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Step 1—Promote a culture where there is joint Executive Director accountability and responsibility for financial performance

Step 2—Ensure finance is covered by the full board and there is not an over-reliance on the finance committee for re-assurance

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NHS board financial governance—five simple steps towards averting an unanticipated financial crisis

Is your organisation ready?

Point of view piece by John Murray and Tom Berry—Deloitte Board Advisory Practice

Introduction

According to NHS Improvement, the total NHS reported deficit, before exceptional technical adjustments, was £827 million in 2018/19. The underlying deficit for the NHS was even higher as £1 billion of the saving delivered in 2018/19 was non-recurrent. These financial pressures are unlikely to ease any time soon as NHS providers grapple with continuing funding constraints, burgeoning costs and unrelenting demand for NHS services.

Against this backdrop, even the strongest boards are susceptible to financial difficulties which could ultimately cast doubt over their long term financial sustainability. However, those with strong financial governance, who closely monitor, pre-empt and actively manage their financial situation, will have the greatest chance of thriving. Unfortunately, we have observed several instances where weaknesses in financial governance have led to a financial crisis, surprising unsuspecting board members. By which point it was too late to tackle the sources of the deficit effectively, and required emergency intervention and support from regulators. It also led to a breakdown in trust amongst board members and dysfunctional boards at a time when they needed to be operating at their best.

Our experience in conducting financial governance reviews and investigations at NHS providers that have faced an 'unanticipated' financial crisis, shows that they share many similar characteristics, with the same mistakes made time after time. As a result, we have identified five key steps which, if followed, whilst not eliminating the possibility of a financial crisis occurring, can strengthen financial governance and reduce the risk that a board will find itself facing an unexpected financial crisis.

We set-out the five steps below, together with a set of questions on page 4, which will enable your Board to self-assess the state of its financial governance.

Step 1—Promote a culture where there is joint executive director accountability and responsibility for financial performance

Funding is often seen as the responsibility of the finance director (FD). This is evident from board meeting discussions we have observed, where we regularly see the FD doing the majority of the talking, and responding to all of the questions about finance with little or no participation from other executive directors.

Furthermore, assurance-based questions, and follow-up questions, are often directed towards the FD, when they should also be shared with the portfolio holders who are actually responsible for spending the money. This pattern can be repeated in other key forums at different levels of the organisation. For example, we regularly observe poor attendance and contribution from non-financial executive directors (EDs) in finance committees, whilst executive level meetings and operational leadership groups can often rely solely on assurances from the senior finance leadership team.

This dynamic can frequently create a situation where the FD has a significant burden placed on their shoulders, which can influence behaviours to the extent that the FD is reluctant to share bad news with other EDs and the board. This in turn leads to a level of optimism bias and a resulting reduction in transparent reporting.

Eventually a situation can develop where EDs do not have sufficient visibility over the finance agenda to fulfil their responsibility as corporate directors. By way of example, we have observed cases where the majority of EDs, including the CEO, were unaware of an underlying double digit deficit, major liquidity problems and a looming financial crisis. The first many became aware of the situation was a few days before this NHS provider was forced to apply for emergency funding from NHS Improvement.

All EDs have a corporate responsibility for the finances and it is critical that the CEO, with support from the Chair, sets the tone and expectations regarding joint responsibility for the finances. This should include actively encouraging wider ED accountability for financial performance in board, committee and executive forums. Financial training should also be provided to EDs where required. This will promote a culture of joint-accountability and also ensure all EDs have good awareness regarding the financial position.

Step 2—Ensure finance is covered by the full board and there is not an over-reliance on the finance committee for re-assurance

The finance committee is an important forum for the board to delegate responsibility to for detailed scrutiny of the financial agenda. However, it is the board that is ultimately accountable for financial stewardship. Despite this point, it is not uncommon in our experience for NEDs in a provider that has faced an unanticipated financial crisis to reflect on the fact that they assumed everything was fine because it was covered by the finance committee.

This situation is often driven by poor articulation/escalation of key issues from the finance committee to the board as well as low levels of transparency in reporting as discussed in step 3 below.

It is critical that the quality of verbal and written reports from the finance committee chair are crisp, clear and unambiguous and the finance agenda receives appropriate attention at board meetings (public and private), and board seminars, to provide sufficient visibility to all NEDs. Specifically, NEDs not sitting on the finance committee should ensure they have access to the monthly finance report, which should be discussed formally in reasonable detail at every board meeting.

Step 3—Challenge and change if financial reporting does not provide a snapshot of the provider's current and future financial health

All too often, our review of financial reports, highlights that they fail to provide a snapshot of the financial position, financial risks, mitigations and outlook for the provider. We have observed this leading to confusion amongst board members and significantly weakening their ability to actively monitor and respond to changes in the organisation's financial health. The common issues that we regularly see in providers who have experienced financial governance failings are as follows:

- Excessive use of technical and wordy accounting jargon, insufficient use of visualisation techniques, such as bridge and variance analysis, to help 'tell the story', and a lack of interpretation to explain the 'so what' factor behind the data presented.
- Backward looking analysis with insufficient focus on key drivers of the forecast position, including triangulation with other operating metrics, consideration of key financial risks, and what the provider is doing to mitigate these risks.
- An emphasis on corporate level data and a lack of 'heat map' exception reporting highlighting areas of underperformance at the divisional, directorate or service level. This can mask significant swings within particular services.
- Insufficient use of analysis presenting the earning position on an underlying or normalised basis. We discuss this point further in step 4 below.

We have observed that the above issues with reporting can often be exacerbated when the FD speaks in jargon and does not adapt language to suit an audience consisting of a wide range of professional disciplines.

It is critical that financial reports serve the needs of a diverse range of non-financial board members and clearly set-out a concise snapshot of the provider's financial health, addressing the various points highlighted above. If they do not then board members need to be prepared to challenge and change.

Step 4—Change the board culture to instinctively think about underlying financial position and cash flow

The culture in many NHS providers is for financial discussion to be centred on control totals and the reported surplus or deficit. Furthermore, we have observed a misconception amongst some board members that the reported financial position in the audited annual accounts provides a good picture of the provider's overall financial position.

However, this focus on the reported surplus/deficit position can provide a misleading representation of the true current and future underlying financial health of the organisation if there are material 'one-off' income and savings benefits and other technical accounting adjustments. For example, we have directly observed a handful of situations where NHS providers consistently reported surpluses when baselining exercises conducted post financial crisis revealed that they had in fact been running a deficit for a number of years. In one example, this underlying deficit had grown to over £40m, or 10% of the cost base, over a three year period. This board was taken by 'surprise' when the financial crisis emerged.

These 'one-off' adjustments to reported earnings are often non-cash items and as such will have a material impact on the cash position despite earnings appearing stable. In addition, the 'one-off' items that do have a cash impact in the current year will affect the cash position in subsequent years if alternative 'one-off' cash generating items are not found to replace them.

It is not uncommon for organisations to offset the reduction in the cash position, driven by the deteriorating underlying position, with extensive cash management techniques aimed at improving the cash flow. The most common method to achieve this effect is for organisations experiencing significant financial pressures to gradually extend the payment terms of creditors. Monitoring of the Better Payment Practice Code (BPPC), which targets the payment of 95% of creditors within 30 days, is therefore a critical KPI to monitor. By way of an extreme example, we have experienced a failing organisation where the BPPC had dropped from 95% to 8% over a period lasting several months. By the time the organisation reached the lower point it had run out of options and required emergency funding.

It is critical that one-off earnings adjustments and cash flow management techniques being used are made explicit to the Board. This should include ongoing analysis of underlying financial performance and the timeliness of payments to creditors.

Step 5—Actively seek 'soft intelligence' regarding financial performance

A financial crisis may occasionally come as a surprise to board members, however our experience in providers that have faced an unanticipated financial crisis is that it rarely comes as a surprise to members of staff. Our observation is that you do not need to search too hard to find members of staff who are able to give examples of services that were reluctant to sign-off cost reduction plans and subsequently struggled to deliver on finances. Furthermore, staff have reported examples of an overly robust approach from finance departments in managing the timing of accruals to improve the reported position and excessive amounts of time for their suppliers to be paid.

Our experience of some organisations facing a financial crisis is that board members have tended to operate within the confines of the boardroom and failed to engage effectively with staff to gain 'soft intelligence' regarding the financial pressures facing the provider.

The finance department itself is also often a rich source of 'soft intelligence' regarding financial pressures but not always visited by board members. We have experienced situations for example where members of the finance department have suffered significant stress levels due to the pressure placed on them. This includes having to robustly manage the reported position and constant telephone calls from irate suppliers who have not been paid for several months.

It is imperative that NEDs find opportunities to engage with staff to gain 'soft intelligence' regarding pressures within the organisation. This should include general staff engagement activities but also chairs of the audit and finance committees periodically meeting with members of staff from the finance department to gauge sentiment.

Is your NHS board prepared?

While relentless financial pressures have become a fact of life in the NHS, following these five steps will strengthen your financial governance and significantly increase the probability that providers will successfully identify and manage the problem before it becomes a crisis. In our experience there is a wide variation in how proactively these steps are followed. The self-assessment below will provide you with an indication of how strong your financial governance is and how prepared your board is to pre-empt a looming financial crisis.

The scoring criteria is to rate your provider between 0 and 2, where

2 POINTS – Absolutely yes, this is a top priority for our board and we have high levels of assurance

1 POINT – Partially agree but scope for further improvement.

0 POINTS – No, this is an area where our board could materially improve and we have low levels of assurance

Please rate your provider either 0, 1 or 2. Mark your score to individual questions in the right hand side column and add them to calculate your self-assessment score out of a maximum of 20.

Step	Key question	Your score*
1. Promote a culture where there is joint Executive Director accountability and responsibility for financial performance	(a) Do the CEO and Chair actively promote a culture where all executive directors are jointly held to account for delivery of the finance agenda in board and executive forums?	-[ ]
	(b) Do the majority of executive directors actively participate in the finance debate in private board meetings and finance committees?	[ ]
2. Ensure finance is covered by the full board and there is not an over-reliance on the finance committee for re-assurance	(c) Do reports from the finance committee clearly present the financial position and risks facing the organisation?	[ ]
	(d) Does your board rigorously debate finances to complement re-assurance provided from the finance committee?	[ ]
3. Challenge and change if financial reporting does not provide a snapshot of the provider's current and future financial health	(e) Does your finance report clearly set out the 'so-what' factor, risks and mitigations and a clear forecast of the outlook?	-[ ]
	(f) Does your provider have the IT and informatics capability to present a 'heat map' highlighting areas of financial under performance down to the service level?	[ ]
4. Change the board culture to instinctively think underlying financial position and cash flow	(g) Does reporting at all levels of your organisation present the reported financial position alongside the underlying/normalised position?	[ ]
	(h) Does your Board actively monitor the impact of 'one-off' adjustments on the cash position and the timeliness of payments to creditors (BPPC)?	[ ]
5. Actively seek 'soft intelligence' regarding financial performance	(i) Do board members regularly seek sources of 'soft' intelligence from members of staff to complement the assurance they receive in the board room?	[ ]
	(j) Do chairs of the finance or audit committees meet with staff members from the finance department on a periodic basis?	[ ]
Total		[ ]

How to interpret the results:
OVER 15 POINTS – Your board financial governance is an exemplar and it is highly likely that emerging financial problems will be identified and managed by the full board long before the provider reaches a financial crisis.
8 to 15 POINTS – Your board financial governance is following many areas of good practice but there is scope for improving board awareness of the financial position to tackle emerging issues on a timely basis.
UNDER 8 POINTS – Your board financial governance is weak and there is a possibility that you could experience a financial crisis that the full board does not anticipate. Immediate action is required.

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