

## Suggested answers and examiner's comments

# Health Service Governance

November 2016

### 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

Performance for the November 2016 session overall was good, with 57% of candidates passing the exam in total. However, there were very few high scoring answers. Such candidates demonstrated not only a very good understanding of the issues and gave detailed and well-structured answers to the questions posed, but they also applied answers to the scenarios in the exam questions. Overall, those scripts which passed demonstrated a good understanding of the issues as discussed in the Health Service Governance (HSG) Handbook and quoted sufficient evidence from both corporate and health service governance guidance. They also used a range of practical examples of the points being made.

All of the scripts were legible and demonstrated that candidates had considered previous comments from the examiner in both their legibility and structure of answers.

Of the scripts which did not achieve passes, they were generally quite far from a pass standard. As in past years, this was because candidates either did not answer all four questions or the answers given were very basic and did not demonstrate an understanding of the issues and topics explored in the HSG Handbook. A number of these answers were also not set out in the format required by the question. Candidates need to consider how they would lay out responses in a professional manner if, for example, their briefing was going to be given to the Chair to read, or if they were writing a letter to follow the

normal convention of address, date, greeting and heading. Some candidates also gave unprofessional examples, for example, the risk of being late from not setting an alarm clock. Candidates are not penalised for this, but marks for the examples are not awarded.

As a consequence, many papers did not meet the standard required to provide high quality support and advice to an NHS Chair or CEO with the relevant knowledge and depth.

Candidates should look at the marks allocated to each part of the question and give sufficient attention to those parts of the question which require a fuller answer. There were examples of question parts worth 14 marks with three or four lines of answer, and a question part worth six marks with an answer the length of a whole page. A number of papers only attempted three questions.

Those answers achieving a good pass stood out from the general range of answers given. However, scripts were often inconsistent, with one excellent answer and also answers which did not meet a pass level, thus resulting in a lower overall mark.

The overarching comment would be that candidates did not seem to have studied the material in the HSG Handbook in sufficient detail. The knowledge demonstrated was sporadic and, although some candidates gave good practical examples, others gave informal examples inappropriate to the question, for example, in the discussion of risks as mentioned above.

Other general comments would be that many candidates did not gain the marks available for referring to the type of organisation in their answer, for example, CCG or FT. There were still answers that did not relate to the correct type of organisation, for example, answers related to an FT when the organisation in the scenario was a CCG.

Answers which passed had good attention to layout and structure, which made for clear and lucid arguments which were easy to follow and mark.

- 1 Kimsey City NHS Foundation Trust ('Kimsey') is the product of three mergers over a ten-year period. This has resulted in an organisation with a flawed management and governance structure, and has ultimately resulted in a series of Monitor Improvement Notices. The latest Notice has resulted in an in-depth governance review of the organisation. One of the conclusions of this review is that the previous board of directors allowed the role of the Company Secretary to become significantly undermined as it was undertaken by one of the executive director's secretaries. The newly appointed Chair and CEO need advice on how to make the role effective.

### Required

Prepare a briefing paper for the Chair and CEO of Kimsey advising on:

- (a) The key guidance establishing the Company Secretary role, its governance functions and the core responsibilities of the role.

(11 marks)

### Suggested answer

#### Briefing paper – Role of the Company Secretary

The Company Secretary is in a unique position to fulfil an important role in governance. In general, the chief purpose is to know about what is going on at board level in the organisation and to offer advice and assistance, not only to the Chair but also to the board as a whole, board committees and individual directors. A key aspect of the role is communication and the vital exchange of information; the Company Secretary is able to help ensure that this happens. This is a challenging role requiring a certain level of gravitas and authority. This would have been very difficult for the secretary of the executive director to be able to fulfil.

The Company Secretary is "responsible for advising the board through the chairman on all governance matters" and all "directors should have access to the advice and services of the company secretary" (UK Corporate Governance Code).

The All Party Parliamentary Corporate Governance Group commissioned research into the role, and their report in May 2012, *Elevating the Role of the Company Secretary*, highlighted the important role that the Company Secretary can play in ensuring effective corporate governance. The report recognised that there was a potential for the administrative duties laid on the Company Secretary to undermine the potential to be seen as a high-level adviser to the board; this was also affected by the use of the term 'secretary' in the title, with a common suggestion that an alternative of corporate governance director be used. This can be seen in the Kimsey scenario, as the administrative duties led to the role being fulfilled by an executive director's secretary without full consideration of the wider and complex duties of the Company Secretary.

The *Integrated Governance Handbook* attempted to establish this new role within the NHS and the authors had discussions with a number of FTSE 100 companies to look at the role of the Company Secretary, exploring, more importantly, whether these companies could exist without such an adviser. The evidence clearly pointed to the need for such integrated corporate support. Guidance for FTs is included in the *FT Code of Governance*. The specific responsibilities of a Company Secretary for governance matters should be decided by the organisation and set out in a clear job description. The *ICSA Guidance Note* provides helpful advice for the FTs on the main responsibilities relating to corporate governance.

According to the *FT Code of Governance*, the Company Secretary would normally be expected to:

- ensure good information flows within the board of directors and its committees and between senior management, non-executive directors and the governors;
- ensure that board procedures of both the board of directors and the council of governors are complied with;

- advise the board of directors and the council of governors (through the Chair) on all governance matters; and
- be available to give advice and support to individual directors, particularly in relation to the induction of new directors and assistance with professional development.

In addition to the specific responsibilities of the Company Secretary set out above, it is important to note that to be effective, a Company Secretary must be regarded by the board as its trusted adviser; must be seen as the board's chief of staff and must be able to win the confidence of and act as a confidential sounding board to the Chair and other directors on issues of concern.

An effective Company Secretary will provide, where appropriate, a discreet but challenging voice in relation to board deliberations and decision-making, drawing in particular on their professional experience and historical knowledge of the organisation. They also keep under review legislative, regulatory and governance developments that may impact the organisation and ensures that the board is appropriately briefed on them.

Examples of specific responsibilities for an effective FT Company Secretary include:

- Board and council meetings, including statutory committees.
- Annual members' meetings.
- Constitutional compliance.
- Monitor Licence compliance.
- Statutory registers, for example, members register and declarations of interest.
- Statutory returns completion, for example, annual report and accounts.
- Annual report and accounts coordination and submission to parliament.
- Membership and stakeholder communications.
- Election of Council of Governors.
- Corporate governance: reviewing developments in corporate governance, for example, board performance reviews, insurance, FT Code compliance, SO's and SFI's.
- Non-executive director and governor support.
- FT seal.
- Trust identity: ensuring official publications of the FT show the name of the FT and any other information as required by statute.
- Advising on subsidiary undertakings, acquisitions, disposals and mergers.

- (b) Best practice to ensure the independence of the Company Secretary, particularly in relation to their appointment and remuneration, and the skills and expertise required by an effective Company Secretary.

(14 marks)

### **Suggested answer**

In the context of business ethics and governance, the Company Secretary can be described as the 'conscience of the organisation'. There will often be situations where it is in the best short-term interests of an organisation to ignore best governance practice or even act in an unethical way. For example, the board of directors may want to 'window dress' the financial statements and make the performance of the organisation appear better than it really is, or an organisation may wish to bribe a government official in order to win a major contract.

The Company Secretary should speak out against bad governance and unethical practice, and remind the board and senior executives of the appropriate course. In order to act in this way, as a 'conscience' for the directors and senior executives, the Company Secretary must be independent-minded, and should not be under the influence of any other individual, such as the Chair or CEO.

The *Integrated Governance Handbook* was also concerned to establish the independence of the Company Secretary and, in addition to the above, also recommended that:

- The Company Secretary will be actively involved in, or be a member of, the executive team to ensure a full understanding of the organisation's business.
- The Company Secretary will not undertake executive activity in respect of having a specific role, but will be the neutral observer and adviser to the board or executive team.
- An NHS based Company Secretary should have sufficient knowledge of the NHS to gain the respect of the doctors in the organisation but need not necessarily be a clinician.
- The Company Secretary should be appropriately qualified to carry out his or her role and should ideally be accredited by a professional body such as the ICSA.

The role of the Company Secretary in governance is such that it is essential to ensure his or her independence from undue influence and pressure from a senior board member. An ICSA Guidance Note on Reporting Lines for the Company Secretary has commented:

'Boards of directors have a right to expect the company secretary to give impartial advice and to act in the best interests of the company. However, it is incumbent on boards of directors to ensure that company secretaries are in a position to do so, for example by ensuring that they are not subject to undue influence of one or more of the board of directors. If the board fails to protect the integrity of the company secretary's position, one of the most effective in-built internal controls available to the company is likely to be seriously undermined. The establishment of appropriate reporting lines for the company secretary will normally be a crucial factor in establishing that protection.'

ICSA Guidance on the Appointment of the Company Secretary (November 2014) recommends that the Company Secretary is responsible to the board, and should be accountable to the board through the Chair on all matters relating to corporate governance and their duties as an officer of the company (core duties). As the person elected by the directors to act as their leader, the Chair is the person to whom the Company Secretary should report with respect to responsibilities, which concern the whole board. If, in addition to the core duties mentioned above, the Company Secretary has other executive or administrative duties, they should report to the CEO or such other director to whom responsibility for that matter has been delegated by the board. The Company Secretary should not report to a director (except the Chair) on any matter unless responsibility for that matter has been delegated to that director by the board.

The UK Corporate Governance Code clarifies this further by recommending that the appointment and removal of the Company Secretary would be a matter for the board as a whole.

With regard to the remuneration of a Company Secretary, there is the possibility that if an individual director was authorised unilaterally to make this decision then that director could gain undue influence. It is therefore recommended (particularly where the Company Secretary reports to the Chair on all matters) that decisions on remuneration and benefits should be taken (or at least noted) by the board as a whole, or by the remuneration committee of the board on the recommendation of the Chair or CEO. In this way, the company secretary is not dependent on one individual, or a small group of board members, for their role or remuneration.

Where the Company Secretary has an additional reporting line to the CEO or other director, the views of that director can be taken into account by the board or board remuneration committee when decisions are taken on the remuneration and benefits of the Company Secretary.

Similar recommended practice is included in King III, which states that the board should appoint and remove the Company Secretary and empower the individual to enable them to fulfil their duties properly. It also recommends that the Company Secretary should have an 'arm's-length relationship' with the board, emphasising the requirement for independence. Departures from these guidelines will reduce the ability of the Company Secretary to perform their core duties in accordance with the standards, which boards of directors should expect.

As can be seen by the more extensive and wide-ranging role within the corporate sector that establishes the role as part of the executive team, there is significant scope within NHS organisations to adopt a similar board level role. The introduction of the role of Director of

Governance, which has encompassed the role of Company Secretary, can be seen as a step towards this. The caveat to this arrangement is that the independence of the role must be maintained within a direct line of report to the Chair for all matters relating to corporate governance and their duties as an officer of the company. In addition, the appointment and removal of the Company Secretary should remain a matter for the board as a whole. The Monitor Code departs from this slightly by requiring the appointment and removal of the Company Secretary to be a joint matter for the CEO and Chair.

Whilst the Companies Act 2006 is not directly relevant to an FT, it does provide a good starting point in understanding the kind of seniority expected for a company secretarial appointment. Under section 273 of the Companies Act 2006, the board must be satisfied that the secretary has the 'requisite knowledge and experience to discharge the functions of the secretary of the company'. In addition, the Companies Act states they must meet one or more of the following qualifications:

- be a member of any of the following bodies: the Institute of Chartered Secretaries and Administrators; the Institute of Chartered Accountants in England and Wales; the Institute of Chartered Accountants of Scotland; Association of Chartered Certified Accountants; the Institute of Chartered Accountants in Ireland; the Chartered Institute of Management Accountants; or the Chartered Institute of Public Finance and Accounting;
- have held the office of Company Secretary of a public company for at least three out of the five years immediately before their appointment as secretary;
- be a barrister, advocate or solicitor called or admitted in any part of the UK; or
- be a person who appears to the directors to be capable of carrying out the functions of Company Secretary, because that person holds or has held a similar position in another body or is or was a member of another body.

This contrasts significantly with the lack of any statutory qualification requirements for a company director. However, like the director, the Company Secretary is an officer of the company and as such owes fiduciary duties to the company and its shareholders. These duties include acting in good faith in the best interests of the company, avoiding conflicts of interest and not making secret profits from dealings for, or on behalf of, the company.

In addition to these qualifications, research by Henley Business School in conjunction with ICOSA (November 2014) identified three broad areas of skills and knowledge required by a Company Secretary:

- technical expertise;
- commercial and business acumen; and
- social skills and emotional intelligence.

Company Secretaries need technical expertise in law, governance codes and an understanding of financial issues. They need commercial experience in decision-making, problem-solving, analytical skills, attention to detail and the ability to get things done properly. Finally, but just as importantly, they need interpersonal skills and relationship management skills including judgement, diplomacy, tact and discretion – along with adaptability and patience.

Company secretaries also need to be incredibly resilient, as without the authority of a board member position they need to be able to challenge and remain independent of the individual board members while at the same time building good working relationships. Anecdotally, it was once said that the best person to take on the role is someone who has already retired or who is not dependent upon their monthly salary from the organisation, as they can then challenge the Chair or CEO when required, without fear of jeopardising their career.

The role of Company Secretary at Kimsey had been undertaken by one of the executive directors' secretaries. This would have meant a junior member of staff, who reported to an executive director. This obviously made it very difficult for the role to have its full level of discretion and challenge within the organisation. They would have been reluctant to speak out for fear of jeopardising their continued employment and would not have had the level of skill and experience as expected in this

role. Even challenging on timely delivery of papers and agendas would have been difficult for someone in such a junior role within the organisation, let alone having the confidence to speak out at a board meeting if they were aware that an unethical or inappropriate decision was being made.

### **Examiner's comments**

Overall, this question was not well answered. The question required an understanding of the role of the company secretary and the governance arrangements for the appointment and remuneration of the role. Most candidates focused on the job description and gave lengthy descriptions of the role of the remuneration committee, including composition, terms of reference, and so on. Given that most candidates are presumably sitting the exam to become qualified company secretaries, it was expected that answers would show a greater understanding about the governance arrangements for their appointment and remuneration. Answers often did not mention the split reporting between Chair and CEO and the role of nomination and remuneration committees in making the appointment / remuneration to ensure independence of role.

- 2 (a) Define the four domains of the Well-Led Framework and their implications for governance, and demonstrate how they are underpinned by the requirements of the UK Corporate Governance Code.

(6 marks)

### **Suggested answer**

The UK Corporate Governance Code states that the evaluation of the board of FTSE companies should be 'externally facilitated' at least every three years; in other words, the company should use specialist external consultants at least once every three years. This is echoed in the NHS Foundation Trust Code of Foundation Governance and has been formalised in the risk assessment framework (RAF). The framework for this evaluation has been published in the Well-Led Framework for Governance Reviews: Guidance for NHS Foundation Trusts (May 2014). Though this was specifically aimed at FTs, it is now required for all NHS providers. The Well-Led Framework represents a 'core' reference in how to structure reviews of board governance.

The framework is built along the lines of the pre-existing Quality Governance Framework, with four domains, ten high-level questions, along with a body of 'good practice' outcomes and an evidence base that an NHS provider and its independent reviewers can use to assess governance. The four domains are as follows:

- (i) Strategy and planning: how well is the board setting direction for the organisation?
- (ii) Capability and culture: is the board taking steps to ensure it has the appropriate experience and ability, now and into the future, and can it positively shape the organisation's culture to deliver care in a safe and sustainable way?
- (iii) Process and structures: do reporting lines and accountabilities support the effective oversight of the organisation?
- (iv) Measurement: does the board receive appropriate, robust and timely information and does this support the leadership of the trust?

'Well led' means that the leadership, management and governance of the organisation assure the delivery of high-quality care for patients, support learning and innovation and promote an open and fair culture.

- (b) Discuss the importance of the stakeholder theoretical approach to governance in the context of the Well-Led Framework.

(7 marks)

### **Suggested answer**

There is a direct link between stakeholder engagement and good governance and 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 planned spending on health care for 2015/16 was approximately £116 billion and yet the recipients of the healthcare provided are often very distant from the holders of the healthcare budget. Therefore, the consideration of the stakeholder theoretical approach is important in considering whether an organisation is well led.

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 a Trust as it gives credence to the views and interests of a wider number of stakeholders as opposed to just concentrating on shareholders.



This view is shared by the Well-Led Framework which requires the board to consider its approach to engagement and involvement, as meaningful involvement and 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.

The Well-Led Framework sets out the questions that FTs and reviewers should ask of themselves and includes amongst others:

- focus groups with internal and external stakeholders such as patients, staff, and commissioners;
- one-to-one interviews with board members, the trust secretary, lead governor, clinical leads and local stakeholders; and
- stakeholder surveys.

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. 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. This is not the case for NHS organisations and in fact the Health and Social Care Act 2012 introduced significant amendments to increase the board's responsibility for public and patient involvement. Whilst the motivation for this will have been the public sector form of the NHS, nevertheless it resonates with the stakeholder approach. This 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.

Whilst acknowledging the wide diversity of stakeholders for NHS organisations and attempting to balance their interests in the decisions that they make, the approach is also 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 each individual part 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.

The key area where the stakeholder approach to governance can be helpful for the NHS is that it gives credence to the views and interests of a wider number of stakeholders as opposed to just concentrating on just financial stakeholders. Yet whilst it acknowledges the wide diversity of

stakeholders for each part of the NHS and attempts to balance their interests in the decisions that they make, 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 NHS organisations should actively consider in their approach to engagement and involvement. An understanding of this breadth and diversity should then inform the approach that is taken with regard to the Well-Led review.

(c) Analyse the strengths and weaknesses of other theoretical approaches to health service governance with regard to a board’s relationship with its stakeholders.

(12 marks)

### Suggested answer

Other approaches could be any of the following:

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

	<b>Strength</b>	<b>Weakness</b>	<b>Applications to board’s approach to stakeholders</b>
Shareholder value	<ul style="list-style-type: none"> <li>• Well established</li> <li>• Simple, clear aim to maximise wealth</li> </ul>	<ul style="list-style-type: none"> <li>• Limited application: who are the owners in the NHS? How do you define wealth?</li> </ul>	<ul style="list-style-type: none"> <li>• If the board could identify owners, then wider stakeholders would still have to be engaged due to public sector nature of NHS</li> </ul>
Enlightened shareholder	<ul style="list-style-type: none"> <li>• Balance long and short term aims</li> <li>• Encourages productive relationships with stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of clarity on how to balance diverse needs of variety of stakeholders</li> <li>• Still largely shareholder driven</li> </ul>	<ul style="list-style-type: none"> <li>• Might be closer to reality as financial regulation is key at present but with an expectation that public and patient involvement will be maintained.</li> <li>• Challenge still remains on how to balance expectations with resources</li> </ul>
Integrated approach – King Code	<ul style="list-style-type: none"> <li>• Best interest of organisation defined as sustainable enterprise and a corporate citizen</li> <li>• Shareholder does not have precedence</li> </ul>	<ul style="list-style-type: none"> <li>• Integration on a case by case basis</li> <li>• Complexity of NHS organisations makes a case by case approach too long winded</li> </ul>	<ul style="list-style-type: none"> <li>• Could be an aspirational approach for individual boards but danger of individualisation and localisation threatening the “national” health service</li> <li>• Could lead to different decisions across the NHS as a whole: postcode lottery</li> </ul>
Policy governance approach	<ul style="list-style-type: none"> <li>• Clarity on objectives set by beneficiaries</li> <li>• Clear delegation to executive to deliver objectives</li> </ul>	<ul style="list-style-type: none"> <li>• Difficulty in setting objectives with such a wide diversity of beneficiaries</li> </ul>	<ul style="list-style-type: none"> <li>• Could also be seen as in existence within boards with reliance on policies and procedures, but limited in application as there is a national policy driver that boards are actively engaged</li> </ul>

			with the patients and communities
Governance as leadership	<ul style="list-style-type: none"> <li>• Requires active dialogue between board, staff and service users</li> <li>• Distinguished by its focus on sharing knowledge and information to problem solve</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of resource and expertise to fully implement this approach into the NHS</li> </ul>	<ul style="list-style-type: none"> <li>• Complexity of NHS organisations may mean there is not a clear solution and compromise is the only option</li> </ul>

### Examiner's comments

Question 2 was not particularly popular. The question asked about the Well-Led Framework in the context of stakeholder engagement and asked for a comparison with other theoretical stakeholder approaches. Candidates that answered this well demonstrated the link between Well-Led and stakeholder involvement for strategy, culture, accountability and controls, and then aligned this with the theoretical stakeholder approach to governance. Very few scripts stated that the three year external review under Well-Led was in line with the UK Corporate Governance Code and copied by the Monitor FT Code and was now formalised in the Well-Led Framework.

- 3 Beevor NHS Foundation Trust ('Beevor') has been discussing its strategy and vision in light of the board's role for defining long-term strategy. It is planning a board development session next month, which will look at strategy and the associated risk management in further detail. The first part of this day will allow the board to consider its principal risks, such as financial sustainability and insufficient paediatric consultant recruitment, in the light of its strategic discussions thus far.

### Required

As an introduction to the board development session, the Chair has asked you to:

- (a) Prepare slides for a presentation, with notes, which define business risk and analyse four categories of business risk, giving examples of each in the health sector.

(16 marks)

### Suggested answer

#### Slide 1

*FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting 2014*

*UK Corporate Governance Code*

Business risks:

- are risks that occur and arise in the business environment
- may also be referred to as strategic risks
- will differ between organisations
- can be positive (upside) or negative (downside)
- are the responsibility of the board to determine

The *FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting 2014* was intended to bring together elements of best practice for risk management; prompt boards to consider how to discharge their responsibilities in relation to the existing and emerging principal risks faced by the organisation; reflect sound business practice, whereby risk management and internal control are embedded in the business process by which an organisation pursues its objectives; and highlight related reporting responsibilities. The guidance is primarily aimed at companies subject to the UK Corporate Governance Code (UK Code) but provides useful best practice benchmarking for NHS organisations. The 2014 FRC guidance describes the board's responsibilities as determining the nature and extent of the principal risks faced and those risks which the organisation is willing to take in achieving its strategic objectives (determining its 'risk appetite').

The UK Code also includes the following principle: 'the board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives.'

The nature and severity of business risks varies from one organisation to another. Risks change over time: some become less significant, and new risks emerge. Business risks are risks that the actual performance of the business could be much worse (or better) than expected due to unexpected developments in the business environment.

Each industry and each organisation within an industry faces different risks. The questions that management should ask are 'What risks does this organisation face?' and 'How can these risks be measured?' It has to be possible to assess the risk in a business, even one with unpredictable

variations in key factors such as activity levels or market prices. High volatility is associated with high business risk.

Risk refers to the possibility that something unexpected or unplanned for will happen. In many cases, risk is seen as the possibility that something bad might happen. In everyday life, there is a risk of becoming seriously ill, being involved in a road accident, having a house burgled or flooded, having a motorcar breakdown, and so on. This can be described as downside risk, because it is a risk that something will happen that would not normally be expected.

There is also upside risk; the possibility that events might turn out better than expected. In a health service context, an example is the possibility that activity levels will be higher than planned or that working days lost through industrial action will be lower than anticipated.

Some risks are easy to recognise because they are always present and an NHS organisation may have had many years of experience in dealing with them. For example, financial risks include the risk that tariff will be set at a substantially lower level or that the costs of pharmaceutical supplies will increase. Other risks, however, are more difficult to identify and anticipate.

## Slide 2

Business risks can be categorised as:

- Financial risk
- Operational risk
- Reputational risk
- Behavioural risk
- Third-party or competition risk
- External risks

(Note: marks were awarded for any four of the six risks and the associated notes.)

Risks will differ between organisations but can generally be categorised as financial, operational, reputational, behavioural, third party, or external risks.

NHS organisations must take risks in order to deliver healthcare but have to assess how much risk they should be prepared to tolerate, and how those risks must be managed. For example, when a trust develops a new service, it will have an expectation of the likely activity level. Actual levels could be higher or lower than expected. With some new services, the risk that activity levels will differ from expectation could be much more severe than with other new services. There are various reasons why activity levels may be less than expected, or may fall unexpectedly. For example, competitors may take away some of the trust's market share; a trust may suffer from bad publicity; there may be new regulations making the provision of a particular service more difficult.

Business risks 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:

- Financial risk: these are risks that financial conditions may change. For example, in the NHS, there can be adverse changes in tariff, control thresholds, or efficiency savings. There may also be higher losses from bad debts or changes in prices from major suppliers or failing to set and manage appropriate cost budgets.
- Operational risk: the risk of losses resulting from inadequate or failed internal processes, people and systems, or external events. For example, the failure of air conditioning units in operating theatres can threaten patient safety and activity levels.

- Reputational risk: the risk of loss of confidence by the trust's local community or its regulators. For example, the impact on staff recruitment at Mid Staffs after the Francis Inquiry or investment in research and development can lead to an upside risk of a growing reputation.
- Behavioural risk: these are risks connected with the workplace and lifestyle behaviors of employees and organisations that have a negative impact on its productivity. For example, failure to take appropriate action when incidents have been reported will lead to staff apathy on future incident reporting which directly impacts on patient safety. Other examples include lack of innovation, employee relations difficulties, low senior management or clinical leadership capability, high sickness absence levels and poor staff retention, lack of ongoing professional development and staff training and any failure to work collaboratively with the local health economy.
- Third-party or competition risk: the risk that business performance will differ from expected performance because of actions taken (or not taken) by other organisations. For example, failure on behalf of IT suppliers in regard to patient records or where payroll services have been outsourced to a poorly performing supplier.
- External risks: these are risks of significant changes in the business environment from political and regulatory factors, economic factors, social and environmental factors and technology factors (the so-called 'PEST' factors). For example, a change of government can lead to the new policy drivers for health provision such as Delivering the Forward View or changes in funding for social care by local authorities.

### Slide 3

BUSINESS RISKS ARE NOT INTERNAL CONTROL RISKS

Business risks are not the same as internal control risks, which are risks that arise because of weaknesses in systems, procedures, management or personnel that are in place within the trust. These are risks that the trust has within its control and it needs to have a comprehensive system in place to manage. The controls for these risks are 'internal controls' and internal controls are applied within an internal control system.

Though all manner of principal risks in the business environment may cause a trust to fail to achieve its objectives, further principal risks may be failures or weaknesses within its own internal systems and operating procedures or human error. These failures and weaknesses could be avoided, or the consequences of failures could be limited, by means of internal controls. Internal controls are measures or arrangements that are intended to prevent failures from happening, limiting their potential effect, or identifying when a failure has occurred so that corrective measures can be taken. The failure or weakness of these controls is classified as an internal control risk.

- (b) Prepare a briefing paper which discusses the importance of risk appetite, risk capacity and risk tolerance for Beevor.

*(9 marks)*

## **Suggested answer**

### Briefing paper

Healthcare itself is inherently risky and although it would be impossible to eradicate all harm, there are many activities and actions that can be introduced that will minimise opportunities for errors.

### Risk appetite and tolerance – decided by the board

The board has overall responsibility for risk management and for deciding the organisation's risk appetite. Risk appetite is the level of risk that an organisation is willing to take in the pursuit of its objectives. At present the two principal risks, which occupy a lot of the Beevor board's thinking, are related to financial sustainability and the difficulty in recruiting sufficient paediatric consultants to maintain safe, high quality services. Exploring the risk appetite of the board in relation to these two risks alone, highlights the different approaches that might be taken.

### Risk appetite is the desire/willingness to take on risk

Risk appetite can be defined as the combination of the desire to take on risk to obtain a specific return (financial or quality), risk capacity and risk tolerance. The 'desire to take on risk' refers to the amount and type of risk that the board of directors would like the organisation to have exposure to. In terms of financial sustainability, despite a statutory duty to break even, the Beevor board assumes a certain level of risk in not meeting that duty in order to continue to provide services. It might want to think about defining its risk appetite in terms of the level of deficit it would be prepared to carry and/or for how long in order to achieve key safety and quality indicators. By contrast, the discussions around the level of risk that can be tolerated if the paediatrics service is two consultants short may demonstrate a very different risk appetite, as the associated harm to patients may be too high or the mitigations to protect patients unworkable.

### Risk tolerance is the amount of risk which is tolerated to achieve the strategic goals

Risk capacity is the maximum risk exposures that the organisation can accept without threatening its sustainability. Risk tolerance is the amount of risk that the organisation is prepared to accept to achieve its objectives. Risk tolerance is therefore the amount of risk that an organisation's board of directors allows the organisation to accept. Risk appetite and risk tolerance are closely related. One is the amount of business risk (and types of business risk) the board would like the organisation to have and the other is the amount of risk that the board is prepared to tolerate.

The 2014 FRC guidance confirms that the board has ultimate responsibility for determining its risk appetite. The board should review risk appetite regularly, and decisions should be taken about the scale of risk that is desired or acceptable. Risk tolerance could be expressed in numerical terms, such as the maximum loss that the board would be willing to accept on a particular venture if events turn out adversely or in terms of the quality of the service that is provided. Alternatively, risk tolerance could be expressed in terms of a total ban on certain types of business activity or behaviour.

## **Examiner's comments**

Question 3 was a very popular question and there was a very wide range of responses. However, it was not answered well overall. Answers which achieved a pass demonstrated an understanding of business risks and did not confuse them with internal control risks. They also addressed the role of the board in risk management, the concept of principal risks and set out clear source guidance for the responses.

Similar questions have been set on this topic before and the responses given highlighted a lack of preparation in this area and a limited review of past papers.

- 4 Smithson CCG ('Smithson') has declared an end of year deficit position for the previous two years and will probably fail to break even again for the financial year ending 2016/17. In 2015/16, the CCG's main acute provider, Whitworth, which is an FT, also failed to deliver a balanced budget for the second year running. Whitworth has now been placed in special measures following a Care Quality Commission inspection that led to an overall care rating of 'inadequate'.

The governing body of Smithson is concerned about declaring that the CCG is a going concern at the end of the financial year 2016/17 and that its main acute provider may also be declared insolvent.

### **Required**

Prepare a briefing paper for the governing body of Smithson which discusses the following issues:

- (a) Smithson's statutory duty to break even and declare itself as a going concern.

(11 marks)

### **Suggested answer**

Briefing paper for the Smithson Governing Body

#### **Smithson's statutory duty to break even and declare itself as a going concern**

Although the break even duty is a statutory requirement for non-foundation NHS trusts, all NHS bodies are expected to operate a balanced budget ensuring that total expenditure does not exceed total income. Paragraph 2(1) of Schedule 5 to the National Health Service Act 2006 states: 'Each NHS trust must ensure that its revenue is not less than sufficient, taking one financial year with another, to meet outgoings properly chargeable to revenue account.'

This is known as the break even duty. CCGs should normally plan to meet this duty by achieving a balanced position on their income and expenditure accounts each and every year. The break even duty includes the phrase 'taking one financial year with another'. This provides some flexibility on the time-scale for matching income with those costs whose incidence is uneven and when managing the recovery of a CCG with serious financial difficulties.

An agreement was reached in 1997 with the Treasury and the Audit Commission that the duty will be assumed to have been met if expenditure is covered by income over a rolling three-year period. As Smithson has already declared a deficit position for the last two years, with the possibility of a third successive year, it is clear that the CCG is in breach of its statutory duty to break even. Exceptionally, the break even duty is assumed to be met if the cumulative deficit being recovered is covered by subsequent surpluses over a four or five-year period. 2013/14 saw a threefold increase in the number of NHS organisations being reported to the Secretary of State for Health for failing to meet their statutory break even duty, with 20 trusts failing (compared with only five trusts for 2012/13). In addition, 24 CCGs (11% of all CCGs) were also referred to the Secretary of State as a result of financial concerns in that period. Where a CCG is recovering a cumulative deficit position, the organisation would be required to produce and agree a robust recovery plan with NHS England.

The 'going concern' concept is a key accounting concept. This is the view that the organisation will continue to trade for the foreseeable future (at least the next 12 months). This is different to an understanding of an organisation's viability. In the UK Corporate Governance Code, the board is required to make an explicit statement in the financial statements about whether the going concern basis of accounting has been adopted and whether there are any material uncertainties about the company's ability to continue to do so in future. It is also required to make a broader statement about the board's reasonable expectation as to the company's viability based on a robust assessment of the company's principal risks and the company's current position. This is developed in the latest FRC guidance on Risk Management, Internal Control and Related Financial and Business Reporting (2014). It is not clear from the scenario as to Smithson's cash position which is a major issue in



declaring a going concern, however, it is extremely likely that, having declared a deficit position for two years and with a third year imminent, the cash position will raise serious liquidity problems for the forthcoming 12 months which would threaten the possibility of a going concern statement. The CCG must work in conjunction with its providers and NHS England to clarify its going concern position.

The financial statements are therefore prepared on the going concern basis, and assets are valued differently from what their value might be if the organisation went into liquidation. The statement of going concern should also give reasons why the directors have reached their view, and also indicate any doubts there might be. Where there is fundamental uncertainty over the going concern basis (for instance, continuing operational stability depends on finance or income that has not yet been approved), or where the going concern basis is not appropriate, the directors will need to disclose the relevant circumstances and should discuss the basis of accounting and the disclosures to be made with their auditors. The auditor's responsibility is to consider the appropriateness of the use of the going concern assumption in preparing the financial statements. They should also consider if there are material uncertainties about the organisation's ability to continue as a going concern that need to be disclosed in the financial statements.

For listed companies, the guidance is set out in the UK Listing Rules and these requirements are mirrored in the CCG Annual Reporting Manual.

In the strict accounting sense, NHS bodies cannot prepare accounts on any other basis than as a going concern. Various Acts of Parliament prevent NHS organisations from becoming insolvent in the strict accounting sense, as the Department of Health bears the ultimate liability for any debts. Even so, NHS annual reporting requirements still require NHS organisations to include a statement on whether or not the financial statements have been prepared on a going concern basis and the reasons for this decision, with supporting assumptions or qualifications as necessary. The distinction between going concern and viability make for interesting audit committee discussions, particularly in the current economic climate.

Interestingly, a recent King's Fund Briefing, *Deficits in the NHS, 2016*, describes deficits in commissioning organisations and provider organisations concluded as follows: "The scale of the aggregate deficit [for the NHS] makes it clear that overspending is largely not attributable to mismanagement in individual organisations – instead it signifies a health system buckling under the strain of huge financial and operational pressures. The recent strategy of driving efficiencies by cutting the tariff has placed disproportionate strain on providers and is no longer sustainable."

(b) The statutory regulations governing insolvency for an FT such as Whitworth.

(7 marks)

### **Suggested answer**

FTs are not required to break even each year, although they must be financially viable, that is, deliver a balanced budget.

A special administration process was introduced in Chapter 5A of the National Health Service Act 2006 (as amended by the Health Act 2009) which made provision for the appointment of a Trust Special Administrator (TSA) over an NHS trust, where the Secretary of State for Health considered it in the interests of the health service. The key objective of a TSA appointed to an NHS trust is to develop and consult locally on a draft report and make recommendations to the Secretary of State for Health in a final report about what should happen to the trust and the services it provides to ensure the continued provision of key services (location specific services). The legal framework sets out a maximum period of 120 working days for completion of the process (unless extended by order of the Secretary of State), by which time the Secretary of State must make a final decision on the future of the NHS trust following the TSA's recommendations.

With many hospitals facing significant financial difficulties as a result of a variety of complex factors, it is vital, both politically and socially, that NHS services are maintained. The Department of Health assesses NHS trusts according to their performance against a set of financial and quality indicators. If clinical or financial performance is below the required standard and does not improve then the Regime for Unsustainable Providers could be triggered under Chapter 5A of the National Health Service Act 2006 as the only way in which the Department of Health can take decisive action to deal with NHS trusts that are either unsustainable in their current form or significantly failing to make progress towards attaining FT status.

The regime has been extended by the Health and Social Care Act 2012 to deal with FTs enabling Monitor to appoint a TSA where the FT is, or is likely to become, unable to pay its debts. The legal framework applicable to FTs is very similar to NHS trusts, although the timetable is longer to enable Monitor to be consulted (a period of 150 days, unless extended). The framework is different from an ordinary administration under general insolvency legislation in that its main objective is to protect patients and staff from failing services and secure the continued provision of patient services.

Since its inception the regime has been used only twice, in relation to South London Healthcare NHS Trust and Mid Staffordshire NHS Foundation Trust.

The Care Act 2014 has also introduced extensions to the special administration timetable to give greater time for the TSA to publish their draft report, the consultation period is extended and it creates an obligation on the TSA to consult:

- (i) other NHS trusts and NHS FTs affected by wider recommendations, their staff and their commissioners;
- (ii) any local authority in whose area the trust in administration and other affected trusts are located; and
- (iii) any Local Healthwatch organisation in the area of any local authority.

There is also a greater role for the Care Quality Commission in the case of FTs to deal with quality and safety failure, by requiring that Monitor appoint a TSA where the Care Quality Commission is satisfied that there is a serious failure by an NHS FT to provide services that are of sufficient quality; and requiring Monitor to consult more widely with the Care Quality Commission, such as prior to publishing guidance. In addition, TSAs may not provide their draft report to Monitor before obtaining a statement from the Care Quality Commission that it considers that the recommendations in the draft report would achieve the sufficient safety and quality of the services.

(c) The special measures provisions for an FT and what changes the CCG might see.

(7 marks)

### **Suggested answer**

Following the publication of Robert Francis's report into care at Mid Staffordshire NHS Foundation Trust in 2013, the Keogh Review then identified significant problems relating to quality and safety and/or leadership in 14 trusts. In July 2013, 11 of the 14 were put into 'special measures'. This regime was new to the NHS and was set out in the *Guide to Special Measures* published jointly by the CQC, Monitor and the NHS Trust Development Authority at the time (now NHS Improvement).

CQC, through the Chief Inspector of Hospitals ('Chief Inspector'), will normally recommend that a trust is placed in special measures when an NHS trust or FT is rated 'inadequate' in the Well-Led domain that is, there are concerns that the organisation's leadership is unable to make sufficient improvements in a reasonable timeframe without extra support and 'inadequate' in one or more of the other domains (safe, caring, responsive and effective).

When NHS Improvement receives a recommendation from the Chief Inspector to place an FT in special measures, it will consider the evidence that CQC provides to them alongside other relevant evidence. On the basis of the full range of information, NHS Improvement will make a decision

whether the FT will be placed in special measures. It is intended that the usual period of time an FT remains in special measures will be a maximum of 12 months, although this may be extended in some circumstances.

In this approach the CQC will focus on identifying failures in the quality of care and judging whether improvements have been made. NHS Improvement will use their respective powers to support improvement in the quality of care provided.

Typically, providers will be subject to the following interventions, although their detailed application will vary according to the specific circumstances of the organisation:

- (i) The appointment of an improvement director who will act on NHS Improvement's behalf to provide assurance of the trust's approach to improving performance.
- (ii) One or more appropriate partner organisations will be appointed to provide support in improvement. Partner organisations are selected for their strength in the areas of weakness at the trust in special measures. Partner organisations will be reimbursed by NHS Improvement for reasonable expenses and may receive an incentive payment.
- (iii) NHS Improvement will review the capability of the trust's leadership. If needed, this may lead to changes to the management of the organisation to make sure that the board and executive team can make the required improvements.
- (iv) NHS Improvement will require trusts in special measures to publish their progress against action plans every month on the NHS Choices website and their own website, and to participate as required in national and local press conferences.

In some circumstances, a transaction may be the best means of securing longer term improvements in the quality of care. In these circumstances, the resulting organisation (whether an acquiring parent organisation, new entity formed by merger, and so on) itself would not automatically be placed into special measures at the point of transaction. The resulting organisation would be assessed on its own merits and regulated accordingly by CQC and NHS Improvement, which would take full account of the nature of the quality problems being taken on within the resulting organisation and how it, as a whole, was seeking to address them.

A trust will only come out of special measures if it has made the required improvements and this is usually expected to be within one year. At the end of the year the relevant CQC Chief Inspector will inspect the trust and judge whether improvements have been made and if it is delivering good enough care to exit special measures. NHS Improvement will only take a trust out of special measures after a trust has been re-inspected, is no longer rated as 'inadequate' in the Well-Led domain and has made progress across the other four CQC domains, and is confident that improvements will be sustained.

### **Examiner's comments**

Question 4 was the least popular question but was answered well by those who chose it. It was clear that those who provided pass answers had revised well around special measures and included relevant details, such as timeframes and the appointment of an improvement director and a Trust Special Administrator.

- 5 Dane Brown is the new Chair of the audit committee at your FT. His background is in the automotive industry. Although he has a financial background he is still getting used to the public sector and the role of internal audit.

### Required

As the FT's Company Secretary, write a letter to Dane explaining the function, scope and status of internal audit and internal auditors in the context of an FT.

(25 marks)

### Suggested answer

Your address  
Date

Dane Brown  
Chair of Audit Committee  
His address

Dear Dane,

#### Introduction and context

Welcome to the trust and to your role as Chair of the audit committee. As requested I am setting out the background to the role of internal audit as part of your induction into the NHS. As you know from your previous experience, the board of directors is responsible for maintaining a sound system of risk management and internal control, as set out in the UK Corporate Governance Code (UK Code) and FRC guidance on Risk Management, Internal Control and Related Financial and Business Reporting (2014). They require the board of directors to set appropriate policies on internal control, to seek regular assurance to satisfy itself that the system is operating effectively and to ensure that the system of internal control is effective in managing risks in the way that it has approved.

In addition the UK Code states that the board of directors (or the audit committee) should carry out a review of the effectiveness of the system of risk management and internal control at least annually. NHS bodies are required to complete an Annual Governance Statement (AGS) which sets out the effectiveness of their internal controls and the internal control system generally. The sources of information about risk management and internal control are management, the internal auditors (if the organisation has an internal audit function) and the external auditors, who notify management and the audit committee about weaknesses in internal controls that they have discovered in their audit. Therefore, Internal Audit is one method of monitoring the internal control system. In fact, the King III Code goes further and states that there should be an effective risk-based internal audit, and an internal audit function in order to carry out this monitoring.

It is important therefore, that information about the FT is objective and robust as stakeholders rely on the quality, performance and financial information that is published by the organisation. As a result, the work of both internal and external audit are vital in making sure that, as far as is reasonably possible, the information is objective and can be relied on. Within NHS organisations the remit of internal and external audit includes the review of quality, performance and financial information. Part of the audit committee's role is to monitor the work of both internal and external auditors and to ensure that the external auditors can place full reliance on the work of internal audit in these three areas of information.

#### Role of internal audit within an internal control system

Internal audit is defined by the Chartered Institute of Management Accountants as 'an independent appraisal activity established within an organisation as a service to it. It is a control that functions by examining and evaluating the adequacy and effectiveness of other controls'. The Chartered Institute of Internal Auditors describes the role as follows: 'The role of internal audit is to provide independent assurance that an organisation's risk management, governance and internal control processes are operating effectively. Internal auditors deal with issues that are fundamentally important to the

survival and prosperity of any organisation.

‘The work done by any internal audit unit is not prescribed by regulation, but is decided by management or by the board (or audit committee). Unlike external auditors, they look beyond financial risks and statements to consider wider issues such as the organisation’s reputation, growth, its impact on the environment and the way it treats its employees.’

The Government Internal Audit Standards for Foundation Trusts set out the requirements for internal audit for FTs and how to assess the service that is delivered. An organisation might have an internal audit unit or section, which carries out investigative work. An internal audit function should act independently of executive managers, but normally reports to a senior executive manager such as the finance director.

In the corporate sector, the FRC Guidance on Audit Committees (2012) suggests that the audit committee should ensure that the internal auditor has direct access to the board Chair and the audit committee, and is also responsible to the audit committee. This means that the internal auditors may be in an unusual position within the organisation. For operational reasons they may have a line reporting responsibility to a senior executive manager such as the finance director.

Executive managers may also ask the internal auditors to carry out audits or reviews of the systems or procedures (and internal controls) for which they are responsible. However, the senior internal auditor should have some control over deciding what aspects of the organisation’s systems should be investigated or audited, and also has a responsibility for reporting to the audit committee and the Chair of the board.

#### Work carried out by internal audit

The work done by any internal audit unit is not prescribed by regulation, but is decided by management or by the board (or audit committee). The possible tasks of internal audit include the following:

- (i) Reviewing the internal control system: traditionally, an internal audit department has carried out independent checks on the financial controls in an organisation, however, this has now been extended to include quality and performance controls as well. The checks would be to establish whether suitable quality, performance and financial controls exist and, if so, whether they are applied properly and are effective. It is not the function of internal auditors to manage risks, only to monitor and report them, and to check that risk controls are efficient and cost-effective.
- (ii) Special investigations: internal auditors might conduct special investigations into particular aspects of the organisation’s operations (systems and procedures), to check the effectiveness of operational controls.
- (iii) Examination of financial and operating information: internal auditors might be asked to investigate the timeliness of reporting and the accuracy of the information in reports.
- (iv) Value for money audits: this is an investigation into an operation or activity to establish whether it is economical, efficient and effective.
- (v) Reviewing compliance by the organisation with particular laws or regulations: this is an investigation into the effectiveness of compliance controls.
- (vi) Risk assessment: internal auditors might be asked to investigate aspects of risk management, and in particular the adequacy of the mechanisms for identifying, assessing and controlling significant risks to the organisation, from both internal and external sources.

#### Investigation of internal financial controls

Internal auditors are commonly required to check the soundness of internal financial controls. In assessing the effectiveness of individual controls, and of an internal control system generally, the following factors should be considered:

- (i) Whether the controls are manual or automated: automated controls are by no means error-proof or fraud-proof, but may be more reliable than similar manual controls.
- (ii) Whether controls are discretionary or non-discretionary: non-discretionary controls are checks and procedures that must be carried out. Discretionary controls are those that do not have to be applied, either because they are voluntary or because an individual can choose to dis-apply them. Risks can infiltrate a system, for example, when senior management chooses to dis-apply controls and allow unauthorised or unchecked procedures to occur.
- (iii) Whether the control can be circumvented easily: an activity can be carried out in a different way where similar controls do not apply.
- (iv) Whether the controls are effective in achieving their purpose: are they extensive enough or carried out frequently enough? Are the controls applied rigorously? For example, is a supervisor doing his job properly? Reports by internal auditors can provide reassurance that internal controls are sound and effective, or might recommend changes and improvements where weaknesses are uncovered.

#### External audit's reliance on the work of internal audit

It is expected that the external auditors will liaise with the internal audit function to obtain a sufficient understanding of internal audit activities to assist in planning the audit and developing an effective audit approach. The auditors may also wish to place reliance upon certain aspects of the work of internal audit in satisfying their statutory responsibilities as set out in the National Health Service Act 2006 and in the Monitor Audit Code. In particular the auditors may wish to consider the work of internal audit when undertaking their procedures in relation to the AGS.

#### The objectivity and independence of internal auditors

The manager of a directorate or department should monitor the internal controls within the operation and try to identify and correct weaknesses. They should also report on reviews of the effectiveness of internal control. However, a line manager cannot be properly objective, because they could face 'blame' for control failures in the system or operation for which they are responsible.

In contrast, internal auditors ought to be objective, because they investigate the control systems of other directorates and departments. However, they are also employees within the organisation and report to someone on the organisation structure. If the internal auditors report to the finance director, they will find it difficult to be critical of the finance director. Similarly, if the internal auditors report to the CEO, they will be reluctant to criticise the CEO. In this respect, their independence could be compromised.

In its Guidance for Audit Committees, the Institute of Chartered Accountants in England and Wales comments that the internal auditors should be separate and independent from line management, but that 'independence' for internal auditors does not have the same meaning as independence for external auditors. To protect the independence of the internal audit function, the FRC's Guidance 2014 suggests that the audit committee should have the responsibility for the appointment of the head of internal audit, and his removal from office.

#### Review of the effectiveness of the internal audit function

The board or audit committee should review the effectiveness of the internal audit function each year. As part of this review, the HFMA NHS Audit Committee Handbook 2014 suggests that the audit committee should make sure that the head of internal audit has direct access to the chair of the board and the audit committee, and is accountable to the audit committee. There should also be a review and assessment of the annual internal audit work plan along with regular reports on the results of work done by the internal auditors. The review should consider and monitor the responses of management to the recommendations made to them by the internal auditors. The audit committee should also meet with the head of internal audit at least once a year without executive management being present. The HFMA Handbook states that the audit committee should actively review the plans of both internal and external audit and assess the quality of the services that are provided.

### Clinical audit

The Healthy NHS Board 2013 also identifies that internal audit needs to be distinguished from clinical audit. Clinical audit serves as a significant source of assurance of clinical quality and clinical audit programmes should be aligned to key strategic and operational risks to maximise the assurance provided by the clinical audit function. There does, however, need to be a clear line of sight from the Board Assurance Framework and the operational risk register to the programme of internal audit and a demonstrable link to the overall programme of clinical audit.

I hope that you found this a helpful introduction and if you have any further questions please contact me directly.

### **Examiner's comments**

Question 5 was also a popular question but was not well answered. Answers which did achieve a pass level were formatted as a letter, as required, and focussed on the question requirement about the scope of internal audit. Most answers which did not meet a pass level addressed the role of the audit committee and external auditors.

- 6 You are the Company Secretary for Crawford CCG ('Crawford'), which is faced with making some key strategic decisions. Recent governing body meetings have been very rushed, with long agendas that allow limited time for discussion. Some papers are being submitted the day before the meeting or being tabled on the day and many of them are for 'noting' by the governing body. Attendance by some of the Lay Members has also become irregular, or they arrive half-way through the meeting. The Chair and Lay Members are keen to think through the governing body's decision-making process.

### Required

Prepare a report for the next governing body development workshop in which you:

- (a) Identify the guidance documents which set out best practice in board decision-making and summarise their recommendations and findings.

*(12 marks)*

### Suggested answer

Report for Crawford CCG governing body development workshop

Subject: Effective decision-making

Date: December 2016

From: Company Secretary

The guidance available thus far relates to the role of boards and their directors. Although this is not binding on the governing body of a CCG, which is not a unitary board unlike other NHS bodies, nevertheless, the best practice which is set out in these publications can provide useful insight for Crawford as it approaches significant discussions and strategic decisions.

Governing bodies and boards can only make effective decisions if they have the right information. One key piece of NHS guidance on information is the Intelligent Board report. Whilst published in 2006, it still contains some key principles of interest for governing bodies to consider. It set out a set of principles and model framework for structuring information to support strategy development and oversight of business delivery and effectiveness. It also suggested practical ways in which boards might use the framework proposed.

The report outlined the growing pressure on boards to raise their game and the need to improve the information they receive and how they use it. It included some key principles that should govern information for the board, together with a proposed framework and minimum data set for reviewing trust performance, supporting decision-making and considering strategy. It also recommended improving the structure of agendas for the board; developing a 'dashboard' of routine performance indicators, which informed the annual cycle of board meetings.

The report also recommends that all information should:

- Cover locally defined priorities as well as national 'must do' requirements.
- Focus on outcomes, not systems and processes.
- Be available in a timely and understandable format.
- Be clearly and simply presented.
- Be forward-looking, presenting trends and anticipating future issues.
- Allow internal comparison between services and make use of external benchmarks.
- Provide interpretation and analysis as well as information.
- Provide a level of detail that is appropriate to the board's governance role.

A further piece of guidance is the Healthy NHS Board guidance (2013), which sets out that embedding board disciplines is the "bedrock of good board functioning" and enables effective decision-making. 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.

*Taking it on trust* (2009) also provided examples of good practice, to ensure that board reports provided a critical examination of the assurance provided by the organisation's internal controls and other forms of assurance. It also emphasised assurance on data quality as being essential for good decision-making.

The FRC Guidance on Board Effectiveness, which applies to corporate bodies, states that an effective board is one that makes well informed and high-quality decisions based on a clear line of sight into the business. It goes on to say that this level of decision-making is a critical requirement for a board to be effective and does not happen by accident. Further 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.

The FRC Guidance sets out clear recommendations, which facilitate good decision-making capability. These are:

- (i) high-quality board documentation;
- (ii) obtaining expert opinions when necessary;
- (iii) allowing time for debate and challenge, especially for complex, contentious or business-critical issues;
- (iv) achieving timely closure; and
- (v) providing clarity on the actions required, and timescales and responsibilities.

The FRC Guidance also suggests that boards become aware of the factors, which can limit effective decision-making, such as:

- (i) a dominant personality or group of directors on the board, which can inhibit contribution from other directors;
- (ii) insufficient attention to risk, and treating risk as a compliance issue rather than as part of the decision-making process, especially cases where the level of risk involved in a project could endanger the stability and sustainability of the business itself;
- (iii) failure to recognise the value implications of running the business on the basis of self-interest and other poor ethical standards;
- (iv) a reluctance to involve non-executive directors, or of matters being brought to the board for sign-off rather than debate;
- (v) complacent or intransigent attitudes;
- (vi) a weak organisational culture; or
- (vii) inadequate information or analysis.

The FRC Guidance highlights that most complex decisions depend on judgment, but that the judgment of even the most well intentioned and experienced leaders can, in certain circumstances, be distorted. Some factors known to distort judgment in decision-making are conflicts of interest, emotional attachments, and inappropriate reliance on previous experience and previous decisions. For significant decisions, therefore, the guidance recommends that a board may wish to consider extra steps, for example:

- describing in board papers the process that has been used to arrive at and challenge the proposal prior to presenting it to the board, thereby allowing directors not involved in the project to assess the appropriateness of the process as a precursor to assessing the merits of the project itself; or
- where appropriate, putting in place additional safeguards to reduce the risk of distorted judgements by, for example, commissioning an independent report, seeking advice from an expert, introducing a devil's advocate to provide challenge, establishing a sole purpose sub-committee, or convening additional meetings. Some chairmen favour separate discussions for important decisions; for example, concept, proposal for discussion, proposal for decision. This gives executive directors more opportunity to put the case at the earlier stages, and all directors

the opportunity to share concerns or challenge assumptions well in advance of the point of decision.

The FRC Guidance concludes that boards can benefit from reviewing past decisions, particularly ones with poor outcomes. A review should not focus just on the merits of the decision itself but also on the decision-making process.

- (b) Evaluate areas of review and improvement that Crawford could consider in order to improve the quality of decision-making by its governing body.

(13 marks)

### **Suggested answer**

From the scenario given it seems that the key area for improvement for Crawford is in relation to the timeliness of its board papers and the commitment to attendance by governing body members. These are key areas that are part of the recommendations from the FRC Guidance on Board Effectiveness, which are as follows:

#### High quality timely board documentation

The governing body (GB) should receive relevant documents in advance of a GB meeting, so that members 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 Chair has the responsibility for ensuring that GB members 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 GB to:

- Understand the needs, views and experiences of members, patients and the public from all backgrounds and communities served.
- Make sure that patients 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 late submission or tabling of papers means that GB members do not have time to assess and scrutinise the information being given and can lead to a "rubber-stamping" approach by boards. If papers are regularly submitted for "noting" then again what role is the GB playing in scrutinising and challenging the decisions being made?

The information flow should be both formal and informal. Information should be provided formally in documents or files, and 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 GB and its committees, between committees, and between executive managers and GB members, including lay members.

Questions that the GB might like to ask are:

- Do GB reports direct the GB's attention to significant risks, issues and exceptions and provide a level of detail appropriate to the GB's role?
- Had the relevant sub-committees considered the GB reports and did they have the relevant delegated authority to interrogate and scrutinise the information they received?
- Did it clearly set out alternative options to any investment or proposal?
- Were the benefits clearly established and tested for credibility?
- Was there clinical and nursing input into the proposal?

- Were the views of existing patients 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?

#### Obtaining expert opinions when necessary

As well as receiving relevant and timely information, GB members 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 a GB member. For example, a Lay Member might ask to consult a lawyer for advice on a matter where the legal position is not clear. It would be interesting to see what expert opinions had been sought in the past and which experts had been considered necessary from a quality perspective.

#### Allowing time for debate and challenge

The late submission of papers and a heavy agenda does not allow adequate time or attention for debate. Members will be reading papers as they are presented and will not have had time to reflect on their contents. Consequently, another area for improvement will be for the Crawford Chair to structure and time the agenda to allow for debate and to insist on the timeliness of papers to allow for greater debate and challenge. This is particularly important for complex, contentious or business critical issues and the FRC guidance recommends that careful attention should be paid to the agenda setting process and the amount of material to be considered. For example: was there sufficient time allowed? Would presentations and site visits have been helpful as well as 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

Once decisions have been made or actions agreed, it is very important to make sure that these are followed through. There must be both a process for this and time allowed to monitor the implementation and impact of decisions. Helpful questions might be as follows:

- Was the GB 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 GB?
- As projects progress, are regular updates provided to the GB along with revised risk assessments?

#### Support and personal behaviour

Mapping the Gap (2011) by the ICSA assessed the behaviours of board members in the NHS. It highlighted the gap between the need for constructive challenge and the actual behaviours of board members in the boardroom. Missing meetings and or arriving late were featured as areas of concern along with using electronic devices, reading non-board papers and holding private conversations during the meeting.

The Crawford Chair will need to speak with those members who are irregularly attending or arriving late. This impacts on the board discussion at the time and means there is a lack of continuity in board discussions.

It may be that the GB members and particularly the Lay Members 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. Crawford may want to consider if there is a sufficient level of support in respect of the significant decisions, which need to be taken going forward.

The GB might also want to spend some time reflecting on how it behaves and how well the values of the CCG are embedded into the GB itself. This may be particularly pertinent for the management of conflicts of interest, which could be a key area for misunderstandings or emotional attachment in light of the strategic decisions that need to be made. A willingness to explore the level of challenge that should be expected and the manner in which this is conducted could also be beneficial. Ensuring that the register of interests is maintained as up-to-date and that the Chair and the GB members are clear on how conflicts will be handled is also essential.

### Summary

There are a number of areas outlined in this report, which might assist the GB to improve its decision-making and I would be happy to provide further support to implement these changes or further review.

### **Examiner's comments**

Question 6 was reasonably well attempted by a number of candidates. Answers achieving a pass level described best practice in decision-making as set out in a good range of guidance. They focused on the key areas of timeliness, expert opinions, timely closure and clear action points, and appropriate support and behaviours. These answers were also clear on the risk management responsibilities of the board and described risk appetite and risk tolerance well. Higher scoring answers referred to a high level of source material.

*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.*