

FINANCIAL REPORTING IN THE HEALTH SERVICE

Professional 2 examination **5 June 2001**

From 10.00 am to 1.00 pm,
plus ten minutes reading time from 9.50 am to 10.00 am.

Instructions to candidates

Answer *four* questions in total: *both* questions from *Section A*, and *two* questions from *Section B*.
The marks available for each question are shown in italics in the right-hand margin.

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examinations room.

Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

SECTION A (Answer both questions)**1**

The following trial balance relates to Muntford NHS Trust for the year ended 31 March 2000:

	£000	£000
NHS patient care income		61,400
Private patient income		600
Other income		16,200
Interest received		45
Salaries and wages	41,300	
Supplies and services	13,200	
Establishment expenses	9,245	
Other expenditure	6,900	
Dividends paid	3,800	
Land	8,200	
Buildings	72,500	
Equipment – NHS	12,050	
Equipment – donated	760	
Accumulated depreciation – NHS		3,100
Accumulated depreciation – donated		200
Stock (as at 1 April 1999)	190	
Suspense account	2,442	
Creditors < 1 year		6,200
Provisions for liabilities and charges		180
Debtors	2,050	
Cash	230	
Public dividend capital		74,620
Revaluation reserve		9,562
Donation reserve		560
Income and expenditure reserve		200
	<u>172,867</u>	<u>172,867</u>

Additional information

- (i) On 1 April 1999 there was a revaluation of the land and buildings by the District Valuer. The asset values are to be altered by the following amounts:

Land valued downwards by	£250,000
Buildings valued upwards by	£320,000

The land impairment is due to market forces and there is a credit balance of £300,000 in the revaluation reserve relating to this land.

- (ii) The following capital purchases occurred during the year.

Item	£000	Notes
Land	850	Purchased August 1999
Buildings	1,500	Purchased January 2000
Equipment – purchased	150	Purchased December 1999
	<u>2,500</u>	

These transactions are currently recorded in a suspense account.

- (iii) During November 1999, equipment valued at £32,000 was donated to the Trust. This is not recorded in the trial balance.
- (iv) Equipment originally purchased in May 1997 was sold during the last quarter of the year for £58,000. The equipment had a gross current cost of £97,000 as at 31 March 1999. The capital receipt is recorded in the suspense account.
- (v) Indexation has not yet been applied. The following indices apply:
- | | |
|-----------|------|
| Land | 0.5% |
| Buildings | 2.5% |
| Equipment | 1% |
- (vi) Depreciation for 1999/2000 is not included in the trial balance. Buildings are depreciated using a remaining life of 50 years and all equipment is depreciated over a 12 year standard life.
- (vii) A provision is to be made for costs relating to preparation for the Euro. The value of this provision is £35,000.
- (viii) Public Dividend Capital dividends still owed at the end of the year amount to £1,200,000. This is not reflected in the trial balance.
- (ix) Stock as at 31 March 2000 was valued at £150,000.

- (x) The Trust has recently been notified about an unfair dismissal case brought by a disgruntled former employee. The possible future costs and probabilities have been estimated:

	Probability	Outcome
Trust wins case	0.2	£10,000 legal fees incurred
Trust loses, minimum payout	0.1	£40,000 compensation including legal fees
Trust loses, maximum payout	0.7	£100,000 compensation including legal fees

The case is expected to be settled in 2 years time, so a provision needs to be made (discounted for two years at 6% per annum).

• **Requirement for question 1**

- (a) Prepare the income and expenditure account for the year ended 31 March 2000. 9
- (b) Prepare the balance sheet as at 31 March 2000. 16
- (25)

2

The following information relates to Oldhampton NHS Trust:

	31 March 2000		31 March 1999	
	£000	£000	£000	£000
Fixed assets				
Tangible assets		70,690		71,280
Current assets				
Stocks and WIP	850		750	
Debtors	2,445		2,655	
Cash	30		50	
	3,325		3,455	
Creditors: due within one year	(3,850)		(4,280)	
Net current liabilities		(525)		(825)
Total assets less current liabilities		70,165		70,455
Creditors: due after one year (finance lease)		(800)		(1,000)
Provisions for liabilities and charges		(690)		(380)
Net assets employed		68,675		69,075
Financed by:				
Public dividend capital		64,000		64,500
Revaluation reserve		2,830		2,680
Donation reserve		1,220		1,200
Income and expenditure reserve		625		695
Total capital and reserves		68,675		69,075

Additional information

(i) Fixed assets breakdown:

	31 Mar 2000	31 Mar 1999
	£000	£000
Donated	1,220	1,200
Other assets	69,470	70,080
	70,690	71,280

(ii) Depreciation provided for the year ended 31 March 2000:

Donated assets	£105,000
NHS owned assets	<u>£2,845,000</u>
	<u>£2,950,000</u>

(iii) During 1999/2000, a net profit of £40,000 was made on fixed assets disposed of during the year. Their net book value was £350,000. Payments to acquire fixed assets amounted to £2,435,000.

(iv) Year end debtor balances consisted of:

	31 Mar 2000	31 Mar 1999
	£000	£000
Operating activities	2,420	2,650
Interest receivable	25	5
	<u>2,445</u>	<u>2,655</u>

- (v) Year end creditor balances consisted of:

	31 Mar 2000	31 Mar 1999
	£000	£000
Operating activities	3,650	3,980
PDC dividends	200	300
	<u>3,850</u>	<u>4,280</u>

- (vi) Included within fixed assets is a piece of equipment acquired under a finance lease arrangement. The net book value of this equipment at 31 March 1999 was £1,000,000 and at 31 March 2000 its net book value was £850,000. During the year the following payment was made relating to this asset:

Principal	£200,000
Interest	<u>£80,000</u>
	<u>£280,000</u>

All relevant accounting entries relating to this transaction have been made, and the Trust has no other finance leases.

- (vii) During 1999/2000, interest receivable amounting to £135,000 was credited to the income and expenditure account, and PDC dividends payable amounting to £4,000,000 were debited. The only interest payable was that which related to the finance lease (see note (vi)).

- **Requirement for question 2**

- (a) Prepare the reconciliation of operating surplus to net cash flow from operating activities (note 1 to the cash flow statement). 6
 - (b) Prepare the cash flow statement for Oldhampton NHS Trust for the year ended 31 March 2000. 7
 - (c) Prepare the reconciliation of net cash flow to movement in net debt (note 2) and the analysis of changes in net debt (note 3). 6
 - (d) The external financing limit was set at £(500,000) for 1999/2000. Explain what this means and show how the Trust has performed against this target. 6
- (25)

SECTION B (Answer two questions)

3

You are the capital accountant of Allsorts NHS Trust.

For the financial year 2001/2002 you are considering how to finance the following assets which will form part of the capital programme for that year:

	Patient administration system	Microbiology system	Payroll system
Asset number	1	2	3
Status	Outline Business Case	Full Business Case	Statement of Need
Fair value of asset (cost if purchased)	£850,000	£225,000	£135,000
Annual lease payments (made in advance)	£135,000 (inflated annually in line with general inflation)	£35,000 (inflated annually in line with general inflation)	£28,000 (fixed for term of lease)
Lease term (years)	8	7	5
Residual value	£70,000 (will inflate in line with RPI)	£20,000 (will inflate in line with RPI)	NIL

The public sector discount rate is 6% (real). General inflation is expected to be 2.83% per year over the next 10 years.

In addition, a finance lease for a radiology system with a fair value of £300,000 has just been signed. The lease term is 10 years which is the period the asset is expected to last for. The annual lease payment has been fixed at £38,000 per year.

• **Requirement for question 3**

Produce a briefing paper which:

- (a) Identifies how each of the assets 1 to 3 above should be financed. 11
- (b) Shows all the accounting journal entries for the radiology system in its first year. Assume the principal repayment is straight line. 5
- (c) Explains how the private finance initiative can be used to acquire the use of capital assets. Include a description of the characteristics of such an arrangement and the possible benefits to be gained from it. 5
- (d) Give two examples of ASB accounting standards which are important in respect of defining how private finance schemes should be accounted for. Explain the requirement of each in respect of privately financed assets. 4

(25)

4

The following trial balance relates to Humbug Health Authority for the year ended 31 March 2000:

	£000	£000
Land	540	
Buildings	810	
Equipment		
Gross replacement cost	400	
Accumulated depreciation		200
Debtors / Creditors	8,140	6,830
Cash	120	
Provisions for liabilities and charges		1,300
Capital account		1,475
Revaluation account		75
Income and expenditure account		320
Purchase of healthcare	193,280	
Establishment expenses	974	
Salaries and wages	1,496	
Supplies and services	8	
Health promotion expenditure	892	
Suspense account		120
DoH income		196,265
Nursing home inspection income		75
	<u>206,660</u>	<u>206,660</u>

The following additional information is relevant to the preparation of the Health Authority accounts:

- (i) The income from the Department of Health in the trial balance excludes capital charges for Humbug Health Authority. The estimate of capital charges for the year is £220,000.
- (ii) Details relating to fixed assets held at the start of the year (1 April 1999) are:

	Revaluation for 1999/2000	Indexation for 1999/2000	
Land	+£60,000	1%	
Buildings	+£90,000	3%	Remaining life 40 years
Equipment		2%	Standard life 5 years

- (iii) During 1999/2000, land with a current replacement cost of £120,000 was disposed of. Proceeds of £120,000 were paid into the Health Authority bank account and the opposite entry was made to a suspense account. This money will be paid back to the Department of Health early in 2000/2001. The revaluation account contains accumulated revaluations totalling £35,000 which relate to this land.
- (iv) The following fixed asset acquisitions occurred during 1999/2000:

Category	£	Date acquired
Buildings (50 year remaining life)	150,000	30 March 2000
Equipment (5 year standard life)	60,000	30 March 2000

These transactions have not yet been recorded in the accounts.

- **Requirement for question 4**

- (a) Calculate depreciation and interest for Humbug Health Authority for the financial year 1999/2000. 5
 - (b) Prepare the income and expenditure account and balance sheet for Humbug Health Authority for the year ended 31 March 2000. 13
 - (c) Explain the following:
 - (i) What is a HImP, what should be contained within it and how is it used to help achieve national healthcare priorities?
 - (ii) What are PCGs and PCTs? 7
- (25)

5

The Non-Executive Directors of Green Trees NHS Trust regularly request papers from experts in different departments to help them understand the complex and changing issues surrounding the NHS. Your Chief Executive has just received the following memo:

MEMORANDUM

To: Steven Quirel, Chief Executive
From: Graham Branch, Non-Executive Director
Date: 5 June 2001

Subject: Funding and Accountability Issues

At our last board meeting, funding and accountability issues relating to Green Trees NHS Trust were briefly discussed. I gathered that our main source of funding was our local Health Authority, and that the Annual Report was our main means of being held accountable for how those funds are spent.

However, I am sure the story is more complicated than this and would greatly appreciate some further guidance. Specifically, would you be able to elaborate on the following:

On the funds flow issue, how do our main *revenue* funds flow from the Parliamentary Vote into our Trust? Please identify:

- Which NHS bodies are involved in the allocation process? and
- How their relative share of funding is decided?

I am sure that there are other 'pots of funding' which are treated differently to the normal revenue stream. So could you let me know what other sources of funding exist, and briefly explain how these funds find their way to Green Trees NHS Trust?

Does capital funding come by the same route as revenue funding? If not, could you explain how the Trust obtains the funds for purchasing buildings and equipment?

Concerning accountability, could you explain exactly what should be included within the Trust's Annual Report? I understand that there are a number of mandatory inclusions and some recommended ones.

I am also sure that there are ways, other than the Annual Report, in which we are held accountable for the use of NHS resources. Could you explain how we as a Trust are monitored in year, and could you describe other ways in which we are held accountable to the public and to patients?

Many thanks.

- **Requirement for question 5**

Draft a response to the above memo which addresses the above queries as clearly as possible. Specifically:

- | | | |
|-----|---|------|
| (a) | Describe how revenue funds flow from Parliament to Green Trees NHS Trust. Identify the bodies involved in the allocation process and the means by which fair shares of resources are decided. | 6 |
| (b) | Identify four other sources of revenue funding and explain how they are obtained. | 4 |
| (c) | Explain how funds for the purchase of capital assets are obtained by the Trust, and how capital funds flow from Parliament down to Green Trees NHS Trust. | 4 |
| (d) | Identify the main items which should be present within Green Trees NHS Trust's Annual report. State which are mandatory and which are recommended. | 6 |
| (e) | Explain how Green Trees NHS Trust is monitored in year, and describe ways other than the Annual Report in which Green Trees NHS Trust is held accountable for the use of its resources. | 5 |
| | | (25) |