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CHARTERED
SECRETARIES

Health Service Governance

June 2013

Suggested answers and examiner's comments

Important notice

When reading these answers, please note that they are not intended to be viewed as a definitive 'model' answer, as in many instances there are several possible answers/approaches to a question. These answers indicate a range of appropriate content that could have been provided in answer to the questions. They may be a different length or format to the answers expected from candidates in the examination.

Examiner's general comments

This is the first time this paper has been set for candidates and the majority of candidates engaged with the study material sufficiently well to achieve a pass grade or above.

Answers that did not achieve a pass standard were generally not robust enough to warrant a pass. The answers on these papers often picked up marks by casual reference to the right areas in the marking scheme but did not show any depth of understanding or application to the question.

Of those candidates who achieved a 'pass', the answers given were either basic answers that covered the basic material set out in the marking scheme and showed some application to the question scenarios, or papers where the candidates did not provide four solid answers, for example, scoring well on two questions but not on the remaining two.

The candidates who achieved a grade band 'merit' showed a greater understanding of the areas set out in the marking scheme, often citing good examples or giving good accurate references to source materials. They demonstrated clear application to the scenario in the question. Again, these candidates often did not deliver four consistently good answers, for example, scoring above 75% in one answer but only achieving a pass mark in another.

Those candidates who achieved a grade band 'distinction' gave answers which showed a depth of understanding and practical application across all four questions.

The most popular questions were Question 1 and Question 5, both of which related to board performance. Some candidates attempted to write the same answer to both, relying on the same areas to address both questions and thus did not score so well. Those candidates who did well recognised that Question 1 was about board composition, NED independence, board behaviours and the role of the nomination committee in an FT; and that Question 5 was about effective decision-making, the need for high quality and timely papers, intelligent information, debate and challenge, action plans and monitoring.

Time allocation between questions also seemed to be a problem for some candidates who wrote at length in answer to the first question they selected, then slightly less on the next question. After that, these candidates appeared to realise they were short of time and therefore had to rush their final two answers. Even if they earned pass marks for their first two answers, these would be offset by poorer marks for the final two answers and the overall result. Candidates need to be prepared to answer four full questions in order to achieve a good pass rate overall. As can be seen in the comments for Question 6, it would appear that this was the least popular and also the weakest answer for many candidates. It would also appear that candidates performed better in those questions which had two or three sections, which suggests that under examination conditions candidates rely on the structure that allows them to marshal their ideas and present them in a coherent way.

However, it was encouraging to see that many candidates had mapped out an answer plan including the main points they intended to make and gave some structure to their answers. One candidate incorrectly numbered their answers, which led to the examiner having to work out which question the candidate was attempting to answer.

Candidates need to pay particular attention to the nature of the organisation in each question. If the question scenario involves a CCG, then the answer should relate to the work of the governing body and not the board. If the trust is an aspirant, then the answer should not make reference to governors as though it were an FT. If the question relates to an FT and the role of the governor is relevant to the answer, then the Council of Governors should be included, otherwise, answers should refer to the board of directors, audit committee and so on, as appropriate.

1. Franks Moor NHS Foundation Trust ('Franks Moor') is well-established. It recently conducted an annual performance review of the board, its committees and its directors, with the assistance of external consultants. Acting on the findings and recommendations of the consultants, the board chairman has arranged a meeting with the deputy chairman and you, as company secretary. The review had highlighted a lack of challenge and scrutiny by the non-executive directors and, in particular, poor board behaviours.

There are ten directors on the board: the chairman, four other non-executive directors and five executive directors, including the chief executive officer (CEO) and finance director. There have been no changes to the board during the past four years.

The board chairman reveals at the meeting that she is considering retirement in 6 to 12 months' time, and before she leaves the trust she wants to make sure that she will leave behind a strong and effective board of directors. However, she is aware that the CEO has also been considering taking early retirement and has expressed an interest in being appointed as the next chairman of the trust. She suggests that you, as company secretary, may be able to offer assistance and advice on these matters.

Required

(a) Identify factors that may lead to poor board performance. Recommend measures that should be taken by the chairman and the board of Franks Moor to improve the performance of the board in relation to the specific criticisms contained within the review.

(12 marks)

Suggested answer

There are a number of factors that may lead to the poor performance of non-executives directors (NEDs) in their role of scrutiny and challenge.

The first area to consider is whether the NEDs are independent. A NED is deemed not to be independent if their opinions are likely to be influenced, in particular, by the senior executive management of the organisation or by a major stakeholder. The FT Code of Governance (FT Code) states that each board of directors should identify in the annual report each NED it considers to be independent. The board is responsible for determining whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. There is also a general view that the independence of an NED is likely to diminish over time, as the NED becomes more familiar with the organisation and executive colleagues. The risk is that the NED will take more of the views of executive colleagues on trust and will be less rigorous in his questioning. This is noted in the FT Code, UK Corporate Governance Code, and the King III Code. The board should therefore consider the independence of each NED and reflect on their length of service to ascertain whether this is impacting on their ability to scrutinise and challenge.

The ability to scrutinise and challenge also depends largely on the quality of information available to the NED. The FT Code states that the board as a whole should be 'supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties'. And this is true for NHS FTs too. However, the senior executives in the trust control the information systems, and so control the flow of information to the board. It is quite conceivable, for example, that the CEO and other executive directors might have access to management information that is withheld from the board as a whole, or that is presented to the board in a distorted manner. Lacking the 'insider knowledge' of executive managers about the business operations, and having to rely on the integrity of the information supplied to them by management and executive directors, can restrict the scope for NEDs to make a meaningful contribution to board decisions.

NEDs often have executive positions in other companies and organisations, where most of their working time is spent. As a general rule, NEDs do not have an office at the trust headquarters and may spend at most two or three days a month on the trust's business. It could be argued, for example, that an individual cannot be an effective NED of a trust if he is also the CEO of another public organisation and holds four or five other NED positions in other companies. All directors should be able to allocate sufficient time to the trust to discharge their responsibilities effectively.

The board at Franks Moor has an equal number of NEDs and executive directors on it and this can alter the balance of the discussions. It is well known that if a difference of opinion arises during a meeting of the board, the opinions of the executive directors are likely to carry greater weight, because they know more about the organisation. As a result, NEDs may be put under pressure to accept the views of their executive director colleagues. Depending on the Constitution, provision may be made for the chairman to have a casting vote but this would not compensate for the possible greater knowledge of the NEDs.

A further factor impacting on the NEDs' effectiveness relates to boardroom behaviours. The ICSA report 'Boardroom Behaviours' (2009) suggested that the corporate governance problem in the banking crisis was partly attributable to inappropriate 'boardroom behaviours'. These behaviours had facilitated the lack of challenge and rigour required in the boardroom. The report findings could be used as a benchmark for Franks Moor to assess whether their boardroom behaviour is characterised by:

(i) a clear understanding of the role of the board;
(ii) the appropriate deployment of knowledge, skills, experience and judgement;
(iii) independent thinking;
(iv) the questioning of assumptions and established orthodoxy;
(v) challenge which is constructive, confident, principled and proportionate;
(vi) rigorous debate;
(vii) a supportive decision-making environment;
(viii) a common vision; and
(ix) the achievement of closure on individual items of board business.

In relation, specifically, to the NHS, the ICSA research project 'Mapping the gap; highlighting the disconnect between governance best practice and reality in the NHS (July 2011)' was initiated to examine the degree to which trust boards in the NHS understood issues of governance, and the extent to which actual boardroom behaviour reflected guidance on best practice. The resulting report stated that the boardroom behaviours observed suggested that more challenge was required to improve discussions and decisions. The project further identified that there were a number of behaviours that did not suggest that all board members were fully engaging with the business to be transacted, for example, using electronic devices, conversing with colleagues, interrupting colleagues, reading non-board papers, arriving late/leaving early, fidgeting, and generally not participating in the debate. Franks Moor might want to consider the findings of both of these reports and draw up its own code of acceptable boardroom behaviour.

(b) Outline the process taken by the nomination committee in the appointment of a new chairman and outline the governance issues raised by the possible appointment of the current CEO as chairman.

(13 marks)

Suggested answer

A key governance issue for any board is effective succession planning for the eventual replacement of board members, and it is particularly important that there should be long-term succession planning for the most important board positions, particularly the positions of board chairman, CEO and finance director. Succession planning is necessary to ensure that the board remains effective and the FT Code makes it clear that the governors are responsible at a general meeting for the appointment, re-appointment and removal of the chairman and the other NEDs.

In FTs there may be one or two nomination committees. If there are two committees, one will be responsible for considering nomination for executive directors and the other for NEDs (including the chairman). Where an FT has two nomination committees, the nomination committee responsible for the appointment of NEDs should consist of a majority of governors. If only one nomination committee exists, when nomination for NEDs (including the appointment of a chairman or a deputy chairman) are being discussed, there should be a majority of governors on the committee and also a majority governor representation on the interview panel. It is important to note that the current chairman must not be involved in the process to identify their successor and therefore should not be a member of the nomination committee. Depending upon the terms of reference of the committee, it is likely that the committee would be chaired by either the Senior Independent Director or the Lead Governor.

The Council of Governors should agree with the nomination committee a clear process for the nomination of a new chair. Once suitable candidates have been identified, the nomination committee should make recommendations to the Council of Governors. The chairman intends to retire within the next year so the nomination committee should have already begun a process of identifying a potential new chairman who would be acceptable to the governors, the board, and the wider stakeholder community in general.

A person may only be appointed as a NED or chairman if he is a member of the public constituency (or the patient constituency if there is one). Where the trust has a university medical or dental school, a person may be appointed as a NED if he exercises functions for that university.

Since the chairman may be appointed from outside the trust, the nomination committee should initiate a search. To do this it may appoint a firm of head-hunters, whose task would be to identify a small number of potential candidates for consideration or it might advertise the position and might conduct its own private search. Alternatively, the nomination committee may consider the appointment of an existing independent NED as successor to the chairmanship, if a suitable candidate exists who is able to take on the role.

Choosing a new chairman is a very sensitive issue for an FT, and the nomination committee chairman may want to consider the opinions of stakeholders such as the chairman of the CCG about the type of person, skills and experience that the board should be seeking to appoint, without discussing specific individuals.

When the nomination committee eventually identifies a preferred candidate, who would be willing to accept the position of chairman, it should make a recommendation to the Council of Governors. Upon receiving such a recommendation, the Council of Governors should consider the qualifications, skills and experience required and the time commitment required. The FT Code stipulates that “no individual, simultaneously whilst being a chairman of an NHS foundation trust, should be the substantive chairman of another NHS foundation trust.”

In accordance with the FT’s constitution, appointment is by a majority of the governors attending the relevant meeting.

If a suitable candidate is identified fairly quickly, the board may consider appointing the individual as deputy chairman until the current chairman retires, and provide suitable induction in the next year so that he or she is better prepared to take on the position when the time eventually comes. Alternatively, the board may consider appointing the candidate as an associate NED in the intervening period. These options are only possible if such an appointment is permissible under the Constitution.

The FT Code states that the board chairman should be independent on first appointment. This means that the chairman is free from any material relationships with the trust and it may be appropriate to make the appointment from the existing pool of independent NEDs or as an external appointee. A current employee (such as the CEO) would not be considered independent. Whilst the FT Code remains a “comply or explain” code, where non-compliance requires an explanation in the annual report, it is unlikely that the appointment of the existing CEO would meet with the approval of the governors or regulators. One of the problems with appointing the CEO as chairman is that the incoming CEO might find it very difficult to run the organisation as they wish because the former CEO is still on the board, monitoring what they are doing. It might also be difficult for the new chairman to remain strategic in focus without straying into the operational detail, and also for the executive directors to adapt to the new line management if the old CEO is still on the board as chairman.

Examiner’s comments

Question 1 was the best answered question, with a number of answers scoring highly. In general, part (a) was answered far better than part (b).

2. **The newly appointed chairman of your trust's audit committee, Danielle Cooper ('Danielle'), is a professionally-qualified accountant with industrial experience. However, her only experience of the NHS is her current appointment as a non-executive director. She clearly has the recent and relevant financial experience necessary to take on the role of chairman but has asked for your advice on the wider role of the audit committee as set out in the NHS Audit Committee Handbook. In particular, Danielle is concerned about the assurance framework and the documents which are to be publicly disclosed that specifically relate to the NHS.**

Since taking on the role, Danielle has also been concerned by the large amount of non-audit work the external auditors do for the trust, in addition to the external audit. In recent months, the trust's auditors have installed a new system for payroll and workforce reporting, have provided VAT advice and have carried out the board's annual performance review. As a result, Danielle also wants advice on how the audit committee should review the independence of the external auditors.

Required

(a) **Explain to Danielle how the standards, as set out in the NHS Audit Committee Handbook, apply to role of the audit committee she chairs, paying particular attention to the assurance framework and any documents that are to be publicly disclosed.**

(13 marks)

Suggested answer

The NHS Audit Committee Handbook (HFMA 2011) describes the role of the audit committee as "critically reviewing the governance and assurance processes on which the board places reliance".

Danielle needs to take this into consideration and take into account this wider role which goes beyond the traditional role of financial scrutiny envisaged by the UK Corporate Governance Code and has resulted from the broad range of stakeholder requirements that exist in the NHS.

As chairman she should ensure that the two key areas that the audit committee provides assurance to the board on are the Assurance Framework and documents that are to be publicly disclosed (i.e. Statement on Internal Control or Annual Governance Statement, registration evidence for the CQC, the annual report and accounts and the quality accounts).

The Assurance Framework (AF) provides the trust with a method for the effective and focused management of the principal risks to meeting its objectives. It also provides a structure for the evidence to support the Annual Governance Statement (AGS). It identifies which of the trust's objectives are at risk because of inadequacies in the operation of controls or where the organisation has insufficient assurance about them. At the same time, it provides structured assurances about where risks are being managed effectively and objectives are being delivered. This allows the board to determine where to make efficient use of resources and to address the issues identified to improve the quality and safety of care.

"Building the Assurance Framework: A Practical Guide for NHS Boards" by the Department of Health and "Taking it on trust" by the Audit Commission both offer guidance on the AF and Danielle should familiarise herself with their content.

The AF is a framework that NHS organisations are required to put in place to identify the key risks to the trust's achievement of its strategic objectives and how these risks are being managed. In documented form this would include:

- the trusts strategic objectives;
- the key risks to achieving the objectives;

- the controls in place to manage the risks;
- the assurances that the trust used to provide evidence that the controls were operating effectively;
- any gaps in the assurances; and
- an action plan to address the gaps.

The gaps in assurance can be used to inform the audit programmes for the following year – both Internal Audit and Clinical Audit programmes.

In order to sign off the AGS, the trust needs to be assured that the systems, policies and people they have put in place are operating in a way that is effective, is focused on key risks and is driving the delivery of objectives.

Although the process of securing assurance has always been a fundamental principle of good management and accountability, the requirement for all NHS Chief Executives to sign the AGS has focused attention on the level of assurance that boards receive. To provide this statement, boards need to be able to demonstrate that they have been properly informed through assurances about the totality of their risks, not just financial, and have arrived at their conclusions based on all the evidence presented to them.

Danielle and the audit committee should not be responsible for creating the AF. Instead, they have a key role in satisfying themselves that the AF is being created appropriately by line management and that the processes and format are valid, relevant and effective. The committee needs to be satisfied that it contains the high risk areas pertinent to the organisation.

With regard to public disclosure statements, Danielle and the audit committee has an essential role in reviewing these prior to approval by the board. They should be satisfied with the strength of the processes and the quality of data, which has been relied upon to produce the statements. Key documents that are specific to the NHS include the Annual Governance Statement, the CQC registration evidence and the quality accounts. Danielle will be familiar with the requirement to produce an annual report and accounts, however, she may want to familiarise herself with the differences required by the NHS Finance Manual, the Financial Reporting Manual (FReM) and/or Foundation Trust Annual Reporting Manual (FT ARM). The director of finance should be able to assist her with the technical aspects and further support can be given by the company secretary on the reporting requirements.

A brief outline of the other documents are as follows:

- The Annual Governance Statement – the annual review of the effectiveness of the systems of internal control and risk management which also makes reference to quality governance and discloses any significant control issues or weaknesses. Assurance is required in respect of ongoing internal audit reports into internal controls and risk management.

- The Care Quality Commission (CQC) registration evidence and assessments – CQC monitors compliance with its registration requirements and, if necessary, uses its enforcement powers to ensure all service providers meet those requirements. It publishes its findings and reviews, as well as independent assessments of how organisations are performing by drawing on a range of sources of information, including what patients and the public tell them. Assurance on the accuracy of the evidence submitted or assessment report is required.

- The Quality Account – this is the annual report on the quality of services provided by an NHS healthcare service. Assurance on the accuracy and transparency of the information presented is required. Further assurance is provided by the inclusion of any statement provided by the CCG (formerly the lead primary care trust), HealthWatch (formerly the Local Involvement Network) and local overview and scrutiny committee. These stakeholders must have an opportunity to comment on the report ahead of its publication.

There is detailed guidance from Monitor on the external audit of quality reports. Auditors' limited assurance report on the content of the quality report should test mandated indicators.

The company secretary plays a key role in supporting the chairman of the audit committee and the committee in ensuring the proper flow of information to the committee and advising on any risks that may have been overlooked or underplayed.

Examiner's comments

Part (a) was the least well answered section of this question. Candidates tended to write a lot about the composition and financial qualifications required for an audit committee as well as focussing on the role of the audit committee. The focus of the answers should have been on the Assurance Framework, Annual Governance Statement, Care Quality Commission registration and the Quality Account.

(b) Explain why the independence of auditors is important and identify the threats to auditor independence.

(7 marks)

Suggested answer

Accountability is an important aspect of good health service governance and the board of directors should be accountable to the stakeholders for their stewardship of the trust's assets and for the way in which they have exercised their powers. The NHS Finance Manual, the FReM and FT ARM require a balanced assessment of the trust's position and prospects. The annual report and accounts set out an assessment of the trust's performance and financial position. For the annual report and accounts to provide accountability, it is essential that the information they contain should be reliable.

External auditors therefore are required to check the financial statements and the way in which they have been prepared, and provide an independent professional opinion to the stakeholders about whether the financial statements give a true and fair view. They are also required to provide an opinion on use of resources and that there are adequate arrangements to secure economy, efficiency and effectiveness and on the content of the quality report. Stakeholder confidence in veracity of the financial statements, including the statement by the board about the going concern status of the trust, and quality report, is therefore dependent on the independent opinion of the auditors.

It could be argued that, unless suitable health service governance measures are in place, a firm of auditors may reach audit opinions and judgments that are heavily influenced by their wish to maintain good relations with the management of a client organisation. If this happens, the auditors are no longer independent and the stakeholders cannot rely on their opinion.

The Audit Code for Foundation Trusts (2011) and NHS Code of Audit Practice (2010) give the audit committee the responsibility for monitoring and ensuring the independence of the external auditors. If the external auditors provide non-audit services to the organisation, the annual report should explain how auditor independence and objectivity are safeguarded.

Five types of threats to auditor independence can be identified:

(i) Self-interest threats, which arise in situations where it is in the auditor's own interests to accept the views and opinions of the client's management and not to challenge them vigorously. The auditors in the scenario carry out a lot of non-audit work for the company, and this may create a self-interest threat. This is because the audit firm may be reluctant to lose the non-audit work and fee income, and so may be less rigorous than it should be in the conduct of the external audit.

(ii) Self-review threats, which arise when the auditors are required to check the validity of work that has previously been carried out by employees of the audit firm. Auditors might be reluctant to report failures in the work of their own staff.

(iii) Familiarity threats, which can develop as members of the audit team become more familiar with a client company and its management, and so become more willing to accept the accuracy and validity of their opinions and what they do.

(iv) Advocacy threats, which arise when the audit firm actively promotes the interests of a client company, for example, in a legal dispute between the company and another party.

(v) Intimidation threats, which arise when the auditors accept the views of a client's management because of threats or domineering personalities.

Examiner's comments

Part (b) was a well-answered section, where candidates focussed on the importance of the independence of external auditors and the threats to that independence.

(c) Recommend checks that Danielle and the audit committee should carry out to assess whether the external auditors remain sufficiently independent.

(5 marks)

Suggested answer

The NHS Audit Committee Handbook states that the audit committee should review the independence and objectivity of the external auditors, and the effectiveness of the audit process. Danielle and the audit committee should therefore monitor the external auditors and actively consider their independence. The committee may gather evidence from a number of sources:

(i) The reports prepared by the auditors for management and the audit committee/board may indicate the extent to which the auditors challenge management views and identify control system weaknesses. The audit committee should meet at least once a year with the head of the audit team, and discuss the issues that arose during the audit. The information obtained from this meeting, and the auditor's letter to management about control weaknesses, should provide useful evidence about the auditors' judgement.

(ii) The audit committee should seek assurances from the audit firm about the procedures that the firm has in place for monitoring the continuing independence of its audit team. For example, the audit committee should seek assurance that none of the audit team is related to a senior manager in the client trust or that they advise any of the individual directors in relation to their other declared interests.

(iii) Reports by the internal auditors on control system weaknesses may help with an assessment of the opinions of the external auditors.

(iv) It is unusual for the auditors of a NHS trust and NHS FT to write a qualified audit report, or to challenge the going concern statement by the board of directors. However, any such disputes between the auditors and the board (and management) should be an indication of auditor independence.

Examiner's comments

Part (c) saw most candidates listing a wide variety of checks to ensure that independence was secured and most offered a good practical analysis to support the role of the audit committee chairman.

3. You are the company secretary of an NHS Trust, applying to become an NHS Foundation Trust, which previously had a sizeable cumulative deficit. In the last few years, significant progress has been made in recovering the trust's financial performance which has largely been due to improvements in the trust's arrangements for managing performance against budgets. This has required a reorganisation of the management structure into a smaller number of clinical divisions and a revised financial strategy. As a result, the trust's budgetary control arrangements have improved considerably over the past three years, resulting in the trust being able to deliver a small surplus this year.

Internal audit is provided by the Mike Consortium, which follows the NHS Internal Audit Standards. You have been discussing the audit committee's review of the effectiveness of the internal control system with the head of internal audit, Shane Williams ('Shane'). As an internal auditor, Shane's concern is related to the production of this year's Annual Governance Statement. He believes that, given the amount of change that has been experienced, there should be regular internal audit testing to assess the effectiveness of internal controls, so that he can adequately prepare for the Head of Internal Audit Opinion which he is required to give. Shane believes that this would give added assurance to the board that the changes have been embedded within the trust.

Required

(a) Describe the main elements of an internal control system, and the contribution of each of these elements to an effective internal control system.

(15 marks)

Suggested answer

A requirement for good health service governance is that an NHS trust should have an effective system of internal control. NHS organisations rely upon the provisions in the UK Corporate Governance Code, which stipulates that the board should maintain sound risk management and internal control systems and, at least annually, it should conduct a review of the effectiveness of the system and report to stakeholders that it has done so. The Code also states that a function of the audit committee should be to review the internal financial controls and (unless a risk committee of the board or the full board carries out the task) review the whole internal control system. The approach therefore provides guidelines, but does not provide specific rules; for example, the Turnbull Guidance on internal control and reviewing effectiveness. The Turnbull Guidance forms the basis of NHS guidance on internal control and internal control systems.

An internal control system is the system that an organisation has to provide assurance. It identifies the internal control risks for each of those areas and then seeks to apply controls to reduce the risk of losses from these risks and taking corrective action when losses occur.

The Turnbull Guidance requires it to be embedded within the business and its operating systems and the controls must remain relevant to the requirements of the organisation. This means they must be regularly reviewed to take account of changing circumstances.

An internal control system has five main elements:

(i) Control environment – A control environment describes the awareness of (and attitude to) internal controls in the organisation, shown by the directors, management and employees generally. It therefore encompasses corporate culture, management style and employee attitudes to control procedures.

(ii) Risk identification and assessment – The system should also provide for the identification of risks and their impact on the trust. The system will then continually monitor these risks and any changes in those risks. The significance of each risk should be assessed, and control measures should be devised for the risks that are considered material. The continual assessment of risks is essential because circumstances change: new risks emerge and existing risks change in character. It is important to look for changes in the nature of risks, so that new controls can be introduced or existing controls amended.

Internal control risks can therefore be categorised into three broad types:

- Financial risks.
- Operational risks.
- Compliance risks.

(iii) Internal controls – Controls should be devised and implemented to eliminate, reduce or control risks. There should be controls to ensure that the organisation, its systems and procedures operate in the way that is intended, without disruption or disturbance and that these risks are managed.

- There should be controls to ensure that assets are safeguarded. For example, there should be controls to ensure that money received is banked and is not stolen, and that operating assets, such as items of equipment and computers, are not damaged or lost.
- Controls should include measures to reduce the risk of fraud.
- Financial controls should ensure the completeness and accuracy of accounting records, and the timely preparation of financial information.
- Controls should be in place to ensure compliance with key regulations, such as CQC regulations, Monitor regulations, or health and safety regulations.

Such controls will include a culture of risk awareness, with a strong lead provided and an example set by the board and senior management. A strong control culture creates an awareness of risks among the management and work force, and an understanding of the need to ensure that controls are properly applied and effective.

Internal controls are the controls that are devised and implemented to prevent risk events from occurring or identifying and correcting control failures that occur. Controls are fundamental to any control system, and they must be well designed and properly applied.

(iv) Information and communication – All employees who are responsible for the management of risks should receive information that enables them to fulfil this task. Information must be produced about risks, controls and control failures, and this information must be communicated to the relevant people, including senior management. People within an organisation need to be made aware of the risks and the controls that should be applied to manage the risks. They should also be informed when there are failures in risk control. Information, including feedback about failures, is essential to a control system.

(v) Monitoring – The effectiveness of risk controls and the internal control system generally should be monitored regularly to ensure that the system remains effective and that measures are taken to remove any weaknesses that are identified (including weaknesses in risk assessment and in internal controls). Internal audit is one method of monitoring the internal control system. Internal controls are also monitored by executive management and (as part of their annual audit) by the external auditors. The board of directors also has a responsibility to review the effectiveness of the system.

All five components of the internal control system must function for an effective internal control system. A serious failure or weakness in any component will make the system ineffective and inadequate.

Examiner's comments

This section was either answered exceptionally well or not well at all. When answered well, candidates clearly listed the five main elements and then applied them to the scenario in the question, or used the scenario as examples of the five key elements. Good answers also clearly defined financial, operational and compliance risks.

(b) Explain why internal controls need to be reviewed regularly, particularly in light of: (i) the progress made by the trust; (ii) the role of internal audit in monitoring the internal control system; and (iii) what other sources of assurance may be considered by the audit committee.

(10 marks)

Suggested answer

If internal controls are not monitored regularly, they are likely to become less effective over time. This is for two reasons. First, the nature of the risk may change so that a control that was established to deal with the risk may no longer be appropriate and so fails to fulfil its intended purpose. Second, there may be a tendency over time to ignore controls and circumvent them, unless compliance is regularly monitored. Monitoring has the effect of helping to ensure that internal controls remain relevant and are applied effectively, or to identify control weaknesses where the controls are no longer appropriate or no longer applied. When weaknesses in the system are identified through monitoring, measures can be taken to deal with them.

In this scenario, considerable progress has been made in budgetary controls within the new clinical divisions and there has been a new financial strategy implemented. As a result, not only has the nature of the risk changed, but so too have the staff involved in the processes as a result of the management restructure.

The internal audit control team may, therefore, be asked to focus its attention on financial controls in the divisions. It will want to check that the controls are appropriate and embedded. It may also want to test the impact on quality arising from these new budgetary controls.

It may also want to test the implementation of the new financial strategy and the role of the finance department and other divisional managers in adhering to the strategy.

The internal audit team is part of the internal control system with a key role in the monitoring of internal controls. An internal audit function can contribute to the monitoring of the internal control system by conducting tests of the effectiveness control. At a detailed level, this will involve audits into specific aspects of operations to check whether financial, operational and compliance controls are properly applied and to identify control weaknesses where existing internal controls do not deal adequately with the significant risks.

To contribute effectively to the monitoring of internal control, internal auditors must be individuals with appropriate capabilities, objectivity and authority. The information they produce needs to be persuasive about weaknesses or failings in key controls, and the management responsible for the operations must act on their reports and recommendations.

Internal audit is not the only way in which the effectiveness of an internal control system may be monitored. The audit committee can obtain reports from management and the external auditors about controls and control weaknesses or control failures. Supervisors may be given responsibilities for checking the effectiveness of controls within their area of operations. There may also be reporting measures embedded in the management reporting system that will signal possible control failures that occur.

The work of internal audit in monitoring the effectiveness of the internal controls feeds directly into providing assurance to the audit committee in its consideration of the Annual Governance Statement. The work of the internal audit team throughout the year should be planned according to the key risks faced by the trust. The external auditors will place reliance on the work of the internal audit team in the production of their audit report.

Examiner's comments

Answers that indicated that risks and/or environment can change, as well as acknowledging the tendency for controls to be ignored or circumvented over time, scored very well, especially where this was aligned to the scenario in the question.

Good answers also made mention of the role of the internal audit team in reviewing internal controls.

With regard to other forms of assurance that were mentioned, weaker answers focussed solely on management report and did not mention the role of external audit, the CQC or the role of staff/managers internally.

4. You are advising Whitmore Partnership NHS Trust ('Whitmore'), as a mental health trust applying for FT status. Whilst much of the FT process is designed to test clinical quality and financial viability, the Department of Health has recognised that this has to be underpinned by robust governance. The Board Governance Assurance Framework (BGAF) is designed to support boards in the assessment of their governance processes. The shift to FT status requires the trust board to understand the key role played by stakeholders and to engage with the increased accountability which will be required of them. As a result, the BGAF includes a section that specifically focuses on board engagement and involvement and the trust board will be required to self-assess its approach to stakeholders.

Required

Advise the board of Whitmore:

(a) On the importance of the stakeholder approach to governance for the trust, identifying the differences in its application to the trust and the wider corporate sector, and contrasting the stakeholder approach with other approaches to governance.

(18 marks)

Suggested answer

To: Whitmore
From: Governance adviser
Date: 6 June 2013

Briefing paper on foundation trust accountability

<u>The stakeholder approach to health service governance</u>

The importance of good governance is of particular importance in organisations where the separation between stakeholder interests and management is wide. This is a significant risk for NHS organisations. For example, government spending on health care for 2011/12 was approximately £106 billion and yet the recipients of the healthcare provided are often very distant from the holders of the healthcare budget.

Health service governance in NHS organisations, therefore, must be resilient enough to hold NHS organisations to account for the responsibility of managing this expenditure. The separation between NHS stakeholders and Parliament is vast and it is only through the health service governance regimes of the individual parts of the NHS that NHS stakeholders can exercise the relatively limited powers they have to hold the boards of directors to account.

As a consequence, the stakeholder approach to corporate governance is worthy of consideration by the trust as it gives credence to the views and interests of a wider number of stakeholders as opposed to just concentrating on shareholders.

In corporate governance, this approach argues that the aim is not just to meet the objectives of shareholders, but also to have regard for the interests of other individuals and groups with a stake in the organisation, including the public at large. This resonates more widely for the trust where the objectives of NHS organisations are influenced by a wide ranging variety of stakeholders.

From a 'stakeholder view', governance is concerned with achieving a balance between economic and social goals and between individual and communal goals. Sound governance should recognise the economic imperatives the trust faces in competitive markets and should encourage the efficient use of resources through sound investment. It should also require accountability from the board of directors to the stakeholders for the stewardship of those resources. Within this framework, the aim should be to recognise the interests of other individuals, companies and society at large in the decisions and activities of the trust.

A problem with the stakeholder approach for corporate governance is that company law gives certain rights to shareholders, and there are some legal duties on the board of directors towards their organisation. However, the interests of other stakeholders are not reinforced to any great extent by company law. The stakeholder approach expects that co-operative and productive relationships will be optimised only if the directors are permitted or required to balance shareholder interests with the interests of other stakeholders who are committed to the organisation. For the approach to be more applicable to corporate governance then, changes in company law would be required to introduce such an approach in practice.

Whilst acknowledging the wide diversity of stakeholders for the trust and attempting to balance their interests in the decisions that the trust makes, the approach is limited in its application to health service governance. This is because the concept of competitive markets is limited within the NHS and whilst there is an increasing emphasis on a market economy with healthcare this is still limited in reality. The introduction of the Any Qualified Provider regime may widen the market economy within the NHS but political arguments remain over the benefits of a market economy within a "national" health service. The concept of individual goals for stakeholders is also tempered by the overriding objective of the NHS and the trust to provide health care at the point of need for all.

A further distinction for health service governance is that the rights of other stakeholders such as employees, suppliers and the general public, although not well protected by company law, are protected by health law (for example, Freedom of Information Act and NHS Constitution) as well as other aspects of law such as employment law, health and safety legislation, and environmental law.

Other approaches could be:

- Shareholder value.
- Enlightened shareholder.
- Integrated approach – King Code.
- Policy governance approach.
- Governance as leadership.

Some strengths and weaknesses of each of these approaches are shown in the table below:

	Strength	**Weakness**
Shareholder value	• Well established. • Simple, clear aim to maximise wealth.	• Limited application, who are the owners in the NHS? • How do you define wealth?
Enlightened shareholder	• Balances long term and short term aims. • Encourages productive relationships with stakeholders.	• Lack of clarity on how to balance diverse needs of a variety of stakeholders. • Still largely shareholder driven.
Integrated approach – King Code	• Best interest of organisation defined as sustainable enterprise and a corporate citizen. • Integration on a case by case basis. • Shareholder does not have precedence.	• Complexity of NHS organisations makes a case by case approach too long winded. • Could lead to different decisions across the NHS as a whole – postcode lottery.

Policy governance approach	• Clarity on objectives set by beneficiaries. • Clear delegation to executive to deliver objectives.	• Difficulty in setting objectives with such a wide diversity of beneficiaries.
Governance as leadership	• Requires active dialogue between board, staff and service users. • Distinguished by its focus on sharing knowledge and information to problem solve.	• Lack of resource and expertise to fully implement this approach into the NHS. • Complexity of NHS organisations may mean there isn't a clear solution and compromise is the only option.

Examiner's comments

Part (a) of this question was not answered well on the whole. Answers did not reflect the key principles of the stakeholder approach, or their impact or relevance for an FT. Candidates who scored well wrote knowledgably about the other theoretical approaches as well as their relevance to an FT.

Marks were available for laying out the answer in the format required, but some candidates just wrote their answer as though it were an essay title.

(b) On the range of internal and external stakeholders that the board might need to consider within the BGAF.

(7 marks)

Suggested answer

<u>Internal and external stakeholders</u>

As part of its FT application process, the trust will be required to complete the Board Governance Assurance Framework (BGAF) in line with Department of Health (DH) requirements.

Whilst much of the FT process is designed to test clinical quality and financial viability, the DH has recognised that this has to be underpinned by robust governance. The BGAF is designed to support boards in the assessment of their governance processes. One of the key sections in the BGAF relates to the board's approach to engagement and involvement as meaningful involvement. Shared decision-making with patients and the public is a key enabler to improvements in quality, innovation, productivity and performance.

As a result, the board is required to consider who it would determine as being its key stakeholders, both internal and external to the trust. It needs to consider those organisations which will provide opportunities for engagement with patients, staff, the local community and the wider public.

External stakeholders that Whitmore might like to consider in respect of its engagement and involvement activity include the following:

- Other NHS mental health providers locally.
- Clinical Commissioning Groups.
- Regional representatives of the National Commissioning Board.
- Health and Wellbeing Boards.
- Overview and Scrutiny Committee.
- Local authorities or councils.
- Local HealthWatch groups.
- Local Community groups.

- Voluntary mental health agencies.
- Care Quality Commission.
- Monitor.

Internal stakeholders might include:

- Staff.
- Patients and their families.
- Patient focus groups or their equivalents.
- Governors.
- Members.

Summary

It can be seen that the key area where the stakeholder approach to governance can be helpful for the trust is that it gives credence to the views and interests of a wider number of stakeholders, as opposed to just concentrating on financial stakeholders. Yet, whilst it acknowledges the wide diversity of stakeholders for the trust and attempts to balance their interests in the decisions that the trust makes, the approach is still limited in its application because the concept of competitive markets is limited within the NHS.

Nevertheless, it helpfully draws attention to the wide range of stakeholders that the trust should actively consider in its approach to engagement and involvement. An understanding of this breadth and diversity should then inform the approach that the trust describes in the relevant BGAF section.

Examiner's comments

This part was very well answered on the whole, with the majority of candidates demonstrating a good understanding of the diversity of stakeholders involved. Good answers demonstrated the relevance of the BGAF in understanding stakeholder engagement.

5. **You have just been appointed as the company secretary of a well-established FT. In discussions with your chairman, you discover that he has serious concerns about the quality of the decision-making by the board of directors. He believes that decisions by the board are often taken without due regard for the quality and safety implications for patients. He mentioned that a recent example of poor decision-making had been a decision by the board to invest in the redevelopment of the outpatient department, which later led to a deterioration in the quality of patient experience. A possible Health and Safety improvement notice demonstrates that there are some lessons to be learnt from the process around how the board came to its decision.**

This was just one example of badly informed decision-making by the board and the chairman says that there have been others. He wants to improve the work of the board, but is unsure about what needs to be done, and he has asked for your views and advice in the form of a report.

Required

Write a report to the chairman, advising on the measures that might be taken to improve the quality of decision-making by the board. In the report, you should take into consideration the concerns that he has expressed and the recent example of poor decision-making that he mentioned.

(25 marks)

Suggested answer

To: The Chairman
From: Company Secretary
Date: 6 June 2013

Report: Board decision-making

The Healthy NHS Board guidance sets out that embedding board disciplines is the “bedrock of good board functioning”. These disciplines include attention to agenda planning, annual programmes of work, board papers, action logs, declarations of interest and maintaining transparency and openness within the board. All of these underpin the ability of the board to make good decisions.

Further guidance on decision-making can be found in the FRC Guidance on Board Effectiveness which says that well-informed and high-quality decision-making is a critical requirement for a board to be effective and does not happen by accident. It goes on to say that boards can minimise the risk of poor decisions by investing time in the design of their decision-making policies and processes, including the contribution of committees. So this has to be a key area for consideration by the board.

The recent decision by the board to invest in the redevelopment of the outpatient department, which later led to a deterioration in the quality of patient experience and a possible H&S improvement notice, demonstrates that there are some lessons to be learnt from the process around how the board came to its decision.

Good decision-making capability can be facilitated by various measures which are set out below, with an examination of questions that the board might like to consider:

<u>High quality and timely board documentation</u>

The board should receive relevant documents in advance of a board meeting, so that they have time to read them and think about the issues they deal with. The UK Corporate Governance Code (UK Code) states that: ‘The board should be supplied in a timely manner with information in a form and of a quality sufficient to enable it to discharge its duties.’

The chairman has the responsibility for ensuring that directors receive the information that they need in sufficient time. The UK Code states that management has an obligation to provide the required information, but that the directors should ask for clarification or additional information if required.

Such information enables the board to:

- Understand the needs, views and experiences of users and non-users from all backgrounds and communities served.
- Make sure that users are receiving a high-quality service.
- Anticipate the potential impact of key policy, technological and socioeconomic developments.
- Assure themselves that the organisation is complying with standards and other regulatory requirements.

The information flow should have been both formal and informal. Information should have been provided formally in documents or files, but this should have been supplemented by informal communication by e-mail, telephone or face-to-face conversation. The role of company secretary should ensure that there are good information flows between the board and its committees, between committees, and between executive managers and NEDs.

A desktop review of the documentation that was submitted to the board in the lead up to the decision would be helpful, along with consideration of the following questions:

- Did the board reports direct the board's attention to significant risks, issues and exceptions and provide a level of detail appropriate to the board's role?
- Had the board reports been considered by the relevant sub-committees and did they have the relevant delegated authority to interrogate and scrutinise the information they received?
- Did it clearly set out alternative options to the investment?
- Were the benefits clearly established and tested for credibility?
- Was there clinical and nursing input into the proposal?
- Were the views of existing users of outpatients consulted (including staff, patients and carers)?
- Was a proper tender process followed?
- What gaps can be identified in the risk assessment process and the management of the project plan?
- Were requests for additional information made and, if so, how timely were the responses?

<u>Obtaining expert opinions when necessary</u>

As well as receiving relevant and timely information, directors should be given access to independent professional advice, at the organisation's expense, when they consider this necessary in order to fulfil their duties as director. For example, a director might ask to consult a lawyer for advice on a matter where the legal position is not clear. In this instance it would interesting to see what expert opinions had been sought and which experts had been considered necessary from a quality perspective. Another question would be whether a health and safety inspection/assessment had been considered before proceeding.

<u>Time allowed for debate and challenge</u>

This is particularly important for complex, contentious or business critical issues such as the redevelopment of an outpatients department. The board should look at the agenda setting process and the amount of material to be considered. Was there sufficient time allowed? Would presentations and site visits have been helpful, as well written reports and business cases? Was the timing of board meetings supportive of the decision-making process or did it lead to rushed documentation and limited discussion at board meetings?

Achieving timely closure and providing clarity on the actions required, and timescales and responsibilities:

- Were the board aware of the necessary deadlines and the imperative for decision-making within the project plan?
- If requests were made for clarity or amendments, were responsibilities clear and action points followed through?
- Were the authority levels for the various stages of sign off clear to the board?
- As the project progressed, were regular updates provided to the board along with revised risk assessments?

Support

And finally, NEDs and possibly also executive directors, may need administrative support or advice on routine matters, and the UK Code includes provisions that board committees should be provided with sufficient resources to carry out their duties, and that all directors should have access to the advice and assistance of the company secretary.

Summary

There are a number of areas outlined in this report, which would assist the board in improving its decision-making. The first step may be to undertake the desktop review outlined above and then to agree an action plan for improvement based on the findings.

Examiner's comments

Candidates who scored well on this question relied on the FRC Guidance for Board Effectiveness. Those who did not answer the question well often reiterated the answers they had given in Question 1 relating to board composition, independence and succession planning.

Good answers also quoted from the Intelligent Board to support the argument for quality of information, clear processes for decision-making and risk management.

Marks were available for good examples and practical suggestions, for example, the use of the BGAF.

6. The chairman of a new CCG, Monopoly Clinical Commissioning Group ('Monopoly'), has called a meeting of its governing body to begin discussions about risk and risk management within Monopoly. As a new CCG, the governing body needs to consider what is required to deliver best practice in risk management.

The chairman is concerned by a recent substantial increase in the number of complaints received about a number of GP practices and falling performance levels in the Clinical Domain of the Quality and Outcomes Framework. He has also been angered by the following incidents reported to him by the Accountable Officer:

(i) There has been a serious breach of health and safety regulations, resulting in a serious injury to three employees.

(ii) An important new IT system was introduced by the CCG a few months ago, apparently without adequate testing of the back-up system in the event of system failure.

(iii) A significant provider being considered under the Any Qualified Provider provisions (AQP) is having serious financial difficulties and the administrators have been called in.

Required

(a) Explain the difference between business risk and internal control risk in the health sector.

(5 marks)

Suggested answer

Business risks are risks to patient safety and financial security that arise from factors in the external business environment, including competition, over which management has no direct control. They are often referred to as strategic risks. NHS organisations must take risks in order to deliver healthcare but have to assess how much risk should they be prepared to tolerate, and if they would be able to withstand 'shocks' in the business environment if an unexpected event or development were to occur.

Internal control risks are risks that arise within Monopoly because of weaknesses in its systems, procedures, management or personnel. Unless there are controls to deal with them, internal control risks can lead to losses because of operational failures, errors or fraud. The controls for these risks are 'internal controls' and internal controls are applied within an internal control system.

The governing body has the responsibility for strategic decisions on risk, and an important aspect of health service governance is for the governing body to recognise its responsibilities and ensure that the risk management system in Monopoly is effective.

It is also the responsibility of the governing body to ensure that the internal control system (and the internal controls within this system) is effective in preventing losses from internal control risks, or identifying losses and taking corrective action when they occur.

Examiner's comments

This section was often not well answered, with little distinction between the two risks made in answers. Candidates either gave a list of internal controls or wrote extensively about internal audit.

(b) Suggest how a system of business risk management should operate within Monopoly.

(10 marks)

Suggested answer

A system of business risk needs to recognise a variety of business risks. These can be categorised or identified in different ways, but it may help to understand the variety of risks by considering the following sources of risk:

- Reputation risk.
- Competition risk.
- Business environment risks.
- Financial risks.
- Liquidity risk.
- Strategic risks.

There are four basic elements to a risk management system (these are the same for both business risk management and internal control systems):

- Risk identification.
- Risk evaluation.
- Risk management measures.
- Risk control and review.

This can be explained to the governing body by use of the following questions:

- What risks does Monopoly face?
- How can these risks be measured?
- For each of these risks, how would Monopoly be affected if the worst outcome came about, or if a fairly bad outcome happened?
- What is the likelihood of a bad outcome for that risk item?
- What is Monopoly's risk appetite or risk tolerance?
- What should Monopoly be doing to manage the risk, either by avoiding it altogether or planning to deal with the problems that will arise in the event of a bad outcome?
- How will this information and these decisions be recorded? For example, use of a risk register.

Regular review of the risks and the introduction of a risk management policy will support the governing body in managing its responsibility for risk at a 'high level'. The responsibilities for the management of the risk itself should be delegated to executive management. The governing body should decide the level of risks that are acceptable at a strategic level, and should ensure that management consider risk in the decisions that they make. It should then satisfy itself that appropriate systems are in place to identify, evaluate and manage the significant risks faced by Monopoly.

The governing body may delegate its responsibility for reviewing the effectiveness of the risk management system to the audit committee, which is also likely to have responsibility for reviewing the internal control system. Alternatively, it may prefer to establish a separate risk committee.

Currently, NHS organisations are required to include a business review in their annual report and this review should include a description of the principal risks and uncertainties facing the organisation.

Examiner's comments

Part (b) was the better answered of the three parts of this question but was still not answered particularly well, with candidates choosing to focus on risk identification and evaluation. Very few answers used the scenario in the question to drive their explanation of the risk management system that the organisation should use.

(c) Discuss how a system of business risk might have assessed the incidents referred to in (i) to (iii) above and discuss whether the more explicit requirements of the King III Code would have benefited Monopoly in regard to these incidents.

(10 marks)

Suggested answer

The three incidents in the scenario explore the dynamic of business risk and internal control risk.

The health and safety risks may have been identified during a risk management process but the internal controls of Monopoly in relation to managing compliance risks should have been sufficient to mitigate the risk. A full investigation into the incident is required to assess where the risk management system had failed Monopoly. The business risk here that may not have been fully considered was the reputation risk of a serious health and safety incident and any operational risks related to the ongoing delivery of services.

The risks associated with implementing an IT system again should have been identified with the risk identification process and mitigation agreed. It would appear that a full analysis of the risks associated with implementing a new system had not been completed. Again, there are clear reputational and operational risks associated with this project.

The financial failure of a significant provider being considered under Any Qualified Provider again highlights a clear reputational risk, as well as a possible lack of due diligence by Monopoly in assessing financial risk.

The King III Code in South Africa is much more explicit about risk management than the Monitor FT Code and UK Corporate Governance Code. Provisions in the King III Code relating to risk management (both business risks and internal control risks) include the following:

- The board's risk strategy should be executed by management by means of risk management systems and processes.
- The board should ensure that effective and ongoing risk assessments are performed by management.
- Risks should be prioritised and ranked, in order to focus on areas where action is most needed.
- The board should regularly receive and review a register of the organisation's key risks.
- Key risks should be quantified where practicable (for example, in terms of maximum potential loss or expected loss).
- The board should ensure that processes are in place for anticipating unpredictable risks.
- Management should identify and note in the risk register the responses that have been decided upon and taken.
- Management should provide assurances to the board that the risk management plan is integrated into the daily activities of the business.

If the governing body had been following the King III Code then it could be that effective risk management may have been more explicit within the culture of Monopoly. As a result, the risks associated with the incidents may have been identified and properly mitigated. They would have been identifiable within the risk register with a documented process for mitigation and control. There may also have been a more formal reporting structure within Monopoly that enabled effective and ongoing risks assessments to be made. If the governing body had considered processes for unpredictable risks, then mitigation may have eliminated or reduced the impact of these incidents.

Examiner's comments

Part (c) was not well answered as candidates did not use the three scenarios given or apply them to a discussion of the business risks they involve. Some answers did make reference to the King III Code but usually with reference to the engagement of stakeholders rather than its implications for risk management.

This question was the least popular question on the paper and the quality of answers reflected this as well. It seemed that this was the fourth answer for most candidates and it was often the weakest answer.

The scenarios included here are entirely fictional. Any resemblance of the information in the scenarios to real persons or organisations, actual or perceived, is purely coincidental.