Feidhmeannacht na Seirbhíse Sláinte
Health Service Executive

AFS 2021 Briefing Template - Update for HSE Board

Subject: Final Approval of Draft AFS 2021 in line with Health Act 2004

Submitted for meeting on: HSE Board for approval on 27th May 2022

Name & title of author: Mairead Dolan ACFO on behalf of Stephen Mulvany CFO

Why is this information being brought to the Boards attention?

The HSE is required annually to adopt Annual Financial Statements (AFS) in accordance with the requirements of S36 of the Health Act 2004. S36 of the Health Act requires the AFS to be adopted by the Board on or before the 1st April annually. Once these are adopted and signed they should be submitted to the Minister for Health and to the Comptroller and Auditor General for formal audit.

The Board formally adopted AFS 2021 at their meeting of 25th March 2022. It was agreed that in the event of material changes arising from the conclusion of the formal audit that these would be re-presented to the Board for final approval prior to submission to the Minister.

Is there an action by the Board required, if so please provide detail
Yes, the HSE Board are being asked to recommend the final approval of these 2021 financial statements and to nominate that it is in order for the Chief Executive Officer of the HSE and the Chairperson of the HSE Board to sign the financial statements and associated reports on behalf of the HSE on the 27th May 2022.

Please indicate which of the Boards objectives this relates to ;

- The development and implementing of an effective Corporate Governance Framework, incorporating clinical governance and a performance management and accountability system;

Background - provide context in order to ensure that the Board fully understand the issue.
A first draft Annual Financial Statements (AFS) 2021 have been submitted to the Department of Health on 28th February 2022 in line with the "Code of Practice for the Governance of State Bodies 2016".
In line with the Health 2004 the HSE Board adopted these AFS on 25th March 2022 which were submitted to the Minister and the C&AG and the audit has been on-going as previously reported.

For clarity the draft Annual Financial Statements (AFS) 2021 presented to the Board incorporate the following:

1. The Draft Financial Statements 2021 and notes to the Accounts including draft accounting policies (AFS) – (to be signed by CEO and Chair of the HSE Board)
2. The Draft Statement on Internal Control (SIC)- to be signed by the Chair of the HSE Board
3. The Draft Compliance Statement required by the DPER Code – to be signed by the Chair of the HSE Board (Appendix 2 to AFS)
4. The Draft Letter of Representation (LOR) – to be signed by the CEO and the Chair of the HSE Board
5. Operating and Financial Review (OFR) *

*The (OFR) is being brought to the Board for their information and approval but is not considered part of the formal AFS and therefore this OFR does not require signing but with the Boards approval will be included in the published AFS 2021.
The Board have not previously reviewed the OFR or the Draft Compliance Statement.

Compliance with Legislation and the Code of Practice for the Governance of State Bodies 2016.

The AFS and the related reconciliations are prepared in line with the requirements of FRS102 subject to specific ministerial derogations as disclosed in Note 1 Accounting Policies. These are consistent with the format of 2020

which was audited by the OCAG without adverse comment other than any issues reported in the Management Letter.
The Revised Code of Practice for the Governance of State Bodies is effective from 1 September 2016. The HSE considers that it is compliant with this code for 2021 other than any matters disclosed in the Statement of Internal Control.

The Chairperson's Statement on Internal Control (SIC) which forms part of the AFS relies heavily on the findings of the formal Review of the System of Internal Control in the HSE. The Internal Control Questionnaire (ICQ) for 2021 was commenced in November 2021 and was concluded in late January 2022. Despite the on-going impact of COVID-19 and the effects of the 2021 Cyber-attack 3,084 management staff completed the ICQ an increase of 6% over 2020 which is very encouraging.
Some of the key conclusions of the review are summarised:

- Increased awareness by HSE staff of the need for accountability and a strong system of internal control
- The HSE has adopted a suite of internal policies and procedures which form the basis of the internal control framework
- Where weaknesses or risks exist there is evidence of mitigating and compensating controls

Highlight any implications that the Board should be made aware of in its consideration;

<u>Update to the Board since March 25th Meeting – Summary of AFS Changes</u>

The Draft AFS 2021 which are brought to the Board for approval today report's a Revenue Income and Expenditure Deficit of circa €195.0m and a Capital Income and Expenditure Deficit of circa €45.5m.
The adopted AFS 2021 reported a Revenue Income and Expenditure deficit of circa €156.7m and a Capital Income and Expenditure surplus of circa €0.5m.
The table below provides a reconciliation from the adopted AFS to the final version brought today for the Boards consideration and approval.

Details	**Ref**	**Revenue I/E**	**Capital I/E**
Adopted 25/03/22		**(156,710)**	**515**
Changes			
"VAT" Debtor Adjustment	1	(61,294)	0
PPE Adjustment	2	12,655	0
Reclassification of PYA	3	6,754	
Reversal of duplicate accrual	4	3,570	
Other Minor	5	(7)	
Capital Template Error reversed	6		(45,977)
Draft "Final" AFS 2021		**(195,033)**	**(45,462)**

The key changes are in relation to the VAT Debtor Adjustment of €61.3m which increases the reported revenue deficit of 2021. This is a technical accounting issue and it is expected to be a timing issue and that the HSE will receive the VAT refund in a later period. See note 1 below.

<u>Update to the Board since March 25th Meeting – Other key issues</u>

<u>Potential Audit Certificate matters</u>

The C&AG provides an annual opinion as to the accuracy of the financial statements, advising the user that the HSE's financial statements are properly presented and therefore that the underlying records and the financial statements are correct.
Additionally the C&AG may make statements on the audit certificate called "emphasis of matter" which relate to information he feels is important that the user is aware of. Generally the HSEs financial statements and SIC

will refer to those issues also.

For AFS 2021 we are expecting the following "emphasis of matter items" may appear on the HSE's audit certificate:

- Non-compliance with procurement rules (as in previous year)
- PPE expenditure due to the material impairment loss suffered (€108.8m). The C&AG is also likely to refer to the contracts with Irish indigenous suppliers for Type 11R masks on the basis that their cost is higher than might be available from abroad. The C&AG may consider this to be "ineffective spend". Additionally the C&AG is likely to make reference to the storage costs for surplus PPE which has been written down.

[redacted]

All of the above are referenced by the HSE in the Statement of Internal Control. It is important to note that these are not qualifications rather they are matters that the C&AG feel are important to the users of the accounts.

Deferred Income

The HSE was advised in Q4 2021 of specific Ministerial initiatives that were required to be funded from the 2021 allocation. Due to the late notification of these funds (circa €28m) the HSE was unable to spend the full amount in 2021. Circa €4m was spent by the year end and a further €24m was provided for.

Subsequently following engagement with the audit team it has been determined that this €24m should not be treated as expenditure but should be treated as deferred income. This has no impact to the overall result reported. It is a reclassification which reduces the DoH grant which is detailed in note 3 to the accounts.

Unadjusted differences below materiality

At the time of writing the C&AG have only reported one significant but not material unadjusted difference relating to their audit of 2021 non-pay accruals.
The audit tested €130m of non-pay accruals and determined that €1.7m were not compliant. This returns an error rate of 1.3% which when extrapolated to the overall HSE non-pay accruals reported in AFS 2021 signifies a potential over-accrual of circa €13m. As this is below C&AG materiality no adjustment is required.

Update to the Board since March 25th Meeting – Details of Adjustments to Draft Final AFS 2021.

Item 1 "VAT" Debtor Adjustment €61.3m

The HSE has engaged with external laboratories who are tasked with performing COVID-19 testing services.

One significant supplier of these testing services has been charging standard rate VAT on the supply of these services and it is the position of the HSE with external advice that these services are exempt from VAT on the basis that the services fall within the scope of "medical tests prescribed by a medical practitioner but carried out by a third party"

Revenues website says that the standard rate of VAT applies to scientific testing – laboratory testing, "however, exempt when samples are tested on behalf of a medical practitioner for the purpose of making a diagnosis and with a therapeutic aim"

Under accounting standards a Debtor cannot be booked by an organisation unless it is considered "virtually certain" and the test for that may change over time. While the standard is not explicit on what constitutes virtual certainty it is generally accepted as being interpreted as being as close to 100% as to make any uncertainty insignificant. Although tax advice indicates that there is a high certainty of recovery, circa 95% this is not considered sufficient from a compliance with the accounting standard perspective and the HSE has sought advice on this which agrees.

The HSE had considered based on information available at the time that the recovery of this VAT was virtually certain" and therefore an additional VAT Debtor was recognised in AFS 2021. Significant progress has been made with the supplier who have agreed to make a submission to Revenue on the VAT treatment, however, this submission has only recently been agreed and without a formal confirmation from Revenue by the date of signing of the financial statements, the HSE cannot recognise the Debtor and remain compliant with the standard. This means that the full amount of the Debtor booked has had to be reversed.

This is now treated as a contingent asset and is reported accordingly in the note 28 to the accounts.

This accounting treatment does not change the HSEs view that the VAT remains due. The HSE will continue to work with the supplier and Revenue to ensure recovery of these monies. This is a timing difference.

Item 2 PPE Adjustment €12.7m

The HSE has continued to ensure that there is an appropriate supply of PPE available as needed and that there is a future pipeline of orders in the event of any further COVID-19 surges or future emergency scenarios. The cost of PPE is therefore a significant part of expenditure incurred in 2021.

The HSE has secured orders of PPE at significantly lower prices than in 2020 when market forces were at their most volatile and where demand materially outstripped supply. Some of the expenditure in 2021 related to orders placed in 2020 and the remaining purchases were made early in 2021. Therefore there was still a significant element of inflated prices albeit not at the same levels as in 2020.

The HSE is required to revalue its stocks to the lower of the cost it bought them at or the replacement cost. Therefore based on the most currently available cost prices at the year- end date, the HSE has recorded an impairment on the basis of cost of circa €70.6m as reported in notes 1(b) and note 16 to the financial statements. This is also reported in the Statement of Internal Control (SIC).

Additionally the HSE has deemed that its stocks of hand-gels are unlikely to be fully used before they are out of date. As most of the hand-gels held at the end of 2021 were purchased in 2020 and early 2021 these have been fully provided for and therefore an additional charge of €25.6m is reported in 2021 expenditure.

A number of items of PPE stock have been approved for donation and these were in stock at the end of 2021. Therefore on the basis that the HSE will not enjoy the usage of these, they are fully impaired at their carrying cost of €12.7m. The overall impairment charge to expenditure in 2021 on the basis of all the above is therefore in the order of €108.8m

The overall charge to 2021 expenditure in relation to PPE is in the order of €279m with a further €73.5m reported in inventories. This is within PPE expenditure levels sanctioned by the Minister.

The impairment charge in the adopted accounts was circa €121.4 and after additional analysis and review this has been reduced by €12.7m.

PPE inventory was valued at circa €61m in the previously adopted financial statements. It is now €73.5m.

Item 3 Reclassification of Prior Year Adjustment €6.7m

During 2021 the HSE undertook a comprehensive review of its non -pay accruals (NPA) as at the end of 2020. This review was conducted to provide additional assurance around HSE working capital and cash management processes arising from engagement with colleagues in the DOH and DPER. This review was always intended to form a future work-stream in relation to the preparation for IFMS but was accelerated during 2021 as part of enhanced working capital and cash reporting.

The review team received €761.3m of NPA accruals representing over 98% of the overall circa €1bn of NPA reported in AFS 2020.

The Board were advised in March that the circa €78m of non-compliant NPA were recorded as a prior year adjustment in the adopted AFS. Following engagement with the auditors this has been amended by circa €6m which is now deemed a change of accounting estimate and reversed in 2021. This means that the PYA entry is €71.4m and 2021 expenditure has reduced by €6m.

Extract from 2021 Statement of Internal Control re PYA:

> The financial statements disclose a non-cash adjustment of €71.4 million to previously reported expenditure figures. This mainly relates to one region ("region A") which uses an accounting system which has limited reporting functionality on accrued balances. Excess accruals were booked over a number of financial years but were most significant between 2016 and 2019. Controls to mitigate the limited functionality had been in place prior to 2016 but due to the impact of structural organisation change, and lack of clarity of responsibilities the errors were not detected for a period.
>
> In 2020, financial staff in the region A identified a problem with the level of accrued balances but due to the onset of the Covid-19 pandemic and re-deployment of staff arising from same, they were not in a position to complete the necessary work to correct the balances until 2021 at which point the National Financial Division (NFD) had commenced a detailed assurance review of almost €761 million or 76% of its overall non-pay accruals that had been reported in the financial statements of 2020. This review included all HSE accruals greater than €20,000 but not limited to same.
>
> The detailed review conducted by the NFD agreed with the findings of "region A" and aside from an immaterial amount in one other region, the review concluded that there was satisfactory evidence to support the accrual balances in the financial statements.
>
> The HSE's financial statements are prepared in line with Irish and UK Generally Accepted Accounting Principles (GAAP), FRS102 with some exceptions specified by the Minister for Health. Therefore the HSE is required to account for the €71.4 million adjustment in line with FRS102. This accounting treatment is considered a technical accounting adjustment and the appropriate accounting treatment is to reduce this expenditure in the HSE's Statement of Movement in Reserves by reducing the opening deficit by the adjustment identified by the review team. This technical adjustment is non-cash impacting, it does not increase expenditure but reduces it, and does not require any additional funding to be provided and therefore does not impact on the delivery of HSE services to patients or service users.
>
> The HSE has reviewed the adjustments found in each relevant year in the context of the overall revenue funding required to deliver health services and has determined that there is no material impact on the financial results of any of the years in which the adjustments arose. The most material of these adjustments €16.3 million relates to 2018 when the HSE's revenue funding was in the order of €15.2 billion. The HSE has concluded that there is no material impact on the Income and Expenditure included in the financial statements in any of the affected years.
>
> The HSE and region A has enhanced its procedures with regard to the checking and validating of accrued expenditure and provisions. It has also strengthened its monitoring and review of ongoing balances.
>
> The NFD are developing a HSE wide process regarding the validation, approval and on-going monitoring of accrued expenditure. Additionally there is some system work which is being conducted to allow aging of accruals which will further enhance the on-going review of same.
>
> Notwithstanding the fact that the HSE has not identified a systemic issue in relation to accrued expenditure, additional assurance activity will take place during 2022.
>
> This adjustment is not the correction of a fundamental error. Up to the implementation of the current accounting standard (FRS102) in 2015, prior year adjustments were rare and were reserved for very limited circumstances, including where there was an error in the financial statements that destroyed their truth and fairness. Since 2015, prior year adjustments are used more frequently in financial statements, including to improve comparability between reporting periods. For the avoidance of doubt, had the higher level of HSE accruals carried on the HSE Balance Sheet been corrected, none of the

necessary adjustments would have threatened the truth or fairness of the financial statements or qualified in previous years as a fundamental error.

Item 4 Reversal of duplicate accrual €3.6m

The HSE identified that there was duplication of accruals resulting in an adjustment of €3.6m which has been reversed. The amount is not considered material and is related to an accrual for specific funding advised by the Minister in late 2021. This amount was accrued centrally and also locally. This is now amended.

Item 5 Minor N/A

Item 6 Capital Template Error Reversed €45.9m

The adopted financial statements include a minor surplus of capital income and expenditure of €0.5m. During the ongoing AFS reviews an error was found in the capital template which incorrectly recorded 2021 capital expenditure in reserves and not in the current year expenditure.

This means that the result is now a deficit of €45.5m and not a surplus as previously advised.

This error occurred because of human error when the capital template was completed and uploaded.

Additional checks are now in place to ensure that this kind of error will not re-occur. This involves an additional review and approval step before the template is uploaded in future.

EMT Review –

The EMT considered these final drafts at their meeting of Tuesday 24th May and are satisfied that it is in order to recommend these for the Boards approval and that the CEO and Chair can sign on behalf of the HSE.

ARC review-

The ARC have reviewed the final drafts at their meeting of Tuesday 24th May. Subject to some clarifications which have been made, the ARC are supporting the submission of these final drafts for Board approval and signature at the Boards meeting of 27th May 2022.

Conclusion

The HSE's AFS require re-approval in accordance with S36 of the Health Act 2004

Recommendation

I recommend to the HSE Board that the re-approval of the draft final Annual Financial Statements is in order and recommend them for final approval, signature and submission to the Minister for Health following receipt of the HSE audit cert from the C&AG.

This will allow the joint publication at the appropriate time of the Annual Report including the financial statements.