Classification: Official

Updates to the risk assessment framework for independent sector providers (IPRAF) of NHS services

Consultation response

December 2020

Contents

1. Introduction

NHS Improvement published a consultation on proposals for updating the risk assessment framework for independent sector providers (IPRAF) on NHS services that ran from 3 February to 28 February 2020. Publication of this response to the consultation has subsequently been delayed due to the impact of COVID-19.

The consultation used ‘agree/neither agree nor disagree/disagree/don’t know’ questions covering each proposed update, and optional free text boxes for further comments.

Over 300 stakeholder organisations were formally notified of the consultation and invited to participate. Publication on the NHS Improvement website also made it ‘public’.

Responses were received from licensed independent providers, licensed independent providers of commissioner requested services (CRS) and clinical commissioning groups (CCGs).

Responses demonstrated broad support for the proposed updates, but with three main themes emerging:

- the overarching approach to monitoring and assessing risk for providers of CRS
- interpreting risk from the proposed operating margin continuity of service risk rating (CoSRR) metric
- alignment to other NHS England and NHS Improvement publications.

There was support for all other proposals in the consultation document, including the new requirement to self-certify compliance with Condition G4 of the licence (Fit and proper persons) that will impact on all licenced independent providers.

Section 2 explores these themes further and the response to them.

Section 3 summarises how the proposed changes will be implemented.

2. Main themes from the consultation

2.1 NHS Improvement's overarching approach to monitoring and assessing risk for providers of CRS

Some respondents suggested that a more holistic approach to oversight should be adopted.

NHS Improvement's response

The licence requires a risk rating methodology to be published. However, the calculated risk rating is only one part of the assessment of risk. The original framework and its update are transparent about the wider financial and non-financial factors that are considered when making an overall assessment of risk to continuity of services.

The proposed metrics (liquidity, capital servicing capacity and operating margin risk ratings), when taken together, give a sufficiently rounded initial indicator of financial risks to continuity of services.

2.2 Interpreting risk from the proposed operating margin CoSRR metric

Respondents generally supported the proposed introduction of an operating margin metric and the proposed CoSRR thresholds (Q1 and Q2 of the consultation survey). However, some respondents suggested that the metric could penalise charitable and not-for-profit organisations that plan only for a marginal operating profit or to utilise reserves. Some respondents suggested that other metrics could be incorporated or may be more appropriate than operating margin.

Views varied on whether the proposed thresholds were too high or too low; these appeared to vary according to the type of organisation represented, eg limited company, charity, social enterprise.

NHS Improvement's response

In developing the proposals, other metrics were considered. The three metrics proposed (liquidity, capital servicing capacity and operating margin) provide sufficient scope for the risk assessment without giving rise to 'double count' of risk, and using a small number of metrics ensures the approach remains straightforward.

Providers that utilise their reserves will be treated according to the overall risk presented and whether it is planned or unplanned. Local knowledge of individual providers will be used to categorise those that score CoSRR 2 as a result of the operating margin metric into 'stable but structural risk' or 'emerging concern'.

Regarding the setting of thresholds for the operating margin metric, from a provider point of view there are arguments for higher and lower thresholds, eg based on the cost of capital. This will vary based on financing arrangements, whether buildings are owned or leased, and whether a provider's services are more/less asset reliant (eg bed- or community-based services).

The thresholds have been set at a level that aims to best reflect the identification of risk, based on the current and historical mix of providers that are under financial oversight. As wider indicators of risk are also considered, at times it may be decided to escalate at a higher or lower margin depending on the circumstances. The thresholds will be kept under review.

2.3 Alignment with other NHS England and NHS Improvement publications

There was general feedback that the proposals did not align with the:

- NHS England and NHS Improvement approach to overseeing trusts and CCGs
- published planning guidance
- scoring methodology in the NHS Oversight Framework.

NHS Improvement's response

The points raised have been considered in turn:

- Licensed independent providers are not subject to the foundation trust conditions of the licence. Consequently, they cannot be regulated using the approach set out in the NHS Oversight Framework.
- Many independent providers have material income streams from outside the NHS, or even other public sources, and therefore elements of the planning guidance will not apply.
- Independent providers are familiar with the existing approach to scoring. As such, it will not be aligned with the scoring methodology used in the NHS Oversight Framework, as this could confuse those providers regulated using it.

2.4 Other technical queries from respondents

A technical query was posed regarding the impact of IFRS16 changes on the operating margin CoSRR metric. NHS Improvement's view is that an accounting change should not alter the financial risk profile of an organisation. For providers adopting IFRS16 (lease accounting) changes, the expectation is that the operating margin will be higher, but that there will be a corresponding decrease in capital servicing capacity.

Based on this and the experience of private finance initiatives moving onto balance sheets in the NHS, it is expected that this will have a broadly neutral impact on an organisation's overall CoSRR. If there is a change in risk rating, the overall risk profile of the organisation will be considered.

3. Summary and next steps

Following consultation and detailed consideration of the main themes coming out of this, the updates below will be made to the IPRAF. To see a detailed comparison between the original and updated provisions, and the rationale for the changes, please refer to the consultation document.

3.1 Introducing an operating margin metric

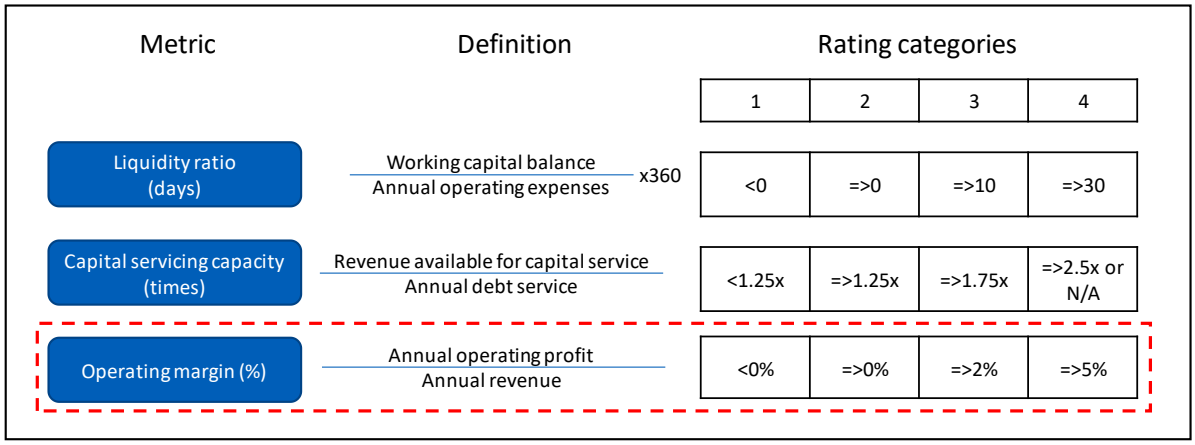
An operating margin metric will be introduced alongside the existing liquidity and capital serving capacity metrics. It will be calculated as shown in Figure 1.

Figure 1: Calculating operating margin

For charities	£	For companies	£
Total service revenue	X	Total service revenue	X
Revenue grants	X	Other operating income	X
Voluntary income donations	X	Staff costs	(X)
Voluntary income legacies	X	Property and asset rentals	(X)
Activities for generating funds	X	Defined benefit pension scheme service cost	(X)
Other incoming resources	X	Building repairs and maintenance expense	(X)
Staff costs	(X)	Other operating expenses	(X)
Property and asset rentals	(X)		
Defined benefit pension scheme service cost	(X)		
Building repairs and maintenance expense	(X)		
Other resources expended	(X)		
Operating margin (numerator)	**X**	**Operating margin (numerator)**	**X**
Total service revenue	X	Total service revenue	X
Revenue grants	X	Other operating income	X
Voluntary income donations	X		
Voluntary income legacies	X		
Activities for generating funds	X		
Other incoming resources	X		
Total income (denominator)	**X**	**Total income (denominator)**	
Operating margin (%)	**X%**	**Operating margin (%)**	**X%**

To calculate a CoSRR for operating margin, the thresholds in Figure 2 will apply.

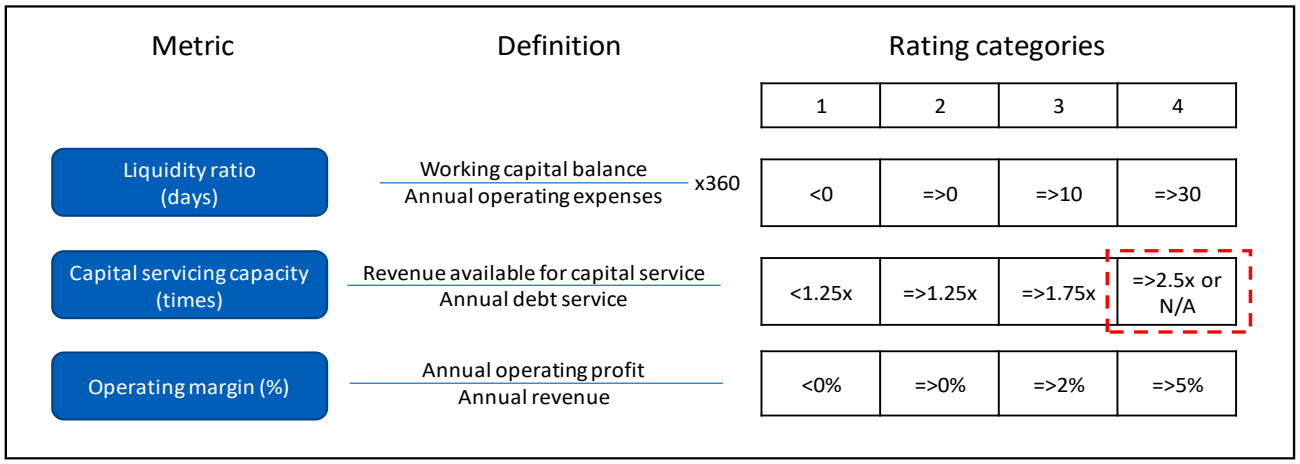
Figure 2: Proposed introduction of an operating margin CoSRR metric



3.2 Recognising zero debt in the capital servicing capacity ratio scoring

Providers with no debt will be assigned a CoSRR 4 capital servicing capacity rating, as shown in Figure 3. CoSRR 4 represents the lowest level of risk.

Figure 3: Recognition of zero debt under the capital servicing capacity CoSRR metric



3.3 Creating an overall risk rating but with two overriding rules

An average risk rating will be calculated for each provider based on an average of the three CoSRR scores. Each score would have equal weighting.

Two overriding rules will also be introduced to the aggregated risk rating:

- if a provider scores CoSRR 1 on one metric, its overall rating cannot be greater than CoSRR 2
- if a provider scores two CoSRR 1s, its overall rating cannot be greater than CoSRR 1.

3.4 Interpreting risk ratings – updates to risk rating consequences

Given the above changes to the metrics, the description of risk rating consequences will be updated as shown in Figure 4.

Figure 4: Risk-rating consequences under the updated IPRAF

Risk rating	Description of consequences
4	**Low risk –** NHS Improvement will continue to review performance on a routine quarterly basis.
3	**Residual risk –** the financial position is such that where NHS Improvement has residual concerns, additional information may be requested and/ or more detailed conversations may be held, but routine quarterly monitoring will be maintained.
2	**Structural but stable risk –** the financial position is stable but lacks resilience. NHS Improvement is likely to request additional information and/ or hold more detailed conversations, but routine quarterly monitoring is likely to be maintained. *Or…* **Emerging concern –** where sudden or sustained deterioration of one or more CoSRR metrics is observed, NHS Improvement is likely to initiate **monthly monitoring** and may consider opening an investigation to determine whether there has been a breach of continuity of services licence conditions. If an investigation finds that a breach has taken place we may take action against a provider to require it to put remedies in place. In some cases NHS Improvement may also start taking an active role in ensuring continuity of services using provisions in the relevant licence conditions, e.g. requesting the co-operation of the provider to assess risk to services; preventing the disposal of assets use in the provision of CRS.
1	**Actual concern –** providers in this category are highly likely to be experiencing financial stress sufficient for NHS Improvement to open an investigation and consider taking an active role in ensuring continuity of services as set out under 'emerging concern' above. Providers scoring CoSRR 1 will be placed on monthly monitoring.

3.5 Refocusing outer year monitoring

The number of years' forward-looking data collected in the standard templates will be reduced to one year.

For providers delivering more than £5 million of CRS per year, a forecast base case for Year 2 will also be collected – and in some exceptional cases Year 3 – with a board-approved downside risk analysis for Year 2 only, as shown in Table 1.

The board-approved downside risk analysis for Year 2 will comprise management's income and expenditure and cash base case in their own format, plus the impact of a reasonable set of downside factors. This may include, for example, the loss of contracts due for re-procurement.

As part of discussions with management, questions may be asked about the impact of such factors on net earnings, reserves and cash and, where appropriate, any mitigating actions.

Table 1: Proposed updates to forward planning and monitoring frequency

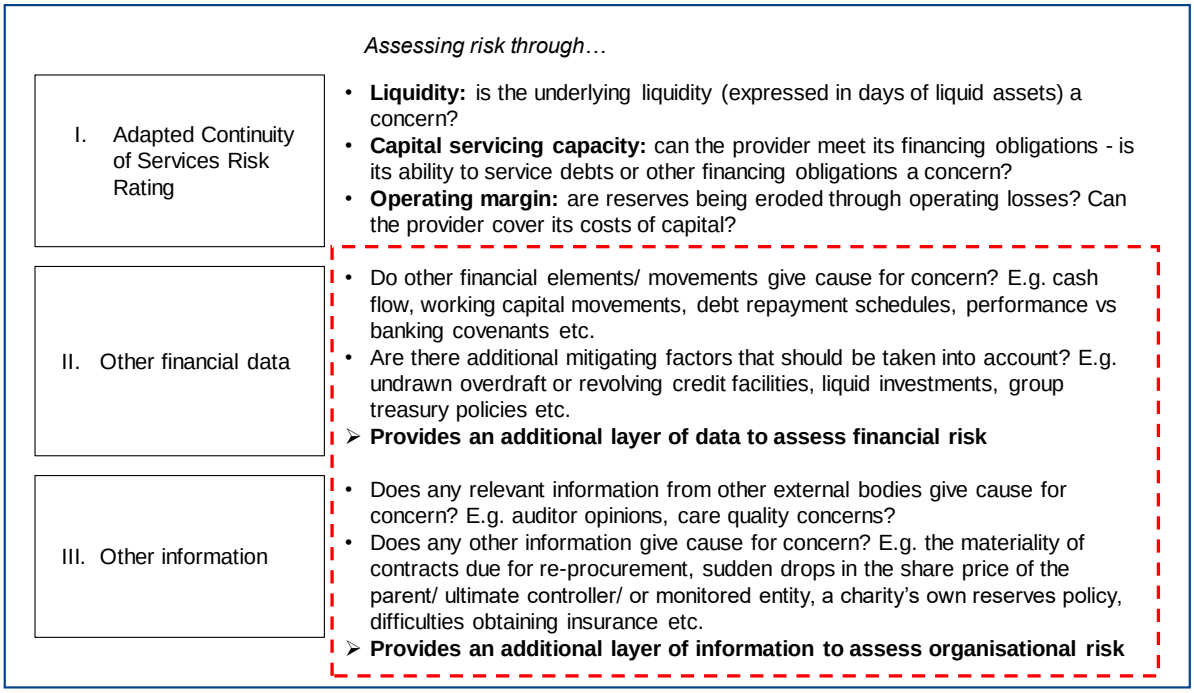
		Overall risk rating			
CRS value	**Forward-looking**	**4**	**3**	**2**	**1**
>£5 million	2 years*	Quarterly	Quarterly	Quarterly/monthly	Monthly
≤£5 million	12 months	Quarterly	Quarterly	Quarterly/monthly	Monthly

*Year 1 in standard template, and Year 2 base case and board-approved downside risk analysis in management's own format.

3.6 Widening the range of factors considered in the overall risk assessment

Figure 5 lists an updated range of factors that may be considered in the overall risk assessment.

Figure 5: Range of factors that may be considered in the overall risk assessment



3.7 Monitoring frequency for CoSRR 3 and 4

Frequency of routine monitoring will be formally established as quarterly, as shown in Table 1.

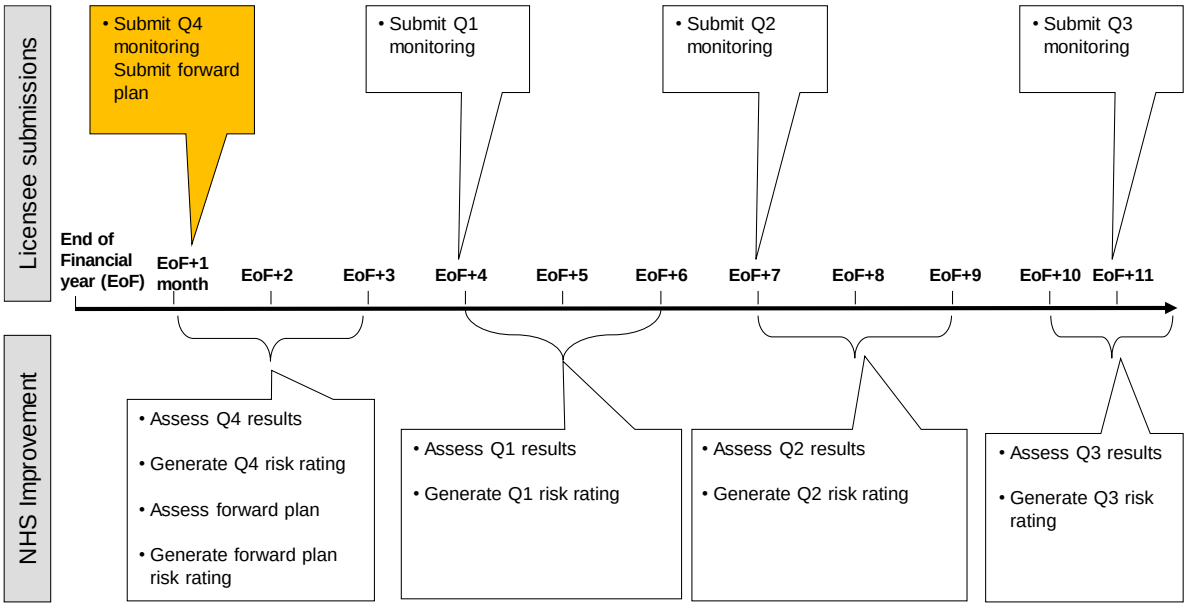
3.8 Monitoring frequency for CoSRR 2

Flexibility will be introduced to monitor providers scoring CoSRR 2 either on a quarterly or monthly frequency according to the nature of risk presented, as shown in Figure 4 above.

3.9 Adjusted annual plan review (APR) timescales for providers of CRS

The Q4 and APR process will be combined to start one month after the financial year end, with one conversation held rather than two, as shown in Figure 6.

Figure 6: Annual plan submission deadline under the updated IPRAF



3.10 Licence condition G4: Fit and proper persons

An annual self-certification against Condition G4 will be introduced to bridge the gap in ongoing monitoring of regulatory compliance. The certification of compliance will be due annually within two months of the financial year end, which will be consistent with the approach to regulating other licence conditions, specifically Condition G6: Systems for compliance with licence conditions and related obligations and CoS 7: Availability of resources.

3.11 Next steps

The approach to the oversight of independent sector providers of NHS services will be kept under review to ensure it remains appropriate and fit for purpose, given any potential changes in the risk environment that emerge in the future.

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Publication approval reference: PAR106