HFMA briefing
December 2020

Financial reporting watching brief

2020/21 and beyond

This paper is intended to update HFMA members on developments in financial reporting that may affect them as finance professionals working in the NHS. This paper was presented to the HFMA's Accounting and Standards Committee on ***26 November 2020***. All major changes to that paper have been highlighted in bold italic.

Introduction

When producing their annual report and accounts NHS bodies are required to comply with a range of standards and guidance. This briefing paper identifies the key changes that are on the horizon in those standards and guidance.

Structure of the paper

The standards and guidance considered in this paper are:

- accounting standards issued by the International Accounting Standards Board (IASB) (see Appendix 1: Accounting standards)
- corporate reporting requirements issued by the Financial Reporting Council (FRC) (see Appendix 2: Corporate reporting requirements issued by the FRC)
- public sector guidance including HM Treasury *Financial reporting manual* (FReM) and papers issued by Financial Reporting Advisory Board (FRAB) and specific NHS guidance, the

Department of Health and Social Care (DHSC) *Group accounting manual* (GAM) and NHS Improvement's *Annual reporting manual* (ARM) (see Appendix 3: Public sector specific guidance).

Key developments that are likely to affect the NHS

2020/21

- the impact of the changes to the NHS financial regime as a result of the Covid-19 pandemic

2022/23

- implementation of IFRS 16 *Leases* for entities which report under the requirements of the HM Treasury FReM ***[Note the amended application date]***

2023/24

- implementation of IFRS 17 *Insurance contracts*

Other developments

Covid-19

The Covid-19 pandemic has impacted on financial reporting. NHS specific guidance for 2019/20 was issued by NHSE&I and the DHSC, additional guidance will be issued in due course for 2020/21.

The FRC has ***consolidated its guidance in relation to Covid-19 for companies[1] and auditors[2]. While this guidance is not aimed specifically at NHS bodies, it does include useful considerations and will be used by auditors.***

The ICAEW has issued Covid-19 specific guidance, including considerations for inventory audit testing[3].

The FRC also published a thematic review of the financial reporting effects of Covid-19[4], they found room for improvement in relation to going concern disclosures. Particularly, the importance of compatibility of key assumptions and judgements throughout the annual report and accounts and the explanation of those assumptions and judgments in the annual report and accounts.

Audit of NHS bodies

The new *Code of audit practice*[5,6] will apply to audits of financial years from 2020/21 onwards. The key changes to the Code include:

- clarification of the key principles of effective public reporting
- the option to introduce enhanced audit reporting at some, or all, public bodies
- a revised approach to assessing, and in particular, reporting on local bodies' arrangements to secure value for money. This revision is intended to maximise the impact of the work that auditors do in this area[7]
- the introduction of an annual auditor's report that will bring together all of the auditors' reports for the year and must be published no later than 30 September following the financial year end.

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[1] FRC, *Company guidance Covid-19 (updated 4 December)*, updated December 2020
[2] FRC, *Bulletin: guidance for auditors and matters to consider where engagements are affected by Covid-19*, updated December 2020
[3] ICAEW, *Covid-19: considerations for inventory audit testing*, [accessed 16 November 2020]
[4] FRC, *Covid-19 Thematic Review: review of the financial reporting effects of Covid-19*, July 2020
[5] NAO, *Code of audit practice*, April 2020
[6] NAO, *Auditor guidance notes (AGN/03): Auditors' work on value for money arrangements*, October 2020
[7] HFMA webinar, *Auditors' work on VFM arrangements under the new Code of Audit Practice*, October 2020

In July 2019, the Ministry of Housing, Communities and Local Government launched the Redmond review[8] of the Local Audit and Accountability Act 2014 in relation to the audit of local authorities. The outcome of the Redmond Review was published on 8 September[9]. The recommendations relate only to local authority audits, as the audit of NHS bodies was outside of the scope of the review, but many of the findings are equally applicable to the NHS in relation to appointing auditors, audit fees and the focus of the audit.

The FRC has published several documents relating to audit quality:

- their audit inspection results[10] for the seven largest audit firms. Of the 88 audits reviews, only two thirds were of a good standard or required limited improvement
- ***a report on their audit quality inspection of local audits[11] that included the audit of three health bodies. The report concludes that the quality of value for money conclusion work remains high, however, nine of the 15 audits reviewed require improvement in the audit of the financial statements. The areas for improvement include property and pension valuation, engagement quality control review and audit testing over material balances such as deferred income, PFI arrangements and amounts receivable. Insufficient challenge and standing up to management in areas of complexity and forward-looking judgement was also identified as an issue***
- ***a summary of their recent round of inspections[12] - 49 out of 130 audits inspected needed improvement or significant improvement.***

The ***majority of the*** work that the FRC is undertaking in relation to improving audit quality is focussed on commercial audits. However, it is likely to affect NHS audits – ***particularly the FRC's conclusions in relation to the importance of the culture of challenge in audit firms –*** that may result in changes to the 'feel' of the audit. This is also There may also be an impact on audit fees.

[8] MHCLG, *Review of local authority financial reporting and external audit*, July 2019
[9] MHCLG, *Results of independent review into quality of council audits published*, September 2020
[10] FRC, *Results of FRC audit inspections*, July 2020
[11] FRC, *Major local audit inspection results*, October 2020
[12] FRC, *Covid-10 strengthens need for audit improvement*, November 2020

Appendix 1: Accounting standards

Access to accounting standards

Access to the unaccompanied IFRS standard and IFRIC interpretations is available through the IFRS website. The DHSC and Technical Accounting Centre of Excellence (TACoE) have procured free access to the full standards for NHS bodies via the EY Atlas Portal. As well as access to the standards the portal also includes other financial reporting guidance

To gain access please email the central TACoE hub based in the MOD at the below email address cc'ing anyone else in your organisation that would value access to the portal.

DFinStrat-TechnicalAccountingCOE@mod.gov.uk

The hub will then arrange access with EY who will then forward on the necessary details to those who have registered for access such as user manuals, passwords, usernames and links to the portal sign in.

New and amended accounting standards which will be applicable from 2020/21

There are no new accounting standards applicable to NHS bodies (applying the FReM) in 2020/21.

Amendments to the following standards are applicable in 2020/21:

- standards that contain references to the *Conceptual framework* have been updated. The only exception is the requirement in IFRS 3 for an entity to refer to the framework to determine what constitutes an asset or a liability – that amendment will be effective from 2022/23
- IFRS 9, IFRS 7 and IAS 39 are amended to reflect the uncertainties that have resulted from interest rate benchmark reforms – as these amendments relate to hedge accounting, they are unlikely to impact on NHS bodies
- IFRS 3 to reflect the clarification of the definition of a business
- IAS 1 and IAS 8 to improve the understanding of the definition of material.

Accounting standards issued but not applicable until January 2021 or later

(These tables are based on the IASB's work plan[13] and the EU endorsement status report[14])

Standard	Timeline	Assessed impact on NHS bodies	Accounting and Standards Committee action taken/required
IFRS 16 *Leases*	The standard was published in January 2015. It was endorsed by the EU in November 2017 for implementation from 1 January 2019. Companies Act reporters following EU adopted IFRS, such as NHS Property Services Ltd and Community Health Partnerships, adopted this standard in 2019/20. HM Treasury has agreed that entities which prepare their accounts in accordance with the FReM, such as the DHSC, NHS provider bodies and CCGs, will now adopt this standard in ***2022/23***. In May 2020, a practical expedient was published that allowed lessees to elect not to treat rent concessions as a lease modification where the	This is the standard which will bring all leases onto the statement of financial position. The IASB has issued an article[15] in which four members discuss their experience of implementation so far. The key messages are: • it is worth taking the time to fully understand the transition options and the impact on the financial position of the entity over the life of the lease • allow enough time to implement the new standard –for decisions to be fully costed and understood. Allow time to find and review all leases and to talk to those parts of the organisation which have entered into the lease or are using the leased asset • making judgements on issued such as discount rates may need new information which will need to be collected and assessed • ensure that you are happy with your IAS 17 disclosures before starting work on the implementation of the new standard to avoid surprises. HM Treasury has been discussing this standard for some time. Guidance has been issued as part of the 2019/20	Briefing presented to the Accounting and Standards Committee and published on the HFMA website[17] and a briefing to explain the standard to non-accountants has also been published[18] The FRC has issued a thematic review of interim disclosures in the first year of application of IFRS 16[19]. The best examples were tailored to the organisation's circumstances and provided more than the minimum requirements. The standard was the topic of three webinars - 28 November 2018, 18 July 2019 and 13 November 2019.

[13] IFRS, *IASB work plan* (accessed 17 November 2020)
[14] EFRAG, *The EU endorsement status report* (dated 12 October 2020)
[15] IFRS, *Leases one year on - putting IFRS 16 into practice*, 2017
[17] HFMA, *Accounting for leases - application of IFRS 16*, 2018
[18] HFMA, *Accounting for leases: why it affects you*, November 2019
[19] FRC, *IFRS 16 Thematic Review: Review of Interim Disclosures in the First Year of Application*, November 2019

Standard	Timeline	Assessed impact on NHS bodies	Accounting and Standards Committee action taken/required
	concession is a direct result of the Covid-19 pandemic and other conditions are met. This amendment is applicable for annual reporting period starting on or after 1 June 2020 ***and was given EU endorsement on 9 October 2020***. The IASB plans to issue an exposure draft to amend IFRS 16 to specific how a seller-lessee would apply the subsequent measurement requirements in IFRS 16 to the lease liability that arises in a sale and leaseback transaction.	FReM and in separate application guidance which was updated in April 2019[16]. Detailed guidance for NHS bodies has been published – see appendix 3. ***HM Treasury are considering the treatment of VAT on right of use assets and guidance will be published shortly.*** ***FRAB are still discussing the impact of IFRS 16 on accounting for PFI schemes and consequential disclosures.***	
IFRS 17 *Insurance contracts*	The new standard was issued in May 2017. Subject to EU and HM Treasury endorsement, it will be effective in 2023/24. In June 2020, the IASB published amendments to the standard as well as deferring the application date to 2023. The amendments are intended to reduce the costs of application, to make the results earlier to explain and to ease transition.	The scope of the standard is not different to IFRS 4, but it is expected that the implementation of the new standard will require a review of existing arrangements which may result in reclassification of contracts as insurance contracts. Insurance contracts combine features of both a financial instrument and a service contract. IFRS 17: • combines current measurement of the future cash flows with the recognition of profit over the period that services are provided under the contract • presents insurance service results (including presentation of insurance revenue) separately from insurance finance income or expenses	Keep on this watching brief

[16] HM Treasury, *IFRS 16 leases – application guidance*, December 2019

Standard	Timeline	Assessed impact on NHS bodies	Accounting and Standards Committee action taken/required
		• requires an entity to make an accounting policy choice of whether to recognise all insurance finance income or expenses in profit or loss or to recognise some of that income or expenses in other comprehensive income. HM Treasury has put together a working group to assess the impact of IFRS 17, that reported to FRAB in March 2020[20]	
Classification of liabilities as current or non-current (amendments to IAS 1)	The amendment was published in January 2020 with an effective date of 1 January 2022. However, in July 2020, the IASB confirmed that this would be deferred to reporting periods beginning on or after 1 January 2023. Subject to EU and HM Treasury endorsement, it will be applicable from 2023/24.	Currently, liabilities are classified as current unless there is an unconditional right to defer settlement of the liability for at least 12 months. This is a difficulty requirement to interpret which results in inconsistent classification between entities. The IASB is therefore proposing to amend IAS 1 to clarify the situation where an asset can be classified as non-current.	This is unlikely to affect NHS bodies but will remain on the watching brief.
Onerous contracts (amendments to IAS 37)	The amendment was published in May 2020 and subject to EU and HM Treasury endorsement it will be applicable from 2022/23.	The costs of fulfilling a contract has been defined and the standard amended to state that before a provision for an onerous contract is established, any impairment loss on assets used in fulfilling the contract should be recognised.	NHS bodies rarely classify contracts as onerous, but this amendment should remain on the watching brief.
Property, plant, and equipment: proceeds before intended use (amendment to IAS 16)	The amendment was published in May 2020 and subject to EU and HM Treasury endorsement it will be applicable from 2022/23.	The cost of testing an asset to check it is functioning properly as an example of directly attributable costs has been amended. The treatment and disclosure of the proceeds from selling items produced when testing the function of an asset has been clarified.	As NHS body's non-current assets are rarely used to produce goods, this is unlikely to be an issue.

[20] HM Treasury, *IFRS 17 insurance contracts – progress update*, March 2020

Standard	Timeline	Assessed impact on NHS bodies	Accounting and Standards Committee action taken/required
Annual Improvements 2018-2020	The amendment was published in May 2020 and subject to EU and HM Treasury endorsement it will be applicable from 2022/23.	The following standards will be amended: • IFRS 1 First time adoption of IFRS – to simply the application of IFRS 1 by a subsidiary that becomes a first-time adopter of IFRS Standards after its parent company has already adopted them • IFRS 9 Financial instruments - clarifies the fees a company includes in assessing the terms of a new or modified financial liability to determine whether to derecognise a financial liability • IFRS 16 Leases – an amendment to the illustrative example relating to lease incentives • IAS 41 Agriculture – to align the fair value measurement requirements in this standard to those in other standards	Keep on the watching brief

Major projects which may affect NHS bodies

Project	Timeline	Assessed impact on NHS bodies	Accounting and Standards Committee action taken/required
Exposure draft on *Accounting policies and accounting estimates (amendment to IAS 8)*	Exposure draft issued on 12 September 2017 with a deadline for comments of January 2018. In August 2019, an exposure draft on the Disclosure of Accounting Policies was published with a deadline of November 2019 for comments[21].	The amendment to the standard is intended to make the definitions of 'accounting policies' and 'accounting estimates' more distinct and concise. The revised standard will also include more examples to illustrate the difference. IAS 1 requires entities to disclose their 'significant' accounting policies. The Board proposes to replace that requirement with a requirement to disclose 'material' accounting policies. In addition, the Board is proposing amendments to IAS 1 and IFRS Practice Statement 2 to help entities apply the concept of materiality in making	Keep this on the watching brief.

[21] IASB, *IASB proposed amendments to IFRS Standards to improve accounting policy disclosures*, August 2019

Project	Timeline	Assessed impact on NHS bodies	Accounting and Standards Committee action taken/required
	In July 2020, the IASB tentatively agreed to delay the effective date to 2023/24.	decisions about accounting policy disclosures. The proposed amendments are intended to help entities: • identify and disclose all accounting policies that provide material information to primary users of financial statements and • identify immaterial accounting policies and eliminate them from their financial statements.	
Primary financial statements	The exposure draft was published in December 2019 with a deadline for comments of 30 June 2020. In May 2020, the deadline for comments was changed to 30 September because of the Covid-19 pandemic.	The proposed exposure draft aims to improve the structure and content of the primary financial statements with a focus on the statements of financial performance.	Keep on watching brief
Disclosure initiative – accounting policies	The IASB is proposing to amendment IAS 1 to require entities to disclose their material accounting policies rather than their significant accounting policies.	This project links to the Exposure Draft on the amendments to IAS 8	Keep on the watching brief
Sustainability reporting	***A consultation paper[22] was published in September 2020 setting out the possible ways that the IFRS Foundation might contribute to the development of global sustainability standards. This would extend the Foundation's current remit beyond financial reporting standards.***	***At the moment, the paper is simply seeking to assess the demand from stakeholders in relation to sustainability reporting and to understand what the IFRS Foundation could do in response to that demand.***	***Keep on the watching brief***

[22] IFRS Foundation, *Consultation paper on sustainability reporting*, September 2020

Appendix 2: Corporate reporting requirements issued by the FRC

The Financial Reporting Council (FRC) is responsible for setting UK accounting standards, UK auditing standards and the corporate governance code of practice. The UK accounting standards only affect the preparation of NHS charity accounts and are not covered by this paper. Changes to auditing standards will not impact on NHS bodies so will not be covered by this paper. NHS bodies are usually required to follow best practice reporting in relation to corporate governance and annual reports so this paper will consider any developments in this area.

In March 2019, the Department for Business, Energy and Industrial Strategy published its response[23] to Sir John Kingman's Independent Review of the FRC. As a result, the FRC will be replaced by a new independent statutory regulator, the Audit, Reporting and Governance Authority (ARGA). The FRC has now published its transition pathway[24]. The new governance arrangements may impact on the audit of NHS bodies once they are fully implemented.

In February 2020[25], the FRC set out its plans to speed up its regulatory oversight and broaden its impact.

End of year letter

In November 2020, the annual end of year letter was published[26] – this sets out the FRC's reporting expectations for preparers of annual reports and accounts. It sets the backdrop of financial reporting as one of economic uncertainty as a result of the Covid-19 pandemic and Brexit. It also expects that the current public health measures in place will continue to restrict travel and office working so it is likely that the accounts will be prepared and audited remotely at least in some part.

While not all of the issues included in the letter will be applicable to NHS bodies, they will be high profile issues for auditors. The key issues include:

- ***disclosure of judgements and estimates, particularly in relation to Covid-19 and Brexit***
- ***the future impact of climate change on the business and how the organisation's activities affect the environment***
- ***IFRS 15 disclosures relating to performance obligations, the timing of income recognition and significant judgements***
- ***clear disclosures in relation to cash flow and liquidity, particularly in relation to assessing going concern.***

Reporting in a time of uncertainty

The FRC has published two short guidance as a result of Covid-19:

- ***Resources, action, the future[27] that focuses on investors' need to understand how much cash an entity has and has access to, what the entity can do to manage expenditure and protect its key assets and value drivers***
- ***Going concern, risk, and viability[28] that focuses on the context that going concern disclosures provide in uncertain times and disclosures around viability that consider a period beyond the going concern period.***

Reporting the impact of climate change

The FRC has announced[29] a major review of how companies and auditors assess and report the impact of climate change. The review will consider how the quality of

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[23] DBEIS, *Letter from the RT Hon Greg Clarke MP to Stephen Haddrill*, 11 March 2019
[24] FRC, *The FRC sets out its transition pathway*, May 2019
[25] FRC, *FRC plans for greater regulatory oversight*, February 2020
[26] FRC, *FRC announces company reporting expectations for 2020/21*, November 2020
[27] FRC Financial Reporting Lab, *Resources, action, the future*, October 2020
[28] FRC Financial Reporting Lab, *Going concern, risk and viability*, October 2020
[29] FRC, *FRC assesses company and auditor responses to climate change*, February 2020

information can be improved and how that information is used by investors to make decisions.

Changes to Companies Act narrative reporting requirements

The *Companies (Miscellaneous Reporting) Regulations 2018*[30] apply to financial years beginning on or after 1 January 2019. The regulations are a response to the Government's Green Paper on Corporate Governance Reform – they require companies to make additional disclosures in their directors' report about how they promise the success of the company for the benefit of its members, their governance arrangements and executive pay.

The *Companies (Directors' Report) and Limited liability Partnerships (Energy and Carbon Report) Regulations 2018*[31] come into force for companies from 1 April 2019. The regulations introduce a requirement to include statements in the directors' report about the entity's energy use and action taken to increase its energy efficiency. There are also requirements for large unlisted companies to make statements in the directors' report concerning greenhouse gas emissions, energy use and action to increase energy efficiency in the UK.

While neither of these regulations are directly applicable to NHS bodies, they amend to the regulations[32] which form the basis for the contents of the directors' report in the HM Treasury FReM. HM Treasury is reviewing the regulations to assess whether the reporting requirements in the FReM will be amended.

[30] *The Companies (Miscellaneous Reporting) Regulations 2018* – SI 2018/860
[31] *The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018* – SI 2018/1155
[32] *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* – SI 2008/410

Appendix 3: Public sector specific guidance

2020/21 manuals

IFRS 16

NHSE&I has a dedicated webpage[33] in relation to IFRS 16 that will be populated soon. The DHSC has issued implementation guidance[34] that remains extant.

HM Treasury FReM

The HM Treasury FReM 2020/21 was published on 19 December 2020. The key changes[35] to the 2020/21 manual include:

- a new chapter that sets out the four purposes of government financial reporting. Each of the four purposes relates to the needs of a different report user. The chapter clarifies that, for annual reports and accounts of bodies following the FReM, the needs of Parliament as the primary user take precedence
- a new chapter on best practice in narrative reporting. This chapter takes lessons from existing good examples and gives guidance to help preparers across government improve reporting
- extensive changes and new requirements in relation to performance reporting
- a new requirement to report staff turnover.

DHSC GAM

The 2020/21 DHSC GAM was published[36] on 30 April 2020. The DHSC's consultation response was published on 29 May 2020[37]

Changes to the GAM include:

- the introduction of a new staff turnover disclosure in the staff report (not subject to audit)
- revision to the definition of materiality as a result of the change to IAS 1 and IAS 8
- deletion of the provider sustainability fund and commissioner sustainability fund sections
- added emphasis on the detail to be included in the performance report in relation to:
  - the risk profile of the entity
  - the provision of staff engagement indicators
- reference to the change made to the *Conceptual framework for financial reporting*.

The reduced reporting requirements that applied in 2019/20 are expected to apply in 2020/21 as well – this means that the performance analysis will be optional to omit as well as reporting sickness absence data.

The DHSC has also published guidance on:

- ***agreement of balances 2020/21[38]***
- ***the NHS injury cost recovery scheme[39] – the rate for non-payment for 2020/21 is 22.43%.***

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[33] NHS, *Financial accounting updates — International Financial Reporting Standard 16 Leases implementation* [accessed 8 September 2020]
[34] DHSC, *IFRS 16 implementation guidance*, December 2019
[35] HM Treasury, *FReM 2020/21 amendment log*, December 2019
[36] DHSC, *Group accounting manual 2020/21*, April 2020
[37] DHSC, *Group Accounting Manual 2020–21: consultation response*, May 2020
[38] DHSC, *Agreement of balances: accounting group*, September 2020
[39] DHSC, *NHS injury cost recovery scheme*, updated October 2020

The financial reporting timetable months 9 to 11 has been published[40].

The NHS Business Services Authority has also issued its guidance on the pension element of the disclosure of senior managers' remuneration - the Greenbury functionality within Pensions Online will be available from 4 January 2021 to 26 February 2021[41].

[40] NHSE&I, *M9 - M11 financial reporting timetable 2020/21*, December 2020
[41] NHSBSA, *Disclosure of senior managers' remuneration (Greenbury)*, [accessed 17 November 2020]

About the HFMA

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For 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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