

FINANCIAL REPORTING IN THE HEALTH SERVICE

**Professional 2 examination
June 2000**

MARKING SCHEME



Question 1

(a)
Ashfordly NHS Trust
Income and Expenditure Account
For the year ended 31 March 2000

	Workings	£000	
Income from activities: continuing operations	1	117,020	
Other operating income	2	29,322	1
		146,342	
Operating expenses: continuing operations	3	-142,910	2
Operating Surplus		3,432	
Profit on disposal of fixed assets	4	5	1
Surplus Before Interest		3,437	
Interest receivable	PER TB	630	
Interest payable	PER TB	-780	
Surplus for the Financial Year		3,287	
Public Dividend Capital Dividends	PER TB	-3,285	
Retained Surplus for the Year		2	

Presentation 1

(5)

1 Income from activities

	£000
Income from HA	95,750
Income for PCG	19,300
Income from private patients	1,970
Total	117,020

2 Other income

	£000
Per trial balance	28,880
Donated	
buildings	55
equipment	390
Profit on disposal*	(3)
Total	29,322

* Profit on disposal is released from donations reserve to cancel out profit on the income and expenditure account.

3 Operating expenses: continuing operations

	£000
Miscellaneous costs	7,800
Salaries and wages	95,800
Establishment costs	1,880
Transport costs	300
Premises costs	6,830
Supplies and services	20,870
Other costs	3,260
Depreciation	
Buildings - purchased	2,650
Buildings - donated	55
Equipment - purchased	3,075
Equipment - donated	390
Total	142,910

4 Profit/loss on disposal

	Purchased	Donated
	£000	£000
Equipment	3,260	210
Less depreciation	3,250	210
Net book value	10	0
Capital receipt	12	3
Profit on disposal	2	3

(b)
Ashfordly NHS Trust
Balance Sheet
As At 31 March 2000

	Workings	£000	£000	
Fixed Assets				
Land	1		8,640	1/2
Buildings	1		74,970	2
Equipment	1		34,290	2
Less accumulated depreciation	1		-25,622	1 1/2
AICC	1		250	
			92,528	
Current Assets				
Stocks and WIP	PER TB	2,810		
Debtors	PER TB	9,370		
Investments	PER TB	5		
Bank	PER TB	10		
		12,195		
Creditors: Amounts falling due within one year	PER TB	-13,230		
Net Current Assets			-1,035	
Total Assets Less Current Liabilities			91,493	
Creditors : Amounts falling due after one year	PER TB		-16,000	
Provisions for liabilities and charges	PER TB		-5,000	
Total Assets Employed			70,493	
Financed by				
Capital and Reserves				
Public Dividend Capital	PER TB		51,500	
Revaluation Reserve	2		15,353	2
Donation Reserve	3		3,610	2
Realised donation reserve			3	1/2
Income and expenditure reserve	4		27	1/2
			70,493	

Presentation 2

(13)

Workings

1 Fixed assets

	Land	Buildings	Equipment	AICC
	£000	£000	£000	£000
At cost/revaluation				
Opening balance				
purchased	7,200	66,080	30,700	
donated		1,665	4,510	
Additions				
purchased		1,890	1,250	250
donated		200	420	
Indexation				
purchased	1,320	4,530	770	
donated		120	110	
Revaluation				
purchased	120	3,105		
donated		85		
Disposals				
purchased			-3,260	
donated			-210	
Total	8,640	77,675	34,290	250
Depreciation				
Opening balance				
purchased			22,000	
donated			2,980	
Depreciation				
purchased		2,650	3,075	
donated		55	390	
Indexed depreciation				
purchased			562	
donated			75	
Disposals				
purchased			-3,250	
donated			-210	
Total	0	2,705	25,622	0

2 Revaluation reserve

	£000
Opening balance	6,070
Indexation	
land	1,320
buildings	4,530
equipment	770
Revaluation	
land	120
buildings	3,105
Indexed depreciation	-562
Total	15,353

3 Donation reserve

	£000
Opening balance	3,195
Additions	
buildings	200
equipment	420
Disposals (entries cancel out)	0
Indexation	
buildings	120
equipment	110
Revaluation	
buildings	85
Depreciation	
buildings	-55
equipment	-390
Indexed depreciation	-75
Total	3,610

4 Retained surplus

	£000
Balance b/fwd	25
Surplus	2
Total	27

(c)
Ashfordly NHS Trust
Cash flow Statement
For the year ending 31 March 2000

	Working	£000	£000	
Operating Activities				
Net cash inflow from operating activities	1		6,630	1/2
Returns on Investments and Servicing Finance				
Interest received	TB	630		1/2
Interest paid	TB	-780		1/2
Net cash outflow from returns on investments and servicing finance			-150	
Capital Expenditure				
Payments to acquire tangible fixed assets	TB	-3,390		1/2
Receipts from the sale of fixed assets	TB	15		1/2
Net cash outflow from capital expenditure			-3,375	
Dividends Paid			-3,285	1/2
Net cash outflow before the management of liquid resources and financing			-180	
Management of Liquid Resources				
Purchase of investments				
Sale of investments	(805-5)	800		1/2
Net cash inflow from management of liquid resources			800	
Net cash inflow before financing			620	
Financing				
Public dividend capital received				
Other loans repaid	(16640-16000)	-640		1/2
Net cash outflow from financing			-640	
Decrease in cash	(30-10)		-20	

Reconciliation of operating surplus to net cash inflow from operating activities

	Workings	£000	
Operating surplus before interest		3,432	1/2
Depreciation charge	Note 2	6,170	1/2
Transfer from donation reserve	Note 2	-442	1/2
Increase in stock	2810-2470	-340	1/2
Increase in debtors	9370-8000	-1,370	1/2
Decrease in creditors	13230-14050	-820	1/2
Net cash flow from operating activities		6,630	

(7)
(25)

Question 2

- (a) Appraisal of options

Option 1

Year	Purchase	Discount Rate	Discounted rental
0	300,000	1	300,000
5	-15,000	.735	-11,025
Net present cost			288,975

2

Option 2

Year	Rental	Discount Rate	Discounted rental
0	63,000	1	63,000
1	63,000	.926	58,338
2	63,000	.857	53,991
3	63,000	.794	50,022
4	63,000	.735	46,305
Net present cost			271,656

2

Preferred option is to **lease**.

1
(5)

NB: Candidates using 6% as a discount rate should also be awarded full marks as per EL (97) 71.

- (b) The candidate should then determine whether the lease is treated as a finance lease or an operating lease.

- Discounted lease payments are £271,656. This is 90.552% of the fair value of the asset. 1
- The lessee is committed to paying 90.552% of the fair value of the asset. Therefore it will be treated as a finance lease. 1

Calculation of finance charge:

Total undiscounted minimum lease payments (63,000x5)	£315,000
Capitalised fair value at the inception of the lease	£300,000
Finance charge	£15,000

Charged on a straight line basis £15,000/5 = £3000 per annum

3

It will be accounted for as follows:

Asset will be capitalised onto the balance sheet:

Dr	Fixed assets	£300,000
Cr	Creditors	£300,000

With the fair value of the minimum lease payments. 1

Asset will be depreciated each year.

Dr	Income and expenditure account	£60,000
Cr	Provision for depreciation	£60,000

Calculated on a straight line basis i.e. $\text{£}300,000/5 = \text{£}60,000$ 2

Payment of rental to the lessor

Dr	Income and expenditure account	£3,000
Cr	Finance charges	£3,000
Dr	Finance charges	£3,000
Cr	Cash/bank	£3,000

1

The finance charge element of the lease payment

Dr	Creditors	£60,000
Cr	Cash/bank	£60,000

1

The Trust is not required to include finance lease assets when calculating the capital cost absorption duty. 1

The risk rests with the lessee. It will be counted against the EFL of the Trust. 1
(12)

- (c) The candidate should show that they understand that there is a revenue consequence of all capital acquisitions. In the above example there is a continuing need to depreciate the asset over its life and the finance charges will be a charge against income. In addition, reference should be made to the following:

- Direct staffing of the new equipment
- Running costs (electricity etc)
- Consumable costs (eg dialysis fluids, paper etc)
- Space occupied
- Any opportunity costs
- Cleaning/domestic costs
- Additional support staff costs
- Trust overheads

The Trust also needs to consider the implications on prices.

(1 mark per point discussed up to a maximum of 8)
(25)

Question 3

(a)

(i) What are HRGs?

HRGs are nationally recognised groups of diagnoses and procedures. Each HRG includes diagnoses and procedures which are iso-resource (consume similar amounts of resource) and homogenous (clinically similar).

3

(ii) How are HRGs used?

- The White Paper 'The new NHS' introduced the concept of reference costs as part of the strategy to deal with unacceptable variations in performance and to raise quality and standards - by sharing and comparing information rather than improvement through competition
- Trusts are required to produce costed HRGs and submit results to NHS(HQ). A single data base is produced (national schedule of reference costs).
- The data base presents retrospective unit costs for individual hospital procedures to enable comparison between one trust and another.
- The reference cost index is derived by comparing the total costs of HRG activity for an individual Trust to the equivalent cost of the same activity using the national average unit cost. Hence a high cost trust will have units costs greater than the national average producing an index greater than 100, where 100 would be the average.

4

(iii) Issues for credible information:

- Clinical coding that is accurate, complete in sufficient depth, and standardised
- Financial information that is accurate, complete, to an appropriate level, based on standardised costing methods
- Has the involvement and agreement of clinicians
- Figures should not be viewed in isolation. Hospital performance cannot be viewed as good or bad on the basis of cost alone. Clinical indicators will contribute to a more balanced picture.

1 1/2

1 1/2

1

1

(5)

(12)

(b)

The candidate should calculate performance indicators to illustrate the differences between the three Trusts:

- Activity levels

Comparison between 98/99 & 99/00	FCEs	Emergency Admissions
Wells	? 7%	? 18%
Shole	? 27%	? 6
Drume	? 6%	N/A *

* Drume does not have an A&E Department

- Average length of stay

Wells	1998/99	50412/10471	= 4.8 days
	1999/00	52612/11241	= 4.7 days
Shole	1998/99	39754/7423	= 5.4 days
	1999/00	41524/9421	= 4.4 days
Drume	1998/99	3752/3457	= 1.1 days
	1999/00	4120/3678	= 1.1 days

- Quality

	Waiting time (days)		Comparison between 98/99 & 99/00	Cancelled theatre sessions as a percentage of scheduled sessions	
	98/99	99/00		98/99	99/00
Wells	41	39	?4.87%	30/1,642 = 1.83%	33/1,680 = 1.96%
Shole	56	63	?12.5%	18/841 = 2.14%	15/829 = 1.81%
Drume	39	41	?5.13%	10/351 = 2.85%	10/365 = 2.74%

Management costs per unit

Wells	1998/99 = 81,251/10,471	= £7.76	
Wells	1999/00 = 91,422/11,241	= £8.13	Gone up
Shole	1998/99 = 72,888/7,423	= £9.82	
Shole	1999/00 = 70,124/9,421	= £7.44	More efficient
Drume	1998/99 = 30,122/3,457	= £8.71	
Drume	1999/00 = 32,122/3,678	= £8.73	Consistent

Shole Trust looks to be most efficient in terms of management expenditure.

- Consultant staff to patient ratio

Wells 1998/99 = $10471/8 = 1309:1$
Wells 1999/00 = $11241/9 = 1249:1$
Shole 1998/99 = $7423/8 = 928:1$
Shole 1999/00 = $9421/8 = 1178:1$
Drume 1998/99 = $3457/4 = 864:1$
Drume 1999/00 = $3678/3 = 1226:1$

Possible problem with Drume as ratio has gone up considerably. This is also the case with Shole. Wells has gone down, this may indicate better quality.

- Cost per member of staff

	Direct Cost per FCE (£)		Comparison between 98/99 & 99/00
	98/99	99/00	
Wells	$2,784,102/10471$ = 265.89	$2,894,120/11,241$ = 257.46	?3.17%
Shole	$2,471,812/7,423$ = 332.99	$2,644,100/9,421$ = 280.66	?15.7%
Drume	$1,021,078/3,457$ = 295.37	$1,198,432/3,678$ = 325.84	?10.3%

- Management costs as a percentage of direct costs

Wells 1998/99 = $81251/2784102 = 2.9\%$
Wells 1999/00 = $91422/2894120 = 3.2\%$
Shole 1998/99 = $72888/2471812 = 2.9\%$
Shole 1999/00 = $70124/2644100 = 2.7\%$
Drume 1998/99 = $30122/1021078 = 3.0\%$
Drume 1999/00 = $32122/1198432 = 2.7\%$

- Credit should be given for other relevant PIs calculated.

1 mark for each set of ratios each looking at every Trust for both years to a maximum of 6

1 mark for each valid comment made up to a maximum of 3

Limitations:

- No standard to measure figures;
- Only measures one aspect of quality;
- No detail on the type of trust;
- They focus on inputs and processes but do not cover outcomes;

- No detail on type of Trust, hence no idea about casemixes, hence cannot say comparisons are like with like;
- No guarantee as to the accuracy of the information provided on the Trusts;
- PIs are not an end in themselves, they do not provide explanations and should be used as a base for further investigations.

1 mark per valid point made to a maximum of 4

(13)

(25)

Question 4

(a)

**Surgical Directorate Summary (subjective)
Month 9**

Description	Annual Budget £000	Budget for Month £000	Expenditure in Month £000	Cumulative Budget £000	Expenditure to Date £000	Variance £000	
Pay							
Medical Staff	410	34.17	32.76	307.53	306.41	(1.12)	
Nursing Staff	2657.40	221.45	273	1993.05	2237	243.95	<i>I</i>
Technical Staff	320	26.67	26.60	240.03	239.60	(0.43)	
Clerical Staff	168	14	12.40	126	114	(12)	
Domestic Staff	154	12.83	13.05	115.47	130.20	14.73	
Total Pay	3709.4	309.12	357.81	2782.08	3027.21	245.13	
Non Pay							
MSSE	500	41.67	75.16	375.03	407.01	31.98	<i>I</i>
Drugs	620	51.67	49.03	465.03	401.40	(63.63)	
Provisions	120	10	10.10	90	91	1	
Other consumables	85	7.08	5.20	63.72	51.70	(12.02)	
Central admin							
Overhead	220	18.33	18.70	164.97	168.27	3.30	<i>I</i>
Capital charges	140	11.67	11.67	105.03	105.03	0	<i>I</i>
Diagnostic service charge	260	21.67	23.44	195.03	210.98	15.95	<i>I</i>
Total non pay	1945	162.09	193.30	1458.81	1435.39	(23.42)	
Total	5654.4	471.21	551.11	4240.89	4462.60	221.71	

NB: Candidates are not required to reproduce the budget statement but marks should be given as indicated for evidence of the necessary amendments.

Comments:

- Directorate is showing a large overspend amounting to 5% of the budget;
- Main cause is nursing staff;
- Non pay is currently under spent;
- Elements of the non pay are not controllable (central charges);
- Medical and surgical equipment is over spent (another result of flu outbreak?);
- Forecast year end overspend is £295.610

- Drugs are underspent by £63,630 (14%), which may need further investigation in light of the flu outbreak;
- The diagnostic services are overspent by £15,950, however these charges are merely estimated based on information from Months 1-4.

*½ mark per point max 3
(8)*

(b) The candidate should be critical in the light of the principles of budgetary control in general and also in terms of devolved budgets.

- Central charges are not controllable by directorates – centrally determined and not agreed.
- Statistics are not kept up to date – system is not satisfactory as does not provide timely information. Also a need to ensure that the apportionment method used is valid.
- Accruals are not made regarding equipment received.
- Capital charges are allocated at the year end. Part is for expenditure over which the directorate has no control (land and buildings).
- The business manager does not understand how expenditure on capital will have a revenue consequence and therefore impact on the capital charge of the directorate.
- Input of pay awards is not timely.
- There are no regular meetings between the business manager and finance.
- Any other relevant comments made

The candidate should then make suggestions on how the situation could be improved:

- Service level agreements between departments, these would be determined at the start of the year. Identification of business units (some description here as to how they would operate).
- Workshop on budgets/capital charge implications to enhance understanding.
- Regular monthly meetings.
- Review of apportionment methods used to charge central overheads or SLAs.
- Information should be provided about budgeted and actual WTE/FTEs to enable the Pay section to be more informative.
- Variations could be additionally presented as percentages in order to assist in the assessment of materiality of any potential problems.
- The financial information should be linked to and viewed in the light of activity information. This is especially important in times of increased levels of activity above those budgeted for.
- Any other relevant comment made

*1 mark per point max 12
(12)*

(c) Benefits at organisation and directorate level:

- Enhance managerial accountability;
- Movement of decision making process from the centre to those delivering end product;
- Increased understanding leading to goal cohesion and achievement of organisational objectives;
- Staff development;
- Potential to reduce overall costs;
- Any other relevant comment made.

1 mark per point up to a maximum of 5
(5)

(25)

Question 5

OLM page 51 and Update 1999 OLM page Funds Flow

- Government allocation of tax and NI to the NHS - voted, based on findings of the comprehensive spending review (CSR). Award given if PES referred to.
- Allocation is directed by government policy that is implemented by the NHSE.
- NHSE allocates funds to HA according to GP registered population based funding formula based on the local populations assessed need which includes adjustments for social deprivation and relative death rates.
- Most of HA allocation is distributed to Primary Care Groups (dependent upon level) for the commissioning of healthcare based on size of population and referral patterns.
- HA also pays GPs, dentists, pharmacists and opticians in accordance with their contracts from a separate allocation.
- PCG or HA negotiate service agreements with providers of healthcare in line with HIP.
- NHSTs retain surpluses and pay public dividend capital dividends to NHSE.

1 mark per point fully explained to a maximum of 5

OLM page 13 Objectives of public service reporting

- To prove accountability for stewardship of public money
- To plan resources and monitor budgets
- To assess the performance and efficiency of management
- To check that the organisation is meeting legal and contractual requirements
- To comply with the concept of open government
- To provide a source of facts and figures for the stakeholders

1 mark per point to a maximum of 4

OLM page 47 Characteristics of creditable information

- Relevant
- Accurate
- Comprehensive
- Compliant
- Timely
- Understandable

½ mark per point fully explained to a maximum of 3

OLM page 20 Influences on NHS reporting

- Users and their needs
- Statutory framework (NHS 1977, 1989, 1997, 1999 Acts, CA1985 (89))
- Applicable accounting and reporting standards (SSAP 2, 18, FRS1, 3, 8, 11, 12)
- Other guidance eg DOH guidance (manual of accounts)

1 mark per point fully explained to a maximum of 4

OLM page 89 Financial Statement

- Income and expenditure account follows FRS 3 format, details surplus/deficit and public dividend capital dividends (In PLC profit and loss account also follows FRS 3 format, details profit/loss, appropriation section covering tax, dividends and transfers to reserves).
- Balance Sheet for NHS Trust details public dividend capital, donation reserves (In PLC share capital, other reserves including share premium, capital redemption, general).
- Cash flow Statement follows FRS 1 (In PLC taxation and financing sections differ).
- Statement of recognised gains and losses follows FRS 3 covers fixed asset valuations and donated assets (In PLC donated assets tend not to be represent).

1 mark per point fully explained to a maximum of 4

Performance measures and organisations

- To break-even after paying dividends
- To stay within the EFL
- To achieve 6% capital cost absorption rate
- To pay non NHS invoices within 30 days
- NHS executive
- Audit commission
- Health service ombudsman

1 mark per point fully explained to a maximum of 4

Presentation 1

(25)