HFMA briefing
June 2018

Subsidiary companies

Financial and governance considerations

In partnership with

NHS Counter Fraud Authority

Introduction

NHS bodies have the power to establish subsidiary companies[1], and whilst this option has been available for many years now, it is currently receiving a lot of attention. Establishing a subsidiary company is a decision which must not be taken lightly. The contractual documentation that is established will be legally binding and the directors of the company will be solely responsible to the regulatory authorities, the shareholder(s) and its customers in running the business.

This briefing is intended to act as a useful list of issues for NHS finance teams[2] to consider when establishing a subsidiary or entering into a joint working arrangement. It does not provide any advice on whether this is the right action for any particular NHS body to enter into, it simply sets out some of the issues that should be considered.

The briefing will be kept under review and will be updated periodically. If you have any comments or anything to add please contact Debbie Paterson, policy and technical manager (debbie.paterson@hfma.org.uk). The briefing is intended to be a useful source of information to consider and, where possible, references are given to useful guidance.

This briefing should be read alongside our previous briefing *Accounting for joint working arrangements*[3] *which* looked at whether the NHS body controls another body or not.

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[1] Different types of NHS bodies have different statutory powers – when establishing a subsidiary or any other joint working arrangement it is important to establish the statutory basis for that arrangement
[2] The briefing is written for HFMA's members who are finance staff and it is largely based on the experience of our members. Finance staff are not the only staff who should be involved in the establishment of a subsidiary or other joint working arrangement – this briefing may be of use to non-finance staff as it identifies wider governance and communication issues, but finance and financial governance is its main area of focus.
[3] HFMA, *Accounting for joint working arrangements*, June 2017

We are grateful for the support and comments received by members of our Accounting and Standards Committee, Governance and Audit Committee and Provider Technical Issues Group. We are particularly grateful to Peter Harding, Anthony Robson and Steven Rourke from QE Facilities Ltd for sharing their experience.

While every care had been taken in the preparation of this briefing, the HFMA cannot in any circumstances accept responsibility for errors or omissions and are not responsible for any loss occasioned to any person or organisation acting or refraining from action as a result of any material in it.

The business case for the new entity

Establishing a subsidiary body or entering into a joint arrangement needs to be supported by a robust and detailed business case which demonstrates that it is the most appropriate way of achieving the desired outcome.

Why establish a company?

It is critical for an NHS body's board and its staff to understand why the subsidiary is being established. A clear vision of why the subsidiary is being established, the options open to each party to the arrangement and the expected benefits that can be derived must be established.

Each NHS body that is considering embarking on this journey should;

- have a detailed assessment of the issue that is being addressed. This should be carried out by people qualified in the subject that the activities of company will undertake
- have detailed discussions about the alternatives that are available – establishing a subsidiary company is likely to be one of several options
- give consideration to the implications of each of the options – the financial implications, the impact on the workforce, on the local health economy and on the operations of the NHS body and
- undertake an assessment of the risks attached to each of the options, including consideration of the levels of risk the NHS body's board is willing to accept.

What will the company's activity be?

Companies and partnerships have been set up in the NHS to fulfil many objectives including:

- income generation using the NHS body's spare capacity
- income generation using the NHS body's specialist knowledge
- benefiting from intellectual property
- managing estates portfolios
- providing facilities management
- developing healthcare technology
- managing and provide services such as pathology and pharmacy
- providing private healthcare services
- working with partners, for example, clinicians, GPs and private sector entities.

It is not appropriate for NHS bodies to establish companies simply to avoid tax, this was confirmed in the letter from DHSC which is attached in the appendix to this briefing.

The business case supporting the new arrangement should include a robust assessment of how much resource will be required to support its establishment both internally and externally. Whilst the cost of any resource provided by the parent NHS body may be recharged to the subsidiary (only relating to work carried out wholly in establishing the subsidiary), the amount of resource needed should not be underestimated and should take into account the increased demands as the company's activities expand to achieve its objectives.

In addition, the business case should consider the amount of increased administration that will be required in operating the company and the types of administration. There is potential that the NHS body will not have experienced personnel to deal with types of administration and consideration should be given to any additional costs that will be incurred, either through the employment of suitably qualified personnel or the need to buy in services to support the company.

Where it is anticipated that the new body will trade with organisations other than its parent the business case will need to include a level of market research to provide comfort to the board that there is a business in the market place to be developed.

Alongside the development of the business case, a communication and consultation plan should be developed. Subsidiaries are currently a high profile issue in the NHS so appropriate communication and consultation is vital. The target audience should be identified as part of the communication and consultation plan – it might include the Department of Health and Social Care (DHSC), NHS Improvement, NHS England, local authorities and health wellbeing boards, the local member(s) of Parliament, staff, unions, patients and patient interest groups.

Understanding the structure of the new arrangement

There are many ways that an NHS body can enter into a joint working arrangement – it is important to understand how that arrangement works in order to establish the appropriate accounting treatment.

In developing this briefing, we have seen various arrangements in operation in the NHS:

- Limited liability partnerships (LLP)
- 100% owned subsidiary companies
- 100% owned subsidiary companies which have their own joint ventures and subsidiaries
- a consolidated charity with a subsidiary company
- joint ventures[4] with other NHS
- joint ventures with non-NHS bodies.

Each party (the NHS body and the subsidiary) should consider the commercial arrangements it is entering in to. The subsidiary, although owned in full, or in part, by the NHS body will need to be independent of its parent and the directors of the company must, under law, act in the best interests of the company.

The contractual documents which are agreed between the two parties must reflect the services that will be provided and these services must be delivered in accordance with the contract.

This briefing only considers the 100% owned subsidiary model – that may not necessarily be the most appropriate model in all instances.

Relationship between the NHS body and the subsidiary

[4] When referring to joint ventures, it is important to remember that joint venture has a very specific accounting definition set out in appendix A of IFRS 11 *Joint arrangements*. However, the term may be used more widely to include other joint working arrangements. The accounting must be based on the actual arrangements in place and not simply on what it is being called.

When establishing a subsidiary the NHS body may want the company's values and objectives to support its own. Where this is the case they should be clearly established in the articles of association.

The relationship between the parent body and its subsidiary needs to be considered, the company is not a department or a division (which it may have previously been). Instead there is:

- the shareholder relationship – as a / the shareholder the NHS body will receive updates from the directors on the strategic performance and future plans of the company;
- a contractual relationship – this must be treated the same as any other relationship the NHS body has with a supplier; and
- the group relationship – this is the relationship between both parties of working towards common goals.

The independence of the subsidiary body and how that is demonstrated to HMRC and other regulators should be carefully considered and attention should be paid to the arm's length guidance and transfer pricing legislation[5].

Culture

As the subsidiary is an independent body, it may develop its own organisational culture which is different to the culture of its parent NHS body. The development of a management style and organisational culture will depend, in part, on the people appointed to senior management posts and the functions that the subsidiary is fulfilling, these softer management issues and differences should be acknowledged. It may be worth spending some time in the early days considering cultural issues and what positive cultural changes can be enacted to improve service delivery and efficiencies.

Formally establishing a new entity

Registration

A company or limited liability partnership can be established with relative ease through Companies House[6].

All companies need to be registered with Companies House. There is guidance on how to do this on their website[7].

NHS bodies may wish to establish a Community Interest Company (CIC) which is a company which has social, charitable or community-based objectives. CICs are also established through Companies House, they differ from other companies in that they must have a community interest and an 'asset lock' which means that the company's assets can only be used for its social objectives and limits the amount that can be paid to shareholders.

CICs are regulated by the Office of the Regulator of Community Interest Companies[8].

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[5] Part 4 of the *Taxation (International and Other Provisions) Act 2010*
[6] www.gov.uk/government/organisations/companies-house
[7] www.gov.uk/limited-company-formation
[8] www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies

Practical considerations

It is worth noting that there are some words/ names which cannot be used in company names without permission – NHS is one of these words, as is health centre and some healthcare professions and titles[9].

A company needs a memorandum and articles of association – there are model documents available from Companies House. It is important to ensure that these documents are tailored to include the activities that the company will be undertaking. For example, if the company will own property, the articles should say that.

The memorandum of association cannot be updated once the company has been registered. The articles of association can be modified or replaced with the approval of the board of directors.

Directors

All companies are required to have at least one director who is legally responsible for running the company. The director must be a person, the position cannot be filled by an NHS body.

There are legal responsibilities involved in being a company director which individuals need to be aware of. Any persons who are to become, or already are, directors of a company should be fully aware of their fiduciary responsibilities by reading the statutory duties of a company director which are set out in Chapter 2 of part 10 of the Companies Act 2016[10] would be a good start. https://www.legislation.gov.uk/ukpga/2006/46/contents

Whilst not covered by this briefing, it is worth noting that limited liability partnerships (LLPs) need to have 2 or more members – these can be individuals or organisations. The NHS body can therefore be a member of an LLP.

For NHS bodies, the governance arrangements of the company with the NHS body need to be considered. In the cases we have reviewed, a decision has been taken by the directors of the company to include at least one member of the NHS body's governing body as a director of the company, this is normally a non-executive director with expertise and knowledge of commercial entities and the NHS. In some cases, all of directors of the company are members of the NHS body's governing body.

The decision as to whether to link directorship of the company to a specific senior management role at the NHS body needs to be made at an early stage. Consideration should be made of how this affects the independence of the subsidiary body.

Directors of limited companies usually have directors' indemnity insurance (note that, if it is taken out then that fact needs to be disclosed). Where the director role is linked to the senior management role at the NHS body, for example, where the director of finance of the NHS body is automatically a director of the subsidiary, it may be appropriate for that indemnity to be provided by the NHS body. Where the directors of the subsidiary are independent of the NHS body then the subsidiary body should consider what insurance is needed.

Accounting/ accountable officer responsibilities

HM Treasury's *Managing public money*[11] reminds accounting officers of arm's length bodies that they need to have meaningful oversight of any subsidiaries, paragraph 3.8.3 states:

'It is not acceptable to establish ALB's, or subsidiaries to ALBs, in order to avoid or weaken parliamentary scrutiny.'

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9 www.gov.uk/government/publications/incorporation-and-names/annex-a-sensitive-words-and-expressions-or-words-that-could-imply-a-connection-with-government#NHS

10 www.legislation.gov.uk/ukpga/2006/46/contents and page 45 onwards of the explanatory notes

11 www.gov.uk/government/publications/managing-public-money

Date of incorporation

The date that the company or LLP is created is its accounting year-end. Consideration should therefore be given to establishing companies so that they align with the NHS body's year end at a planned point in time.

It is possible to consolidate bodies which have different year ends. However, where the company's accounts are consolidated into the NHS body's accounts, auditable part-year financial information will have to be prepared by the subsidiary to enable parent NHS body's accounts to be prepared as well as to allow the auditor to complete the audit of the parent NHS body's accounts.

It is also possible to change the reporting date of a company by informing Companies House but this will involve preparing part year accounts (or accounts for more than a year) in the year of alignment. A subsidiary may have a long, or short accounting period prior to alignment of its year end with its parent company.

Annual returns

Annual accounts need to be submitted to Companies House and an annual tax return to HMRC. The deadlines for submission of these returns is more generous than the deadlines for the NHS accounts submissions.

Disclosure to NHS Improvement/ NHS England

For NHS Improvement to prepare consolidated accounts for the provider sector and assist DHSC with its group consolidation, it is important that they know whether an NHS provider has a subsidiary. The summarisation schedules (TAC forms) will be completed on a consolidated basis but there is an additional information tab which must be completed.

NHS Improvement are looking at the level of oversight of NHS subsidiary bodies[12]. NHS bodies should inform NHS Improvements of their plans to establish a subsidiary as soon as possible.

No CCGs have subsidiary companies at the time of writing, but it is possible that they might enter into such arrangements. If this does happen this will require prior consultation with NHS England.

Where several NHS bodies are shareholders in a company, consideration needs to be given to the accounting at a DHSC group level as well as the NHS body level. The company may not be consolidated by any of the NHS bodies because they do not have control but, by the fact that the DHSC has control of the NHS bodies, it may need to be consolidated at the group level.

Accounting by the NHS body

NHS bodies are required to comply with the DHSC's *Group accounting manual*[13] and NHS Improvement's *Annual reporting manual*[14]. Both contain guidance in relation to the application of the relevant accounting standards to NHS bodies and in the context of the DHSC group. As stated above, there are specific reporting requirements for NHS bodies in relation to subsidiaries which need to be met as well as applying accounting standards.

When determining the appropriate accounting treatment, the key consideration is control. Our previous briefing *Accounting for joint working arrangements*[15] looked at the questions an NHS body should consider when determining where control lies. Control needs to be reassessed if arrangements/ ownership of the subsidiary or the NHS body change. As with all complex

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[12] www.parliament.uk/documents/commons-committees/public-accounts/Correspondence/2017-19/nhs-improvement-subsidiaries-150318.pdf
[13] www.gov.uk/government/collections/department-of-health-group-accounting-guidance
[14] https://improvement.nhs.uk/resources/financial-reporting/
[15] HFMA, *Accounting for joint working arrangements*, June 2017

arrangements, the determination of the appropriate accounting treatment must be based on the facts of the situation.

The key consideration in determining the accounting treatment is whether control exists. This briefing assumes that it does, which would mean that the NHS body has a subsidiary body and therefore must prepare consolidated accounts in accordance with IFRS 10 *Consolidated financial statements* with the necessary disclosures required by IFRS 12 *Disclosure of interests in other entities*[16].

Paragraphs B86 to B93 of IFRS 10 set out the guidance for the preparation of consolidated financial statements. In summary, for wholly owned subsidiaries:

- all like items of assets, liabilities, equity, income, expenses and cash flows are combined
- the carrying amount of the parent's investment in the subsidiary and the parent's portion of equity on the subsidiary should be offset
- intra group assets, liabilities, equity, income, expenses and cash flows are offset
- uniform accounting policies need to be adopted across the group prior to consolidation
- all entities in the group should have the same reporting date.

This briefing does not contain comprehensive accounting guidance but identifies some issues that NHS bodies should consider.

Early discussion with external auditors of the new arrangement and the proposed accounting treatment is best practice.

Group accounts

A set of consolidated accounts needs to include the group and the parent entity's financial information for all primary statements and notes. Where the difference between the group and parent's information is not material then both sets of information do not necessarily need to be disclosed.

The Companies Act allows the parent entity to exclude its figures from the statement of comprehensive income (SOCI) and disclose only the group position. Some NHS bodies take advantage of this exemption.

Group accounting policies

The example accounting policies provided by NHS Improvement and NHS England include accounting policies for accounting for subsidiaries and other joint working arrangements. However, these need to be tailored for the circumstances of the NHS body.

There may be other accounting policies which need to be revised when preparing group accounts – for example, in relation to corporation tax.

Asymmetric accounting arrangements

Where there is a lease arrangement between a parent and its subsidiary then the new leases standard will cause complications for consolidation. Under the new lease accounting standard – IFRS 16, the accounting treatment differs for lessees and lessors, so the consolidation will need to eliminate all the lessee accounting entries to leave the only the leased asset in the consolidated accounts.

This will be the case when the subsidiary is the lessor whether it accounts for leases under IFRS or UK GAAP. Where the subsidiary is the lessee then if it is using UK GAAP, the accounting treatments should mirror each other.

[16] Unaccompanied versions of the accounting standards are available from the IFRS foundation www.ifrs.org/issued-standards/list-of-standards/ – login is required.

There may be other instances where the parent and the subsidiary do not adopt symmetrical accounting arrangements. For example, there may be a provision for a loss on impairment against a receivable in one set of accounts which is not reflected in the payable in the other set of accounts or an adjustment for the time value of money on a long term balance which is reflected in only one set of accounts.

These arrangements will need to be identified as part of the consolidation and appropriate adjustments made to ensure that they are appropriately consolidated out of the group accounts.

Segmental reporting

The financial position of each part of the group is usually reported and managed separately. Consideration should be given as to whether the subsidiary is a separate segment which needs to be disclosed in the segmental reporting note.

Shareholdings

Most NHS bodies disclose their investment in the subsidiary as a long-term investment in the parent body's statement of financial position. This is consolidated out in the group's statement.

The parent body's investment in the subsidiary should be valued at cost when the subsidiary is established. A note to the account shows any movement in that investment.

Care should be taken to account for capital contributions made by the parent to the subsidiary body in the appropriate way – these are not the same as shareholding investments.

Remuneration report

Where members of the governing body are also directors of a subsidiary company this needs to be disclosed in the remuneration report. Interests in the subsidiary should be declared in the register of interests and at governing body meetings.

Where the subsidiary is material, consideration should be given as to whether the directors of the subsidiary are senior managers of the NHS body and should be included in the remuneration report.

The IASB's Conceptual framework for financial reporting states 'Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.' The GAM requires the that the remuneration report includes information on those people who have authority or responsibility for directing or controlling major activities within the NHS body and can therefore influence the decisions of the entity as a whole rather than the decisions of individual directorates or departments. It will therefore depend on the size of the subsidiary body's operations as well as the scope of the services it provides as to whether its directors should be included in the remuneration report as senior managers.

Governance statement

Where the subsidiary is material to the parent NHS body, it may be appropriate to include disclosures around the group structure and the group governance in the governance statement.

This is particularly the case where significant issues have been identified as part of the subsidiary's going concern assessment or where the subsidiary's accounts are not prepared on a going concern basis.

The results of the going concern assessment of both the NHS body and its subsidiary should be considered when the governance statement is being drafted.

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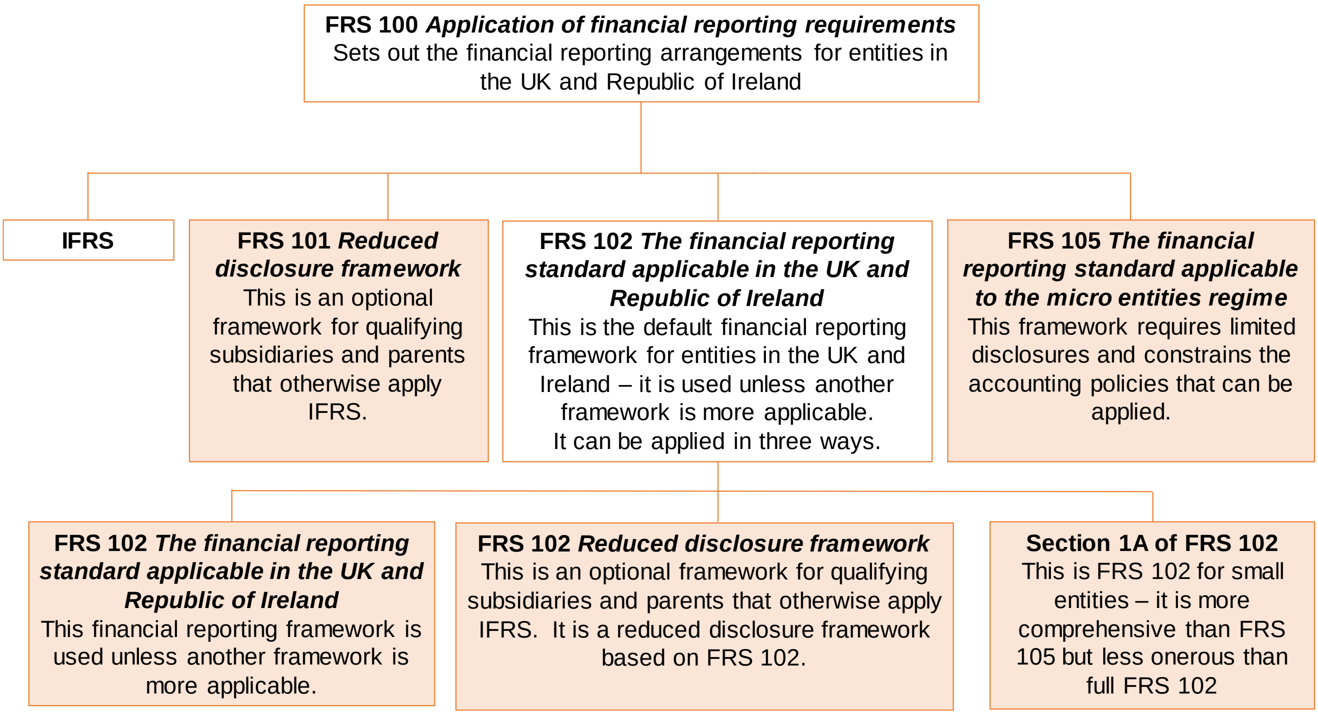
Accounting by the subsidiary

Accounting standards

UK companies are not required to apply IFRS unless they are publicly listed. This means subsidiary companies can be accounted for in accordance with UK and Ireland generally accepted accounting practice (UK&I GAAP) which is made up of five regimes in addition to IFRS. The choice of regime depends on:

- whether the entity is eligible to use the regime – based usually on its size with thresholds set out in the Companies Act[17]
- the most appropriate regime for the particular circumstances[18].

The accounting frameworks available are summarised in the following chart which highlights the five UK&I GAAP regimes:



Aligned accounting policies

Where the subsidiary adopts UK&I GAAP rather than IFRS, there are likely to be differences between the accounting policies of the subsidiary and the NHS body. Whilst UK&I GAAP is largely aligned with IFRS there are differences, particularly in relation to new:

- IFRS 9 *financial instruments*
- IFRS 15 *revenue from contracts with customers*
- IFRS 16 *leases*.

Going concern

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[17] See sections 10 to 12 of the *Companies House Company accounts* guidance for the thresholds for micro and small companies

[18] The Financial Reporting Council's *Overview of the financial reporting framework* sets out the options available and the eligibility criteria

Subsidiary companies can fail and therefore a full going concern assessment will need to be undertaken each year[19].

Both IAS 1 *Presentation of financial statements* (paragraphs 25 and 26) and FRS 102 (paragraphs 3.8 and 3.9, 32.7A and 32.7B) require management to make an assessment of going concern as part of the preparation of the annual accounts. This assessment takes into account all available information about the future (at least twelve months from the date that the accounts are signed). Material uncertainties relating to events or conditions that cast significant doubt on the entity's ability to continue as a going concern must be disclosed.

Where the subsidiary's accounts are not prepared on a going concern basis then this should be disclosed in the accounts of the subsidiary and, depending on materiality, the parent NHS body.

The outcome of the going concern assessment may need to be reflected in the NHS body's risk register and governance statement if material.

Taxation

There are many differences between the tax arrangements for NHS bodies and those for commercial entities. A very useful resource is the Tax Centre of Excellence (TCOE)[20] which is a central resource for tax advice available to all government bodies. Using this resource may avoid the need to use external advisors for basic advice.

Registration for corporation tax

All companies must be registered for corporation tax within three months of starting to do business.

Accounting for corporation tax can be complicated and is probably outside an NHS accountant's experience. A good starting point for understanding corporation tax is the TCOE's *Corporation tax guide for non-departmental government bodies/ arm's length bodies*[21]*.* Key differences include, for example:

- some subsidiaries have to account for deferred tax which can be complex
- some accounting decisions (such as whether a lease is operating or finance) may have tax implications which need to be understood and taken into account as part of the decision-making process.

Expert advice may be needed for complex arrangements.

On a practical note, corporation tax files need to be sent to HMRC in iXBRL format which will be new for most NHS finance teams and may require new software. Corporation tax computations are a complex area requiring expertise that the subsidiary company may not have access to from within the group. It is important that the subsidiary company takes the relevant advice and, where required, ensures staff receive the appropriate training.

In the case of joint ventures, understanding where any tax liabilities fall (the parent or the joint venture) is important - this will depend on how the arrangement has been set up. Information from the partnership return will be needed to prepare the tax return. The arrangements for funding the tax liabilities need to be considered before those liabilities become due.

The VAT regime

19 It is worth noting that IAS 1 has been interpreted in relation to going concern for public sector bodies. This interpretation will not apply to subsidiaries unless they adopt IFRS and the HM Treasury FReM. For more information on going concern in the public sector context see our briefing *Going concern – assessment and reporting requirements in difficult times*, 2016

20 www.taxcentreofexcellence.uk

21 Corporation tax (CT) guidance for non-departmental government bodies

Where the company breaches, or expects to breach, the VAT registration threshold it must to register for VAT[22].

The VAT regime for companies is different to the regime for NHS bodies. For example:

- companies, even those wholly owned by NHS bodies, fall outside of the NHS VAT divisional registration. This means that the trade of taxable goods and services between the subsidiary and any NHS body would be subject to VAT at the prevailing rate
- NHS bodies currently submit VAT Returns on a monthly basis. A company may submit its returns on a quarterly basis (normally a 'payment' trader) or on a monthly basis (normally a 'repayment' trader).
- the company may be required to make payments on account[23].

The subsidiary body's VAT regime will be governed by 'main stream' VAT legislation, the subsidiary will not be subject to the contracted-out services refund scheme. This may be something that the NHS bodies finance staff and shared service providers are unfamiliar with so expert advice or additional training may be required.

Where staff are employed and paid by the NHS body and seconded/ recharged to the subsidiary, and the subsidiary directs and controls those staff, it is a supply of staff by the NHS body which would be subject to VAT.

Registration for PAYE

If the subsidiary company is going to employ staff it will also need to register for PAYE. It will have to comply with pension auto-enrolment requirements and it is likely that it will be required to pay the apprenticeship levy[24].

Practical issues

Governance framework

A new subsidiary company will need to have appropriate governance arrangements. It is likely that the NHS body's own standing financial instructions (SFIs) can be used as a basis for the SFI's of the company. However, they will need to be reviewed to ensure that they are appropriate where the subsidiary is much smaller than its parent. For example, authorisation thresholds suitable for a large NHS provider may not be appropriate for a small commercial company.

The standing orders of an NHS body will take into account the statutory framework that NHS bodies work within, this will be different for a company so new standing orders will be needed. For example, there is no requirement for companies to hold their board meetings in public whereas this is a requirement for NHS bodies. Whilst there is no requirement for meetings to be held in public, consideration should be given to whether it be open and transparent to do so. Commercial sensitivities should be taken into account when making this decision.

The governance arrangements should reflect shareholder relationship between the NHS body and its subsidiary. This includes consideration of how the operational independence between the bodies is demonstrated through segregation of duties, disclosure of conflicts of interest, documented contracts between the parent and subsidiary as well as clear reporting arrangements

[22] Currently £85,000 of *taxable* income, see www.gov.uk/vat-registration-thresholds and www.gov.uk/government/publications/vat-maintain-thresholds-for-2-years-from-1-april-2018/vat-maintain-thresholds-for-2-years-from-1-april-2018

[23] See HMRC's *VAT notice 700/60; payments on account*

[24] www.gov.uk/government/publications/apprenticeship-levy/apprenticeship-levy

Banking and cash management

The company will have to have its own bank account. Experience is that this may take a considerable amount of time to set up.

As the company is new it will not have a credit limit until it has been trading for a while. This may mean that suppliers require payments on account which the company should take into account when estimating its cash requirements. A parental guarantee may also be required from the NHS body.

The new subsidiary will not have cash reserves. If there are transactions between the NHS body and the subsidiary, same day payment terms for the NHS body to make immediate payment to the subsidiary may need to be considered to ensure that the subsidiary maintains its cash position.

A subsidiary may require a working capital loan to cover initial expenditure as there are no cash reserves. This can be done in the form of a loan by the NHS body to its subsidiary or in the form of a capital investment (additional shares).

If a loan is made then consideration needs to be given to the terms of that loan – length, repayment terms and interest rate. These should all be set out in a loan agreement signed by both parties. Legal advice may be required when drafting the agreement.

Alternatively, the NHS body could make a capital contribution to the subsidiary – this will be reflected in the reserves of the subsidiary body.

General ledger and other software

A decision will need to be made as to what the most appropriate finance systems will be for the subsidiary. This will include a decision as to whether to use a single financial system for the parent NHS body and its subsidiaries or whether to use separate systems. As part of the process consideration should be given to whether the end product will have adequate separation of controls. Whatever system is selected it is important that data is held safely and securely and meet all of the requirements of the General Data Protection Regulations (GDPR).

In either case, consideration should be given to how the consolidation will be undertaken and how intra-company transactions will be eliminated. It may be tempting to use a spreadsheet to undertake the consolidation when the subsidiary is small, but plans should be made for when this is not the case.

Data access needs to be established when the new arrangements are set up. It may not be appropriate for the parent body's staff to have access to the subsidiary's data and vice versa. This is particularly important in light of the new General Data Protection Regulations – it cannot be assumed that personal data held by one of the entities can be used by the other. For example, the subsidiary will need to collect and process the personal data of staff in order to function effectively as an organisation.

Personal data is processed for a variety of reasons and all such personal data will be collected and processed in accordance with the requirements of GDPR and the Data Protection Act 2018.

Where NHS bodies use other NHS organisations as shared service providers they will need to discuss with the supplier what services can be provided for a non-NHS subsidiary body.

Where a different ledger or payroll is being set up then it is important to allow time to set up the new arrangement and transfer appropriate information, including staff details, to the new system.

Cyber security arrangements need to be considered as part of the establishment of the subsidiaries arrangements[25].

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[25] Our briefing, *Cyber ABSs; an introduction to accountants, board members and chief financial officers*, 2017 provides references to further information on cyber security

Case study

For example, we are aware that one NHS body has had to employ a different payroll provider for their subsidiary body as NHS Shared Business Services (SBS) was unable to provide that service. This is not always the case and it is important to discuss the new arrangements as early as possible. When this briefing was being drafted, we were contacted by SBS who said:

'NHS Shared Business Services can support subsidiary companies, and currently does so for a number of clients. For example, the provision of VAT, second set of books and extra payrolls. In relation to the latter, the NHS central team will only issue one ESR virtual personal database (VPD), therefore subsidiary companies must be managed in the same VPD. This is part of the service currently offered.

Occasionally third-party suppliers working with NHS Shared Business Services cannot support subsidiary companies, but in the last 15-years since the company was created this has only happened on a handful of occasions. For the vast majority of subsidiary companies this presents absolutely no problem.'

Insurance

Subsidiary bodies will need appropriate insurance, for example; directors' insurance, buildings and contents cover, public liability and employers' insurance. This may be provided by the NHS body's insurers at an additional cost but may be taken out completely separately. It is important to decide what the appropriate levels of cover are before the subsidiary starts trading.

Auditors

External auditors

Subsidiary companies may be exempt from audit in particular circumstances[26]. Where an audit is required, the qualifications needed for an auditor of a company may be different to those for an NHS body. Auditors will be need to demonstrate that they can provide the right staff with appropriate skills and qualifications to undertake the work.

There is no requirement for the auditor of the subsidiary body to be the same as the auditor of the NHS body. Where different auditors are involved and the auditor of the NHS body plans to rely on the work of the subsidiary's auditor, they will need to issue group instructions to the auditors of the subsidiary body in accordance with auditing standards.

Internal auditors

There is no requirement for companies to have internal auditors and whether or not they are appointed should be part of the governance considerations. Where internal auditors are appointed, there is no requirement for them to be the same as the NHS body's.

Where there are shared systems between the subsidiary and its parent then internal auditor's access to systems needs to be determined as part of the new arrangement.

Where internal auditors are used, it will be for the board of the subsidiary body to agree their work programme and receive the auditor's reports. If the subsidiary does not have its own internal auditors then the NHS body's internal audit work programme may include consideration of elements of the subsidiaries arrangements where the subsidiary is providing services on behalf of the NHS body.

It may be appropriate for a subsidiary audit function (internal or external) to report to a joint group audit committee to maintain the group relationship and best deliver the combined goals.

[26] www.gov.uk/audit-exemptions-for-private-limited-companies

Staff

Subsidiary bodies can employ staff. Some NHS bodies second their staff to the subsidiary, others transfer staff. If staff are transferred, then the Transfer of Undertakings (Protection of Employment) regulations (known as TUPE) apply. Staff are transferred on the same terms and conditions that they were previously employed on.

The use of secondments where businesses are transferred is complicated so legal advice may be required[27].

Subsidiary bodies do not need to employ new staff on the NHS terms and conditions. Some recruits may see this as a positive, others may not. This is a particularly contentious issue which needs careful consideration. There may be objections to the transfer of staff to the subsidiary, so they and their representatives should be engaged with the new process as early as possible.

In particular, whether or not employees of the subsidiary body are members of the NHS pension scheme is likely to be contentious and needs careful consideration at an early stage.

The appropriate auto-enrolment arrangements must be offered to the subsidiary's staff.

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[27] See the House of Lords decision in the case of Celtec Ltd vs Astley
https://publications.parliament.uk/pa/ld200506/ldjudgmt/jd060621/nwales-1.htm

Reference material

Government guidance

Companies House and HMRC Running a company

www.gov.uk/topic/company-registration-filing/running-company

www.gov.uk/running-a-limited-company

Companies House *Companies accounts guidance*

www.gov.uk/government/publications/life-of-a-company-annual-requirements/life-of-a-company-part-1-accounts

HMRC and HM Treasury guidance on business tax

www.gov.uk/topic/business-tax/vat

www.gov.uk/topic/business-tax/corporation-tax

Tax centre of excellence

www.taxcentreofexcellence.uk

Other background reading

House of Commons debate on NHS Wholly Owned Subsidiary Companies

https://hansard.parliament.uk/Commons/2018-03-06/debates/EEF6EE28-8B5F-4A3A-8C07-8DA267FB6805/NHSWhollyOwnedSubsidiaryCompanies

NHS providers *Wholly owned subsidiaries in the NHS*

http://nhsproviders.org/wholly-owned-subsidiaries-in-the-nhs

Grant Thornton *Why set up an NHS company?*

www.grantthornton.co.uk/insights/why-set-up-an-nhs-company/

Grant Thornton *NHS companies – an enterprising approach to health*

www.grantthornton.co.uk/insights/nhs-companies-an-enterprising-approach-to-health/

Unison *Wholly owned subsidiaries in the NHS*

www.unison.org.uk/at-work/health-care/key-issues/wholly-owned-subsidiaries-nhs/

ICEAW *guide to the duties and responsibilities of directors*

www.icaew.com/en/technical/business-resources/legal-regulatory-tax-governance/directors-duties/the-icaew-guide-to-the-duties-and-responsibilities-of-directors

Institute of Directors *Directors' duties and responsibilities*

www.iod.com/services/information-and-advice/resources-and-factsheets/details/directors-duties-and-responsibilities

Appendix: text from the letter from the finance director of the Department of Health

28 September 2017

NHS Provider Finance Director

Dear Colleagues

Tax Avoidance Issues in the NHS

Whilst the challenge facing NHS organisations in delivering efficiency savings remains a clear priority; within that context this letter seeks to clarify the Departmental of Health (and Government) view on the use of tax advisors, with particular reference to tax avoidance.

You will be aware that an element of VAT incurred on the supply of any applicable services "contracted-out" of the public sector is genuinely 'reclaimable' and this is accepted practice worth in the region of £2 billion per annum across the NHS.

However, The Department has been made aware of a number of tax advisors offering tax solutions to health bodies which, although legal, avoid the payment of tax for which that body has been funded. The fees chargeable to the tax advisors represent a direct leakage out of the health system and while at a local level there may be an immediate financial benefit, there is an overall net loss to the exchequer as a result.

The only tax advice the Department deems acceptable is that necessary for the fulfilment of statutory functions or to assist in compliance with tax rules beyond in-house expertise. Tax avoidance schemes should not be entered into under any circumstances: for the avoidance of doubt, HMRC's definition of tax avoidance is:

"...bending the rules of the tax system to gain a tax advantage that parliament never intended. ...it often involves contrived, artificial transactions that serve little or no purpose other than to produce this advantage. It involves operating within the letter, but not the spirit, of the law."

HMRC are actively investigating the health sector in relation to tax avoidance schemes and the level of scrutiny is likely to increase in the future. Any findings indicating systemic issues will likely have significant implications, both locally for those organisations directly involved and nationally for the future use of the contracting out regime by the NHS.

I ask that careful consideration be given by NHS organisations when looking into contractual arrangements which give rise to a tax advantage. If there are genuine commercial reasons for entering into contracts which, as a by-product, have a tax benefit this Is considered acceptable. However, arrangements considered solely to gain a tax advantage is clearly tax-avoidance and should not be entered into for the reasons set out above.

For further information and any advice on this matter, please do not hesitate to get in touch.

Yours sincerely

Chris Young

Finance Director

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Fraud costs the NHS an estimated £1.25 billion every year.

The NHS Counter Fraud Authority leads on identifying, investigating and preventing fraud and other economic crime in the NHS.

Visit **www.cfa.nhs.uk** to find out how we work with organisations across the NHS and beyond to tackle NHS fraud and safeguard vital resources intended for patient care.

If you have any concerns about NHS fraud, call us on 0800 028 4060 (powered by Crimestoppers) or report online at www.cfa.nhs.uk/reportfraud

NHS fraud. Spot it. Report it. Together we stop it.