



HFMA briefing
November 2020



Non-statutory and hosted bodies

Accounting and governance issues



Background

Integration, working in a joined-up fashion, has been a key objective for the NHS for many years now. As NHS bodies are ‘creatures of statute’, they can only undertake activities that they have the statutory power to do. Different NHS bodies have different statutory powers and different functions so working together and making changes often means that one or more of the partner bodies acts as host for new arrangements.

Recent examples include the better care fund pooled budgets, integrated care systems (ICSs) and now, in response to the Covid-19 pandemic, Nightingale Hospitals. These arrangements all result in an ‘entity’ that has no statutory basis or standing but that is often referred to independently of the organisations that host it and from which it is formed. Managing these non-statutory entities will require financial information and financial reports.

This briefing sets out the considerations finance teams need to make when determining what financial structures should look like for the new arrangements. This briefing does not cover the establishment of a separate

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corporate body such as a subsidiary body as that is covered by other guidance¹.

Understanding the arrangement

The accounting treatment for any transaction is always based on the detail of the transaction itself. It is therefore important to review and understand:

- the substance of the transaction – what is the purpose of entering into or establishing the non-statutory body and what is it intended to achieve. For example:
 - the Nightingale hospitals were established at pace to meet a very specific need and their establishment was driven initially by the centre rather than locally. The hosting arrangements were put in place to ensure that expenditure, and income, could be incurred and managed separately for each hospital
 - other joint arrangements include pathology joint ventures are intended to reduce costs through economies of scale while ensuring critical services are still provided
 - ICSs are very different in that they are a way of separate organisations working together at a strategic/ management level. An ICS will not directly contract for or provide services, but some staff may be needed at the ICS level to act at a system wide rather than organisational level. As an ICS is not a legal entity, staff will have to be employed by one of the organisations in the system so there will need to be arrangements put in place for sharing those costs. Currently, financial reports at an ICS level aggregate rather than consolidate the financial reports of all of the member bodies. The financial position of the system as a whole is assessed and managed based on the aggregated control totals and plans for the bodies that make up the system
- the legal form of the transaction. NHS bodies are creatures of statute, meaning that they can only undertake activities that they have a statutory basis to do. So, although the arrangement that they are entering into creates a non-statutory body, there needs to be a statutory basis for setting it up. For example, CCGs can create a pooled budget with local authorities under s75 of the NHS Act 2006, NHS providers have general powers to ‘do anything which appears to it to be necessary or expedient for the purpose of or in connection with its function’ and all NHS bodies have a duty to co-operate with each other in exercising their functions in accordance with s72 of the NHS Act 2006
- the purpose of the financial reports being produced. For example:
 - the host body of a pooled budget established in accordance with s75 is required by the regulations to produce a memorandum account for the pooled budget that is shared with all members of the pool
 - the integrated ICS financial report is intended to bring together the financial performance of all bodies in the system to enable performance against system wide control totals to be managed
 - a Nightingale hospital is likely to be a separate operating segment for the NHS host body as it will be managed separately to ‘normal’ operations so the financial information will be needed to allow financial decisions and disclosures to be made.

It is important to remember that a non-statutory entity cannot enter into financial transactions itself – all transactions must be entered into by a statutory entity and recorded in that body’s financial records. Therefore, understanding the reason for the establishment of non-statutory body it is vital to be able to develop the financial reports that are needed to oversee and manage it.

¹ HFMA, *Subsidiary companies: financial and governance considerations*, 2018 or Grant Thornton, *NHS companies - an enterprising approach to health*, 2017

Hosting

One approach to non-statutory entities is to decide that one body will act as host. This is the approach taken for s75 pooled budgets and Nightingale hospitals. All transactions will flow through the host body.

In the case of the Nightingale hospitals, a host NHS body has been identified for each one. That host NHS body incurred the costs relating to the establishment and running of the hospital.

Where it has been agreed that staff costs should be recharged between NHS bodies, the host body will manage recharges from other NHS bodies where staff were seconded, or goods or services supplied. It may be that there has been an agreement that there will not be recharges but that only the costs relating specially to the Nightingale hospital will be recorded by the host body. It is important that the arrangements are clearly set out and understood so reimbursement of costs from the centre ends up in the accounts of the body that incurred the cost.

It is likely that the host NHS bodies will include the Nightingale hospitals as a separate segment in their 2020/21 accounts where they are material – however, this will be determined towards the end of the financial year. Whether separate disclosure is required in the published accounts or not, it is best practice to be able to separately identify the costs relating to the Nightingale hospitals.

Consolidation or aggregation

Another approach will be for each entity to account for its own transactions but then either a consolidated or an aggregated financial statement to be produced for management purposes. This is likely to be the case in relation to ICSs or groups of NHS bodies working together under a committee in common.

In the case of ICSs, where a consolidated financial statement is produced, there will be services that are provided to and by entities outside of the ICS boundary that will need to be either included or excluded from the consolidated position. If the ICS consolidated report contains non-NHS bodies, such as local authorities there will be difference in accounting treatment and reporting timetables that will need to be considered at an early stage. In this case, the consolidation needs to be prepared in the same way that group accounts are prepared by NHS bodies that have subsidiary companies. The issues that need to be considered when preparing consolidated accounts are discussed in a later section of this briefing.

Currently, ICSs are being managed on an aggregated basis – so the financial position of all the entities in the system are simply added together to produce a system report. It is important to note that an aggregated statement will overstate both income and expenditure where there are transactions between organisations in the system. An aggregated statement will include all transactions with entities not within the system, but these are unlikely to be separately identified.

Blended approach

It may be that an element of both approaches is required. For example, some staff working for an ICS may be employed by one body acting as host so the arrangements need to be made to ensure that the host body is reimbursed for the costs incurred on behalf of the whole ICS.

In addition, ICS wide financial reports may be produced to either consolidate or, more likely, aggregate the financial performance of all the bodies belonging to the system.

Whatever the approach taken, it must be clear and widely understood. One of the lessons learned from the establishment of Better Care Fund pooled budgets was that clarity and simplicity made the operation of the arrangement much smoother.

Governance and oversight

Internal governance

All of those who have a role in the oversight and governance of the statutory bodies involved in the non-statutory arrangement will need to agree the approach to financial management. This may be formally documented as part of establishing the new arrangement or it may be developed over time in which case it would need to be documented as it is developed and formally agreed at a later point.

Internal control arrangements are the primary control in relation to non-statutory bodies in the same way that they are for statutory bodies. Therefore, all the normal internal governance arrangements need to be established for the non-statutory body. It may be possible to simply agree that the policies and procedures for one organisation, probably the host body, can be adopted for the non-statutory body but a blended approach may be necessary.

It is important that all staff that are working as part of the non-statutory body understand which arrangements they should adhere to and how decisions should be documented so that everyone involved in the non-statutory organisation is aware of them. For example, authorised signatories and their authorisation thresholds should be clearly identified, the arrangements for engaging with specialists such as procurement specialists should be clear, and contracts must be documented in the contract registers of the bodies that are signatories to them.

This briefing focuses on financial controls but other policies from cyber security to staff handbooks to counter fraud need to be considered and established for the new arrangement.

External oversight

It is important to understand the role of all bodies that have an external oversight role, particularly where the non-statutory body is made up of members from different sectors. For example, NHS England and NHS Improvement (NHSE&I) have a regulatory role in relation to NHS bodies but not local authorities. Local government Health and Wellbeing Boards have a role in the oversight of the provision of health and social care to their population. The CQC may have a role where health and social care services are being delivered but it will engage with the statutory entity providing those services rather than the non-statutory entity.

Auditors will be engaged by each of the statutory entities and will therefore want to understand how transactions flow through the arrangement and what impact they have on the financial management and governance of their client organisation. In relation to their work on the financial reports, auditors may want to understand recharging arrangements and how funding flows around a joint working arrangement.

This will particularly be the case for ICSs where funding, for example, Provider Sustainability Funds (PSF) or Commissioner Sustainability Funds (CSF) are shared between statutory entities or where there is an element of the funding that is dependent on another organisation's performance or system wide performance. It is difficult for auditors to assess the collectability of a PSF receivable when it is dependent on system wide performance as the auditor will have no information on the performance of the organisations they do not audit.

Where the auditor is required to give a regularity opinion, on commissioning bodies, they will want to understand that any transfers of funding or recharges have a statutory basis. Auditors will also want to review the arrangements that each entity has made for the proper use of resources within the ICS as part of their value for money work.

Communication is key to ensuring that all parties understand the new arrangement, its purpose and aims and how it will be governed. As far as possible, the consequences of new arrangements in relation to financial reporting and regulation should be considered in advance. This is particularly an issue for 2020/21 where the financial regime is changing as the Covid-19 pandemic progresses.

Common accounting policies

Where a non-statutory entity has members from different types of statutory body, it is highly unlikely that those members will have common accounting policies.

It may not be necessary to harmonise these arrangements, but it will be important to understand where the differences are and what impact those differences will make when a common set of financial reports is produced or even when simply looking at different financial reports at the same time.

Where the financial performance of the non-statutory entity is monitored against budgets then it will be important that common accounting policies are used so that the performance against those budgets is measured on the same basis. For financial reports prepared in accordance with the DHSC's *Group accounting manual* this should be relatively straightforward. However, management accounts are not always prepared on the same basis so common working practices need to be agreed. For example, some NHS bodies will charge depreciation to budgets monthly, others quarterly or annually. Others still will manage depreciation centrally.

Cash flow

A non-statutory entity has no power to hold cash balances or enter into cash transactions. Therefore, arrangements need to be made to ensure that cash flows to the appropriate statutory entity at the right time. For example, usually, signatories to a s75 pooled budget transfer their contribution to the pool to the host body. The host body then makes the necessary payments from the pool. However, at the year-end, any cash balance 'held' by the pool is allocated back to the member organisation².

Staff costs - secondments

As said before, staff can only be employed by a statutory body. Therefore, one or more of the bodies working together must employ the staff that are undertaking the functions of the non-statutory entity, for example, working in a system wide role. Where these are all NHS bodies, terms and conditions are likely to be common and staff will be members of the NHS pension scheme. However, where staff work in different sectors, for example in local authorities, terms and conditions and pension funds are different. HR should be involved in establishing any secondment arrangements.

It must be clear from the outset what the total costs of staff include, for example, the apprenticeship levy, pension costs, as well as tax and national insurance. Also, the arrangements for sharing these costs needs to be agreed. It may be that the employing body will incur these costs, and this will be their contribution to the non-statutory arrangement, or it may be that a cost sharing or secondment arrangement is put in place. It must be clear whether the arrangements to share costs are on an agency or principle basis – in other words, where the risks around employing staff lie³.

Off-payroll arrangements need to be considered as well – if the non-statutory entity is expected to have a short life then services may be provided on an off-payroll arrangement rather than by an employee. Again, only statutory organisations can enter into off-payroll arrangements and any such arrangements must meet the statutory requirements in relation to reporting and taxation⁴.

Individuals on secondment must be clear about their relationship to their substantive employer and the non-statutory body. As with all secondments, agreement should be reached prior to commencement about whether any benefits (such as pay upgrades or lease car) are to be temporary or permanent and how any exit costs (such as redundancy pay) are to be funded.

Assets and liabilities

Every transaction must be reflected once and only once in the accounts of one statutory entity.

² HFMA, *Pooled budgets and the Better Care Fund*, October 2014

³ HFMA, *Accounting for joint working arrangements*, June 2017

⁴ HFMA, *Off payroll: reform of the intermediaries (IR35) legislation*, September 2017

During the Covid-19 pandemic, it is vital that the right inventory is in the right place at the right time. This means that, in some cases, NHS bodies have procured or are procuring stock for others. It is important that the entity that procured the stock either includes it in its inventory and is informed when it is used or recharges the other entity, so it is included in their stock. What must not happen is for the item of stock to be counted by two entities or none.

Arrangements need to be established for the custody of non-current assets, such as medical devices and vehicles, including proper record keeping, registration in the asset register, licences, maintenance, storage, and disposal.

Financial assets and liabilities also need to be recorded and managed – particularly debt collection, prompt payment of suppliers and management of supplier relationships.

Consolidation

Currently, ICSs are managed on an aggregated basis. However, financial management may move to a consolidated basis as systems mature. There are three stages to preparing a consolidated set of accounts and these apply when preparing a consolidated report for a non-statutory entity:

- align the accounting policies – as most public sector bodies follow IFRS, most accounting policies will be aligned, but it will be important to consider areas of estimate and judgement to ensure that similar policies are used
- remove transactions between the statutory entities that make up the non-statutory entity
- add together the remaining transactions – this will result in a consolidated financial report for the non-statutory entity⁵.

Where the non-statutory entity is an ICS, it will be important to align performance metrics as well so that the performance of the whole ICS can be assessed on the same basis. For example, some members of the ICS may report balance sheet metrics such as cash flow, debtor and creditor days and performance against the prompt payment target, but others may not. A common set of performance metrics will need to be agreed by all members of the new arrangement. It will also be important to decide in advance what financial information is required by those responsible for the governance and management of the ICS. The focus should be on what information is needed for decisions to be made and necessary action taken.

All NHS bodies prepare their financial reports for management purposes slightly differently – this can be seen by looking at the board reports of a few NHS bodies. Where a financial report is being prepared for an ICS, it will be important to agree early the format of the financial report and the basis of its preparation. It will be important to consider what information is needed to allow those managing the non-statutory body to understand the financial position and make appropriate decisions.

A number of questions need to be considered in advance of preparing a consolidated finance report:

- what is the purpose of the consolidation? Does it provide management with information that they can use to take action? It may be useful to understand that the system as a whole is working within the available resource or not but if the report does not provide information on where the over- or under-spends are then can it be used to make decisions?
- what is the financial position of the system being reviewed against? If a system is working on the basis of meeting the sum of its members' control totals, then performance against the system control total will be judged on the aggregated financial position so it may not be necessary to prepare a consolidated position
- a system does not work in a vacuum, so how transactions outside of the system are to be reported needs to be considered. Is it important that these transactions are identified? This might provide information on patient flows and the services that are being provided locally to the population

⁵ HFMA, *Guidance on the consolidation of NHS charities*, January 2014 (please note, this is being updated and will be reissued later in 2020)

VAT and tax

VAT is complicated in the NHS. It is made even more so if any members of the non-statutory entity are outside of the NHS divisional VAT registration. VAT needs to be considered at an early stage of setting up a non-statutory entity to ensure that the new arrangements do not have unexpected consequences⁶. It is particularly important to understand VAT implications when determining which entity is to host the non-statutory body.

Other issues – insurance, CNST, information governance

Non-statutory bodies cannot enter into insurance arrangements with private sector insurers or NHS Resolution – therefore, the organisations that have come together to form the non-statutory entity will need to ensure that all of the functions of the non-statutory entity are covered by member organisations' policies. This will not be an issue where the arrangement is a mechanism for sharing funding, such as a pooled budget or a mechanism for financial management, such as an ICS. However, it will be an issue where services are being provided direct to patients, for example, the Nightingale hospitals. In this case, it is likely to be the host that arranges insurance cover.

Similarly, the Information Commissioner's Office will recognise statutory bodies and will expect them to be compliant with GDPR and the same will apply to other information governance requirements. It is important that information governance is considered at an early stage.

⁶ NAO, *Investigation into the collapse of the UnitingCare Partnership contract in Cambridgeshire and Peterborough*, July 2016 and NHS England, *NHS England review of Uniting Care contract*, April 2016

About the HFMA

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For nearly 70 years, it has provided independent and objective advice to its members and the wider healthcare community. It is a charitable organisation that promotes best practice and innovation in financial management and governance across the UK health economy through its local and national networks.

The association also analyses and responds to national policy and aims to exert influence in shaping the wider healthcare agenda. It has particular interest in promoting the highest professional standards in financial management and governance and is keen to work with other organisations to promote approaches that really are 'fit for purpose' and effective.

The HFMA offers a range of qualifications in healthcare business and finance at undergraduate and postgraduate level and can provide a route to an MBA in healthcare finance. The qualifications are delivered through HFMA's Academy which was launched in 2017 and has already established strong learner and alumni networks.

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