



The HFMA's response to the National Audit Office's consultation on Auditor Guidance Note 3

Who we are

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For 70 years, it has provided independent and objective advice to its members and the wider healthcare community. It is a charitable organisation that promotes best practice and innovation in financial management and governance across the UK health economy through its local and national networks.

The association also analyses and responds to national policy and aims to exert influence in shaping the wider healthcare agenda. It has particular interest in promoting the highest professional standards in financial management and governance and is keen to work with other organisations to promote approaches that really are 'fit for purpose' and effective.

The HFMA offers a range of qualifications in healthcare business and finance at undergraduate and postgraduate level and can provide a route to an MBA in healthcare finance. The qualifications are delivered through HFMA's Academy which was launched in 2017 and has already established strong learner and alumni networks.

Question 1 – Do you have any comments on the scope of proper arrangements set out under each of three reporting criteria that auditors are required to report? If you think the scope of proper arrangements could be improved, please provide details.

The HFMA welcomes the proposed new approach to assessing and reporting on value for money (VFM), which we hope will maximise the impact of local audit work. In the past, we have had concerns that NHS organisations may not fully understand the auditor's conclusion on the arrangements to secure VFM and the action they need to take as a result (see [HFMA's External audit reports: the role of the audit committee](#)).

The new proposed commentaries on financial sustainability, governance and improving economy, efficiency and effectiveness, tailored to local circumstances, should focus NHS boards' attention on the areas that need improving as they will be set out as recommendations. The scope of the proper arrangements set out under each of the three reporting criteria provides clarity. It would be helpful if the descriptor of financial sustainability referred to the fact that in the public sector, resources are limited. In our opinion, consideration should be given to adding the word 'available' before resources.

We suggest that it would also be helpful to reflect:

- **The impact of system working on financial sustainability**
The current criteria include how the body ensures its financial plans are consistent with other plans – this should be expanded to explicitly reference how the body is working with partners to ensure financial sustainability across a system. This is particularly relevant with the accelerated system working for many NHS bodies during the Covid-19 pandemic and the expectation that resources will increasingly be allocated at a system level.
- **The auditors' assessment of going concern**
It would be helpful to provide further guidance on how the assessment of going concern relates to, and interacts with, auditors' work on VFM arrangements. A number of our members have raised specific issues in this area. In many cases, NHS bodies view auditors' focus on going concern as unnecessary because of the interpretation of IAS 1 in relation to going concern set out in the Department of Health and Social Care's Group accounting manual. However, it is important to recognise, particularly in the current financial climate, that a large number of NHS organisations do have financial sustainability issues and, in particular, cash flow issues which will impact on their VFM assessment. It is worth emphasising the importance of focusing on cash when reviewing this area. There are cases, for example, in Barking, Havering and Redbridge University Hospitals NHS Trust where the focus on reporting of income and expenditure metrics and cost improvement plans did not flag an upcoming cash flow and financial sustainability issue. It may, therefore, provide better value for money if auditors' focus, both in relation to going concern and use of resources, could be on the importance of cashflow forecasting, alongside monitoring both the income and expenditure position and the balance sheet position throughout the year.
- **Consideration of both capital and revenue**
Our members have consistently identified capital as an area of concern. Capital resources have repeatedly been used, at all levels within the NHS system, to relieve urgent revenue pressures. The specified reporting criteria should explicitly refer to the consideration of both capital and revenue plans and highlight the linkages between the two.
- **Changing governance arrangements**
There have been a number of essential changes to arrangements as a result of the response to Covid-19 such as: flexible working; accelerated approval processes; a greater use of technology; carry-over permissions; and a streamlined financial regime. These changes were introduced at pace at the end of the 2019/20 financial year, but mostly impacting on the 2020/21 financial year. Now that the NHS is entering the third phase of dealing with the pandemic, NHS organisations and systems are working through which changes are appropriate to retain over the longer term. In 2020/21, as the auditor assesses VFM arrangements, many of these discussions will remain ongoing. In particular current, and ongoing, uncertainty over the financial framework and the lack of contracts in place throughout the year is likely to cause difficulties in how NHS organisations approach their annual budget setting processes. It would be helpful to include some expanded reference to this in the section on Covid-19 and assessment of significant weakness, with particular reference to the reporting criteria.

Other minor comments:

- we suggest that the word 'financial' is added before pressures in the first bullet point in relation to financial sustainability
- it would be helpful if further guidance on the legislative/ regulatory requirements that should be considered is included in the final bullet point in the governance section
- the phrase management cost in the first bullet of the improving economy, efficiency and effectiveness section is not clear. Does this mean the cost of managing the organisation or is it the management of cost and performance information? It would be clearer if the word management was simply deleted.

Question 2 – Do you have any comments in respect of the approach to planning the audit work?

Paragraphs 19 and 20 provide a helpful list of considerations for planning work and the guidance clearly expects issues to be raised as they are identified. Paragraphs 22 and 23 are welcome inclusions to ensure planning is completed in a timely manner and revisited on an ongoing basis. It may be helpful to explicitly refer to major incidents as being a significant risk which would include Covid-19 in 2020/21.

It would be helpful to provide further clarification on how the auditors' work on economy, efficiency and effectiveness of corporate arrangements links to other assessments, such as the NHS Improvement and Care Quality Commission use of resources assessment and well-led framework. Where different reports, by different bodies, cover the same area this can undermine the credibility of the work and cause confusion. There should be one clear test undertaken by all regulators. We recognise that each organisation undertakes these reviews for different purposes, but it can lead to duplication of work and confusion if different conclusions are being reported or if there is cross referencing and circular reliance on other regulators' reports. Paragraph 3.9 clarifies that the auditor's work should be informed by the work of inspectorates and other bodies and this could be expanded, within the Code or in further guidance, to provide further clarity to the specific linkages between the assessments.

Question 3 - Do you agree that the characteristics of a significant weakness in the AGN are helpful? If yes, are there any further characteristics of a significant weaknesses that could usefully be included?

Yes, we agree that the characteristics of a significant weakness set out in paragraph 29 are helpful.

It may also be helpful to add in a characteristic to recognise the impact on other bodies, for example with system working a financial benefit to one organisation may be to the detriment of the wider system.

Question 4 - Do you agree that the examples to help consider whether or not a weakness is 'significant' is helpful? If yes, are there any further considerations to determine when a weakness is 'significant' that could usefully be included?

Yes, we agree that the characteristics of a significant weakness set out in paragraph 30 are helpful. It may be worth expanding the final bullet point in paragraph 30 to include the length of time that the weakness has existed. For example, at the start of the Covid-19 pandemic, decisions were made at pace and staff moved to different working arrangements very quickly. This may have resulted in temporary weaknesses in arrangements that were then resolved as the new ways of working became established. Auditors may want to consider the significance of these temporary weaknesses. Paragraph 27 implies that where a significant weakness has been identified there will be an associated recommendation. However, this may not be the case for weaknesses that the audited body has identified itself and has remedied, for example, as the Covid-19 pandemic working arrangements developed.

We note that paragraph 31 could be clearer. In particular:

- the reference to considering findings in relation to the judgement in place during the year could lead to a restricted view which only looks back at arrangements in the year only, rather than providing an up to date review of the bodies response to issues raised.
- the reference to the fact that a significant weakness that has already been identified and reported does not need to be repeated, could lead to an omission of information in the annual report commentary that may be the only element read by members of the public.

Question 5 - Do you agree that the illustrative significant weaknesses in the AGN are helpful? If yes, are there any further illustrative examples that could usefully be included?

Yes, illustrative examples are always particularly helpful and we agree with those included.

Further examples would be helpful. It may be particularly relevant to include examples relating to issues identified above such as cost collection and budgets, in light of expected issues for Covid-19; a lack of system wide financial understanding and plans; going concern; working capital management and cash flow forecasting; and capital.

An issue for some members, particularly when the previous binary approach was in place, was how the auditor should assess a situation where an NHS organisation reported a deficit but which was in accordance with their agreed plan and trajectory. An example in this area covering how the changed VFM assessment arrangement can be applied would be helpful.

The key regulatory, statutory and professional requirements listed in the final bullet point in paragraph 35 all apply to local authorities, it would be helpful to have some NHS examples as well.

Question 6 – Do you think that the considerations for deciding how to report a significant weakness in arrangements are clearly communicated?

Yes, the considerations for deciding how to report a significant weakness in arrangements is clear.

We note that paragraph 5 of the AGN refers to the auditors' annual audit report and defines this in relation to the Accounts and Audit Regulations that apply to local authorities only. However, paragraph 6 of the AGN states that for NHS bodies, the annual report should be published at the same time as the opinion on the financial statements for NHS bodies. It is not clear whether the commentary is part of the annual audit letter or the audit report on the financial statements for NHS bodies. An example report would be very useful.

Question 7 – Do you think that the expectations set out in the auditor's commentary section on will help audited bodies to get more value out of the work auditors undertake on value for money arrangements?

The reasons for the financial difficulties that NHS bodies face are many and complex and no NHS body works in a silo. We welcome the move to a commentary-based approach, which should be more meaningful for readers of the accounts and provide a clear focus for discussions with senior management and boards as well as identifying recommendations for action.

We also recognise that a commentary approach is particularly helpful for those organisations that received unqualified opinions in the past and therefore little feedback on how VFM could be further improved.

For NHS bodies, financial sustainability issues are past, present and future and the auditor's report will now be able to reflect the NHS context. With the commentary on the VFM arrangements being more forward looking, it will be able to reflect organisations' direction of travel and allow the agreement of meaningful recommendations.

However, we are also concerned about the potential impact on the capacity of auditors, many of whom are already struggling to meet audit deadlines. This will be especially difficult in 2020/21 when auditors will be playing 'catch up' as a result of the Covid-19 related delays to NHS and local authority reporting deadlines. Our members reported that, partly as a result of Covid-19, but also as a result of the pressures faced by auditors at the moment, agreement of audit opinions was difficult this year. Some consideration must be made for the amount of time it will take auditors to process a commentary-based report through their approval and sign-off procedures.

We do also have concerns about the impact of any extra work on audit fees, which would be an additional financial pressure on NHS resources.

Question 8 – Do you think that the section setting out the approach to subsequent events is clearly communicated?

Yes, we think that the section setting out the approach to subsequent events is clear.

Question 9 – Do you agree with the proposal to maintain the supporting information separately from the statutory guidance set out in the draft AGN?

Yes, we agree with the proposal to maintain the supporting information separately from the statutory guidance set out in the draft AGN. This allows for it to be regularly updated to reflect ongoing changes and issues.

Question 10 - Are there any other ways in which you think that the guidance could be further strengthened or improved?

The section on Covid-19 is helpful. The challenge of dealing with the Covid-19 pandemic and the changes that have been made at pace should be used to allow the NHS to consider how funding, both revenue and capital, should be best spent to deliver integrated health and social care in the right place at the right time. It would be helpful to emphasise the important role auditors have in providing an independent assessment and recommendations during this challenging time.

The Covid-19 pandemic will have a very significant impact on financial matters throughout 2020/21. With a focus for the rest of the year on restoring of services to pre-Covid-19 levels; dealing with the winter flu season; and ongoing preparations for a second wave of Covid-19, there will be significant capacity issues for both finance and audit teams. In these extraordinary times, significant changes in the approach will be an added pressure.

In July 2020, the HFMA surveyed its members about the year-end process to see whether there were any lessons that could be learned. This included specific questions about the audit process. Although the additional time to finalise the 2019/20 annual report and accounts was welcomed, in a number of cases members felt that it led to more audit work being undertaken. They were unable to see the value in this additional work. As we said above, the impact of the delays to the 2019/20 accounts will be felt by auditors throughout 2020/21. Auditors will need to consider the scope and the timing of their VFM assessments to ensure that weaknesses are identified in a timely manner, to maximise the benefits of their work while minimising the burden on both audit teams and finance departments.

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