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Austerity and financial governance: a UK case study of the National Health Service

Abstract

Purpose – This research concerns the issue of financial governance within the UK NHS and aims to assess the effectiveness of existing financial governance arrangements in the main providers of health services in the UK. Also considered is the importance of good financial governance in a time of financial austerity.

Design/methodology/approach – The primary research for this project was based on the use of a questionnaire to all finance directors in NHSTs in England supported by semi-structured interviews with: finance directors, non-executive directors, executive directors and senior finance staff.

Findings – Among the main findings of the study were: certain financial management systems were not prioritised in line with what is seen as good practice; existing financial management systems were not always seen as adequate for the achievement of good financial governance; there was sometimes a lack of understanding of financial issues by non-executive directors; and the complexity of the NHS funding process often resulted in opaqueness of the financial risks.

Research limitations/implications – The research is limited by the relatively small coverage of NHS trusts but this has been compensated for by a series of in-depth interviews with key stakeholders in the governance process.

Practical implications – Weaknesses in financial governance could result in further scandals which result in loss of life and poor patient care.

Originality/value – There are many papers on the issue of governance in the public sector in general and the NHS in particular. However, there is little published on the issue of financial governance in the NHS. Also of great value is the emphasis on strengthening financial governance in an era of austerity

Introduction

Governance in business organisations has been at the forefront of political, economic and commercial debate for many years. The response to early governance failures from the 1990s onwards was a series of reports and guidance, particularly, Cadbury (1992), Greenbury (1995), Hampel (1998), and Higgs (2003), which provided valuable guidance and templates for behaviour that should prevent governance failures. More recently, the current financial crisis in the western world generated considerable discussion concerning the failure of governance systems in the banking industry (Conyon et al., 2011; Berglof, 2011; Yeh et al., 2011) and this is after several major corporate failures such as Enron, WorldCom, Polly Peck, BCCI and Lehman Brothers (Solomon, 2007). Thus, governance issues still appear to be problematic. Around the same time, there were also concerns in the UK public sector about governance failures especially in the National Health Service (NHS). Cases included concerns about computer contract overruns in Wessex Regional Health Authority and the privatisation of the management services division in the West Midlands Regional Health Authority. Consequently, there was a plethora of guidance and advice in relation to governance in the public sector.

There is now a further contextual issue. Currently, (and for some time to come), public services in many countries are going through a period often referred to as financial austerity. The term austerity is complex and ill-defined but can be thought of as a financial environment where the public sectors has to operate in a situation where the annual growth in financial resources is sometimes nil or even negative, whilst the Government is attempting to enable growth in the economy at the same time (Ferry and Eckersley, 2011; Ferry and Eckersley, 2012). This contrasts sharply with previous eras where public authorities received annual growth in resources. In many countries this unprecedented situation will require difficult decisions to be made in the public sector about the use of declining resources and it is important that such organisations have effective financial governance arrangements in place when such decisions are being made. Governance in any organisation is complex and multi-faceted. In the NHS, governance has many different dimensions including: clinical governance, corporate governance, financial governance etc. This paper is an empirically based study of financial governance, within what are termed NHS Trusts, or Foundation Trusts: –these being the main providers of health services in the UK (abbreviated in both cases to NHSTs), and particularly the nature of financial governance in a time of severe and unprecedented financial austerity. In doing this it is recognised that financial governance is only one aspect of the whole gamut of governance and has strong inter-relationships with other aspects of governance.

Description of the research

NHSTs are faced with mounting pressures that have finance at the very core and correspondingly the systems of financial governance are likely to be tested. Clearly NHSTs will have various frameworks of financial governance which have been in place for some time and, in all probability, these frameworks will show variations in the degree of adequacy or robustness.

The onset of financial austerity involves something of a paradigm change. The NHS itself is going from an organisation which received significant annual growth in funding throughout the first 64 years of its existence to a situation where it now must operate in an environment of virtually nil growth in resources (Appleby et al., 2009) and the need to generate large scale efficiency savings. Whatever the robustness of existing frameworks of financial governance, it seems probable that the onset of this austerity will place pressure on those frameworks and will require change.

The underlying purpose of this research concerns the effectiveness of financial governance in the NHS in a new organisational paradigm. The project focusses on financial governance in those organisations responsible for the delivery of the vast bulk of publicly-funded health services in the UK, namely NHSTs. The main aims of this study were as follows:

- . to clarify the meaning and purpose of financial governance, within the overall governance framework in NHSTs;
- . to identify what should constitute good practice in relation to financial governance regimes;
- . to obtain views about the degree of importance attached, by respondents, to various aspects of good financial governance in the NHS, particularly in the context of financial austerity; and
- . to obtain views from respondents about the degree of compliance with these aspects of good financial governance in their NHST.

The authors designed a multi-method approach for triangulation, in terms of method, organisation and professional role to enable claims of both ecological and population validity (Gill and Johnson, 2010).

The organisations targeted for the project were NHSTs in England as these were the types of organisation, identified where there had been failings in governance. Initial talks were undertaken

with senior NHS managers, at a strategic level, to establish support for the study and as a sounding-board for ideas.

A questionnaire was designed to gather information concerning practices and understandings for financial governance in the NHS identified from the Delivering Excellence in Financial Governance document (NHS, 2003). The questionnaire was pilot tested with a group of NHS finance professionals and subsequently circulated electronically to all DoFs in England in NHSTs. A 12 per cent rate of return was achieved and analysed to determine trends in responses.

After receipt and analysis of the questionnaire additional face-to-face interview questions were established based upon the survey results. In total ten interviews were undertaken with a combination of DoFs, NEDs and other finance staff with governance responsibilities for their organisations, from one region of England considered representative from the survey results. In addition documents were obtained from research sites, primarily reports to the board concerning financial governance. Once the analysis was complete the key findings were reviewed by the research team with senior NHS personal from across the UK.

Governance and financial governance in the NHS

The issue of corporate governance has, since Cadbury (1992), been defined and debated. The Cadbury Report itself defines corporate governance simply as “the system by which companies are directed and controlled” while Solomon (2007, p. 4) extends this to define corporate governance as: “the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity”. In relation to the NHS, the UK Department of Health has taken this broad approach in terms of bringing all aspects of healthcare governance under one integrated framework (NHS, 2006, p. 10) and defines integrated governance as: “systems, processes and behaviours by which trusts lead, direct and control their functions in order to achieve organisational objectives, safety and quality of service and in which they relate to patients and carers, the wider community and partner organisations”.

This definition clearly implies that corporate governance in the NHS is multi-faceted and combines a number of elements including: clinical governance, employee governance, financial governance etc. The early 1990 s saw the introduction of the ‘internal market’ in healthcare and the introduction of a more commercial style of Board to accompany this new environment, which was financially focussed, and therefore altered views of accountability in some parts of the public services, particularly the NHS (Ezzamel and Willmott, 1993). Early studies of the new style of Board introduced at this time into the NHS indicate that there were issues concerning accountability and strategic implementation (Harrison, 1998). However, there was evidence that the new model improved the quality of board members and their contribution (Ferlie et al., 1995, Ferlie et al., 1996). Generally, however, the overwhelming view of the early research was that there were difficulties associated with private sector models being imported into the public services without any real attempt to adaption to their environment (Clatworthy et al., 2000). The degree of appropriateness of this model is again reviewed in this work.

The issues concerning governance in an NHS environment have been explored, in more recent years, largely, in terms of clinical and general governance issues There is, therefore, a paucity of current studies examining the financial aspects of governance of healthcare organisations either within the UK or internationally.

Recent years have seen several breakdowns in the services provided in several NHSTs, resulting in the avoidable death of patients. Two examples of such failure were at Maidstone and Tunbridge Wells NHS Trust (concerning an outbreak of the c-difficile bacterium by the BBC in 2007) and the Mid Staffordshire NHS Foundation Trust. The case of Mid Staffordshire hit the national media and has

generated many investigations. It concerned many failings in patient care which it is believed led to many hundreds of avoidable deaths. In both the above cases, considerable managerial and governance failings within the organisations were identified and there was an alleged or perceived over-concentration on financial issues by the Board at the expense of service delivery standards, which ultimately had an adverse effect on the management resource allocated to service delivery. It is sobering to reflect that the events at Maidstone and Mid-Staffs took place some years before the onset of austerity and at that time there were already seen to be difficulties in balancing financial pressures with service pressures as part of the overall governance process.

Whilst, in these examples, it is claimed there was an over-focus on financial aspects, in other less-publicised cases (e.g. Trusts with large overspends) the focus may well have been the other way around. These examples clearly illustrate the tension that will always exist between financial aspects of governance and other aspects.

Financial governance within the NHS is wide ranging. The guidance and principles of good financial governance within the NHS are set-out in 'Delivering Excellence in Financial Governance' (NHS, 2003). The main criteria identified for good financial governance are as follows (NHS, 2003, pp. 9-10):

- . Financial objectives for the organisation are clearly defined and approved by the Board.
- . Board level responsibility for financial management is clearly defined
- . Audit Committee overseeing the financial aspects of governance.
- . Standing Financial Instructions, adopted by the Board, and promulgated throughout the organisation.
- . Financial risk management processes exist throughout the organisation.
- . Internal control – there is an effective and documented system for all financial management systems.
- . Finance function – There is an adequately resourced, trained and competent finance function.
- . Financial management – all employees, including managers and the Board, are provided with adequate information, instruction and training.
- . Review of internal control – the Board reviews the effectiveness of its system of internal financial control at least annually.
- . Performance – the Board receives regular reports on financial performance and activity.
- . Risks – the Board is made aware of significant risks and determines and takes appropriate action.

While the above elements of financial governance are clear and precise and are built upon sound governance principles, it is the understanding and application of these guidelines that is important and that, in addition, to systems, processes, skills etc., the appropriate behaviours are present, which enable the governance systems to safeguard the interests of all parties. While the contents of the above guidance are necessary attributes for good governance, they do not appear to be sufficient in that they fail to describe the status of certain key issues which underpin good financial governance.

As part of the financial governance process, Board members need to be assured about the robustness and effectiveness of certain key financial and management processes. Reviewing good practice in various sectors and discussions with senior finance managers in those sectors lead us to

conclude that the items shown in Table I are also key aspects of good financial governance in any organisation and also need to be considered.

Research findings

The research undertaken focussed on those aspects of financial governance listed in

Table I. The findings have been summarised under the following headings:-

- . Corporate financial strategy.
- . Budgeting systems.
- . Accountability structures and costing systems.
- . Financial reporting to the board.
- . The effectiveness of the Board and its members.

Corporate financial strategy

A financially robust corporate strategy is key to dealing with the challenges of austerity as well as meeting strategic objectives. Table II shows that there was a relatively high priority attached by DoFs to having a financial strategy which underpinned the corporate strategy of the Trust. Furthermore, Table III, identifies that 93 per cent of DoFs either “agreed” or “strongly agreed”, that the corporate strategy of their NHST was underpinned by a robust financial strategy. However, the qualitative findings of the survey also indicated that respondents were concerned, in times of rapid change, that it was difficult to plan owing to the rapidly changing environment.

Table I. Key aspects of financial governance

Aspect	Description
Corporate strategy and financial strategy	The corporate strategy of the Trust is underpinned by a robust financial strategy. The detailed approach to capital investment appraisal in the Trust supports the strategic intent of the organisation
Budget structures	The configuration of budgets in the Trust largely aligns with the Trust's organisational structure
Budget responsibilities	Financial responsibility and accountability is sufficiently clarified through the budget system
Budget setting process	The budget setting process of the Trust operates in such a way as to reflect and implement the corporate strategy of the organisation
Budgets and performance	In relation to budget holders in the Trust, there is a clear link between funding and expectations of output and quality of service
Adequacy of costing systems	The current costing systems and methods in the Trust are suitable and adequate for the organisation's activities
Risk assessment	The Trust has an appropriate and adequate approach to the assessment of risk, including financial risk
Risk management	The Trust has an effective approach to managing the risks it identifies
Audit arrangements	The effectiveness of internal and external audit services and are directed at the highest areas of risk
Financial reporting to the Board	The financial information provided to the Board is adequate and appropriate for effective (financial) governance purposes
Non-executive directors skills	The non-executive directors of the Trust Board have the skills and experience to make an effective contribution to Trust governance
Non-executive directors contribution	The contribution of the non-executive directors of the Trust is not being maximised

Interviews with other staff groups indicated a similar finding. The interviews also indicated that in spite of the comments about the importance of financial strategy, in reality, there was little substantial strategic development taking place generally, and particularly in terms of finance. When interviewees were asked to discuss the financial strategy of their organisations there was a discussion of strategy documents but few could discuss their financial strategy in any detail or indeed the main points of that strategy.

Thus, there is little evidence to confirm that all NHSTs do have a robust financial strategy.

Budgeting systems

An effective budgeting system would usually be regarded as an important vehicle for dealing with the challenges of financial austerity, as a means of distributing resources to priority areas, improving performance and control etc. The existence of such systems therefore should be a key component of good financial governance. There are two key themes to consider:

(1) whether the budget setting process facilitates the implementation of the corporate strategy of the organisation; and

Table II. The relative priority given to a particular aspect of good financial governance compared to other aspects

Aspect	High (%)	Medium (%)	Low (%)
Financial strategy which underpins the corporate strategy	64	29	7
Budget system which clarifies financial responsibility and accountability	36	25	39
Budget setting process which facilitates the implementation of the strategy	11	36	53
Clear linkages between budgets and expected service performance	11	39	50
Costing systems which identify the true costs of service activities	4	29	67
Strategically focussed and effective risk assessment and risk management systems	39	32	29
Effective audit services coupled with effective audit reporting arrangements	7	25	68
Comprehensive and appropriate financial reporting to the Board	46	25	29
Non-executive directors with appropriate skills, experience and attitudes	21	32	47
Executive directors committed to having effective financial governance	60	29	11

(2) whether there are clear linkages between budgets and expected service volume and performance.

Table II suggests that most DoFs do not see either of these themes as being of great priority with respectively 53 per cent and 50 per cent identifying them as a relatively low priority in their NHST. This seems a surprising conclusion but it was also supported by the subsequent interviews.

When we turn to the capabilities of the current budgeting systems both Table III and interview findings indicate that while a large majority of respondents view the budget setting process of their NHST as operating in such a way that reflects and implements the corporate strategy of the organisation almost half of them did not identify a clear link between budget funding and expectations of output and quality of service. The latter point appears to suggest significant weaknesses in relation to the promotion of organisational performance.

Accountability structures and costing systems

A significant majority of DOFs (67 per cent) indicated that their accountability structures were not fully clarified through the budgetary control system. This deficiency has been identified by other studies as being an issue of concern (Harradine et al., 2011). This is a likely problem for the future in terms of the changes in funding patterns facing these organisations and also the need to implement difficult cost improvement targets.

The above is also likely to be compounded by the perceived lack of trust in the adequacy of costing systems by DoFs (67 per cent). Many suggested that that Service Line Reporting (SLR) would assist this problem. SLR is a methodology that identifies costs to clinical specialties, which is designed to assist control through better

Table III. The extent of agreement with statements about compliance with particular aspects of good financial governance

Theme	Question	Strongly agree (%)	Agree (%)	Disagree (%)	Strongly disagree (%)	Unsure (%)	Total (%)
Strategy	The corporate strategy of the Trust is underpinned by a robust financial strategy	23	70	7	0	0	100
Investment	The detailed approach to capital investment appraisal in the Trust supports the strategic intent of the organisation	27	60	10	0	3	100
Budgets	The budget setting process of the Trust operates in such a way as to reflect and implement the corporate strategy of the organisation	20	67	13	0	0	100
Budgets	The configuration of budgets in the Trust largely aligns with the Trust's organisational structure	40	53	7	0	0	100
Budgets	Within the Trust there are still some areas where financial responsibility and accountability are not sufficiently clarified through the budget system	10	67	23	0	0	100
Budgets	In relation to budget holders in the Trust there is a clear link between funding and expectations of output and quality of service	10	43	43	3	0	100
Costing	The current costing systems and methods in the Trust are suitable and adequate for the organisation's activities	7	30	53	7	3	100
Costing	The current costing systems and methods in the Trust will need to be significantly improved to meet future challenges	7	30	53	7	3	100
Risk	The Trust has an appropriate and adequate approach to the assessment of risk, including financial risk	17	83	0	0	0	100
Risk	The Trust has an effective approach to managing the risks it identifies	10	53	13	0	23	100
Audit	Internal audit services in the Trust are effective	13	70	13	0	3	100
Audit	External audit services in the Trust are effective	13	70	13	0	3	100

(continued)

Theme	Question	Strongly agree (%)	Agree (%)	Disagree (%)	Strongly disagree (%)	Unsure (%)	Total (%)
Audit	Internal audit services are directed at the highest areas of risk	13	70	13	0	3	100
Audit	External audit services are directed at the highest areas of risk	13	70	13	0	3	100
Audit	The current reporting arrangements for internal audit are adequate and appropriate	23	57	13	0	7	100
Audit	The current reporting arrangements for external audit are adequate and appropriate	23	63	0	0	13	100
Board reporting	The financial information provided to the Board is adequate and appropriate for effective (financial) governance purposes	33	57	10	0	0	100
Non-executives	The non-executive directors of the Trust Board have the skills and experience to make an effective contribution to Trust governance	37	40	10	0	13	100
Executives	The contribution of the non-executive directors of the Trust is not being maximised	0	30	23	13	33	100

Table III.

information flows and accountability systems as well as assisting the planning process (Monitor, 2006). Initial studies have, however, indicated that while there is considerable potential for this system to assist, in the areas outlined, it may not be the panacea to solve all the problems of accountability within NHSTs (Harradine and Prowle, 2012).

These studies indicate that the budgeting systems are seen as control tools. However, in the cases explored accountability was seen to be sometimes frustrated by the 'role' of the medical staff in the budgetary and SLR processes. This is, therefore, likely to be an issue for the respondents to this study and it is suggested that this will also likely to impact upon strategic issues. Overall, these findings suggest limitations in NHST budgeting systems which are of particular importance during a time of austerity.

Financial reporting to the Board

There was a view expressed (Table II) that there needed to be clear reporting to the board on financial issues and that there should be a clear reporting structure. In all cases, interviews with executive and non-executive board members indicated support for strong financial governance and

the importance of reporting financial risk to the Board was stated as being paramount. Comments were generally favourable concerning the adequacy of audit reporting to the board.

An examination of a sample of board reports, however, showed in the majority of cases that there was considerable detail provided on financial issues and that the total volume of material for every meeting was considerable. NEDs often stated that the volume of material was a concern: “cannot see the woods from the trees”. A worrying outcome of the interviews with NEDs, including chairs of trusts, was their answers to the question of their organisation’s financial situation at that point in time. The answers ranged from an incorrect answer to: “I’m not sure but our director of finance can assist you with that”. In all cases there appeared to be an over reliance on the DOF or other senior finance personnel. One chief executive stated that he did not understand the financial issues of the organisation but trusted a Non-executive director (NED) who had a financial services background. There were examples of NEDs with considerable commercial and finance expertise who also demonstrated a lack of understanding of the financial position.

The effectiveness of the Board and its members

Table III suggests that DOFs were very much of the view that the contribution of non-executive directors was not being maximised. However, it is a mixed picture and one DOF commented “The value of non-executives has become apparent over the course of my time in post; however it is a truism that not all non-executives are equally valuable”.

Two interviews undertaken at one site, a large acute hospital, with the chair of the NHST and the DOF offered an interesting insight into the dynamics of understanding of the financial issues, primarily risk, being faced by the organisation. The chair, as in other cases, did not have a detailed understanding of the financial issues of the organisation and said that he was reliant on the skills of the DOF who he said was highly skilled and was trusted. He said that he was sure that all items were taken to the board if there was a financial risk involved. This point was discussed with the DOF who indeed said that he would take important issues to the board but then stated that many of the issues of funding were extremely complex and said that many of the problems were dealt by himself and/or his team: “. . . it is not worth taking to them (the Board) as they would not understand the intricacies; at times I do not understand how everything works”. This offers an intriguing view of the complex nature of financial systems within the NHS and how there is a lack of understanding. The above statement was tested with others interviewed and many agreed about the issues of complexity and therefore the general lack of understanding of financial issues. One interviewee stated that there were few NEDs with the background to even attempt to understand some of the technical finance issues that were at the root of the risks faced by the organisation. The above comments offer interesting parallels with the perceived issues of governance, and the recent banking crisis, concerning the lack of understanding by participants, at all levels, of the financial risks at play (Conyon et al., 2011; Muller-Kahle and Lewellyn, 2011).

Key themes and conclusions

The key themes emerging from this study can be summarised as follows:

- . A high degree of commitment was stated, by all parties, to having effective financial governance.
- . It was accepted that financial strategy is an essential part of financial governance but it is not clear that such a commitment is translated into having robust financial strategies in practice.
- . The necessity of financial reporting to the Board was acknowledged but there are concerns about the complexity of the reports produced and the extent to which they were understood by the various parties involved.

- . There are potential inadequacies of budgeting systems and costing systems which are serious concerns in a time of financial austerity.
- . There was an acknowledgement of the need for effective risk assessment and risk management systems.
- . There was seen to be a lack of understanding of the financial issues by the NEDs and their contribution is not being maximised.
- . The complexity of the funding process was causing opaqueness, for all concerned, of the financial risks for the organisation. This may have parallels with the complexity of the banking sector and the failures of governance in that sector.

The above analysis provides strong evidence of issues that cause concern regarding financial governance within the NHS. There is evidence of complacency among all parties that the system is relatively robust in many areas. However, the complexity of the systems is the cause of opaqueness in the window of governance, which the authors see as a contribution to the debate in financial governance in the NHS and which mirrors the general perceived failings of governance in other sectors, which have resulted in catastrophic consequences for the World economy.

As already noted, the NHS is undergoing change on a scale never before experienced in its history in terms of management reorganisation, financial philosophy and, in particular, the scale of financial austerity. This would seem to be a time when the need for strong financial governance has never been greater. However, it is important to emphasise that this research took place partly before the onset of financial austerity and partly after its onset. It appears that many of the weaknesses in financial governance were in existence prior to the onset of austerity and it would seem likely the onset of financial austerity will only magnify these weaknesses. Indeed, some of the interviews undertaken with DOFs and NEDs identified recognition of this and a need for urgent action. We see an urgent need for research into how NHSTs are dealing with the pressures of austerity and how well the existing frameworks of financial governance are coping.

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