Auditor Guidance Note 5 (AGN 05)

NHS Audit Planning

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About Auditor Guidance Notes

Auditor Guidance Notes (AGNs) are prepared and published by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General (C&AG) who has power to issue guidance to auditors under Schedule 6 paragraph 9 of the Local Audit and Accountability Act 2014 (the Act).

AGNs set out guidance to which local auditors must have regard under Section 20(6) of the Act. The guidance in AGNs supports auditors in meeting their requirements under the Act and the *Code of Audit Practice* published by the NAO on behalf of the C&AG.

The NAO also prepares and publishes Supplementary Guidance Notes (SGNs) under Schedule 6 paragraph 9 of the Act. SGNs are prepared and published when the C&AG wishes to address a particular issue. SGNs are part of the full suite of AGNs which as such constitute guidance to which local auditors must have regard under Section 20(6) of the Act.

The NAO issues Weekly Auditor Communications (WACs), and less frequently Special Auditor Communications (SACs) to local auditors to bring to their attention relevant information to support them in carrying out audit work. Whilst these are for information, they may draw attention to guidance that has been issued by the NAO on behalf of the C&AG in AGNs to which, as stated above, auditors must have regard. The NAO may also use SACs to clarify expectations in relation to interpretation of specific issues.

The interpretations and guidance on auditing standards set out in *Practice Note (PN) 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom, (Revised 2022)* are relevant to the work undertaken under the Code. Therefore, the C&AG's expectations on how auditors approach their audit of the financial statements is based upon the principles and guidance set out within PN 10.

The firms that are local auditors under the Act may use these communications to update their own internal communications and reference tools.

AGNs are numbered sequentially and published on the NAO's website. Any new or revised AGNs are brought to the attention of local auditors through the WACs.

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The AGNs are designed to assist local auditors in forming their own understanding of the requirements of the Code. Auditors are required to have regard to AGNs, which means that they must take into account the guidance issued by the NAO, and, if they decide not to follow it, they must give clear (in the sense of objective, proper, and legitimate) reasons within audit documentation as to why they have not followed the guidance. AGNs are in no way intended as a substitute for the exercise of the independent professional skill and judgement of a local auditor in deciding how to apply the NAO's guidance or when providing explanations as to why guidance has not been followed.

Local auditors should not assume that AGNs are comprehensive or that they will provide a definitive answer in every case.

AGN 05 is relevant to all local auditors of health bodies covered by the Local Audit and Accountability Act 2014 and the *Code of Audit Practice* including auditors of NHS foundation trusts. Guidance on auditors' work on value for money arrangements and on reporting is published in AGN 03 and AGN 07 respectively.

Introduction and context

The guidance within this document is prepared to assist auditors in meeting their responsibilities as the statutory auditor of local health bodies, under the *Code of Audit Practice* (the Code). This AGN sets out guidance for auditors to support planning work on audits of financial statements of local health bodies.

As part of their planning process, audit teams identify changes to accounting requirements drawing on any relevant technical briefings prepared by their firms. This guidance is not intended to replace auditors' own procedures.

Local auditors are also component auditors. The NAO group audit teams issue group instructions which local auditors need to follow. The group instructions set out requirements for local auditors to assist the NAO group audit teams in meeting their responsibilities supporting the C&AG as the statutory auditor of the bodies of which local health bodies are components. Auditors are reminded that whilst, the regularity opinion is not required for an NHS trust or NHS foundation trust, they should consider any requirements set out in the group audit instructions issued *under ISA (UK) 600 (Revised November 2019) (Updated May 2022) Special Considerations –Audits of Group Financial Statements Including the Work of Component Auditors* to support the NAO's group audit assurance over the regularity opinion.

The C&AG qualified the *Department of Health and Social Care's (the Department) annual report and accounts 2021-22* on 26 January 2023 on the following basis:

Qualified opinions on the financial statements:

- lack of records in respect of inventory, the onerous contract provision balance and associated transactions;
- inability to obtain sufficient, appropriate audit evidence to support the UK Health Security Agency transactions and balances included in the Department's accounts (with a disclaimer of opinion issued on the Agency's financial statements);
- insufficient evidence to demonstrate the opening balance of accruals is free from material mis-statement; and

- a disagreement on the application of IFRS 9 *Financial instruments* therefore impacting on the opening balance of other financial assets (loans issued by the Core Department to NHS Trusts and Foundation Trusts).

Qualified opinions on regularity:

- being unable to obtain sufficient appropriate audit evidence to demonstrate that the spend incurred by the UK Health Security Agency was regular under the framework of authorities; and

- excess of outturn of Resource Non-Budget Expenditure by £2.457 billion due to the impact of the recognition of a prior period adjustment affecting the clinical negligence provision.

The C&AG provided further explanation on the issues above in his report on accounts (pages 261-267) covering:

- COVID-19 procurement and inventory management;
- lack of governance, oversight and control at UK Health Security Agency;
- financial management and oversight of NHS bodies; and
- an Excess Vote due to a control total breach.

The C&AG issued an unqualified opinion on *the NHS Commissioning Board's annual report and accounts 2021-22* but qualified the regularity opinion due to ineligible payments made to suspended medical practitioners, where the transactions do not conform to the relevant statutory regulations specifying entitlement to such payments. Further explanation on this is included in the C&AG's report on accounts (pages 143-146) as well as the following updates:

- **Special severance payments**: The C&AG's regularity opinion was qualified in 2020-21 due to a special severance payment which had not been submitted to HM Treasury for approval. The completeness and regularity of exit packages was identified as a significant risk in 2021-22 where special severance payments continued to be made across the NHS England group without HM Treasury approval. Five of these occurred within CCGs and one within the NHS England parent. Whilst these were deemed irregular, they did not lead to a qualified regularity opinion due to not being material by nature or value at the consolidated group level. However, the C&AG has reported that the regularity framework for special severance payments is still not sufficiently well understood across the NHS England group and that, given the structural changes in 2022-23, there continues to be an increased likelihood of further exit packages and specifically special severance payments.

- **Oversight of bodies within the NHS England group**: The C&AG refers to the explanatory report included alongside the audit certificate on the Department's 2021-22 annual report and accounts (set out above) which is relevant as it reports on the timetable and preparation and audit of NHS England group bodies.

The C&AG issued an unqualified opinion on the *NHS Improvement Consolidated Provider Account 2021-22* but also refers to the explanatory report included alongside the audit certificate on the Department's 2021-22 annual report and accounts (set out above) which is relevant as it reports on the timetable and preparation and audit of NHS trusts' and NHS foundation trusts' financial statements.

The NAO's first report on *NHS backlogs and waiting times in England* shows that the performance against these was deteriorating before the COVID-19 pandemic and worsened since it began. The NAO's second report on *Managing NHS backlogs and waiting times in England*, November 2022, states that activity so far in 2022 has continued to lag behind the pre-pandemic level and is well below the planned trajectory. The government announced a multi-year funding settlement in September 2021, which included £8 billion to support the recovery of elective care in the three years to 2024-25. The NHS's funding package is being eroded by inflation, so that its overall funding up to 2024-25 is set to grow more slowly than the long-term average in real terms. The report sets out concerns that the 129% activity target and the target to eliminate all waits of longer than 52 weeks by 2025 are at serious risk of not being achieved. There are significant threats to the recovery, including the effects of strain on the workforce, uncertainties about whether new initiatives will be able to deliver results as quickly as NHS England needs them to, and the pressures elsewhere in the NHS and adult social care. If the recovery programme is to deliver value for money NHS England will need to manage the programme in line with best practice. It will need to ensure that all component initiatives are well integrated with one another and that it is agile in responding to results and challenges as they emerge, including supporting local systems to make best use of recovery funding. The Department has an essential part to play too in holding the NHS to account, providing support and challenge as needed.

The NAO's report *Introducing Integrated Care Systems: joining up local services to improve health outcomes* provides an overview of integrated care systems (ICSs) introduced into legislation by the Health and Care Act 2022. The report describes their structure, objectives, and governance arrangements; an overview of the positions that ICSs are starting from, in terms of finances, staffing and activity levels, and some of the wider challenges facing the health and care sector; and an examination of government's efforts to improve population health through better integration and a focus on prevention, and an assessment of ICSs' prospects for success this time.

When considering the planning issues highlighted in this AGN, auditors should be mindful that audits under the Code of Audit Practice are integrated. Auditors should therefore consider the extent to which any issues highlighting risks to the opinion on the financial statements, or which suggest that non-standard reporting may be necessary and, any work required to inform their commentary on arrangements to secure value for money under AGN 03.

Auditors should also consider whether it is appropriate to draw particular attention to any issues arising from their work under AGN 03 or AGN 05 by exercising their additional public reporting powers, such as making statutory recommendations or issuing public interest reports. Further guidance on relevant considerations when exercising additional powers can be found in AGN 04.

Contents

This AGN is structured as follows:

Section 1: Accounting Manuals and Financial Reporting

Accounts Directions

What are the issues?

1. The Department of Health and Social Care (DHSC) is required to issue accounts directions to NHS trusts. The accounts directions are included in Chapter 2, Annex 4 of the 2022-23 Group Accounting Manual (GAM).

2. The Health and Care Act 2022 received Royal Assent on 28 April 2022 which formally renames the NHS Commissioning Board to NHS England and brings NHS Improvement (comprising the Trust Development Authority & Monitor) into NHS England and accounted for within NHS England's accounts.

3. It establishes 42 Integrated Care Boards (ICBs) across England from 1 July 2022 at the same time as abolishing 106 Clinical Commissioning Groups (CCGs) on 30 June 2022. ICBs will take on the NHS commissioning functions of CCGs as well as some of NHS England's commissioning functions. It will also be accountable for NHS spend and performance within the system. The Establishment Order legally establishes ICBs with effect from 1 July 2022.

4. NHS England is required to issue directions to CCGs and ICBs in respect of their annual report and accounts. CCGs are required to produce part year annual report and accounts for the period 1 April to 30 June 2022. The accounts directions will be published on NHS England's SharePoint site. The NAO will highlight relevant guidance published on SharePoint via weekly communications and include on the LACG extranet.

5. NHS England issues the directions to foundation trusts, which will be issued with the Annual Reporting Manual for foundation trusts (FT ARM).

Why is this important?

6. The accounts directions set out instructions, in accordance with legislation, that health service bodies must comply with. The directions cover:

   - the method and principles for the preparation of accounts including compliance with HM Treasury's Financial Reporting Manual (FReM) and the GAM;
   - submission of the draft accounts; and

- submission of the audited accounts.

What should auditors do?

7. Auditors should be aware of the accounts directions for the audited body, to support their audit planning work under *ISA (UK) 300 (Revised June 2016) (Updated May 2022) Planning an Audit of Financial Statements*, and *ISA (UK) 250 (Revised November 2019) (Updated May 2022) Section A – Consideration of Laws and Regulations in an Audit of Financial Statements*.

Group Accounting Manual 2022-23

What are the issues?

8. DHSC issued the 2022-23 Group Accounting Manual (GAM) on 17 June 2022, following a consultation exercise. The GAM provides a single mandatory accounting document for the whole of the departmental group. The main areas of change and the responses received in response to DHSC's consultation on the GAM are set out here.

9. The GAM includes guidance on the completion of annual reports for NHS trusts, CCGs and ICBs. The Annual Reporting Manual for foundation trusts provides guidance for the completion of foundation trusts' annual reports only.

10. Additional appendices are included within the GAM where there are additional sector specific reporting requirements. Additional appendices provide supplementary guidance for CCGs, ICBs, NHS trusts and foundation trusts in the relevant chapters of the GAM.

11. The GAM will be supplemented as necessary by additional guidance over the course of the year. Updates will be posted to the DHSC GAM area of 'gov.uk'. All content issued in this way should be treated as having the same status as the manual. The most recent updates to the GAM include incorporating changes as a result of the Health and Care Act 2022 and the creation of ICBs.

12. Guidance relevant to CCG and ICB accounts completion in the NHS England Group 'Integrated Single Financial Environment' (ISFE) will be issued on the NHS England SharePoint. Each of the audit firms has access to this site. Additionally, the NAO will highlight relevant guidance published on SharePoint via weekly communications.

13. A detailed accounts submission process, showing deadlines and procedures for handling statutory accounts and summarisation schedules is available on DHSC's website.

14. The C&AG's explanatory report on DHSC's accounts (see pages 261-267 of the report) highlights the continued deterioration in the timely finalisation of NHS bodies' accounts and completion of local audits, undermining accountability and oversight across the group. In 2021-22, a quarter of providers and a fifth of commissioning bodies failed to meet the deadline of 22 June set by the Department. This is twice as many bodies as missed the deadline in 2020-21. The report highlights that the complex structural changes in the Departmental Group, (as set out in paragraphs 2-3 above) will cause additional risks to achieving timely financial reporting. Changes part way through a financial year will add further pressures to the timely preparation of accounts and the delivery of external audit at a local level with part-year accounts for both the demised CCGs and the new ICBs and external audits required for all of these entities.

Why is this important?

15. NHS trusts, foundation trusts, CCGs and ICBs are required to produce their annual (and part-year) accounts in line with the GAM issued by DHSC and in accordance with the submissions timetable.

What should auditors do?

16. Auditors should familiarise themselves with the content of, and changes to, the 2022-23 GAM to support their audit planning work under *ISA (UK) 300 (Revised June 2016) (Updated May 2022) Planning an Audit of Financial Statements*, and *ISA (UK) 315 (Revised July 2020) Identifying and Assessing the Risks of Material Misstatement*. Auditors will be aware of the significant changes made to *ISA (UK) 315* which takes effect for audits of financial statements for periods beginning on or after 15 December 2021. This will affect the way in which auditors design and perform audit procedures to respond to the risks of material misstatement.

17. When considering going concern, auditors should refer to SGN/01 Going Concern – Auditor's responsibilities for local public bodies. The GAM states in paragraphs 4.22-4.24:

"Where an entity ceases to exist, it must consider whether or not its services will continue to be provided (using the same assets, by another public sector entity) in determining whether to use the concept of going concern in its final set of financial statements. While an entity will disclose its demise in various areas of its Annual Report and Accounts such as in the Performance Report and cross reference this in its going concern disclosure, this event does not prevent the accounts being prepared on a going concern basis or give rise to a material uncertainty in relation to the going

concern of the entity. DHSC group bodies must therefore prepare their accounts on a going concern basis unless informed by the relevant national body or DHSC sponsor of the intention for dissolution without transfer of services or function to another entity."

18. Auditors should note the submission dates within the DHSC timetable for audited NHS trust, foundation trust, CCG and ICB accounts and consider the impact on their resource planning for the audit of the financial statements.

19. Auditors of CCGs, ICBs, NHS trusts and foundation trusts do not make submissions but are required to ensure that all relevant documents and signed statements are provided to bodies in reasonable time to enable them to meet submission deadlines.

20. Although the NAO will bring auditors' attention to other relevant guidance and the submissions timetable, auditors may also wish to establish arrangements to obtain copies locally.

New Accounting Standards

What is the issue?

21. *IFRS 16 Leases* will replace *IAS 17 Leases*. Implementation will be effective from 1 April 2022 for entities that follow HM Treasury's FReM and the GAM. The transitional reporting requirements for IFRS 16 have been adopted such that the preceding year is not restated.

22. The new standard eliminates the distinction between operating and finance leases for lessees and brings in a single approach under which all but low-value or short term (less than 12 months) leases are recognised. The distinction between operating and finance leases for lessors is maintained.

23. Successful implementation of the new standard will depend on organisations collating and reviewing relevant information and contracts about their new and existing leases. This will require a significant exercise to collect and analyse relevant information and organisations will need to have an effective project plan and timetable to prepare for implementation on a timely basis.

24. Organisations will need to take steps including having arrangements for capturing information on leases.

25. The FReM and therefore the GAM will be deferring application of IFRS 16 measurement principles to public private partnership (PPP) liabilities until 2023 to 2024. Consequently, entities will continue to account for such liabilities on the basis employed through 2021 to 2022, which is reflected in paragraphs 4.245 to 4.249 and

chapter 4 annex 5 of the GAM, principally be removing reference to IFRS 16 in these sections and noting the deferral in paragraph 4.248.

Why is this important?

26. The standard is likely to lead to significant changes to lessees with all major leases coming onto the Statement of Financial Position as well as additional disclosures. This includes a disclosure objective which gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee and lessor. There are additional disclosures for the right-of-use asset, depreciation charges and interest expense on the lease liabilities and disclosures on the exemptions for recognition (i.e. low value and short-term leases).

27. NHS bodies will need to consider the implications for their own financial reporting and supporting arrangements as they prepare for the standard to be adopted. Chapter 4, annex 11 of the DHSC GAM contains guidance on the application of the standard. Further guidance and resourcesare available on the NHS England designated IFRS 16 financial accounting and reporting page here. This page also includes details of data submissions required by NHS England in terms of transition and forecasts to inform HM Treasury on the impact to capital and revenue outturn.

What should auditors do?

28. Auditors should discuss with their bodies the implications of the introduction of IFRS 16 for their financial reporting and consider the requirement for early planning and reviewing of balances and disclosures and any required adjustments.

Annual Report

What is the issue?

29. NHS bodies are required to publish a single document containing the annual report and accounts.

30. Guidance for the preparation of the annual report for CCGs, ICBs and NHS trusts is included in Chapter 3 of the DHSC GAM. Guidance for foundation trusts is included in the 2022-23 FT ARM.

Why is this important?

31. Certain elements of the annual report are subject to audit as set out in paragraph 3.47 of the GAM and corresponding paragraphs of the FT ARM. These comprise:

- single total figure of remuneration for each director;
- CETV disclosures for each director;
- payments to past directors, if relevant;
- payments for loss of office, if relevant;
- 'fair pay' disclosures set out in paragraph 3.107-3.123 of the GAM (further guidance is set out within the Hutton *Fair Pay Disclosures – Implementation guidance (Revised 2021)*);
- exit packages, if relevant and noting that the disclosure is for those exit packages agreed in year, irrespective of the actual date of accrual or payment; and
- analysis of staff numbers and costs.

32. Auditors are also required to review the information within the annual report for consistency with other information in the financial statements. Paragraph 3.30 of the DHSC GAM requires that auditors are required to read the information in the annual report and refer to this in their audit report. NHS bodies should submit the draft annual report to auditors to allow them sufficient time to undertake their review.

33. Paragraph 3.48 and 3.125-3.126 of the DHSC GAM requires that NHS bodies include the audit report within the Accountability Report.

34. Paragraph 3.125-3.132 of the GAM sets out a number of disclosures that are required to be included in the Parliamentary Accountability Report. NHS providers and commissioners are not required to produce a Parliamentary Accountability Report, but have the option to include these disclosures in the Annual Report. Where the NHS body elects not to do this, it must, in accordance with paragraph 3.128, include the disclosures on remote contingent liabilities, losses and special payments, gifts, and fees and charges as notes within its financial statements.

35. Paragraph 2.86 of the GAM includes expanded guidance regarding the applicability of HM Treasury's Managing Public Money to all DHSC group bodies and the requirements for obtaining prospective HM Treasury approvals. This includes, but not limited to, approvals for novel, contentious or repercussive expenditure - including certain losses or special payments such as special severance payments.

36. Prior to discussing with an individual or making any special severance payment to an individual, CCGs, ICBs, trusts and FTs must follow HM Treasury guidance on special severance payments and pre-approval must be sought. The limit for approvals of special severance payments is £zero. The same threshold applies to disclosure of these payments in the annual report and accounts.

37. It is expected that staff employed by CCGs will transfer to the newly established ICBs, and NHS England has made an employment commitment to staff to provide stability and minimise uncertainty. However, the demise of CCGs may result in the termination of employment of staff.

38. The C&AG has reported that the regularity framework for special severance payments is still not sufficiently well understood across the NHS England group and that, given the structural changes in 2022-23, there continues to be an increased likelihood of further exit packages and specifically special severance payments.

What should auditors do?

39. Auditors should familiarise themselves with the guidance for the annual report in the DHSC GAM. The NAO will bring auditors' attention to other relevant guidance issued by DHSC and NHS England as it is implemented.

40. Auditors should engage in early discussions with their NHS bodies to ensure the body includes and publishes the required information in accordance with relevant guidance.

41. Auditors should be aware of the approval process and HM Treasury severance payments guidance in force set out in paragraphs 35-36 above.

NHS Foundation Trust Annual Reporting Manual 2022-23

What is the issue?

42. NHS England issue the FT ARM that provides guidance to foundation trusts on the completion of the annual report. Foundation trusts are required to complete their accounts in accordance with the GAM. The FT ARM is available on NHS England's financial accounts and reporting updates page here.

Why is this important?

43. The FT ARM outlines the process foundation trusts should follow when producing and submitting their annual report.

What should auditors do?

44. Auditors should familiarise themselves with the content of, and any changes to, the 2022-23 FT ARM to support their audit planning work under *ISA (UK) 300 (Revised June 2016) (Updated May 2022) Planning an Audit of Financial Statements*, and *ISA (UK) 250 (Revised November 2019) (Updated May 2022) Section A – Consideration of Laws and Regulations in an Audit of Financial Statements*.

Agreement of Balances

What is the issue?

45. DHSC is required to consolidate the accounts of all organisations falling within the accounting boundary. The agreement of balances process aims to identify all income and expenditure transactions, and payable and receivable balances that arise from the provision of goods and services between component bodies in order to eliminate these transactions and balances on consolidation.

46. NHS England also eliminate transactions and balances between their component bodies in preparing their sector-specific consolidated accounts.

47. DHSC and NHS England published its *2022-23 Agreement of Balances guidance* in September 2022 which is designed to provide practical guidance to all NHS bodies within the resource accounting boundary.

48. On 1 July 2022 CCGs and London Shared Services (0DJ) were abolished as they absorbed into their local ICBs and the functions of Monitor and NHS TDA were transferred to NHS England. Any income and expenditure from 1 April 2022 to 30 June 2022 should be recorded against the predecessor body, and for 1 July 2022 onwards against the new organisation. The payable and receivable balances transferred to the new organisations on 1 July 2022. An additional month 3 exercise was carried out to support the part-year three-month demising CCGs accounts process.

Why is this important?

49. The exercise completed at quarter 1 (month 03) and year-end (month 12) contributes directly to the year-end production of the NHS provider sector, NHS England and DHSC consolidated final accounts.

50. There are a number of arrangements between bodies that can cause complications for this process, including lead commissioning arrangements and the treatment of disputed balances. Joint working arrangements, including those arising from

integrated care systems may also give rise to different accounting treatments between participating bodies.

51. Auditors may also complete work on agreement of balances as part of their work on the financial statements audit and as part of the work under the NAO group instructions.

What should auditors do?

52. Auditors should discuss at an early stage the level of evidence required to substantiate balances.

53. The increasing use of pooled budgets and lead commissioning arrangements, including with local government bodies, can provide additional complexity to the agreement of balances process. Auditors should be aware of the guidance on pooled budgets and joint arrangements, including the Better Care Fund, within Chapter 4 Annex 8 of the GAM – Accounting for Pooled Budgets and Joint Arrangements and discuss the accounting treatment of such arrangements to ensure they are satisfied with the accounting treatment for the body in which they are auditing.

Summarisation Schedules / Consolidation Template

What is the issue?

54. In addition to the statutory annual report and accounts produced by each entity, NHS bodies need to communicate the same data, with further analysis to permit consolidation, to NHS England in a standard format that can be automatically processed.

55. Paragraph 2.11 of the Code of Audit Practice requires auditors to report on the consistency of the schedules or returns with the audited body's financial statements for the relevant reporting period. This should be done using the final audited accounts and final schedules, making sure that all audit adjustments are appropriately reflected, and where relevant, disclosure notes are consistent. Auditors should note that this is a requirement for all local NHS bodies and is in addition and separate to any work required of component auditors by the NAO group audit teams.

56. Auditors are also required to submit the final summarisation schedules to the NAO group audit teams as required by the group audit instructions.

57. NHS England group accounts consolidates the accounts of both CCGs and ICBs and NHS England as a parent of the group. These are required to be consolidated into the DHSC Group Accounts.

58. The Consolidated NHS Provider Accounts (CPA) consolidates the accounts of both foundation trusts and NHS trusts which together make up the NHS provider sector. The CPA is required to be consolidated into the DHSC Group Accounts.

Why is this important?

59. The consolidation templates and summarisation schedules form the basis of the group consolidation process. Differences are time-consuming to resolve and delay consolidation at the group level. It is important that differences between the accounts and consolidation schedules are highlighted to the audited body on a timely basis.

What should auditors do?

60. The Code of Audit Practice requires auditors to report on the consistency of the schedules or returns with the audited body’s financial statements for the relevant reporting period. This should be done using the final audited accounts and final schedules, making sure that all audit adjustments are appropriately reflected, and where relevant, disclosure notes are consistent.

61. It is the responsibility of audited bodies to ensure they submit the final and correct version of their consolidation schedules to NHS England. It is important that auditors ensure that the summarisation schedules submitted to the NAO group audit teams are the final version.

Section 2: Other Matters 2022-23

Funding Regime

Funding, cash and capital regime 2022-23

What are the issues?

62. NHS England published *'2022/23 priorities and operational planning guidance: Revenue finance and contracting guidance'* in April 2022. The 2022-23 financial year moves away from emergency COVID block payment arrangements and back to local contracting and commissioning. Therefore, signed written contracts between commissioners and all providers (NHS and non-NHS) are expected to be required. Contracts will transfer to the relevant ICB through a nationally agreed transfer scheme. Contracts for all commissioned healthcare services, other than core primary care services, must be in the form of the NHS Standard Contract. Allocations methodology will be reset to move systems back towards a fair share distribution of resource approach at the levels affordable within the Spending Review 2021 settlement.

63. Funding for elective recovery will revert to a commissioner basis, not a provider basis. In total, additional elective funding has been allocated to commissioners to deliver 104% of 2019-20 levels of value-based activity across elective ordinary, day case, outpatient procedures with a published tariff price and first and follow-up outpatient attendance activity for acute specific treatment function codes. Payments from commissioners to providers are expected to follow the rules set out in the National Tariff Payment System. This involves the agreement of a fixed payment to fund the level of elective activity providers have agreed with their commissioners. NHS England guidance on elective recovery is set out in *'Elective recovery planning supporting guidance'*.

64. NHS England introduced a *'Protocol for changes to in-year revenue financial forecast'* in November 2022 which is available to auditors via the LACG extranet. The protocol sets out NHS England's expectations of system achievement of financial balance and how organisations within each system have a duty to co-operate in the delivery of system objectives, to ensure the NHS as a whole remains within its spending limits. The protocol focuses on deterioration to financial positions and sets out that in exceptional circumstances it may be necessary for a system or an individual organisation to revise its forecast to reflect an overspend. In this event, the system or organisation must demonstrate that all possible steps have been taken to minimise the extent of any overspend. This should be set out in the form of a recovery plan that describes the mitigating actions being implemented to reduce spending and improve financial control. The recovery plan should aim to bring the

organisation/system back to financial balance as quickly as possible, which may take up to 12 months or potentially longer in more extreme cases.

Capital regime

65. The Spending Review 2021 provided the NHS with a three-year capital settlement covering 2022-23 to 2024-25. NHS England's *'Capital guidance 2022 to 2025'* states that the capital allocation will be split into three categories:

(1) A system-level allocation (£4.1bn) – to cover day-to-day operational investments which have typically been self-financed by organisations in ICSs or financed by DHSC through normal course of business loans or system capital support PDC (previously known as emergency capital PDC). From 2022-23 onwards this also includes £0.1bn of capital for investment in primary care estates and IT.

(2) Nationally allocated funds (£1.1bn) – to cover nationally strategic projects already announced and in development or construction, such as hospital upgrades ('STP schemes') and new hospitals.

(3) Other national capital investment (£2.7bn) – including national programmes such as elective recovery, diagnostics and national technology funding and the mental health dormitory programme.

66. The Health and Care Act 2022 includes a new discretionary power allowing NHS England to make an order imposing a limit on the capital expenditure of an NHS foundation trust. As part of the Act, NHS England must publish statutory guidance about the circumstances in which we are likely to make an order and the method we would use to determine the limit. NHS England has published statutory guidance regarding NHS foundation trust capital resource limits. The power to impose a limit on the capital expenditure of an NHS foundation trust will be used as a last resort where a foundation trust is actively pursuing capital expenditure that is not affordable within integrated care system capital envelopes or allocated capital through national programmes, thereby creating a risk of DHSC breaching its capital departmental expenditure limit. It is expected that system, regional and national mechanisms should mitigate this risk. However, this discretionary power is intended to complement how the capital regime operates to support system working and expected to only be exercised where all other options have been exhausted. NHS foundation trusts will be notified of their notional capital resource limits through the monthly Provider Finance Return. This notional capital limit will be used by NHS England in its assessment as to whether a formal limit should be imposed by use of the power. The guidance includes illustrative circumstances that will result in an NHS England review of a foundation trust's actions with a view to imposing a capital limit, as well as how such limits will be imposed.

Cash regime

67. NHS England will issue ICBs with an annual cash drawdown limit as part of the overall commissioning group cash mandate (as applied to CCGs). This will be reviewed during the course of the year with a view to ensuring each ICB receives its fair share of the cash mandate allocation. Revenue cash support for NHS trusts is expected to be in exceptional circumstances only and in accordance with the principles set out in the Reforms to the NHS Cash Regime effective from 1 April 2020.

Why is this important?

68. The NHS finance regime is complex operating across an integrated care system with shared system control targets. However, individual NHS bodies within a system are still required to maintain the integrity of their financial accounts. The NHS provider licence includes a duty regarding integrated care, and that "the licensee shall not do anything that could reasonably be regarded as detrimental to enabling integrated care." The licence applies directly to NHS foundation trusts, and NHS England's oversight of NHS trusts is designed to apply this with equivalence. However, it is important that where an NHS provider or commissioner takes a decision that is balancing its objectives as an organisation with how 'integrated care' (i.e. system working) serves the interests of patients, that it can support the true substance of its transactions and its accounting with evidence.

What should auditors do?

69. Auditors should familiarise themselves with the revised funding regime for 2022-23 to support their audit planning work under *ISA (UK) 240 (Revised May 2021) (Updated May 2022) The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, ISA (UK) 300 (Revised June 2016) (Updated May 2022) Planning an Audit of Financial Statements*, and *ISA (UK) 315 (Revised July 2020) Identifying and Assessing the Risks of Material Misstatement.*

70. This includes understanding the policy decisions impacting the financial statements, such as new expenditure, investment or grant schemes, commitments, obligations or losses and special payments. Enquiries on finance processes should explore how finance processes have changed, particularly focusing on areas where the operation of a control being relied on for assurance purposes has changed and what local arrangements are in place and whether this is in the spirit of the guidance issued by NHS England.

Auditors will be aware of the changes made to ISA (UK) 240 which takes effect for audits of financial statements for periods beginning on or after 15 December 2021, with greater focus on professional scepticism and the requirement for the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material mis-statement due to fraud. This will affect the way in which auditors design and perform audit procedures to respond to the risks of material misstatement due to fraud. Auditors should also refer to PN10 *The public sector auditor's responsibilities relating to fraud* set out in paragraphs 1-39 to 1-51.

71. Auditors will need to be aware of the risks associated with particular accounting treatments, for example, any directions regarding whether transactions should be on a revenue or capital basis, or which are not supported by evidence. The specific capital funding for projects may create incentives for NHS providers to treat expenditure relating to a project as capital when the specific elements of projects do not meet the criteria for capitalisation, or to recognise capital expenditure during 2022-23 in order to report positions in line with expectations for this funding.

72. Whilst this AGN sets out the overall funding flow from DHSC, auditors will need to consider NHS providers' assessment of revenue recognition under *IFRS 15 Revenue from contracts with customers* and CCGs' assessment of liabilities. These should reflect local arrangements in place and the substance of the transaction. As set out above, signed written contracts between commissioners and all providers (NHS and non-NHS) are expected to be in place.

73. Auditors are reminded that, under Section 4.9 of the Code, the auditor of a health service body has a duty to consider whether there are any issues arising during their work that indicate possible or actual unlawful expenditure or action leading to a possible or actual loss or deficiency that should be referred to the Secretary of State and NHS England as appropriate. AGN 07 *Auditor reporting* sets out further guidance on referrals of matters arising.

74. Auditors will also need to be aware that due to the timing of the Health and Care Act 2022, with structural changes taking place part way through 2022-23, NHS England is still developing guidance to support the new system architecture. Therefore, further NAO guidance may be issued at a later date setting out any implications to the audit of the financial statements and the auditor's wider reporting powers in relation to financial duties to break-even within an ICS.

Use of Management's Expert – Valuations of Property, Plant and Equipment

What are the issues?

75. NHS providers hold a significant quantity of property, plant and equipment. Chapter 4, Annex 4 of the GAM states that:

> '*Assets which are held for their service potential (i.e. operational assets used to deliver either front line services or back office functions) must be measured at their current value in existing use. For "in use" non-specialised property assets current value in existing use should be interpreted as market value for existing use. In the Royal Institution of Chartered Surveyors; (RICS) "Red Book" (RICS Appraisal and Valuation Standards), this is defined as Existing Use Value (EUV).'*
>
> '*For specialised properties (i.e. those for which no active market exists), depreciated replacement cost is considered to be a satisfactory approximation of current value in existing use. Within that methodology, the MEA [modern equivalent asset] concept is applied: the "replacement cost" is based on the cost of a modern replacement asset that has the same productive capacity as the property being valued.'*
>
> *'There is no pre-determined frequency with which assets must be re-valued. Instead the Standard requires that asset values should be kept up to date and that the frequency of revaluation will need to reflect the volatility of asset values. Where assets are subject to significant volatility, then annual revaluations may be required. Conversely, where changes in asset values are insignificant then a revaluation may be necessary only every 3 or 5 years.'*

76. Many of the property assets held by NHS providers are of a specialised nature and a valuer is usually engaged as management's expert to carry out a valuation of these assets. The DHSC GAM goes on to say in paragraph 4.428:

> *'It is for valuers, using the RICS Red Book, and following discussions with the entity, to determine the most appropriate methodology for obtaining either a current value in existing use or a fair value'.*

77. In support of the RICS Red Book, RICS issue the UK National Supplement. This 'reflects *valuation standards* and other authoritative requirements that are specific to the UK jurisdiction, and provides additional valuation applications guidance accordingly'. This therefore has the effect of being guidance rather than being a standard. The latest version of the UK National Supplement was issued in November

2018, effective from 14 January 2019. RICs is currently consulting on updates to the UK National Supplement but changes are unlikely to be in force for 2022-23.

78. In November 2018 RICS also issued UKGN 2 – Depreciated replacement cost method of valuation for financial reporting, also effective from January 2019. This provides further guidance on how to apply the UK National Supplement and 'highlights the reporting requirements outlined in *RICS Valuation – Global Standards 2017 – UK national supplement (RB UK)* that are particularly relevant when the DRC method has been used'.

79. In October 2021 RICS issued an update Application of the EUV Basis of Value in UK Public Sector Accounting. This was in response to differences in interpretation by valuers (and auditors) of the Existing Use Value (EUV) definition – and the conceptual framework for valuations of operational owner-occupied properties. In recognition of this issue, RICS is in the process of creating an expert working group to produce further guidance and clarification on the interpretation and application of UK VPGA 6 of RICS Valuation – Global Standards: UK national supplement (Red Book UK). In the interim, this update is intended to assist members by explaining and reaffirming the underpinning principle.

80. In summary, the RICS Red Book constitutes the standard which valuers should adhere to. The updated UK National Supplement and UKGN 2 constitute application guidance which UK valuers should take account of when preparing DRC valuations.

81. Paragraph 4.432 – 4.4356 of the GAM also sets out the treatment of VAT in the valuation methodology:

> *'Where DRC is used as the valuation methodology, entities must use the "instant build" approach. Generally the valuation should be gross of VAT, however circumstances may arise where the asset would be more appropriately valued net of VAT. For instance, entities may recover VAT on payments for certain contracted-out services, including the provision of a fully managed and serviced building under a PFI. When revaluing assets arising from a PFI project, entities may take the view that this should be based on a value excluding recoverable VAT, reflecting the cost at which the service potential would be replaced by the PFI operator. PFI assets must only be revalued exclusive of recoverable VAT where there is clear evidence that this is appropriate, which must be to the satisfaction of local auditors. Where an asset was not previously acquired through a route that permits VAT to be recoverable, and there is no clear indication that VAT would be recoverable on any replacement, the asset must be valued inclusive of VAT."*

82. The auditor may also engage an auditor's expert to evaluate and challenge the work of management's expert.

Why is this important?

83. The valuation of land and buildings included in the NHS provider's financial statements is complex and often includes a number of assumptions and judgements. The valuations are also likely to have a high degree of materiality.

84. NHS bodies need to demonstrate whether or not a valuation is necessary (as not all NHS bodies have a full valuation each year) and be able to support their assessment in the years between formal valuations.

85. Management are responsible for the accounting estimates they use when preparing any set of accounts. For property valuations, while management may employ an expert in the form of a professional valuer (following the RICS guidance), management retain responsibility for the estimates within their accounts which includes ensuring there are adequate controls in place over the accuracy of the year-end valuations and that the controls are operating as intended; assessing the reasonableness of what they are provided with by their expert and challenging appropriately; and for applying accounting policies in respect of property assets in accordance with *IAS 16 Property, Plant and Equipment* and the DHSC GAM.

What should auditors do?

86. Auditors should consider the requirements of *ISA (UK) 500 (Updated May 2022) Audit Evidence*, which states that *'if information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:*

    a) Evaluate the competence, capabilities and objectivity of that expert;
    b) Obtain an understanding of the work of that expert; and
    c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.'

87. Where the auditor engages an auditor's expert, the auditor should consider the requirements set out in *ISA (UK) 620 (Revised November 2019) (Updated May 2022) Using the Work of an Auditor's Expert*.

88. Auditors should ensure that the consideration of the work of management's expert and any auditor's expert engaged is adequately documented, including evidence obtained of work undertaken to challenge and evaluate key assumptions.

89. The *Royal Institute of Chartered Surveyors (RICS) Valuation – Professional Standards (Red Book)* highlights the increased level of reliance placed by valuers on their clients in respect of depreciated replacement cost (DRC) valuations: *'with specialised assets the valuer may have to place greater reliance on information provided by the client, or its other advisers, than would be the case with more conventional assets'*. Auditors should have regard to this point when seeking such assurances under *ISA (UK) 500 (Updated May 2022) Audit Evidence*, e.g. by requesting details of any assumptions made by the valuer based on discussions with the audited body.

90. Auditors should also consider historic accounting judgements which may have a significant impact on the current year financial statements and whether the judgements remain appropriate.

91. Auditors should consider the following factors which may affect assumptions in property valuations and in certain cases, trigger impairments or accelerated depreciation:

    - Changes to accommodation plans (e.g. disposal, exercising a lease break, change in property use, modern equivalent asset assumptions in respect of service potential)
    - Significant new capital expenditure
    - Changes to the income generated from subletting properties or other activities (e.g. pharmacies, cafes, gift shops, newsagents)
    - The valuer's ability and intention to inspect properties that are subject to professional valuation in 2022-23.

92. Auditors should consider the requirements of *ISA (UK) 540 (Revised 2018) (Updated May 2022) Auditing Accounting Estimates and Related Disclosures* when assessing management's accounting estimates in relation to property valuations.

Subsidiaries and joint ventures

What are the issues?

93. A number of NHS providers have established subsidiaries or joint ventures that, whilst they have similar characteristics, can have unique and complex arrangements in their own right. Some structures involve sale and leaseback models, for example, an NHS trust providing assets on a finance lease to the company which the company then leases back to the trust. The property company may provide a range of services to the trust, for example, the maintenance of a trust's non-PFI estate and associated services such as portering; security; laundry; waste; reception; grounds maintenance and repairs; and some back-office functions such as finance and accountancy.

Why is this important?

94. The associated transactions within the NHS provider's financial statements can be complex and often include a number of assumptions and judgements, particularly in relation to which entity's accounts assets are recognised; whether subsequent managed service agreements contain an embedded lease; and the treatment of VAT and whether or not this is recoverable which can impact the valuation of assets which are also likely to have a high degree of materiality.

95. The considerations regarding the treatment of VAT where depreciated replacement cost is used as the valuation methodology and revaluing the assets arises from a PFI project are set out in paragraph 4.432 – 4.435 of the GAM (and quoted in paragraph 81 above in this AGN).

96. NHS England issued guidance in October 2022 *'Forming or changing a subsidiary'*. This framework clarifies the required approval process before trusts can implement plans for subsidiaries; it does not affect their legal ability to develop such plans.

What should auditors do?

97. Auditors should be aware of the risks associated with complex subsidiaries to support their audit planning work under *ISA (UK) 300 (Revised June 2016) (Updated May 2022) Planning an Audit of Financial Statements*, and *ISA (UK) 315 (Revised July 2020) Identifying and Assessing the Risks of Material Misstatement.*

98. Auditors should consider the requirements of *ISA (UK) 500 (Updated May 2022) Audit Evidence* as set out above in paragraph 87.

99. Where the auditor engages an auditor's expert, the auditor should consider the requirements set out in *ISA (UK) 620 (Revised November 2019)(Updated May 2022) Using the Work of an Auditor's Expert*.

100. Auditors should ensure that the consideration of the work of management's expert and any auditor's expert engaged is adequately documented, including evidence obtained of work undertaken to challenge and evaluate key assumptions. This will include the consideration of the economic reality of the arrangements under *IFRS 16 Leases* when determining whether there is a lease in substance.

101. Auditors should also consider historic accounting judgements which may have a significant impact on the current year financial statements and whether the judgements remain appropriate.

Co-commissioning

What are the issues?

102. Under the Health and Care Act 2022, on 1 July 2022 all ICBs will assume delegated responsibility for primary medical services (previously delegated to all CCGs) and 9 ICBs will also take on delegated responsibility for one or more pharmaceutical services, general ophthalmic services and dental services (primary, secondary and community). It is planned to delegate responsibility to all ICBs for all pharmaceutical, general ophthalmic and dental services from 1 April 2023 as well as specialised services that have been identified as suitable and ready for further integration.

103. CCGs and ICBs receive direct funding for the commissioning of general practice services and have primary responsibility for obtaining assurance for these transactions. Auditors should be aware that NHS England has contracted Capita to deliver primary care support services at all NHS sites and that there are regional differences in the method of operation and controls, with some elements being undertaken by NHS England local regional teams.

Why is this important?

104. Primary care expenditure is significant and is likely to be material.

What should auditors do?

105. Auditors should engage in discussions with ICBs to understand the co-commissioning agreements that have been entered into. The systems which support these costs are complex and may present a number of audit risks which auditors will need to consider as part of their planning process.

106. Auditors will need to consider the findings of service auditor reports as well as assurance letters relating to Primary Care Support England services which were operated by Capita for the period 1 April 2022 to 30 June 2022 to support their audit planning work under *ISA (UK) 300 (Revised June 2016) (Updated May 2022) Planning an Audit of Financial Statements*, and *ISA (UK) 315 (Revised July 2020) Identifying and Assessing the Risks of Material Misstatement.* Copies of these reports will be made available on the LACG extranet.

107. Where auditors wish to undertake substantive procedures, evidence requests should be submitted to ICBs. NHS England will facilitate the process of obtaining the evidence from PCSE where applicable.

Other Support and Raising Technical Issues or Queries on this AGN

108. Auditors in firms should raise queries within the firm, in the first instance, so that the relevant technical support service can consider whether to refer queries to the NAO's Local Audit Code and Guidance (LACG) team by e-mailing LACG.queries@nao.org.uk.

109. Information supporting auditors is available on the LACG extranet. This includes details of third-party reports and information. Copies of referenced third party information and service auditor reports will also be available on the LACG extranet following issue. Updates will be communicated through the Weekly Auditor Communication (WAC). If there is a need for further statutory guidance during the year, the NAO may issue an addendum to this AGN.

110. The NAO also engages with the firms through its Local Auditors' Advisory Group (LAAG) and supporting technical networks to consider any emerging regime-wide technical issues on a timely basis. Auditors should follow their in-house arrangements for bringing significant emerging issues to the attention of their supplier's representative on LAAG or the relevant technical network.