p> <p>The clinical chairs and Accountable Officer of the Alliance agreed to place all the CCGs within the Alliance into financial turnaround to help co-ordinate the approach to financial recovery across the CCGs.</p> <p>The CCG has agreed a deficit budget of £17.6 million for 2018/19 with NHS England, which represents its share of the Alliance control deficit. This requires the achievement of gross savings of £7.9 million. The key work streams within the STP will support the development of a system wide financial recovery plan going forward, but the STP financial position remains extremely challenging.</p> <p>Although there is evidence of improvements to arrangements in 2017/18, the CCG does not yet have a credible medium term financial recovery plan to reduce its cumulative deficit and it remains under legal directions and financial special measures imposed by NHS England in previous years. We consider this indicates significant weaknesses in arrangements to achieve planned and sustainable outcomes for taxpayers and local people.</p>

APPENDIX

REPORTS ISSUED

We issued the following reports in respect of the 2017/18 financial year.

REPORT	DATE
Audit plan	8 December 2017
Section 30 referral to the Secretary of State	19 May 2018
Audit completion report	23 May 2018

FEES

We have not had to amend our planned fees.

AUDIT AREA	FINAL FEES £	PLANNED FEES £
Code audit	33,000	33,000
Total audit	33,000	33,000
Fees for audit related services	-	-
Fees for other non-audit services	-	-
Total assurance services	33,000	33,000

FOR MORE INFORMATION:

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The matters raised in our report prepared in connection with the audit are those we believe should be brought to the attention of the organisation. They do not purport to be a complete record of all matters arising. No responsibility to any third party is accepted.

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