HFMA briefing
June 2017

The importance of strong financial governance

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Background

The HFMA's Governance and Audit Committee has been considering the importance of strong financial governance, particularly when finances are tight and there is enormous pressure to achieve efficiencies. This briefing highlights the key themes that tend to emerge when there are governance weaknesses, identifies some of the early warning signs to look out for, and sets out the key steps to take.

The briefing is based on the experiences of and prepared for the Committee by PwC; the authors are Matthew Plummer, Matthew Elmer and Joanna Watson.

Contributions have come from the Governance and Audit Committee whose members are drawn from NHS bodies, the National Audit Office, Grant Thornton, The Internal Audit Network (TIAN), Baker Tilly Risk Advisory Services LLP, Ernst and Young LLP, TIAA and a number of independent consultants who have worked extensively in and with the NHS.

Introduction

The last 12 to 18 months have seen an ever-increasing focus on financial governance and leadership because of the level of financial deterioration in both providers and commissioners. Sudden changes in the financial position of trusts and clinical commissioning groups (CCGs) cause significant concerns for the regulators who need to rapidly understand the underlying causes. We are increasingly engaged to investigate the root cause of sudden deterioration at both trusts and CCGs. We have found that inadequate financial governance is a common issue and highlight five key themes that are often seen where financial governance is weak:

1. Over-optimistic outlook

- Financial plans are expected to be met because they always have been historically, and so they are not scrutinised sufficiently.

- There is reliance on one-off savings which run out quickly, and a lack of sustainable recurring savings.
- The need to secure sustainability and transformation fund monies, or other similar pressures, results in plans that are unlikely to be delivered or are based on heroic assumptions.
- Failure to take out adequate costs recurrently in previous years has stored up a problem, which is now becoming visible (through cost improvement programmes (CIPs)/ quality, innovation, productivity and prevention (QIPP) schemes).

2. Poor budgeting with lack of ownership

- The starting point for budgeting is often not realistic and/ or accurate.
- The budgeting process does not start early enough and does not engage with key individuals.
- Budgets are not signed off before start the financial year - or are not 'owned' by budget holders.
- An over-reliance on perceived external scrutiny of plans by regulators, in particular by non-executive directors (NEDs) or lay members - it is the responsibility of each trust or CCG to ensure that their plans are realistic.

3. Inadequate financial information

- Board/ governing body and committee reports are backward looking, with limited information on expected future trends or early warning indicators.
- Reports fail to highlight the key issues and actions, and instead provide excessive detail with little or no focus.
- There is a lack of reporting of the underlying financial position, meaning that the board/ governing body is not properly sighted on underlying financial gaps.
- Monthly budget reports are static without the ability to easily drill down into data and understand variances.

4. Unclear ownership and accountability

- The financial challenge is not owned or seen as important by all board and governing body members – it's left to the chief finance officer/ director of finance.
- The need for all staff - and in particular clinicians, to be on board is often not made clear; issues being seen as finance department problems.

5. Lack of escalation of risks and exceptions

- There is limited exception reporting, with board/ governing body members unable to see the wood for the trees.
- Risks are recorded but little is done with them and the escalation process is weak.

Questions to ask about financial governance

Financial governance reviews at trusts and CCGs are a good mechanism to understand what has gone wrong and why. Below are some of the questions that might be considered:

- Is the in-year reporting effective?
  - Understand the quality of your information – is it reliable and useful, and has it been produced promptly?

- Track what happens when something goes wrong - does the trust/ CCG take timely, appropriate action?
- Would your minutes stand up to scrutiny? What do the NEDs or lay members really think happened?
- Are the numbers easy to understand? Is it clear what is recurring/ non-recurring and is the underlying position set out?

- Are the financial controls and reporting systems sound?
  - Collate your evidence – is it good enough? Have your external providers of assurance really looked at what you think they have, and in sufficient detail?
  - What could be done to improve controls and systems?
  - Ask the users of the finance function – how do they rate the team?

- How effective is contract management or commissioning?
  - Review management arrangements – is sufficient time/ resource allocated?
  - Are governance arrangements fit for purpose?
  - Look more broadly – how well are stakeholders managed?

- How effective is procurement?
  - Is a procurement strategy in place and does it operate effectively?
  - Does the organisation know what needs to be achieved and are there clear plans and controls?
  - Are you clear in your disclosures – for example, on perceived and actual conflicts of interest?

- How sound are your workforce arrangements?
  - Do you have a robust workforce strategy which is understood?
  - Are all the strategies consistent with your overall plans, including the sustainability and transformation plan (STP)?
  - Have you commissioned independent board/ committee observations as part of your development programme – and acted on the findings?

- Are the organisation's risk management systems embedded and well-focussed?
  - Critically appraise your assurance framework – does it show what really matters?
  - Review your risk management arrangements – are they truly effective?
  - Is risk management part of how you operate, rather than being left to one individual or a small group?

Good governance is essential in addressing the challenges that the health sector faces. Boards and governing bodies have a key leadership role to play and should be focussed on strategy and planning, accountability, shaping culture and risk/ performance oversight within their organisation.

Early warning signs

It is vitally important for organisations to have mechanisms in place that help to spot the early warning signs of financial governance problems.

The three lines of defence is a model commonly used to conceptualise the assurance framework and risk management in an organisation. Each line plays an important role and can help identify the early warning signs that governance is deteriorating:

- ***First line of defence*** - functions that own and manage risk (i.e. management controls)
  The first line focuses on control design and implementation. It is able to detect when controls are not working as intended such as being done late – or not at all.
- ***Second line of defence*** - functions that oversee or specialise in risk management, compliance and quality.
  The second line has oversight through monthly reporting and management information. Late, missing or incomplete reporting should alert NEDs/ lay members and senior management to potential issues that are gaining traction.
- ***Third line of defence*** - independent assurance providers, often internal audit.
  Assurance providers in the third line can spot areas of concern such as a lack of management response, delays to planned work and a culture of leaving work until the last minute.

Weaknesses in financial governance arrangements can often be categorised into one of four types. If the objectives below are not met this could indicate underlying issues:

- Board/ governing body reporting - information from a range of sources should be visible to boards so that it can be triangulated. Information provided needs to be accurate, concise, sufficiently comprehensive and presented clearly. There needs to be a balance between the level of detail provided and the identification of key issues. Exception reporting must be meaningful.
- Appropriate checks and challenge - a culture of challenge and asking questions needs to be present. Boards should not take information at face value and be wary of signs that identify issues are present.
- A strong control framework - suitable levels of segregation of duties needs to be present, to prevent collusion and overriding of controls. Verifications and reconciliations of key data need to part of the control framework.
- Key controls that operate effectively - access and authorisation controls are needed. Form over substance needs to be followed.

What are the key steps to take – a summary

Good financial governance has always been important, but is even more important given the extent of financial pressure facing so many NHS bodies. Organisations and their regulators need to get assurance over arrangements, and should be conducting reviews pro-actively to identify any early warning signs. Areas that organisations need to consider include:

Systems

- Robustness of basic systems and controls
- Quality of the budgeting process, and buy-in from budget-holders.
- Whether risk management/ escalation processes are fit for purpose.

People

- Whether people understand their roles and responsibilities
- The extent to which board/ governing body members are fully engaged.
- The capacity and skill-set of the leadership/ senior management team to respond to current challenges

- Is there a culture of transparency so that people are comfortable about raising concerns and the whistle-blowing/ speak up guardian is well known?

Information

- Adequacy of information available to budget holders
- Quality of financial reporting – is it realistic and forward-looking?

In addition to any actions arising from a review of financial governance, management need to ensure that the finance team in their organisation has the right skills and capabilities and establish whether any of these need to be strengthened. Finance function effectiveness reviews are a good mechanism to obtain a baseline of the team's relative strength and the way forward.

Finally, in all of this, organisations need to consider the impact on quality of all financial and operational changes. Good financial governance should be there to support the organisation as it strives to meet its challenges here and now, and look ahead to the future.

About the authors

Matthew Plummer is a senior manager in the health advisory practice at PwC, specialising in governance and leadership reviews. Matthew has worked with a large number of NHS trusts, CCGs and private healthcare companies nationally to deliver improvements to governance arrangements and to support boards/ governing bodies in their interactions with regulators.

Matthew Elmer and Joanna Watson are senior managers in the health assurance practice at PwC. Both have a wide range of experience in providing assurance services to health bodies, whether they are commissioners or providers, and in particular value the importance of strong financial governance. Matt is a member of the West Midlands HFMA Research and Development group, and Joanna is past chair of the East Midlands branch and is an honorary fellow of HFMA.