



Department
of Health

Constitutional requirements of NHS Trusts' and Clinical Commissioning Groups' audit committees

Government response to consultation

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Contents

Contents	4
Introduction	5
1. Overview of Government Response	6
2. Consultation Replies and Government Responses.....	7
3. Government Next Steps.....	12
Annex A: Respondents by sector	13
Annex B: List of respondents	14
Annex C: List of consultation questions	16
Proposed Requirements	17

Introduction

On 30 January 2014, the Local Audit and Accountability Act 2014 received Royal Assent. The Act set out the government's proposals to disband the Audit Commission and establish a new local public audit framework.

The Act replaces the current centralised arrangements for the audit of local bodies and gives them the freedom to appoint their own auditors and manage their own audit arrangements, with auditor panels advising a body on maintaining an independent relationship with its auditor and on their selection and appointment. The Act allows health service bodies to nominate their existing audit committee to operate as an auditor panel, and this is intended to apply for Clinical Commissioning Groups and NHS Trusts. Foundation Trusts are not included under the Act as their arrangements are separately set out in other legislation.

The consultation set out our proposals for audit committees of NHS Trusts and Clinical Commissioning Groups, and was completed at the end of December. The purpose of the consultation was to gauge the views of organisations affected by these changes and other interested parties to help develop the proposals. This document summarises the comments received and sets out the government's response.

1. Overview of Government Response

- 1.1. The consultation paper – Health Service Bodies Audit Committees: Consultation about proposed new constitutional requirements for NHS Trusts and Clinical Commissioning Groups - issued in October 2013 asked for views on the chair and membership of audit committees, including the ability to include non-board members and non-independent members, criteria for determining independence and whether the proposals were cost neutral.
- 1.2. When the consultation ended on 31 December the Department had received 64 responses. 32 of the 64 responses were received from Clinical Commissioning Groups (CCGs), 19 NHS Trusts, 4 from auditors including the Audit Commission and 9 from others including independents and HFMA. A breakdown of the number of responses by sector is included in Annex A, while a full list of respondents is included in Annex B.
- 1.3. We are grateful to all those that responded to the consultation. The consultation had eight questions and the full list of consultation questions is included at Annex C. Overall, the respondents were supportive of all the proposals, with the exception of the last question on cost neutrality where the positive answers were just under 50%. One of the proposals is not being taken forward in order to address concerns on implementation raised by CCGs. The following sections provide a summary of the responses to each consultation question, along with the government's response.

2. Consultation Replies and Government Responses

- 2.1 Question 1 asked **whether an audit committee must have a chair who is an independent non-executive member of the governing board, (proposed requirement 1)**. 95% of the respondents agreed with this question and a number of responses stated that they considered this to be essential. The 'No' responses related to the definition of independence and is picked up under question 2.
- 2.2 A number of CCGs, together with NHS England, wanted the term 'lay member' used for CCGs instead of 'non-executive members'. Respondents also pointed out that CCG legislation requires them to have a 'governing body' rather than a 'governing board'.
- 2.3 The government's view is that this requirement will be included in the regulations, and that the regulations will be worded to incorporate 'CCG governing body'. With reference to lay members on CCG governing bodies, while they are most likely to be independent non-executive members there are other members who could also be independent non-executive members (see paragraph 2.6) so the term relates to a different wider category.
- 2.4 Question 2 asked whether respondents agreed that an **audit committee must have a majority of independent non-executive members, either from the governing board or elsewhere**, proposed requirement 2. 83% agreed with the proposal including all NHS Trust respondents. Six responses said the audit committee should **only** have independent members, including two audit firms. (One of these six responded No on that basis).
- 2.5 Some CCGs agreed or strongly agreed with the proposal, however the other responses that disagreed were mainly representatives of Commissioning. Their concerns largely regarded:
- the number of governing body non-executive members available to CCGs
 - cost implications of having additional members
 - it would change the members currently on the CCG audit committee, and
 - it could change the arrangements for CCG's Governing Body set out in the 2012 Regulations.

Several CCGs expressed the view that GPs needed to be included on the Audit Committees to provide patient and clinical focus. There was also concern about whether retirees from local trusts, local authorities and FTs could be considered as independent.

- 2.6 The CCG 2012 Regulations specify requirements for the CCG Governing Body, and that there should be at least two lay members (one appointed chair of the audit committee) and a registered nurse and clinical doctor. These Regulations specify a range of people excluded and disqualified as lay members. The Audit Committee proposals additionally consider the following factors to determine independence: employees of the health body within the last 5 years, individuals who had a material business relationship with the Health Body in the last 3 years, close family ties, and individuals with cross directorships.

- 2.7 The government's view is that the underlying principle for independence should apply i.e. whether the individual has "relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement." (UK Corporate Governance Code) with the judgement made by the Governing Boards/Body. Retirees could be considered independent if they met the above principle.
- 2.8 The government considers that non-executive members could be the registered nurse or the clinical doctor members of a CCG governing body, rather than only the two lay members. Including these members should increase the number of non-executive members available to CCGs for audit committees.
- 2.9 The government's view is that this requirement will be included in the regulations, but also looks to address the number of non-executive members required in the question below.
- 2.10 Question 3 asked respondents whether they agreed **that the audit committee should normally, wholly or mainly, comprise of independent non-executive members of the governing board (proposed requirement 3)**. 86% agreed with the proposal, including all NHS Trusts. 7 of the 8 responses that disagreed were from the commissioning sector, with concern again focused on the limited number of lay / non-executive members. This concern was also reflected in other comments where respondents agreed in principle but thought it would be difficult (and one said impossible) to implement. The proposal goes further than local government provisions which require an independent chair and majority of independent members.
- 2.11 The proposals in the next questions (requirements 4a and 4b) are designed to allow independent members who are not on the governing board / body and also permit governing board / body members who are not considered independent. The government recognises the concerns raised with regard to audit committees for small entities which may only have three members. If the above applied, then one independent non-executive governing board member, one non-independent governing board member and one other independent would not comply with the regulations. This scenario would require a further independent non-executive governing board member to be appointed, and potentially incur further costs.
- 2.12 The government view is that while this proposal is desirable for most organisations, it has practical implementation issues for small committees, and works against the intentions of requirements 4a and 4b. Requirement 3 is therefore proposed **not** to be taken forward.
- 2.13 Question 4 asked whether respondents agreed that **an audit committee should potentially be able to include non-executive members of the governing board who are not considered to be independent (proposed requirement 4a)**. 70% of respondents agreed with the proposal. Most responses that disagreed considered all audit committee members should be independent, and this proposal represented a blurring or dilution of the independence principle. Among those who disagreed were nine of the NHS Trust responses, six from CCGs, two from audit firms and one other. However, a number of CCGs supported this as a way of allowing GPs the opportunity to be on Audit Committees, and so achieve appropriate clinical input to the committee. A few responses suggested that including non-executive members should only be in exceptional circumstances in order to secure the proper skills.
- 2.14 The government view is that organisations are able to adopt fully independent membership of their audit committee but some organisations may need to include

members who are not considered to be independent to ensure the committee has the requisite knowledge and skills. The conflict of interest arrangements should ensure that the objectivity of the committee is not compromised.

- 2.15 Question 5 asked whether respondents agreed that **an audit committee should potentially be able to include independent members, who are not members of the governing board (proposed requirement 4b)**. 73% agreed with the proposal. 10 out of the 16 responses that disagreed came from NHS Trusts, and 4 came from CCGs. Several respondents noted that the provision to appoint additional independents was already part of the CCG regulations. Several of the 'No' responses expressed concern that if members were not on the Governing Body they would not have sufficient insight. However, there were also a significant number of r responses which considered this was needed to meet other proposed requirements for CCGs and to give the audit committees the necessary experience.
- 2.16 The government's view is that this requirement will be included in the regulations, to be consistent with the CCG regulations and to permit additional independent advice where not all the non-executive governing body / board members are considered independent. This will also assist small organisations meet the criteria set in proposal requirement 2 (question 2).
- 2.17 Question 6 asked whether respondents agreed that **the governing board should determine the independence of a prospective audit committee member by taking into account the criteria set out in proposed requirement 5**. 83% agreed with the proposal. Comments on responses that disagreed reflected the earlier concerns on number of non-executive members at CCGs. A few responses felt the criteria were too specific and some wanted to ensure there was the potential for clinical involvement from GPs on the audit committee. Some comments wanted greater definition on the criteria.
- 2.18 The Department has discussed this issue further with NHS England in respect of CCGs and the relation to the CCG regulations as set out in paragraph 2.5. It was considered useful to state the minimum independence core criteria and emphasise that the governing body / board uses the criteria as factors in reaching their judgement. To make the criteria more specific to CCGs it was proposed to include 'lay members' in addition to 'directors' in requirement 5d. Some additional wording will be placed in requirement 5b, to clarify that an employee of a member practice (e.g. a practice manager or a practice nurse) should be excluded. As set out previously, the ability to allow a non-independent member on the audit committee would allow GP representation.
- 2.19 Requirement 5c, as drafted, also could be interpreted to mean receiving any payment from a health service body would count against qualifying as an independent member. The government will therefore amend the receipt of remuneration criteria to a three year period (the period in line with requirement 5b).
- 2.20 The government considers that further defining the criteria would take areas of judgement away from the Governing Board / Body and that any guidance could be viewed as a further set of rules, e.g. defining close family ties for example where family relationships vary considerably.
- 2.21 The government intends to adopt the requirement, adjusted for the factors above, given that the criteria is consistent with that adopted by FTs, was largely supported by the consultation comments and because the criteria guide the judgement on independence to be made by the Governing Board / Bodies.

- 2.22 Question 7 asked whether respondents agreed that **the proposed requirements 1-5 above are appropriate and proportionate, given the responsibility that a health service body's audit committee will have to advise the health service body's governing board on the selection, appointment and maintenance of independent relationships with external auditors from April 2015 onwards**. 75% agreed with the proposal. The responses that disagreed mainly came from the commissioning sector, with several comments considered the proposals were not proportionate for CCGs, and limited their audit committee membership. One response went further than this and suggested the regulations should be solely for auditor panel arrangements rather than for the audit committee.
- 2.23 The previous discussion sets out the government's response on membership and clarifies that the governing body makes a judgement on independence, taking the criteria in total rather than each individual criteria being a strict pass/fail test. This approach would allow, for example, retired senior officials from another health body to be members of the audit committee if the governing body / board was satisfied that their judgement was not adversely affected, or that they are not influenced by, or could be seen as representing, an organisation that has a financial interest in the operation of the health body.
- 2.24 The Department's policy is for health bodies' audit committees to act as the auditor panel, under the Local Audit and Accountability Acts regulations. This is because separate auditor panels would duplicate part of the functions of the Audit Committee and would complicate relationships and governance. It would also be confusing for the public and stakeholders. Separate auditor panels could also potentially increase costs acting as another committee, and may not resolve the issue of independence, with the committee and panel potentially having different standards for similar functions.
- 2.25 The Audit Commission disagreed on the timing, in respect to an interim body, and they expected appointment of auditors by the NHS bodies' audit committees to take place from December 2016 at the earliest.
- 2.26 Question 8 asked whether respondents agreed that **the proposed requirements 1-5 above will be cost neutral for health service bodies or otherwise**. 48% agreed with the proposal, 50% disagreed and there was one with no response. The responses which disagreed came from the commissioning side, and a few NHS Trusts. The comments expressed the view that there would be increased costs associated with requiring additional independent members. A number of the answers from NHS Trusts related to the potential incurring of additional costs if an independent member was drawn from outside the Governing Body. However, requirement 4b is only anticipated to be needed if there are insufficient independent members available from the governing Board, which we consider is unlikely for NHS Trusts.
- 2.27 The increased costs mentioned included:
- recruitment costs to meet the proposals (5 responses)
 - training (3 responses)
 - remuneration (5 responses), and
 - management costs (2 responses).

One reply estimated the remuneration for each additional independent member would be in the region of £400 per day for 4 to 6 half days a year.

- 2.28 One audit firm pointed out there are on-going costs of maintaining audit committees with regard to training and coaching. The Audit Commission, and three other respondents, commented they would not expect any significant additional compliance costs.
- 2.29 Seven responses noted that they expected the procurement of external audit would be more costly, although this is outside the scope of the consultation.
- 2.30 The government considers that the clarifications and adjustments made to the previous requirements in response to the consultation exercise will reduce the need for additional independent members. It recognises that this may not prevent all additional costs, and some organisations may need to appoint an additional member in order to achieve impartial and independent audit committees. However, the overall level of additional cost is not considered to be significant in respect to the total administrative budget of an organisation.

3. Government Next Steps

- 3.1 The government is grateful for all those who responded to the consultation. The draft regulations will be developed and amended as noted in section 2 of this document and requirement 3 will not be taken forward. This will allay some of the concerns raised about potentially requiring CCGs to appoint further independent members to their governing body to meet the requirement.
- 3.2 The government will now prepare the regulations in draft for a final consultation in the summer, and plan to lay the regulations before Parliament in the autumn.

Annex A: Respondents by sector

Type of respondent	Number of responses	%
NHS Trusts	19	30%
CCGs	32	50%
Other Commissioning Bodies / representatives (including NHS England)	3	5%
Audit Bodies (Auditors and Audit Commission)	4	6%
Others (including individuals)	6	9%
Total	64	100%

Annex B: List of respondents

Audit Commission
Baker Tilly
Barnsley CCG
Bradford City CCG and Bradford Districts CCG
Bradford District Care Trust
Bridgewater Community Healthcare NHS Trust
Bristol CCG
Central London Community Healthcare NHS Trust
Central London, West London, Hammersmith & Fulham, Hounslow and Ealing CCG
Chorley & South Ribble CCG
Coventry & Rugby CCG
Coventry & Warwickshire Partnership NHS Trust
Deloitte LLP
Devon Partnership NHS Trust
Dudley & Walsall Mental Health NHS Partnership Trust
Gateshead CCG
Grant Thornton UK LLP
Greater Huddersfield CCG
Greater Huddersfield CCG
Greater Huddersfield CCG
HFMA
Kernow CCG
Leeds Community Healthcare NHS Trust
Manchester Business School
NHS Birmingham CrossCity CCG
NHS Calderdale CCG
NHS Clinical Commissioners
NHS Coastal West Sussex CCG
NHS Doncaster CCG
NHS Dudley CCG

NHS England
NHS Hartlepool and Stockton-on-Tees CCG
NHS Herts Valleys CCG
NHS Nene CCG,
NHS Sheffield CCG
NHS Sunderland Clinical Commissioning Group
NHS Telford CCG
NHS Wakefield Clinical Commissioning Group
NHS Wiltshire CCG
North Bristol NHS Trust
North Bristol NHS Trust
North Hampshire CCG
North Kirklees CCG
North Norfolk CCG
North Staffs CCG and Stoke on Trent CCG
Portsmouth NHS Trust
Princess Alexandra NHS Trust
Redditch and Bromsgrove CCG
South Devon & Torbay CCG
South West Commissioning Support
Southern Derbyshire CCG
St George's Healthcare NHS Trust
Stafford & Surrounds CCG and Cannock Chase CCG
Sunsoa & Co Limited (HR co)
The North West London Hospitals NHS Trust
The Whittington Hospital NHS Trust
Warwickshire North CCG
West London Mental Health NHS Trust
West Middlesex University Hospital NHS Trust
Weston Area Health NHS Trust
Worcestershire Acute Hospitals NHS Trust
Wye Valley NHS Trust
Personal Response
Personal Response

Annex C: List of consultation questions

Question 1: Do you agree an audit committee must have a chair who is an independent non-executive member of the governing board (see proposed requirement 1)?

Question 2: Do you agree an audit committee must have a majority of independent non-executive members, either from the governing board or elsewhere (see proposed requirement 2)?

Question 3: Do you agree that the audit committee should normally, wholly or mainly, comprise of independent non-executive members of the governing board (see proposed requirement 3)?

Question 4: Do you agree an audit committee should potentially be able to include non-executive members of the governing board who are not considered to be independent (see proposed requirement 4a)?

Question 5: Do you agree an audit committee should potentially be able to include independent members, who are not members of the governing board (see proposed requirement 4b)?

Question 6: Do you agree the governing board should determine the independence of a prospective audit committee member by taking into account the criteria set out in proposed requirement 5?

Question 7: Do you agree that the proposed requirements 1-5 above are appropriate and proportionate, given the responsibility that a health service body's audit committee will have to advise the health service body's governing board on the selection, appointment and maintenance of independent relationships with external auditors from April 2015 onwards?

Question 8: Do you agree that the proposed requirements 1-5 above will be cost neutral for health service bodies or otherwise?

Question 9: Do you wish to make any other comments about the proposed requirements?

Proposed Requirements

Proposed requirement 1

The audit committee must have a chair who is an independent non-executive member of the governing board.

Proposed requirement 2

The audit committee must have a majority of independent non-executive members.

Proposed requirement 3

The audit committee should normally, wholly or mainly, comprise of independent non-executive members of the governing board.

Proposed requirement 4

The audit committee, to ensure appropriate level of skills and experience, may also include members who are:

- a) Non-executive members of the health service body's governing board but do not meet the definition of independent
- b) Independent persons, who are not members of governing board,

Proposed requirement 5

The governing board will determine if a prospective audit committee member is independent. They will do this by taking into account if s/he:

- a) has been an employee of the Health Service Body within the last five years;
- b) has, or has had within the last three years, a material business relationship with the Health Service Body either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the Health Service Body;
- c) has received or receives additional remuneration from the Health Service Body apart from a "Governing Board member's fee", participates in the Health Service Body's performance related pay scheme, or is a member of the Health Service Body's pension scheme, other than the NHS Pension Scheme;
- d) has close family ties with any of the Health Service Body's advisers, directors or senior employees;
- e) holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- f) has served on the board of the Health Service Body for more than nine years from the date of their first appointment; or

g) _____ is an appointed representative of the Health Service Body's university medical or dental school.