HFMA briefing
June 2022

How to review and scrutinise the annual accounts

Guidance for board/ audit committee members

The CPD Standards Office
CPD PROVIDER: 50137
2020-2022
www.cpdstandards.com
Accredited cpd Activity

Introduction

This briefing sets out a series of questions that non-executive directors (NEDs) could ask at board and audit committee meetings to assess how things are going and to identify any areas of potential concern.

Good governance involves NEDs appropriately challenging financial reports during the year[1] and at the year-end[2] – it is important that they feel able to ask questions and understand why they're asking them. Although the questions relate primarily to the annual accounts, they could also be used when reviewing the monthly or quarterly financial position.

The questions are grouped under six headings, namely:

- overall performance
- accounts preparation
- statement of comprehensive income/ statement of comprehensive net expenditure
- statement of changes in taxpayer's equity
- statement of financial position
- statement of cash flows.

It is not intended to be exhaustive in its coverage – instead, it focuses on key questions that may be helpful and relevant when discussing financial performance and the organisation's accounts.

[1] HFMA, *How to review and scrutinise the numbers during the year*, April 2022
[2] HFMA, *Year-end reminders for NEDs 2021/22*, March 2022

Overall performance

Question	Underlying reasoning
Has the organisation met its statutory duties? If the organisation has not met one or more of the targets, was this expected and do you know why this is the case?	NHS bodies are 'creatures of statute' with a number of duties set down in law that must be achieved. You should know what these are but if not, find out.
Has the organisation met the better practice payment code target?	Failure to meet this administrative duty indicates that there could be underlying cash flow issues. Performance against this target should tie up to the movement in balances on payables.
Are the accounting policies consistent with what you know the organisation does in practice?	Example accounting policies provided by NHS England and NHS Improvement must be tailored to reflect local circumstances
Do the accounts include disclosures relating to: • **judgements made when applying key accounting policies[3]** **areas where there is uncertainty about the estimates used[4]?**	Do these disclosures reflect your understanding? Have auditors raised these issues? Are there issues that auditors have raised which are not reflected in the accounts?
Can you see the impact of any savings schemes during the year? These schemes may include a reduction in headcount, income generation or changes to procurement. How are savings managed?	To check whether known changes have been reflected. Successful savings schemes should be reflected in the accounts – for example, reductions in headcount should result in reduced staff costs.
Are the financial assumptions consistent with the organisation's annual plan and previous financial information provided?	If in-year forecasting and reporting is accurate, there should not be any surprises at the year-end: the year-end accounts should reconcile to the in-year financial reports. If there are any inconsistencies, can they be explained?
Have there been any significant issues raised with the governing body/ board during the year (for example significant weaknesses in systems, or variances between planned and actual activity), that could cast doubts on the assumptions made?	If there is any potential missing information or doubts over assumptions, have these been explained?
Do the disclosures in relation to the external auditor reflect your understanding of the terms of their engagement?	The auditor's work under the *Code of audit practice* (the audit of the financial statements and value for money work) should be disclosed as audit remuneration. Any other work which does not relate to the audit should be disclosed as non-audit fees. Each NHS body should have a

[3] This is where a decision has been made about how to apply an accounting policy which significantly affects the amounts recognised in the accounts. As NHS bodies are required to follow standard accounting policies these are likely to be rare but possible examples include, deciding whether expenditure is capital or revenue in nature or making a judgement about where control lies in a joint working arrangement.

[4] This is where assumptions are made about the future or value of an asset or liability that may change in the following year. Where there is a change, the effect on the amounts recognised in the accounts will be material. For NHS bodies, these include valuation assumptions for property, plant and equipment and provisions relating to legal claims.

	policy on the amount of non-audit work an auditor can undertake – are the fees disclosed in accordance with this policy? The auditor may set a limit on their liability. This should be disclosed in the notes to the accounts. Does the amount reflect the amount that has been agreed in the letter of engagement?
Have the annual governance statement and head of internal audit opinion recorded any internal control issues?	A key part of the year-end process, the accountable/ accounting officer must review the system of internal control and whether the organisation has faced any significant control issues – for example, serious incidents. Do these disclosures reflect your understanding? Have any issues raised the previous year been resolved? Are milestones in place for outstanding issues?

Accounts preparation

Question	Underlying reasoning
Does the financial outturn in the accounts tie up to the management accounts?	All financial reports should be based on the financial ledger with very few adjustments. If the amounts reported in the management accounts (budget reports) differ from the amounts reported by the financial reporting team, there could be unexpected surprises at the year end.
What is the level of adjustments via manual journals?	The finance team uses journals to adjust the amounts in the ledger. This is normal financial management. However, NHS bodies that encounter financial difficulties may report large/ material journals that adjust the financial position and cannot be adequately explained on deeper investigation.
Is the governance relating to the use and approval of journal amendments appropriate[5]?	Journal entries should always be approved at a senior level. Are you satisfied with the governance arrangements surrounding manual journals?
Do you understand and agree with any judgements/ estimates that have a material impact on the financial statements?	There are always areas of judgment/ estimation when preparing the accounts. For example, in considering the level of provisions that should be established; the basis of valuation of non-current financial assets; write-off of receivables/ stock. These should be consistent with your understanding of the organisation and its wider policies/ strategies.
Have any unadjusted errors from the previous accounts been corrected as part of the preparation of the current accounts?	Auditors will report errors identified in the accounts to the finance team as they conclude their audit. Where the decision is made not to adjust the accounts to correct

[5] Grant Thornton, page 10 of *University Hospitals of Leicester NHS Trust audit findings report 2019/20*, March 2022

	those errors, they will be reported to the audit committee/ board in their ISA 260 report to those charged with governance. Those errors may be corrected during the following accounting period but, where they are not, they will continue to be reported. Where the level of errors is material, they will need to be corrected to avoid a qualified audit opinion.
Do the financial statements as a whole (and as part of the annual report and accounts) focus on the important issues and highlight the key financial issues for the NHS body?	Some disclosures in the financial statements are required by either the Department of Health and Social Care or accounting standards. However, there is an initiative within financial reporting to 'cut the clutter' which means taking out immaterial disclosures, zero rows and columns to help the reader of the accounts identify what is important. Taking a step back, think about whether the accounts, as a whole, reflect your understanding of the financial position of your organisation.
Are the figures in the accounts consistent with the figures/ narrative elsewhere in the annual report?	Where the annual report includes financial information, it should be the same as the information in the annual accounts. However, financial data can be analysed in many ways so there may not always be a direct link. Where the difference raises additional questions, a reconciliation should be provided. Where there are changes to the annual accounts as a result of audit, has the annual report been updated to reflect those amendments?

Statement of comprehensive income (SOCI)/ statement of comprehensive net expenditure (SOCNE)

Question	Underlying reasoning
General	
How have the figures changed compared to last year and the year before that? Are any changes expected/ unexpected?	For changes that you were expecting, do the figures look right[6]? If no changes were anticipated, you would generally expect figures to increase with inflation. If there are movements that are much larger than this, you should find out why.

[6] For comparison, you could use the prior year accounts or monthly financial reports to the board. An example of an 'expected change' would be an increase or decrease in costs or income linked to a change in the way a service is delivered.

	Covid-19 has made comparisons difficult because the financial regime changed, and the operational impact of the pandemic affected financial performance. When making year on year comparisons, the development of the pandemic and restrictions/ infection levels at the time needs to be considered to determine what changes could be expected. Any unexpected changes need to be identified and explained.
Do the figures seem reasonable and complete, including those entries that are zero?	Is any information missing? If it is, do you know the reason?
Is the surplus/ deficit consistent with the forecasts made during the year?	If in-year forecasting is accurate, there should not be any surprises at the year end. If there is a significant change, can it be explained?
Has there been a prior period adjustment?	Is this due to a change in accounting policy that should be reflected in the opening note to the accounts, or another reason?
Do you know what expenditure has been included in the 'other' category?	Expenditure is expected to fall into the specified categories in most cases. If it is included in 'other', do you know what this is and understand why it does not fit with any of the specified categories?

Income (NHS provider bodies only)

How has income from patient care activities changed during the year? Does it fit with previous reports on performance against contracts?	Income from NHS commissioning bodies during the pandemic was on a block basis so any increases at the year-end should be 'explainable'. Is income related to the elective recovery scheme (ERS) consistent with performance? Look at the value of receivables – has that increased or decreased over the last two years? If receivables have increased, ask about the collectability of the income. Look at the growth in bad debts – if there are issues, the time taken to pay invoices will increase.
Do the income figures appear reasonable and can officers explain the reasons for any changes from the previous year?	A wider understanding of what income is expected can flag potential areas of omission or where further review is needed.
Does the level of any private patient income look reasonable?	If the levels don't accord with expectations, it may mean that there are omissions or a need for further investigation. It is also worth considering whether the level of receivables for private patient income is being managed and that write-offs are low. Does private patient work make a positive contribution to the financial position of the

	NHS body (in other words, is the income greater than the amount it costs to provide the services)?
Consider how much income the organisation receives through research and development: does it contain any time-limited significant amounts?	It may be a significant source of income but may not continue at the current levels. How much is the financial performance of the NHS body reliant on these non-recurring items?
Has there been a change in income through the NHS Injury Cost Recovery Scheme? Is it a one-off or a trend?	This is income that is due under statute whenever a patient claims compensation for an injury that the NHS body has treated. If there is a fall in income is this due to problems in collecting the income or is there a wider issue with the claims process?
Expenditure (staff costs)	
What has caused changes in pay expenditure?	How much of the change relates to pay awards? Does the disclosure reflect expected agency staff costs? Which areas of staff expenditure are still increasing?
Does any movement in staff costs correspond to the change in staff numbers?	If there are significantly more people in post compared to this time last year, has a new service come on stream? Otherwise, is the organisation paying significantly more (or less) for no extra staff?
Do any material amounts of employee benefits and early retirements due to ill health correspond with your expectations?	Any unexpectedly high levels may highlight the need for further review.
Does the organisation have any staff who are members of a local government pension scheme? If so, have the details been disclosed? Also, has the organisation disclosed the financial liability (or financial asset, if the scheme is in surplus) of any local government pension scheme? You should be able to see this within 'other financial liabilities' (or possibly 'other financial assets') on the statement of financial position.	Most NHS staff will be part of the NHS pension scheme which are reflected as a cost in the notes to the SOCI/ SOCNE. The cost reflects the contribution made by the NHS body as an employer and can therefore be forecast accurately. Accounting for local authority pension schemes is very different and, in part, the amounts included in the accounts are dependent on actuarial valuations. As the valuation can change and is only made at the end of the financial year, there can be an impact on the financial position of the NHS body which is difficult to forecast. Are you satisfied that you understand the impact that staff belonging to this scheme could have on the financial position of the organisation?
To the best of your knowledge, does the disclosure in relation to directors' remuneration appear complete?	Do the figures reflect your knowledge of directors in position during the year and any changes? Do the amounts disclosed reflect your understanding of the amounts paid to each individual?

Does the organisation pay any staff 'off-payroll'? If so, how has this changed during the year?	Where it is determined that the off-payroll rules apply (and the individual would be classified as an employee if they were not being paid via an intermediary), the organisation body is responsible for deducting and paying employment taxes and national insurance (NI) contributions relating to the engagement.

Expenditure (non-staff costs)

(Providers only) Has the organisation purchased additional capacity from private providers? If it has, it will show under 'purchase of healthcare from non-NHS bodies'. Can officers explain why this activity could not be done within the organisation's own resources?	You want to understand the reasons for using non-NHS bodies and whether there are any strategies that can be put in place to change things in future.
Do the expenditure figures appear reasonable, and can officers explain the reasons for any significant changes from the previous year? For example, do you know what services you now buy from another organisation that you did not buy last year?	A wider understanding of what expenditure is expected can flag potential areas of omission or where further review is needed.
Is there a meaningful change in the depreciation figure in the statements?	Has the organisation changed the useful economic lives of its assets (this should be reflected in the accounting policies noted above)? If so, this will reduce expenditure in-year without affecting the amount of cash held. Overall financial performance has been 'propped up' by an accounting adjustment that isn't matched by cash.
If there has been an impairment (loss in asset value), do you know why? Does the property, plant and equipment note to the accounts reflect the situation accurately and clearly?	Assets lose value due to changes in the economic climate and damage/ obsolescence. Is any change reasonable based on your knowledge of the organisation and the prevailing economic climate?
Does the organisation have (or is it party to) a subsidiary, associate, joint venture, or special purpose vehicle? This includes pooled budget arrangements for CCGs.	It is important to identify how this part of the business or contract is performing and whether or not core activities are keeping it afloat. Are gain/ loss share arrangements in place? What are they and is there a 'parent guarantee' (i.e., where the parent organisation guarantees to meet any liabilities)? Does it have an impact on the organisation's core business?
Is there an extended disclosure relating to the accounting standard IFRS 16 *Leases* in the note on accounting standards issued not adopted?	IFRS 16 is applicable from 1 April 2022 and considerable work has been undertaken ahead of its adoption. The note to the accounts should therefore disclosure the expected financial impact of the new standard in 2022/23.
Has the organisation incurred any expense under the late payment of	It is important to understand the reasons – for example, it may indicate a cash flow

commercial debts (interest) Act 1988? If so, do you know why?	difficulty or possibly a temporary shortage of staff processing invoices?

Statement of changes in taxpayer's equity (SOCTE)

Question	Underlying reasoning
Do the lines that should net to zero do so when added together[7]? Lines which net to zero are transfers between reserves.	Do you understand the reason for the transfer? This may identify any omissions or amendments elsewhere in the accounts that have not tracked through.
Has there been a prior period adjustment?	Is this due to a change in accounting policy that should be reflected in the opening note to the accounts, or another reason?
Are there any significant changes to the revaluation reserve? (See also the questions on non-current assets under the statement of financial position)	Have these been explained and does the reason fit with what you know? Are revaluations based on appropriate assumptions? Have those assumptions been discussed and reviewed by the audit committee?
(CCGs only) Is the amount of Parliamentary funding the amount that you expected? Does it tie up with the note on the financial performance of the CCG?	For CCGs, funding from NHS England is shown in this statement.

Statement of financial position (SOFP)

Question	Underlying reasoning
Have any items changed significantly since last year?	Do any changes fit with your knowledge of the organisation's activities? Use the note references to find out more detail about any items that look unusual.
Non-current assets (property, plant and equipment)	
Does the movement in the valuation of property, plant and equipment agree to the revaluations and impairments of these assets and are they what you expect?	Assets lose value due to changes in the economic climate and damage/ obsolescence. Is any change reasonable based on your knowledge of the organisation and the prevailing economic climate? Assets can increase in value due to changes in the property market or changes in the building trade (for example, the price of building materials).
Do non-current asset additions and disposals tie in with your knowledge of the organisation's capital programme?	A wider understanding of asset movements expected can flag potential areas of omission or further investigation. The level of additions and disposals should tie in with your understanding of the capital

[7] Transfers between reserves should net to zero – the most common transfer would relate to impairments charged to income and expenditure which are transferred to the revaluation reserve. This is to take account of a Treasury amendment to IAS 36 (Impairment of assets) as applied to public sector bodies.

	programme and estates management plans.
Has there been a professional valuation of the estate this year?	There is no requirement to have an annual valuation, but the asset values must be materially correct. Do you understand your organisation's policy on valuation?
Has the valuer or the valuation basis changed?	The valuation of NHS estates requires judgments, assumptions and estimates to be made. Different valuers make different judgements. Do you understand the reasons for the judgements/ estimates made and do they make sense in relation to the NHS body's capital programme, estates, and overall strategy?
Has there been a loss on the disposal or sale of an asset? Was this expected?	Any disposals should be part of the wider capital programme. It is worth asking why there was a loss on disposal. A wider understanding of expected asset movements can flag potential areas of omission or error.
Has there been a reclassification out of assets under construction into property, plant and equipment – does the organisation have a new building that has just become operational?	This should be part of the capital programme. Once an asset is operational, the costs related to that asset (depreciation, maintenance and so on) should be included in financial plans and forecasts. A wider understanding of expected asset movements can flag potential areas of omission or error.
Current assets	
Are receivables growing? Does the organisation have more money tied up in debtors? Is there an effective debt recovery process?	What are the underlying reasons? The longer debts take to be paid, the greater the pressure on the organisation's cash flow.
Are there any particularly large receivables this year, or significant changes from the prior year? Can officers explain the reasons for these?	When reviewing receivables, it is important to consider the collectability of balances. If receivables increase, what is the effect on aged debtors and debtor days? Any unexpected or unexplained large movements may highlight an area for further review.
How has the agreement of balances process progressed during the year and at year end?	Are there any underlying issues of which NEDs should be aware? For example, have NHS disputes been particularly difficult to resolve? Are these disputes with neighbouring organisations?
Can officers explain the level of bad debts that have been provided for and written off? Has it been reflected in the losses and special payments schedule?	Bad debt provision is a judgement – are the assumptions used in calculating this in line with expectations? The Comptroller and Auditor General highlighted the importance proper approval of losses and special payments in his report

	on the DHSC's[8] and NHS England's[9] annual accounts for 2020/21. As a result, the losses and special payments note is likely to be a focus of audit attention.
Does the provision for impairment of receivables look reasonable?	Provisions are based on judgement – are the assumptions used in calculating this in line with expectations?
Have prepayments only been made to organisations that have sound financial standing and where the organisation gains value from the prepayment?	Public sector bodies generally should not make payments in advance of receiving goods or services. Making a payment should only be made to achieve value for money. The risk that the goods/ services may not be delivered should be recognised and a mitigation strategy put in place. The organisation's cash flow should also be protected.
If the stock/ inventories figure is different to last year, why is this?	Any unexpected or unexplained large movements may highlight an area for further review. For example, stock taking processes may need to be looked at to ensure they remain fit for purpose. Do stock movements reflect the procurement policies of the NHS body? Is the level of write-off of stock a concern?
Non-current/ current liabilities	
Has trade payables (creditors) grown? How much money does the trust owe its suppliers?	If this is increasing, the organisation may be experiencing cash flow problems and delaying payment to creditors to manage its cash position. If payables are increasing, has there been a corresponding fall in performance against the prompt payment requirements?
Are there any particularly large trade or other payables this year, or significant changes from the prior year? Can officers explain the reasons for these?	An increase in payables may indicate cash flow problems. Does the movement in payables correlate performance against the prompt payment metric? Any unexpected or unexplained large movements may highlight an area for further review.
Can officers explain significant receipts in advance and deferred income?	Public sector bodies generally should not make payments in advance of receiving goods or services. Given that NHS bodies generally trade within the NHS, they would not generally expect to have significant receipts in advance. Have the services/ goods that have already been paid for been taken into account in forecasts? What is the reason for the deferral? If there is a judgement required, has it been discussed and agreed with both the third party involved and both sets of auditors?

[8] C&AG, *Certificate of the Comptroller and Auditor General to the House of Commons*, January 2022
[9] NHS England, *NHS Commissioning Board: Annual report and accounts 2020/21* (page 136), January 2022

	Receipts in advance and deferred income require agreement with the third party involved. Failure to gain appropriate agreement can result in in material income and expenditure mismatches. This may result in audit adjustments at the year-end.
If the cash balance has changed, do you know why? (There are more detailed questions on cash in the 'statement of cash flows' section of this checklist.)	This needs to be looked at alongside receivables and payables to get the full picture: low cash balances, growing receivables and payables means cash flow difficulties. If cash balances are falling, does this correspond with a falling surplus or increasing deficit? If not, ask how the financial performance in the SOCI ties up to the movement in cash balances?
If provisions have changed, why is this?	Provisions should be reasonable to cover the organisation against future liabilities[10]. If there are increases in provisions what is the reason for this? Equally, if provisions have fallen, is this because they have been discharged and payment made or is it due to a change in estimates? If the estimation basis has changed, are you happy with the reasons for this change?
If there are large borrowings, do you know what they are?	Does the organisation have any loans that it is in the process of repaying? Has it made the repayments it should have done during the year?
Do the figures seem reasonable and complete, including those entries that are zero?	Where entries for current and prior years are zero, or where a line is missing, check whether this is because of rounding or because it reflects a lack of activity.

Statement of cash flows (SOCF)

Question	Underlying reasoning
Do the changes in cash and cash equivalents result in a net cash outflow or a net cash inflow?	Liquidity problems are highlighted by cash inflows in the year that are less than cash outflows.
Are you satisfied with the reasons for any negative cash flow (more cash flowing out of the organisation than in) in respect of investing and financing operations?	Is the organisation experiencing cash flow difficulties?
Do you understand the reasons for any large movements?	A large capital programme may result in a net outflow of cash. Equally, loans may result in an increase. However, any unexpected or unexplained large movements may highlight areas for further review.

[10] Note: NHS bodies do not include provisions for clinical negligence claims in their accounts. Therefore, clinical negligence claims do not directly affect the level of provisions held by an NHS body.

Does the organisation's reported cash flow position at the year-end correspond with that reported during the year?	If in-year forecasting is accurate, there should not be any surprises at the year end. If there is a significant change, can it be explained?
Has the organisation bought any assets during the year? Can you see them in the payments for property, plant and equipment?	Capital purchases should all be reflected in the capital programme. The overall effect of capital purchases may not affect cash balances if the purchase is funded by a loan. Do the purchases have the expected effect on cash?
Has the organisation bought or invested in any subsidiaries or other organisations during the year?	This may result in cash outflows and have an impact on the organisation as a whole.
Has the organisation made any loan repayments during the year? Are you aware of the reasons why the organisation has a loan and what its repayment profile is?	If payments are due and have been delayed, is this because there is insufficient cash flow to meet commitments?
Have the organisation's cash balances increased overall during the year? Is there a long-term plan as to how to use these balances?	Is this expected? Or is it because payments have been delayed? The cash balances should be in line with reported plans.

About the HFMA

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

4 Broad Plain, Bristol BS2 0JP

T 0117 929 4789

E info@hfma.org.uk

Healthcare Financial Management Association (HFMA) is a registered charity in England and Wales, no 1114463 and Scotland, no SCO41994.

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