HFMA briefing
July 2017

Accounting for joint working arrangements

Background

NHS bodies are seeking new and innovative ways of working with other organisations for a variety of reasons and in a variety of ways.

Accounting for these working arrangements is sometimes straightforward but can also be complicated. This briefing sets out the questions that the finance team should be asking as the new arrangement is being developed to be able to fully understand the financial implications of the decisions taken.

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New working arrangements

There are many different ways that NHS bodies can enter into joint working arrangements. Some are straightforward - for example the establishment of a wholly owned subsidiary. Others are more complex such as the new vanguard arrangements.

What is clear is that NHS bodies cannot continue to operate in silos but must work, to a greater or lesser extent, together with other NHS bodies as well as organisations outside of the NHS such as local authorities, private sector and third sector providers.

From a financial accounting perspective, any new working arrangements need to be reviewed to determine whether they will result in changes to accounting practices and policies. It may be that nothing changes but it could be that everything changes and experience tells us that it is always best to consider the accounting arrangements as part of the planning process rather than once the deal is done.

Accounting, or a particular financial outcome, should not be the driving force behind any of these new ways of working – the focus must be on achieving the best possible outcome for patients. If the accounting is considered as part of the planning process then the financial outcomes of the proposal(s) will be understood from the start.

The arrangements into which NHS bodies are entering are developing locally so it is unlikely that any one accounting arrangement will fit all of the new circumstances. Therefore, this briefing sets out the questions that should be asked as new working arrangements are being developed.

Accounting arrangements

Control

One of the key considerations during the planning process is who has control over the services being delivered and how they are delivered.

In accounting terms, control has a very particular meaning which is discussed below (appendix 1 lists the various accounting terms which relate to working together and their definitions according to accounting standards). In the public sector, the Office of National Statistics (ONS) also uses an assessment of control to determine whether any new entity is a public sector body and, if so, which part of the public sector it belongs to. From an organisational perspective, NHS bodies will only be concerned with their own accounts and applying the accounting standards but the ONS assessment may impact on the consolidated Department of Health group accounts and other information you may be asked to provide for consolidation purposes.

An assessment of control may also help to identify governance issues as it involves consideration of the decision-making process and where statutory and other responsibilities lie.

Control in accounting terms

In accounting terms, the key consideration when determining formal relationships between bodies is control. This is the basis for determining the accounting treatment set out in the following accounting standards:

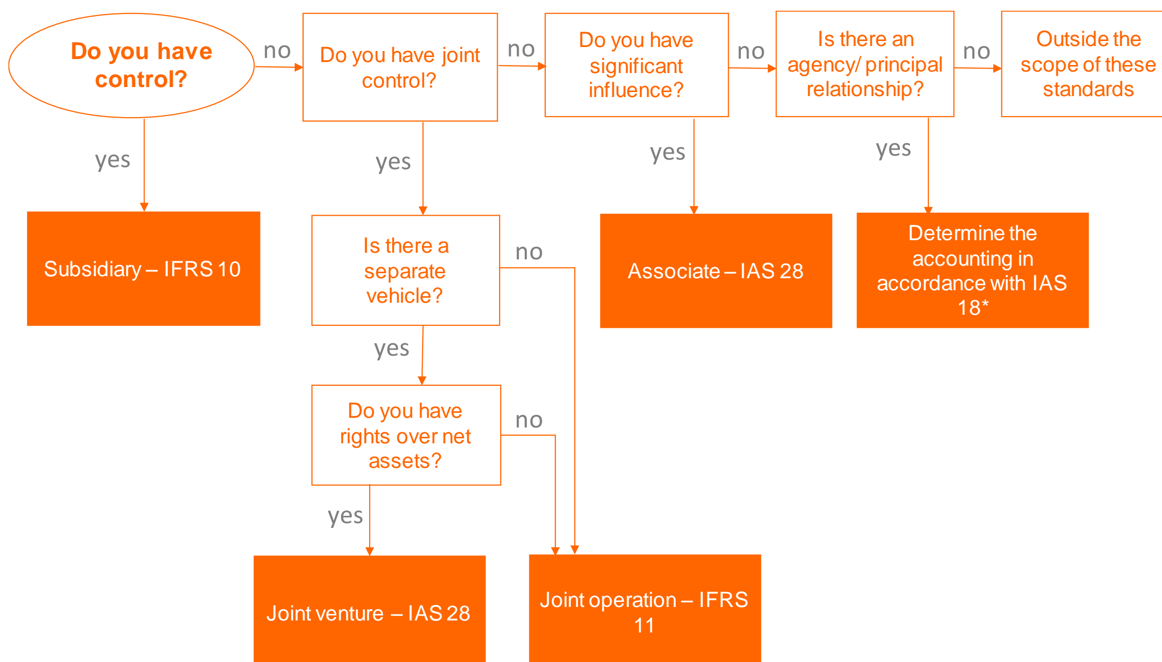
- IAS 28 *Investments in associates and joint arrangements*
- IFRS 10 *Consolidated financial statements*
- IFRS 11 *Joint arrangements*
- IFRS 12 *Disclosure of involvement with other entities.*

The links between these accounting standards is shown diagrammatically below.

The critical question is whether or not there is control. In accordance with IFRS 10[1], there will be control if one body (the investor) has all of the following:

[1] This briefing should not be read instead of the appropriate accounting standards and the application guidance that is published with them. The standards and relevant application guidance are not replicated in this briefing. Appended to this briefing is a list of terms defined in the accounting standards.

1. Power over the other body (the investee) – power arises from rights, in particular, the rights to direct the investee's activities. The rights may come from voting rights or from contracts and they do not have to have been exercised to exist
2. Exposure or rights, to variable returns from its involvement with the investee (returns may be positive, negative or both)
3. The ability to use its power over the investee to affect the amount of its returns.



* Note: IAS 18 will be replaced by IFRS 15. This is expected to be in 2018/19

Where an entity has the majority of voting rights stemming from an equity investment then it is clear that control exists and consolidation is required. However, the accounting standards still apply when control is less easy to assess. In that case, the decision as to whether control exists is based on the contracts and other legal arrangements put in place to establish the arrangement.

This is likely to be the case in the public sector where working together will not always involve a cash investment in another entity or the purchase of shares. Whilst no contract or arrangement should be established to result in a specific accounting treatment - the arrangement should always be for the best operational reasons, it is important to consider control as the arrangement is being put together.

The following questions[2] should be considered when determining whether control exists:

- What are the arrangements in place:
  - Is a separate entity (public or private sector) being established?
  - Is a wholly owned subsidiary being established?
  - Are there shares in the new organisation? If so, who holds those shares?
  - Is there an agreement based in statute- for example a s75 agreement; does a contract exist or is there a mixture of the two:
    a) Which arrangement takes precedence?
    b) Which arrangement sets out who can make decisions?

[2] This list is not exhaustive and will need to be tailored to the particular circumstances of the arrangement in place.

- What are the governance arrangements in place – is there a joint committee/ board that has overall responsibility for the arrangement? If so:
  - Who are the members of that committee/ board?
  - What is the basis for their selection? Is it because they hold a particular role in one of the organisations working together or is it a personal appointment?
  - Who can appoint members to the committee/ board?
  - What is the decision-making arrangement for the committee? Does there have to be a unanimous vote, a majority vote or can one party make a decision?
- Who can make decisions:
  - Does it have to be a committee?
  - Has it been delegated to a lead body?
  - Are there limits to the decision-making powers?
  - Where does the final responsibility rest? Is it with the board of each organisation? One organisation?
- What are the activities covered by the new arrangement?
  - Are they clearly defined?
  - Can they be altered by any of the parties involved or does it need unanimous agreement? If they can be altered at what point can this take place?
  - Are they separable from the rest of the body's activities?
  - Are these the sole activities of any of the bodies involved?
- What are the resources involved in supporting the activities covered by the arrangement?
  - Are staff involved?
  - If so, are those staff solely working on activities covered by the arrangement?
  - Who are they employed by?
  - Who can appoint staff? Which parties have the right to veto any appointment?
  - Who sets the terms and conditions of employment?
  - Who are they managed by?
  - Who can direct their activities? Could one of the parties direct the staff involved to work on other activities not covered by this arrangement?
  - Can those staff be made redundant? If so, which organisation is liable for any costs incurred? Who would have to agree to the redundancy programme?
  - If staff are sick or otherwise unavailable which organisation is liable for their sick pay and organising, and paying for, cover?
  - Are there non-current assets involved?
  - Who owns those assets?
  - Who can make decisions about those assets? Could they be disposed of or their use changed without consultation with other parties to the agreement?
  - Which body is responsible for discharging liabilities?
- What are the key decisions that can affect the success or failure of the new arrangements?
  - Which of the parties to the arrangement has the right to make those decisions?
- Under what circumstances can the agreement be terminated?
  - Which bodies can decide to terminate the agreement?
  - Which body/ bodies would be liable for any costs incurred as a result of the end of the agreement - for example, redundancy costs, non-current assets, lease liabilities? Overspends?

- Can any of the partners pull out of the arrangement without terminating it completely?
- What are the financial risks? Have they all been identified and agreed by all parties?
  - Is there a risk sharing agreement in place?
  - What basis are risks allocated to each partner organisation?
- What are the financial rewards arising from the new arrangement?
  - If there is a surplus/ profit which partner organisations benefit from that?
  - Is there a gain/ loss share arrangement in place? If so, where do the risks lie?
- Are any of the parties to the agreement related parties[3]?
  - If so, does that affect the decision-making process and the assessment of control?
  - When considering the rights of the parties, are the rights substantive? In other words, are there any barriers to the parties exercising those rights?

It is likely that the some of the answers to these questions will indicate control exists and others that it will not. A judgement will need to be taken to decide whether control does exist taking all of the issues identified into account The balance of yes/ no answers should be considered but the relative importance of some of the questions and likelihood of some of the outcomes in each particular case should also be taken into account. Making this judgement can be helped by working through particular scenarios - for example, the termination of the agreement or a substantive change in the services provided. Specific, realistic scenarios can highlight which are the most important factors in determining where the control lies.

Ideally, this process will be undertaken by all parties to the agreement together but, as a minimum, it is vital that all parties agree on the conclusions reached and the accounting treatment to be adopted. As always, it is also important that these arrangements should be discussed at an early stage with the external auditors of all of the parties involved to ensure that they are all in agreement with the conclusions reached and the proposed accounting treatment.

If one party has sole control over another then it should be consolidated under IFRS 10 – appendix 2 to this briefing sets out the steps which should be taken when consolidating a subsidiary body. If there is joint control then IFRS 11 should be consulted to assess whether there is a joint operation or a joint venture in place (see appendix 3).

Departmental control

The formation of new entities may need to be raised with NHS England and NHS Improvement to determine whether they will need to complete the HM Treasury designation questionnaire as part of the classification process. This is a separate process that determines which entities are within the Department of Health's accounting boundary. This is through classifications by the ONS according to criteria set out in the European System of Accounts – ESA10[4].

The process looks at whether there is de facto government control of the entity, on a similar but slightly different basis to the accounting standards - with the main factors being:

- appointment of offices
- whether there is determination by government of functions, objectives and operating provisions
- contractual arrangements
- degree of public financing and risk exposure.

[3] IAS 24 *Related party disclosures* defines a related party. In summary, related parties have a relationship which might mean that transactions between them would not be on an arm's length, commercial basis.

[4] http://ec.europa.eu/eurostat/web/products-manuals-and-guidelines/-/KS-02-13-269

This will determine not only if the new entity is to be consolidated as part of the group but also whether its capital and revenue spending will score against the Department of Health's budgetary control totals.

It is possible for the accounting and the ONS conclusion in relation to control to be different. For example, if there is a three-way joint venture between NHS bodies with equal influence, each organisation in accounting terms does not have a controlling interest and the joint venture would not be consolidated into any of the individual NHS bodies' accounts. But at Department of Health group level the joint venture would need to be fully consolidated as a group entity. If it is separately included on the listing of public sector bodies, its expenditure would score to Parliamentary capital and revenue budgets and it would be needed to be treated like other NHS bodies for year-end accounts and agreement of balances purposes.

Where the conclusion in accounting terms is that an entity is controlled by an NHS body it is unlikely that the ONS conclusion would be different so the new entity would be consolidated through the NHS body into the Department of Health accounts.

It is where the decision is that there is no control that the issue should be discussed with NHS Improvement or NHS England. This is particularly the case where the other parties involved are NHS bodies or where the decision was a fine judgement call.

Principal or agent

If there is no control, then it is likely that the arrangements between bodies will be based on contracts although they may be underpinned by statutory agreements.

One key consideration when determining accounting treatment is identifying whether parties are acting as principals or on an agency basis.

This is important because when bodies are acting as principals then all of the transactions relating to the arrangement go through their accounts. A body acting as an agent will simply pass payments through their accounts and will not recognise any income and expenditure in its accounts.

Paragraph 21 of the illustrative examples to IAS 18 *Revenue* provide the following guidance on whether an entity is acting as a principal or as an agent:

> 'Determining whether an entity is acting as a principal or as an agent requires judgement and consideration of all relevant facts and circumstances.
>
> An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that indicate that an entity is acting as a principal include:
>
> a) the entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer
> b) the entity has inventory risk before or after the customer order, during shipping or on return
> c) the entity has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services and
> d) the entity bears the customer's credit risk for the amount receivable from the customer.
>
> An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. One feature indicating that an entity is acting as an agent is that the amount the entity

earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer.'

The key question here is to determine which bodies are exposed to which risks and who is set to gain from any rewards associated with the arrangement. In terms of arrangements between NHS bodies this assessment will usually focus on the risk share arrangements in place. The key question is often, where a contract is let by one party on behalf of another party who bears any overspends? However, there are other risks which need to be considered, such as operational risks: if the service is not up to standard who bears the reputational risk and who is responsible for putting things right?

A useful practical way to determine where the risks and rewards lie is to consider what will happen if/ when the arrangement is terminated.

Other, non-accounting considerations

Legal powers

NHS bodies are creatures of statute. This means that they can only enter into arrangements where they have the legal power to do so.

All NHS bodies have a duty to co-operate with each other in exercising their functions under section 72(1) of the *National Health Service Act 2006* (the 2006 Act).

NHS trusts and NHS foundation trusts have similar general powers which allow them to:

- acquire and dispose of property
- enter into contracts
- accept gifts of property
- employ staff.

NHS foundation trusts have powers to invest in companies under section 56 of the 2006 Act[5]. NHS trusts do not have equivalent powers. However, under paragraph 18 of Schedule 4 of the 2006 Act, NHS trusts can enter into arrangements with other bodies or individuals to jointly carry out any of their functions.

It is important to be sure that the appropriate power exists to enter into joint working arrangements. Where necessary legal advice should be sought.

Governance for the organisation and the wider healthcare economy

Entering into a new working arrangement does not necessarily result in the delegation of statutory responsibilities. The board and the audit committee of each organisation involved should have oversight of any new arrangement as it is established. They will also need to take responsibility for on-going oversight of the arrangement to ensure that they are continuing to fulfil their statutory duties.

However, the boards and audit committees should also consider the new arrangement in the round. One of the findings in the National Audit office's (NAO) report[6] in the collapse of the UnitingCare Partnership was that there was no overall, holistic oversight of the new arrangement. Each party, including the regulators, considered their own part of the arrangement but no-one took a holistic view of the impact on the wider health economy.

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[5] NHS Improvement have issued guidance on structuring foundation groups which covers some of the powers NHS provider bodies have to enter into joint working arrangements. See https://improvement.nhs.uk/uploads/documents/Foundation_groups_guidance.pdf

[6] The NAO's report can be found here www.nao.org.uk/report/investigation-into-the-collapse-of-the-unitingcare-partnership-contract-in-cambridgeshire-and-peterborough/. Also of interest is the public accounts committee's report on the same contract www.publications.parliament.uk/pa/cm201617/cmselect/cmpubacc/633/633.pdf

In any new arrangement, it should be clear as to what the responsibilities are of each party and individual involved. It should be clear what the decision-making process is and who has the authority to make decisions. This will require a review of standing orders, standing financial instructions/ prime financial policies and schemes of delegation.

Consideration should also be given to whether senior managers for the new arrangement are also senior managers for any of the NHS bodies involved. If so, their remuneration and terms and conditions will be covered in the remuneration report of the NHS body as well as any new entity. As senior managers of an NHS body, they will need to make declarations of interest including their role in the new arrangement.

Any conflicts of interest should be identified and declared at an early stage. Where conflicts are identified, action should be taken to mitigate any risks arising[7].

Legal charges

In some cases, it may be that non-current assets are sold or transferred to another body to be used as part of the new arrangement. Where this is the case, the sale or transfer document may contain a legal charge that states if the asset is no longer needed then the original seller should have first refusal on buying it back or that the asset would be transferred back. The wording of the legal charge may mean that the NHS body transferrin the asset has a service concession under IFRIC 12[8].

VAT

The potential VAT liability of the transactions will need to be assessed based on the operational and contractual arrangements. The organisations involved should not artificially arrange the contractual and operational management procedures in such a way to minimise any VAT liability or maximise VAT recovery.

All NHS bodies in England, except Moorfields Eye Hospital, are part of the same divisional VAT registration. This means that they do not charge VAT on transactions between each other.

If the new arrangement results in the creation of a new non-NHS body, then the VAT arrangements will be different as the new organisation will be outside of the NHS divisional registration. This will also be the case if the arrangement involved GPs who are independent contractors. It was the VAT arrangements and resulting VAT liability that was one of the causes of the collapse of the UnitingCare Partnership contract[9].

Where a new entity is created, then a new VAT registration is likely to be required[10]. Until confirmation is received from HM Revenue and Customs (HMRC) to the contrary, it should be assumed that the new entity is subject to commercial VAT rules rather than the specific arrangements set out in the VAT Act 1994 for NHS bodies (section 41 of the Act) or local authorities (section 33 of the Act).

It should not be assumed that VAT which is recoverable by an NHS body under the contracted-out services rules will automatically be recoverable by a new non-NHS body.

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[7] The HFMA has issued a briefing on conflicts of interest aimed at CCGs, It is equally applicable to other NHS bodies. www.hfma.org.uk/publications/details/conflicts-of-interest

[8] The guidance on the now defunct FinMan website remains extant on this issue www.info.doh.gov.uk/doh/finman.nsf/4db79df91d978b6c00256728004f9d6b/44ca3e860916466b8025761e004a2176?OpenDocument

[9] www.england.nhs.uk/mids-east/wp-content/uploads/sites/7/2016/04/uniting-care-mar16.pdf and www.nao.org.uk/wp-content/uploads/2016/07/The-collapse-of-the-UnitingCare-Partnership-contract-in-Cambridgeshire-and-Peterborough-Summary.pdf

[10] Registration will be required when the business' VAT taxable turnover is more than the threshold (currently, April 2017, this threshold is £85,000). See www.gov.uk/vat-registration

Clearly, if the new non-NHS body is not registered for VAT then it will not be able to recover any VAT.

If an organisation is acting as an agent in a transaction, then the VAT rules which apply will be those of the principal.

Commercial considerations

Any entity set up on a commercial basis – a subsidiary company, joint venture or partnership, may be subject to corporation tax or may be taxed as a partnership. This will mean that the necessary tax returns will have to be submitted to their timescale. In order to make the necessary returns, the subsidiaries accounts will have to be completed in accordance to that timescale. If the subsidiary is to be consolidated then the timescale may need to be brought forward to enable the NHS body to reflect the full liability in the consolidated accounts. Clearly, corporation tax is an additional cost to be managed.

It may also have to be registered with Companies House and, if so, will have to submit the necessary returns. The timescale for submission of these returns will be different to NHS submission timetables.

Commercial entities may not necessarily have a 31 March year-end. This should be considered when setting up the new entity as clearly it is more straightforward if all financial year ends are aligned.

Consideration should be given to whether separate commercial software may be required to produce corporation tax and Companies House returns. As discussed in Appendix 2, one practical consideration is the ledger to be used for the non-NHS body and how that will be structured to make consolidation easier.

Finally, commercial organisations will be subject to going concern considerations in full. Unlike, NHS bodies where the focus is on service delivery, commercial bodies can, and do, go out of business. Therefore, a full going concern assessment has to be undertaken each year and the accounting treatment adjusted as necessary.

Pension arrangements

Where staff are transferred from local authorities to NHS bodies they may remain on their local authority terms and conditions including membership of their local authority superannuation scheme. This would result in the NHS body becoming an admitted body to the local authority scheme.

Local authority superannuation schemes are defined benefit schemes where the assets and liabilities can be identified. This means that the scheme needs to be accounted for as a defined benefit scheme under IAS 19 *Employee benefits*. In practical terms, this is more complicated than the accounting for the NHS pension scheme and requires access to actuarial reports in time for the preparation of the annual report and accounts.

Depending on how the staff transfer is worded it may also result in pension scheme liabilities for the NHS body which are usually large and unpredictable. This could have an effect on the financial position of the NHS body year on year.

Agreement of balances

All NHS bodies must take part in the agreement of balances process. Where a new arrangement is hosted by an NHS body then it must be clear with which body balances and transactions resulting from the arrangement should be agreed.

Where the new body is not an NHS body then it may be that the transactions and balances fall outside of the agreement of balances process. However, where there is an agency arrangement it may be that the agreement must be with a different party to the one which makes the cash payment.

Reliance on third parties

Joint working arrangements, by their very nature, involve more than one entity. Some arrangements may mean that one entity acts as a host or lead body. This is particularly the case for bodies where there is an agency/ principal arrangement or for joint arrangements under IFRS 11.

At an early stage, all parties to the arrangement will need to determine what information they will need from the other parties and what assurances they will need in relation to that information. They should also discuss with their external auditors the assurances that will be required in order to sign off the year-end accounts.

Feedback from clinical commissioning groups (CCGs) in relation to better care fund arrangements[11] indicates that difficulty in obtaining the necessary third-party assurances, including service auditor reports from other organisations, causes severe difficulties at the year-end when accounts are being prepared and audited. Practical steps to mitigate these risks include:

- early engagement with all parties at senior management level
- joint review of accounting policies and accounting treatment
- agreement of exactly what information is required
- early agreement of deadlines.

[11] www.hfma.org.uk/publications/details/pooled-budgets-and-the-integration-agenda

Appendix 1: Accounting terms

Agent	An entity is an agent if the entity's performance obligation is to arrange for the provision of goods or services by another party.	IFRS 15 (para B36)
Associate	An associate is an entity over which the investor has significant influence.	IAS 28
Consolidated financial statements	The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.	IAS 28
Control of an investee	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.	IFRS 10
Decision maker	An entity with decision-making rights that is either a principal or an agent for other parties.	IFRS 10
Equity method	The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.	IAS 28
Group	A parent and its subsidiaries.	IFRS 10
Investment entity	An entity that: a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both c) measures and evaluates the performance of substantially all of its investments on a fair value basis.	IFRS 10
Interest in another entity	For IFRS 12 purposes, an interest in another entity refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship.	IFRS 12
Joint arrangement	An arrangement of which two or more parties have joint control.	IAS 28

Joint control	The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.	IAS 28
Joint operation	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement	IFRS 11
Joint operator	A party to a joint operation that has joint control of that joint operation.	IFRS 11
Joint venture	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.	IAS 28
Joint venturer	A party to a joint venture that has joint control of that joint venture.	IAS 28
Non-controlling interest	Equity in a subsidiary not attributable, directly or indirectly, to a parent.	IFRS 10
Parent	An entity that controls one or more entities.	IFRS 10
Party to a joint arrangement	An entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.	IFRS 10
Power	Existing rights that give the current ability to direct the relevant activities.	IFRS 10
Principal	An entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer. However, an entity is not necessarily acting as a principal if the entity obtains legal title of a product only momentarily before legal title is transferred to a customer. An entity that is a principal in a contract may satisfy a performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf.	IFRS 15 (para B35)
Protective rights	Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.	IFRS 10
Relevant activities	For the purpose of this IFRS, relevant activities are activities of the investee that significantly affect the investee's returns.	IFRS 10
Removal rights	Rights to deprive the decision maker of its decision-making authority.	IFRS 10
Separate financial statements	Separate financial statements are those presented in addition to consolidated financial statements or in addition to the financial statements of an investor that does not have investments in subsidiaries but has investments in associates or joint ventures in which the investments in associates or joint ventures are required by IAS 28 to be accounted for using the equity method, other than in the circumstances set out in paragraphs 8–8A.	IAS 27

Separate vehicle	A separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.	IFRS 11
Significant influence	The power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.	IAS 28
Structured entity	An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. Paragraphs B22–B24 provide further information about structured entities.	IFRS 12
Subsidiary	An entity that is controlled by another entity.	IFRS 10

Appendix 2: practical considerations for consolidation

IFRS 10 is the accounting standard which deals with the consolidation of subsidiary bodies. This appendix does not repeat the content of that accounting standard, it simply sets out some of the issues which need to be considered and a high-level step by step process for consolidation.

Practical considerations

Materiality

Where the IFRS 10 tests are met, the standard requires that the subsidiary is consolidated. However, accounts need to be materially correct rather than absolutely correct. Where subsidiaries are relatively small, it may be that their consolidation into the NHS body's accounts would not have a material effect and a decision can be made not to undertake the consolidation.

Materiality is assessed annually and will vary depending on the NHS body's financial position as well as that of any subsidiaries. It is a judgement which will need to be reassessed annually.

The judgement and decision not to consolidate should be discussed by each NHS body with their auditor.

Even where it is agreed that the subsidiary is immaterial and will therefore not be consolidated, auditors may report this in their ISA(UK&I)260 report to the audit committee. It is important, therefore, to agree at an early stage that the audit committee is happy to accept this outcome.

Timing

All NHS bodies have a 31 March year end. However, companies can select their year-end based often on their date of incorporation. Also, companies do not have to work to the submission deadlines that NHS bodies are required to meet.

Each NHS body and their auditor will have to determine whether it is necessary for the audit of any subsidiary body's accounts to be completed and signed off before the parent body's accounts are signed or whether they can accept an auditable trial balance which they will audit to a level of materiality acceptable for the consolidated accounts. NHS organisations should discuss auditor's requirements with them at an early stage. Whatever is required, it is likely that at least some of the preparation and audit of the subsidiaries accounts will need to be brought forward to meet the earlier NHS organisation's deadline.

There may be things which can be done to reduce the burden on accountants and auditors between March and June for example:

- parts of the subsidiaries' annual report and accounts can be prepared before the year end and then simply updated to reflect the final year end position
- the template for the subsidiaries' accounts can be prepared in advance and the narrative parts of many notes completed before the year end
- auditors may prepare a list of the documents or working papers that they need to see ahead of the year end
- auditors may undertake an audit at month 9, 10 or 11 and then roll forward their work to the year end.

Different auditors

Where the subsidiary and the NHS body have appointed different auditors, the auditor of the NHS body will issue group instructions to the auditor of the subsidiary. These group instructions will set out:

- a programme of work that the NHS body's auditors (the group auditor) requires the subsidiary's auditors to complete
- the deadline for the completion of that work and
- the assurances required from the subsidiary's auditors.

Undertaking the consolidation

Align accounting policies

It is likely that the subsidiary company will prepare its accounts in accordance with UK Generally Accepted Accounting Practice (UK GAAP) requirements whereas NHS bodies prepare their accounts under IFRS. The first stage in the consolidation is therefore to ensure that the accounting policies of the subsidiary are aligned with those of the NHS body.

With the development of new UK GAAP, the differences between IFRS and UK GAAP are few. However, whilst all NHS bodies have common accounting policies, there is no requirement for companies to have common policies as the UK GAAP allows for a choice in policy. Therefore, this assessment needs to be undertaken based on the accounting policies adopted by each subsidiary. For example, FRS 102 allows for non-current fixed assets to be held at cost or revaluation. Where the subsidiary holds fixed assets at cost there will be a difference of accounting treatment with the NHS body.

Once all differences in accounting policy have been identified then the subsidiary body's accounts need to be restated to reflect the revisions.

Remove intra-group transactions

The second stage in the consolidation process is to remove any transactions between the NHS body and its subsidiary. These will be income and expenditure items and associated cash flows as well as year end balances between the two bodies.

The experience of NHS bodies who currently consolidate subsidiaries is that this is a huge piece of work. It should be considered before the subsidiaries are set up. It may be that a separate chart of accounts is maintained but this means that the consolidation has to take place outside of the ledger. Alternatively, a separate segment of the ledger for the subsidiary can be set up but this needs to be policed and regularly reviewed.

In either case, imbalances are likely to occur and must be managed on a timely basis so that the internal consolidation does not adversely affect the preparation of the NHS body's accounts in accordance with the Department of Health's timetable.

Disclosures required in the NHS body's accounts

As a parent entity, the NHS body's accounts must include disclosures for its own parent accounts alongside the group position. This will usually mean that a columnar approach to disclosure is required for each of the financial statements and notes.

IFRS 12 sets out all the necessary disclosure requirements.

Appendix 3: joint arrangements

IFRS 11 is the accounting standard which deals with the consolidation of joint arrangements where there is joint control. This appendix does not repeat the detailed content of that accounting standard, it simply sets out some of the issues which need to be considered.

What type of joint arrangement?

Under IFRS 11 there are two types of joint arrangement:

- a joint operation or
- a joint venture.

A joint arrangement not structured through a separate vehicle is a joint operation. In such cases, the contractual arrangement establishes the parties' rights to the assets and obligations for the liabilities (relating to the arrangement) and their rights to the corresponding revenues and obligations for the corresponding expenses (IFRS 11, para B16). Joint operations have to be accounted for in accordance with IFRS 11.

A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation. Whether a party is a joint operator or a joint venturer depends on the party's rights to the assets and obligations for the liabilities relating to the arrangement that are held in the separate vehicle (IFRS 11, paras B19 and B20). Joint ventures have to be accounted for using the equity method in accordance with IAS 28.

Equity accounting

In summary, under IAS 28, the initial investment in the joint venture or associate is recognised in a separate line on the statement of financial position of the investor at cost. Determining the cost may not be straightforward as the standard does not provide a definition – care should be taken where there is an existing relationship or where there are shares involved. The investment is then adjusted to reflect the investor's share of the profit or loss of the joint venture or associate. Dividends paid are deducted from the carrying amount of the investment. Other adjustments may be required to reflect changes to the investor's proportional interest in the associate or joint venture.

If the investor's share of losses equals or is greater than its investment then it does not recognise further losses unless there are legal or constructive losses arising from them. After the application of the equity method, IAS 39 should be applied to determine whether any additional impairment loss should be recognised in relation to the net investment.

The investor's share of profit or loss after tax is shown as a separate line in the statement of other comprehensive income (SOCI). The investor's share of other comprehensive income is shown in a separate line in the other comprehensive income part of the SOCI.

Practical issues when applying IAS 28

IAS 28 requires that the financial statements of joint ventures or associates used to apply the equity method are prepared to the same accounting period as the investor. If this is impracticable then there must be no more than three months between the end of the reporting periods. If the financial periods are different then adjustments need to be made to take account of significant transactions or events that occur between the two dates.

The practicalities of accounting for associates or joint ventures are eased when the entities involved adopt similar accounting policies and arrangements. Where all of the parties involved are public sector bodies this should be relatively straightforward as the HM Treasury *Financial reporting manual* (FReM) will be the overarching guidance for everyone

involved. Where any of the parties is outside of the public sector then this may be more complex.

Transactions between investors and joint ventures and associates are dealt with by the standard. Gains and losses on these transactions, whether ‘upstream’ or ‘downstream’ are only recognised to the extent of the other parties’ interests in the joint venture or associate. Care must be taken when assets are transferred into joint ventures as the accounting can be complex.