HFMA briefing
February 2020

2019/20 year-end reminders

Issues raised at the pre-accounts planning conferences

This paper is intended to provide HFMA members with key year-end reminders as they prepare their 2019/20 annual report and accounts.

This briefing paper has been written following the pre-accounts planning conferences held on 29 and 30 January 2020. It may be updated as the issues develop over the year-end period.

2019/20 accounts

All NHS bodies need to prepare their annual report and accounts in accordance with the *Group accounting manual 2019/20*[1] (GAM) issued by the Department of Health and Social Care (DHSC). The only exception is that foundation trusts prepare their annual report in accordance with the *Foundation trust annual reporting manual 2019/20*[2] (FT ARM) published by NHS Improvement rather than chapter 3 of the GAM. This briefing does not repeat the guidance included in the manuals.

IFRS 16 *leases*

Although IFRS 16 does not come into force in the NHS until 2020/21, it is likely to be a key issue in the preparation and audit of the 2019/20 annual report and accounts. The HFMA has prepared a more detailed briefing on the practical implementation of IFRS 16[3].

Standards issued not yet adopted

Although IFRS 16 is not applicable until 2020/21, IAS 8 requires disclosures in relation to standards that have been issued but have not yet been adopted. Appendix 1 to this briefing summarises the

[1] DHSC, *Group accounting manual 2020/21*, December 2019
[2] NHS Improvement, *Foundation trust annual reporting manual*, December 2019
[3] HFMA, *IFRS 16 leases: practical application*, 2020

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disclosures that need to be made and gives some examples of the disclosures made by organisations that have already adopted the standard.

NHS bodies need to include IFRS 17 *Insurance contracts* in this note to the 2019/20 accounts as well. However, this disclosure will be much less detailed.

Operating and finance lease disclosures in the 2019/20 accounts

NHS bodies are required to use the grandfathering arrangements in IFRS 16 on transition. This means that where a contract has been determined to be a lease under the current accounting arrangements it will continue to be classified as a lease under IFRS 16. So, those leases disclosed in the operating and finance lease notes in the 2019/20 accounts will be the leases that form the opening balances for the transition to IFRS 16 on 1 April 2020.

However, this is only the case where there has been a robust assessment under the current accounting standards. Where NHS bodies have identified leases that they are not currently including in their leases disclosures as either an operating or a finance lease they may want to restate their 2019/20 disclosures so that the reconciliation from one standard to the other in 2020/21 is simpler. This may be the case for managed service contracts and leases with NHS Property Services Ltd. This works both ways, where arrangements have been previously disclosed as operating leases under IAS 17 and IFRIC 4 but are now considered not to be leases should be excluded from the 2019/20 disclosures. This is may be the case for lease car arrangements.

Leases identified after the 2019/20 accounts have been signed off may result in an adjustment to the comparatives in the 2020/21 accounts due to an error depending on their materiality.

Budgetary impact of IFRS 16

Although it is not a 2019/20 accounting issue, it is important to understand that IFRS 16 will have a budgetary impact on NHS bodies and the DHSC group as a whole. The returns that NHS bodies make during 2020 to NHS England and NHS Improvement will be used by the DHSC as the basis for discussions with HM Treasury about the budgetary coverage, particularly capital departmental resource limit (CDEL), that will be needed to ensure that the change in accounting does not impact on the financial position of NHS bodies. It is therefore important that these returns are as accurate as possible as soon as possible.

IFRS 9 *financial instruments* and IFRS 15 *revenue from contracts with customers*

These two accounting standards were first applied in the NHS in 2018/19:

- IFRS 9 *Financial instruments*
- IFRS 15 *Revenue from contracts with customers.*

While neither standard had a material impact on the financial position of NHS bodies and the DHSC group, the general consensus was that the application of the standards in 2018/19 was done as a year-end exercise rather than being embedded into financial processes. It is likely that auditors made recommendations relating to the implementation of these standards in 2018/19 and will therefore want to follow up on progress with addressing their recommendations. This is particularly the case where new, significant or material contracts and arrangements have been entered into in 2019/20.

The FRC have identified in their year-end letter a series of questions that organisations may want to consider when reviewing their disclosures:

- in relation to IFRS 9:
  - does the description of your business model adequately explain and support the hold to collect model?
  - have you removed all old IAS 39 terminology from your disclosures?

- do your accounts reflect the fact that the scope of the impairment requirements includes, for example, IFRS 15 contract assets, lease receivables and also applies to loans to subsidiaries and other undertakings in your individual parent company accounts?
- if relevant, do you explain why the impact of IFRS 9 is not material, particularly where significant financial instruments are recognised in the accounts.

- in relation to IFRS 15:
  - do your accounting policies identify the specific nature of your performance obligations and explain the point at which they are satisfied?
  - does your policy description clearly set out when revenue is recognised in respect of all material revenue streams?
  - have you focused your disclosure on the specific judgements you have made which have a significant impact on the amount or timing of revenue recognition?
  - have you quantified estimation uncertainties relating to revenue and, where helpful, provided sensitivities or ranges of outcomes?
  - have you explained significant movements in contract assets and liabilities?

Discount rates for 2019/20

The discount rates for provisions have been published by the DHSC in FAQ1 in the year-end additional guidance[4]. It is expected that the provisions discount rate will have a cost impact on NHS bodies so this will need to be assessed and managed as soon as possible.

Employer contributions to the NHS pension scheme

During 2019/20, NHS employers have been paying an employer contribution of 14.38% to the NHS pension scheme. However, the from 1 April 2019, the employers' pension contribution is actually 20.68%. The difference of 6.3% has been funded and paid to the NHS BSA centrally by NHS England.

In NHS bodies' accounts, the full contribution must be recognised by all NHS employers. The fact that it is being paid by NHS England will be reflected in nominal income so the effect on the bottom line is neutral.

For NHS providers, the amount that should be reflected as income and expenditure will be calculated by NHS Improvement based on the month 10 position.

For commissioners, NHS England will populate the ISFE ledger based on the month 9 position.

NHS bodies are expected to use the figures provided by the regulatory bodies, but they need to put in place arrangements to review these amounts for reasonableness. This will particularly be the case where changes of circumstances mean that the extrapolation of the full year impact based on month 9 or 10 will not be materially correct.

Auditors will expected NHS bodies to have undertaken a review and to have satisfied themselves that that amounts are materially correct.

Provider sustainability fund (PSF)/ commissioner sustainability fund (CSF)

The arrangements for the distribution of PSF, financial recovery fund (FRF) and marginal rate emergency tariff (MRET) for providers and CSF for commissioners is expected to be similar to last year.

[4] DHSC, *Group accounting manual additional guidance version 1*, December 2019

For providers, the key change is the treatment of gains on asset disposal which will not longer count towards meeting control totals.

For providers, it is vital that the key data return is submitted on time (midday Friday 17 April) and that movements between this data return and the draft accounts submission are minimal. PFR tab 08a will allow providers to calculate their expected income.

Valuation of non-current assets

The impact of the change to the RICS guidance in January 2019 may impact on valuations at the end of March 2020. Where NHS bodies are getting a new valuation, it is important to ensure that the updated guidance is being followed. Where a valuation is not needed, NHS bodies should satisfy themselves that their non-current asset valuations are not materially misstated.

There have been no major changes to RICS guidance this year although RICS are discussing material uncertainty and what this means for their reports.

'Whilst it is implicit in the standards and guidance that where "material uncertainty" exists it should be flagged and a specific comment added, it is important from the point of valuation users that the term "material uncertainty" is expressly used as a signal in circumstances where VPS 3 Section 2.2(o) applies.'

This may mean that there may be a reference to uncertainty in the valuers' report

The HFMA has issued a briefing on valuation and accounting issues.

Practical and general reporting issues

Submission

The DHSC is only able to lay its consolidated annual report and accounts before Parliament ahead of recess because they use the draft accounts submissions to prepare their draft accounts which are then audited. Any changes between draft and final submission make that consolidation preparation and audit more difficult and jeopardise the publication deadline. It is vital that the draft accounts are as accurate as possible and that any possible changes between draft and final are discussed with NHS Improvement or NHS England as early as possible.

Similarly, late submissions can affect the publication of the consolidated accounts, so it is important to meet the submission deadlines and take note of the time of day for the deadline as well as the date.

All NHS providers and commissioners are responsible for submitting their summarisation schedules to the consolidating bodies. Auditors are responsible for submitting summarisation schedules to the NAO. It is vital that the same version is submitted to the consolidating body and the NAO – each year differences are found which take time and resource to resolve.

In 2018/19, there were a number of late accounts that made the various consolidations that inform the DHSC group consolidation more difficult. NHS bodies also reported difficulties with their auditors especially at the end of the audit with last minute decisions and questions as well as late changes to the annual report and accounts.

The preparation of the DHSC group annual report and accounts is a very large consolidation involving over 400 different entities and it is done within a very short timescale. Both NHS bodies and their auditors are under pressure to complete their work to a high standard within that timescale. The

HFMA has produced a briefing[5] on best practice when working with auditors that may be useful when planning the year-end process.

Financial position and going concern

The financial position of the NHS remains stretched and there a risk of pressure on finance professionals to achieve particular financial results. Receipt of PSF monies is dependent on remaining within control totals. This may mean that relatively small changes in judgements and estimates may become material or may be subject to auditor scrutiny. Such judgements and estimates need to be documented and agreed at a senior level. The same considerations should be applied to arrangements for funding to be moved around a system – these should be subject to management scrutiny and may be the focus of auditor attention.

Due to the HM Treasury reporting requirements, NHS bodies are highly unlikely to prepare their accounts on any basis other than going concern. However, material uncertainties around the financial position must be disclosed in the financial statements[6]. It is management's responsibility to consider going concern and, in particular, any significant uncertainties.

Significant judgements and estimates

IAS 1 *Presentation of financial statements* requires the disclosure of those judgments which have the most significant effect on the amounts included in the accounts and the sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the accounts in the next financial year. The disclosure should therefore focus on material and significant judgments and estimates and should provide enough detail for the reader of the accounts to understand why they are critical and what impact they could have on the financial position of the reporting body.

For NHS bodies, this disclosure may include some discussion of the decisions made around:

- the valuation of non-current assets and their useful economic lives
- the identification of leases and their likely impact on 2020/21 when IFRS 16 is adopted
- income recognition under IFRS 15
- the establishment of provisions and accruals
- EU exit
- the coronavirus/ COVID-19 – its impact on supply chain, workforce and capacity
- PSF funding receivable.

Judgements and estimates are, by their very nature, subjective and there is no right or wrong answer. It is therefore important that they are properly documented and the basis for the decision is clearly stated. Wherever possible, evidence used to make the decision should also be referenced and documented. This will assist auditors when they are undertaking their work but will also help with the preparation of future sets of accounts as these judgements and estimated are revisited each year.

EU exit

The UK left the EU on 31 January 2020. However, the transitional period will not end until the end of December 2020. While no specific disclosures are required in relation to the EU exit, the uncertainties that NHS bodies face should be disclosed in the accounts in the same way as any other operational risks. For example:

- in the annual report, probably in the annual governance statement any impact that EU exit is expected to have in relation to workforce or supply chain. The risks identified along with the actions taken to manage those risks should be disclosed in the same way that any other risks are discussed

[5] HFMA, *The external audit: best practice in working well together*, February 2020
[6] HFMA, *Going concern - Assessment and reporting requirements in difficult times*, October 2019

- as an area which has been taken into account when making estimates and judgements, for example, it may mean that there is greater uncertainty in property valuations
- potentially as part of the going concern assessment, where there are areas of uncertainty which have been included in forecasts and sensitivity analysis for the next 12 months. Consideration should be given to whether any of these uncertainties should be included in the going concern disclosure.

Disclosures need to be factual and relate to the work that NHS bodies have done and the assumptions they have made about future events so that the annual report and accounts meet the requirements of the DHSC's *Group accounting manual 2019/20*[7] (GAM) and the foundation trust *Annual reporting manual 2019/20*[8] (FT ARM).

Agreement of balances

There have been no major changes to the guidance for 2019/20. Generally, the results of the agreement of balances exercise have been improving in recent years. However, it remains a material risk for the DHSC and the guidance should be re-read each year.

The guidance has been amended to make it easier to read, for example, paragraphs 5.8 to 5.11 have been revised to make it clearer how the accrued column in the forms should be used.

Other changes in the guidance reflect the organisational changes to NHS England. Paragraph 7.1 and appendices 1 and 3 of the NHS England appendices are particularly important for organisations that transact with NHS England.

Paragraph 6.52 deals with the changes in relation to PSF, FRF and MRET and how they affect agreement of balances.

It is worth noting that in-year mergers of NHS provider bodies always cause problems in relation to agreement of balances particularly when the merger occurs near the year end. Merged organisations and those who transact with them need to understand which entity is agreeing which balances and transactions.

Provisions vs accruals

For NHS bodies, the decision whether a liability is a provision, or an accrual does not make any difference to the bottom line and is largely one presentational. However, for NHS England and the DHSC, the difference between a provision and an accrual makes a difference to their position against their financial targets.

NHS England and the DHSC have two revenue limits:

- departmental expenditure limits (DEL) – this is expenditure that is considered to be under management's control. The vast majority of the NHS's revenue spend is DEL. This is the target that both organisations' performance is judged against and in the past few years it has been met by very narrow margins
- annually managed expenditure (AME) – this is expenditure that is outside of management's control, for example – impairments which are the result of changes in market values and the establishment of provisions. The AME limit is more generous and performance against this limit is less of a concern.

Accruals hit RDEL when they are established. However, provisions do not hit RDEL until the cash is paid and the liability is discharged. The establishment of a provision hits AME.

Eventually, all provisions and accruals will be a charge to DEL and the difference between the two is a matter of timing. The financial position of the DHSC group means that auditors take an interest in the classification of accruals and provisions.

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[7] DHSC, *Group accounting manual 2019/20*, December 2019
[8] NHS Improvement, *Foundation trust annual reporting manual 2019/20*, January 2020

As the DEL impact occurs when the provision is paid out, NHS England and DHSC use the expected timing of cashflows information to manage their future financial position. This part of the note to the accounts therefore needs to be as accurate as possible.

In 2019/20, NHS bodies should consider whether provisions are required in relation to:

- the various employment tribunals looking at the calculation of holiday pay, in particular, the treatment of overtime payments[9]
- final pay control payments in relation to increases in salary in the three years before a staff member retires[10].

Fraud

The DHSC has a material risk in relation to fraud. The NAO is therefore asking auditors to consider the completeness of losses and special payments disclosures by NHS bodies. In particular, auditors will consider whether the disclosure has been reconciled to the local counter fraud report. The two will not be the same as there are timing differences in the issues reported but these will form the reconciling items.

Apprenticeship levy

NHS bodies should not be recognising a payment in advance in relation to their apprenticeship levy because the GAM (paragraphs 4.100 to 4.103) mandates that the levy should be accounted for as a tax. If any payments in advance are recognised, they should be reviewed now that the first two year period has ended meaning that some money in the digital account cannot be accessed.

2019/20 annual reports

In relation to the annual report, foundation trusts continue to follow the *Foundation trust annual reporting manual* (FT ARM). All other NHS bodies comply with chapter 3 of the GAM.

There are some minor changes to the detail for all NHS bodies – it is important that the teams that are preparing the annual report are given the appropriate guidance.

Annual governance statement

NHS bodies are reminded that they need to include a conclusion which lists significant internal control issues or states that there are none. Control issues are not the same as listing the risks that the NHS body is facing.

Staff and remuneration report

The deadline for submitting requests for senior managers' pensions information is 28 February 2020.

Changes to the NHS Business Services Authority guidance include:

- a reference to GDPR
- a change to the method used to calculate CETVs to remove the adjustment for guaranteed minimum pension
- a change in the inflation rate to 2.4% (3.0% last year)

It should be noted that the December pensions newsletter states:

> 'We published the timescales for Greenbury requests in our Pensions Update of November 2019. We asked that all requests for disclosure information, which includes pay figures up to 31 March 2020, are received between 7 January 2020 and 28 February 2020.

[9] HFMA, *Holiday pay and overtime – accounting and governance issues*, February 2020
[10] HFMA, *Final pay controls – accounting and governance issues*, November 2019

We appreciate that in the majority of cases the pay figures provided will be estimated and during last year's exercise we were asked to recalculate a number of cases after an individual's pay up to 31 March 2019 had been finalised.

Due to the limited timescale we have to complete the exercise which must correspond with the group financial reporting timetable for 2019/20, we will not be able provide revised calculations once final pay figures are known.'

Appendix 1: examples of standards not yet effective disclosures

IAS 8 requires that the impact of accounting standards that have been issued but that are not yet effective is disclosed.

Paragraphs 30 and 31 of IAS 8 state:

31 When an entity has not applied a new IFRS that has been issued but is not yet effective, the entity shall disclose:

a) this fact; and

b) known or reasonably estimable information relevant to assessing the possible impact that application of the new IFRS will have on the entity's financial statements in the period of initial application.'

32 In complying with paragraph 30, an entity considers disclosing:

a) the title of the new IFRS;

b) the nature of the impending change or changes in accounting policy;

c) the date by which application of the IFRS is required;

d) the date as at which it plans to apply the IFRS initially; and

e) either:

  i) a discussion of the impact that initial application of the IFRS is expected to have on the entity's financial statements; or

  ii) if that impact is not known or reasonably estimable, a statement to that effect.

Usually, this disclosure is relatively limited either because it is expected that the standard will not have a material impact on the accounts when it is adopted or because there has not been sufficient work done to make an assessment of its expected impact.

For IFRS 16, this is not the case. By the time that the 2019/20 accounts are prepared, NHS bodies will have already made two submissions to NHS England/ NHS improvement so this information will be a starting point to make the appropriate disclosure.

IAS 8 requires the following disclosures:

- the name of the standard
- the date that it is effective
- a summary of what it means in practice
- a summary of the impact of the standard

1.36 Changes to accounting standards not yet effective

IFRS 16 *Leases*

IFRS 16 *Leases* supersedes IAS 17 *Leases* and is effective for periods beginning on or after 1 January 2019. IFRS 16 provides a single lessee accounting model and requires a lessee to recognise assets and liabilities for leases which last over 12 months, largely eliminating the current 'off-balance sheet' treatment of operating leases under IAS 17.

Impact of the new standard

The Group has assessed the impact that the application of IFRS 16 will have on the comprehensive net expenditure for the financial year ending 31 March 2020 and on the statement of financial position at that date. The figures below are for existing leases as at 31 March 2019.

The standard is expected to increase total expenditure in 2019-20 by approximately £20million. The right of use asset is expected to be increased by approximately £1,461million, whilst the associated lease liability will increase by approximately £1,463million.

SoCNE impacts IFRS 16	**£m**
Depreciation expected – 2019-20	89
Interest expense expected – 2019-20	16
IAS 17 basis Rental payments expected – 2019-20	(85)
Increased Expenditure	**20**

SoFP impacts IFRS 16	**£m**
Existing IAS 17 Operating Leases – Right to Use Asset – 1 April 2019	740
Increased/ (decreased) Right to Use Asset - 1 April 2019	721
Increased Right to Use Asset	**1,461**
Existing IAS 17 Operating Leases – Lease Liability – 1 April 2019	(757)
Re-measured Finance Leases Increased Lease Liability - 1 April 2019	(706)
Increased Lease Liability	**(1,463)**

The above figures are calculated before intercompany eliminations are made, these will not have a material impact on the figures.

The above figures also exclude leased assets held under peppercorn leases which are required to be fair valued as at 1 April 2019. The majority of the groups peppercorn leased assets are already included at fair value within our 2018-19 accounts and therefore the impact of recognising the fair value of peppercorn leased assets are not expected to be material.

1.27 Adoption of new and revised standards

2018-19

The following standards have been adopted by the 2018-19 FReM:

IFRS 9 *Financial Instruments* replaces IAS 39. This has resulted in changes in some accounting terminology, with no material impact on balances and transactions. The detailed accounting policies are disclosed in **Note 1.10-1.17**.

IFRS 15 *Revenue from Contracts with Customers* replaces IAS 11 and IAS 18. It has been implemented by the cumulative catch-up method, meaning that the comparative figures for 2017-18 have not been re-stated. The detailed accounting policies are disclosed in **Note 1.23** and **Note 1.24**.

2019-20

IFRS 16 *Leases* provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less, or the underlying asset meets the IFRS 16 criteria to be classified as of "low value". The IFRS is effective in the private sector for accounting periods commencing on or after 1 January 2019. The Group will adopt IFRS 16 in the financial year commencing 1 April 2019, although most government bodies will adopt it during the following year.

IFRS 16 gives a narrower definition of a lease than IAS 17 *(Leases)* and IFRIC 4 *(Determining Whether an Arrangement Contains a Lease)*, by requiring that assets and liabilities will be recognised initially at the discounted value of the minimum lease payments, and that the assets, to be described as "right of use" assets, will be presented under Property, Plant and Equipment. The Group expects that its existing finance leases will continue to be classified as leases. All existing operating leases will fall within the scope of IFRS 16 under the 'grandfathering' rules mandated in the FReM for the initial transition to IFRS 16. Therefore, implementation of IFRS 16 will increase the value of property, plant and equipment assets and the value of lease liabilities.

After initial recognition, right-of-use assets will be amortised on a straight-line basis and interest will be recognised on the liabilities. Except where modified for revaluation where material, the cost model will be applied to assets for leases other than leases with a peppercorn rental, which will be measured on a depreciated replacement cost basis. As a result, the timing of the recognition of the total costs of leasing will change, as interest costs will be higher at the start of a lease.

HM Treasury propose that IFRS 16 will be implemented using the cumulative catch-up method; as a result, comparatives will not be restated and the measurement of the asset and liability balances recognised with effect from 1 April 2019 will reflect the Group's intentions as at that date. HM Treasury also propose to issue a central internal rate of borrowing for entities to apply, when they cannot obtain the rate implicit in the lease contract.

As IFRS 16 will be implemented using the cumulative catch-up method, comparatives for 2018-19 will not be re-stated, and the adjustment to net assets will be made with effect from 1 April 2019. For the material arrangements within the scope of IFRS 16, the impact of implementation is currently considered to be an increase in assets and liabilities of approximately £1 billion.

The right-of-use assets and leasing obligations have been calculated according to the policy described above.

This assessment indicates that the total discounted value of right-of-use assets and lease liabilities under IFRS 16 is higher than the value of minimum lease commitments under IAS 17, since a number of the leases have tenant break-clauses which the Group does not expect to trigger.

Subsequent years

IFRS 17 *Insurance Contracts* requires a discounted cash flow approach to accounting for insurance contracts. Subject to EU adoption, it may come into effect for accounting periods commencing on, or after, 1 January 2021 and should be included in the 2021-22 FReM at the earliest. The Group considers that it has no contracts which meet the definition of insurance contracts and intends to treat its financial guarantee contracts as financial instruments rather than insurance contracts.

The Group does not consider that any other new, or revised standard, or interpretation will have a material impact.

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.

HFMA
1 Temple Way, Bristol BS2 0BU

T 0117 929 4789

F 0117 929 4844

E info@hfma.org.uk

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HFMA is also a limited company registered in England and Wales, no 5787972. Registered office: 110 Rochester Row, Victoria, London SW1P 1JP

www.hfma.org.uk