



# Independent auditor's report

## to the Council of Governors of County Durham and Darlington NHS Foundation Trust

### REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

#### 1. Our opinion is unmodified

We have audited the financial statements of County Durham and Darlington NHS Foundation Trust ("the Trust") for the year ended 31 March 2019 which comprise the Group and Trust Statements of Comprehensive Income, Group and Trust Statements of Financial Position, Group and Trust Statements of Changes in Equity and Group and Trust Statements of Cash Flows, and the related notes, including the accounting policies in note 1.

#### In our opinion:

- the financial statements give a true and fair view of the state of the Group and the Trust's affairs as at 31 March 2019 and of the Group and Trust's income and expenditure for the year then ended; and
- the Group and the Trust's financial statements have been properly prepared in accordance with the Accounts Direction issued under paragraphs 24 and 25 of Schedule 7 of the National Health Service Act 2006, the NHS Foundation Trust Annual Reporting Manual 2018/19 and the Department of Health and Social Care Group Accounting Manual 2018/19.

#### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Group and Trust in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

#### Overview

<b>Materiality:</b>	£6m (2018:£5.75m)
Group financial statements as a whole	1.2% (2018: 1.2%) of total income from operations

<b>Coverage</b>	100% (2018:100%) of group income
-----------------	----------------------------------

<b>Risks of material misstatement</b>	<b>vs 2018</b>
---------------------------------------	----------------

<b>Recurring risks</b>	Valuation of land buildings and accounting for impairments	◀▶
------------------------	------------------------------------------------------------	----

## 2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (unchanged from 2018) in arriving at our audit opinion above, together with our key audit procedures to address those matters and our findings ("our results") from those procedures in order that the Company's members as a body may better understand the process by which we arrived at our audit opinion. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

All of these key audit matters relate to the Group and the parent Trust.

	The risk	Our response
<p><b>Valuation of land and buildings and accounting for impairments</b></p> <p>(Land and buildings £144.5 million; 2018: £140.9million, Impairment charge £13.6m 2018: £8.1m)</p> <p><i>Refer to Annual Report section 2.1.2 (Audit Committee Report), Accounts pages 7,8, 11 and 12 (accounting policy) and pages 32-35 (financial disclosures).</i></p>	<p><b>Subjective estimate</b></p> <p>Land and buildings are required to be maintained at up to date estimates of current value in use (EUV). For specialised assets where no market value is readily ascertainable, EUV is the depreciated replacement cost of a modern equivalent asset that has the same service potential as the existing property (DRC).</p> <p>The DRC basis requires an assumption as to whether the replacement asset with the same level of service provision would be situated on the existing site or, if more appropriate, on an alternative site, with a potentially significant effect on the valuation. The Trust has assumed that, if replaced, the four current sites would be amalgamated into two sites which remains a significant judgement in determining the valuation.</p> <p>Determining whether VAT should be included in DRC valuations is dependent on a judgement as to whether VAT could be recovered on a new capital development and has a material impact on the valuation.</p> <p>The Group's external valuers produced a valuation at 31 March 2019 through indexing their full valuation supported by inspection as at 1 April 2016. The valuers inspected significant capital additions in the period. The valuation is underpinned by data, including floor areas, compiled by the Group which can be inherently difficult to measure and compile. Indexing the valuation requires judgement as to the choice of indices, whether averaging is used and the appropriateness of regional factors.</p> <p><b>Accounting treatment</b></p> <p>Consideration is also required as to whether revaluation gains and impairment losses are processed through other operating income/expenses, or recognised in other comprehensive income. This treatment could have significant impact on the reported surplus or deficit for the year.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the valuation of land and buildings has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> <li>— <b>Assessing the valuer's credentials:</b> We assessed the competence, capability, objectivity and independence of the Trust's external valuer and considered the terms of engagement of, and the instructions issued to, the valuer for consistency with the requirements of the NHS Group Accounting Manual;</li> <li>— <b>Methodology choice:</b> We assessed the appropriateness of the basis of the full valuation at 1 April 2016 and of the method used to index the valuation to the current year end, including the updates RICS guidance issued in the year;</li> <li>— <b>Our sector experience:</b> We challenged the assumptions relating to what a replacement asset would comprise and how equivalent service provision could be achieved with reference to our knowledge of the Group and of the local NHS Health economy;</li> <li>— <b>Historical comparisons:</b> We considered the Group's history of VAT recovery through its PFI arrangements and commercial subsidiary and critically assessed the consistency of this judgement with the evidence presented;</li> <li>— <b>Data comparisons:</b> We critically assessed the source of data used by the valuers with reference to our experience from previous years' audits;</li> <li>— <b>Benchmarking assumptions:</b> We challenged the appropriateness of the factors used to index the valuation with reference to third party indices and sector practice;</li> <li>— <b>Accounting analysis:</b> We re-performed the gain or loss on revaluation for all applicable assets and checked whether the accounting entries are consistent with the NHS Group Accounting Manual; and</li> <li>— <b>Assessing transparency:</b> We considered the adequacy of the disclosures about the key judgements and degree of estimation involved in arriving at the valuation and the related sensitivities.</li> </ul> <p><b>Our results</b></p> <ul style="list-style-type: none"> <li>— We found the estimated valuation of land and buildings, and the accounting for impairments, to be acceptable.</li> </ul>

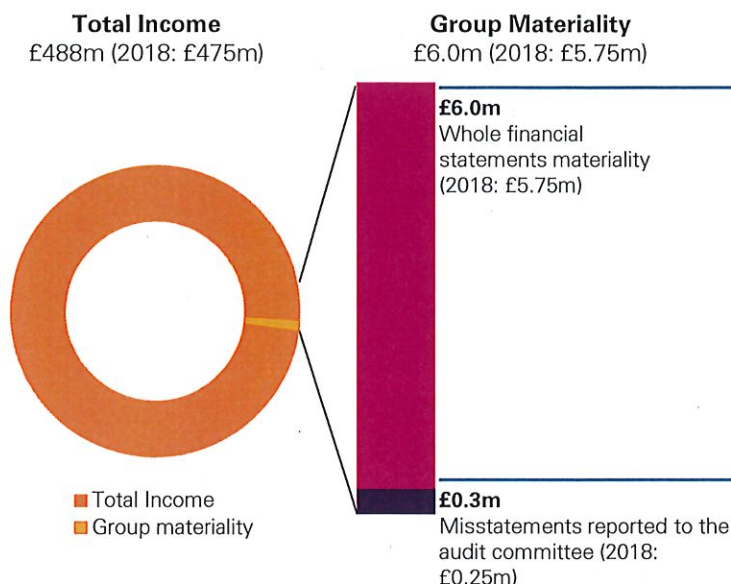
### 3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £6.0 million (2018: £5.75 million), determined with reference to a benchmark of total operating income (of which it represents approximately 1.2% (2018: 1.2%)). We consider operating income to be more stable than a surplus or deficit related benchmark.

Materiality for the parent Trust's financial statements as a whole was set at £6.0 million (2018: £5.75 million), determined with reference to a benchmark of operating income of which it represents approximately 1.2% (2018: 1.2%).

We agreed to report to the Audit Committee any corrected and uncorrected identified misstatements exceeding £0.3 million (2018: £0.25 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

The Group team performed the audit of the Group as if it was a single aggregated set of financial information. The audit was performed using the materiality set out above.



#### 4. We have nothing to report on going concern

The Accounting Officer has prepared the financial statements on the going concern basis as they have not been informed by the relevant national body of the intention to dissolve the Trust without the transfer of its services to another public sector entity. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Accounting Officer's conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Trust will continue in operation.

In our evaluation of the Accounting Officer's conclusions, we considered the inherent risks to the Group's and Trust's business model and analysed how those risks might affect the Group's and Trust's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Trust's available financial resources over this period were:

- Uncertainty over the achievement of cost improvement programmes
- Uncertainty over the availability of working capital loans
- The impact of Brexit on the Group and Trust's operations

As these were risks that could potentially cast significant doubt on the Group and Trust's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group's Trust's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Accounting Officer consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as the impact of Brexit.

Based on this work, we are required to report to you if we have anything material to add or draw attention to in relation to the Accounting Officers statement in Note 1.2 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Trust's use of that basis for a period of at least twelve months from the date of approval of the financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter

#### 5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

In our opinion the other information included in the Annual Report for the financial year is consistent with the financial statements.

#### Remuneration report

In our opinion the part of the remuneration report to be audited has been properly prepared in accordance with the NHS Foundation Trust Annual Reporting Manual 2017/18.

#### Corporate governance disclosures

We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for stakeholders to assess the Group's position and performance, business model and strategy; or
- the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- the Annual Governance Statement does not reflect the disclosure requirements set out in the NHS Foundation Trust Annual Reporting Manual 2018/19, is misleading or is not consistent with our knowledge of the Group and other information of which we are aware from our audit of the financial statements.

We have nothing to report in these respects.

#### 6. Respective responsibilities

##### Accounting Officer's responsibilities

As explained more fully in the statement set out on page 90, the Accounting Officer is responsible for the preparation of financial statements that give a true and fair view. They are also responsible for: such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Trust's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they have been informed by the relevant national body of the intention to dissolve the Group and parent Trust without the transfer of their services to another public sector entity.

##### Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities)

## REPORT ON OTHER LEGAL AND REGULATORY MATTERS

### We have nothing to report on the statutory reporting matters

We are required by Schedule 2 to the Code of Audit Practice issued by the Comptroller and Auditor General ('the Code of Audit Practice') to report to you if:

- any reports to the regulator have been made under Schedule 10(6) of the National Health Service Act 2006.
- any matters have been reported in the public interest under Schedule 10(3) of the National Health Service Act 2006 in the course of, or at the end of the audit.

We have nothing to report in these respects.

### Our conclusion in respect of our work on the Trust's arrangements for securing economy, efficiency and effectiveness in the use of resources is qualified

Under the Code of Audit Practice we are required to report to you if the Trust has not made proper arrangement for securing economy, efficiency and effectiveness in the use of resources.

#### Qualified conclusion

Subject to the matters outlined in the basis for qualified conclusion paragraph below we are satisfied that in all significant respects County Durham and Darlington NHS Foundation Trust put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources for the year ended 31 March 2019.

#### Basis for qualified conclusion

The Trust's outturn position for 2018/19 was a deficit of £15.9 million before impairments and PSF income against a planned deficit of £10.0 million. During the year, the Trust received £30.1 million of interim revenue funding from the Department of Health and Social Care (DHSC).

The Trust's financial plans for 2019/20 show a forecast deficit before PSF of £1.2m and a forecast surplus including PSF of £9.5m. This includes cost savings of £24.2 million of which £17.6m are currently identified. The plan includes an assumption of further DHSC revenue support of £6 million in the financial year.

Whilst the Trust has identified efficiency schemes that will support the achievement of the Trust's short-term financial plans, it is still expected that interim revenue support will be required in the medium term beyond the repayment date for the current facilities.

Given the performance against control total in 2018/19, the under delivery against the cost improvement programme and the reliance on interim revenue funding from DHSC for the short and medium term we concluded that these issues are evidence of weaknesses in the Trust's arrangements for planning finances effectively to support the sustainable delivery of the Trust's strategic priorities.

Respective responsibilities in respect of our review of arrangements for securing economy, efficiency and effectiveness in the use of resources

The Trust is responsible for putting in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources

Under Section 62(1) and Schedule 10 paragraph 1(d), of the National Health Service Act 2006 we have a duty to satisfy ourselves that the Trust has made proper arrangements for securing economy, efficiency and effectiveness in the use of resources.

We are not required to consider, nor have we considered, whether all aspects of the Trust's arrangements for securing economy, efficiency and effectiveness in the use of resources are operating effectively.

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the specified criterion issued by the Comptroller and Auditor General (C&AG) in November 2017, as to whether the Trust had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We planned our work in accordance with the Code of Audit Practice and related guidance. Based on our risk assessment, we undertook such work as we considered necessary.

### Report on our review of the adequacy of arrangements for securing economy, efficiency and effectiveness in the use of resources

We are required by guidance issued by the C&AG under Paragraph 9 of Schedule 6 to the Local Audit and Accountability Act 2014 to report on how our work addressed any identified significant risks to our conclusion on the adequacy of the Trust's arrangements for securing economy, efficiency and effectiveness in the use of resources. The 'risk' in this case is the risk that we could come to an incorrect conclusion in respect of the Trust's arrangements, rather than the risk of the arrangements themselves being inadequate.

We carry out a risk assessment to determine the nature and extent of further work that may be required. Our risk assessment includes consideration of the significance of business and operational risks facing the Trust, insofar as they relate to 'proper arrangements'. This includes sector and organisation level risks and draws on relevant cost and performance information as appropriate, as well as the results of reviews by inspectorates, review agencies and other relevant bodies.

The significant risks identified during our risk assessment are set out overleaf together with the findings from the work we carried out on each area.

Significant Risk	Description	Work carried out and judgements
<p><b>Delivery of Cost Improvement Programme (CIP)</b></p>	<p>The Trust should be able to demonstrate delivery against a CIP at the planned level of improvement and have delivered planned savings.</p> <p>The Trust had an original CIP target of £33.4m for 2018/19. The Trust achieved £24.6m which is £8.8m behind the original target.</p> <p>There is therefore a risk that this indicated that the Trust does not have proper arrangements in place to deliver recurrent cost improvements.</p>	<p><b>Our work included:</b></p> <ul style="list-style-type: none"> <li>— We held discussions with the Programme Management Office and obtained documentation supporting the Trust’s approach to meeting targets agreed with NHSI; and</li> <li>— We viewed evidence of the Trust having planned for the target set by NHSI and assessed why targets had not been achieved.</li> </ul> <p><b>Our findings on this risk area:</b></p> <ul style="list-style-type: none"> <li>— We concluded that whilst the Trust did have controls in place to manage the CIP process, that given the performance was significantly behind target and given the impact on the Trust’s financial performance and cash position, we concluded that this is evidence of weaknesses in the Trust’s arrangements for planning finances effectively to support the sustainable delivery of the Trust’s strategic priorities.</li> </ul>
<p><b>Management of the Trust’s cash position</b></p>	<p>The Trust is currently reliant on a £30m facility from NHSI and needs to continue to closely manage its cash position to ensure that the trust has sufficient cash to meet its working capital requirements.</p> <p>There is therefore a risk that this indicates that the Trust does not have proper arrangements in place for managing working capital and monitoring cash flows.</p>	<p><b>Our work included:</b></p> <ul style="list-style-type: none"> <li>– Reviewing the Trust’s cash flow forecasts and the use of distress funding;</li> <li>– Reviewing correspondence with NHS Improvement around the Trust’s current financial health, financial risk ratings and requirements for further distress funding;</li> <li>– Confirming the terms of the loans to consider the timing of future repayments and the availability of funding;</li> <li>— We assessed the process in place for forecasting and monitoring cash levels and the associated financial controls; and</li> <li>— We made an assessment of the Trust’s funding arrangements and consideration of borrowing facilities put in place.</li> </ul> <p><b>Our findings on this risk area:</b></p> <p>We are satisfied that the Trust has appropriate arrangements in place to:</p> <ul style="list-style-type: none"> <li>- Manage working capital, including forecasting cash flow requirements on a regular basis;</li> <li>- Monitor cash flow against forecasts to identify any unexpected variances;</li> <li>- Forecast and communicate the level of required cash flow, such that DHSC cash can be accessed in a way that enables the Trust to continue to meet its obligations as they fall due; and</li> <li>- Produce accurate and complete monthly finance reports for Trust Board.</li> </ul> <p>The Trust’s financial plans for 2019/20 show a forecast deficit before PSF of £1.2m and a forecast surplus including PSF of £9.5m. This includes cost savings of £24.2 million of which £17.6m are currently identified. The plan includes an assumption of further DHSC revenue support of £6 million in the financial year. During 2018/19 the Trust received £30.1 million of interim revenue funding for a fixed term of 3 years.</p> <p>Whilst the Trust has identified efficiency schemes that will support the achievement of the Trust’s short-term financial plans, it is still expected that interim revenue support will be required in the medium term beyond the repayment date for the current facilities.</p> <p>Given the performance against control total in 2018/19, the under delivery against the cost improvement programme and the reliance on interim revenue funding from DHSC for the short and medium term we concluded that these issues are evidence of weaknesses in the Trust’s arrangements for planning finances effectively to support the sustainable delivery of the Trust’s strategic priorities.</p>

## **THE PURPOSE OF OUR AUDIT WORK AND TO WHOM WE OWE OUR RESPONSIBILITIES**

This report is made solely to the Council of Governors of the Trust, as a body, in accordance with Schedule 10 of the National Health Service Act 2006 and the terms of our engagement by the Trust. Our audit work has been undertaken so that we might state to the Council of Governors of the Trust, as a body, those matters we are required to state to them in an auditor's report, and the further matters we are required to state to them in accordance with the terms agreed with the Trust, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Council of Governors of the Trust, as a body, for our audit work, for this report, or for the opinions we have formed.

## **CERTIFICATE OF COMPLETION OF THE AUDIT**

We certify that we have completed the audit of the accounts of Countess of Chester Hospital NHS Foundation Trust in accordance with the requirements of Schedule 10 of the National Health Service Act 2006 and the Code of Audit Practice issued by the National Audit Office.



**Rachel Fleming**  
**for and on behalf of KPMG LLP (Statutory Auditor)**

*Chartered Accountants*  
Quayside House, 110 Quayside,  
Newcastle upon Tyne, NE1 3DX

29 May 2019