

FINANCIAL REPORTING IN THE HEALTH SERVICE

Professional 2
June 2001

MARKING SCHEME

Question 1

(a) **Muntfield NHS Trust**
Income and Expenditure Account for the year ended 31 March 2000

		£000	
Income from activities	(W.1)	62,000	1/2
Other operating income	(W.2)	<u>16,265</u>	1
		78,265	
Operating expenses	(W.3)	<u>(73,363)</u>	4
Operating surplus		4,902	
Loss on disposal of fixed asset	(W.4)	<u>(18)</u>	2
Surplus before interest		4,884	
Interest receivable	(per trial balance)	<u>45</u>	
Surplus for financial year		4,929	
Public dividend capital dividends payable	(W.5)	<u>(5,000)</u>	1/2
Retained deficit for the year		<u>(71)</u>	
		<i>Presentation</i>	1
			(9)

Working 1

		£000	
NHS patient care income	(T.B.)	61,400	
Private patient income	(T.B.)	<u>600</u>	
		62,000	1/2

Working 2

Other income	(T.B.)	16,200	
From donation reserve		<u>64.63</u>	
		<u>16,264.63</u>	1

Working 3

Salaries and wages	(T.B.)	41,300	
Supplies and services	(T.B.)	13,200	
Establishment	(T.B.)	9,245	
Other expenditure	(T.B.)	6,900	
Stock	190-150	40	1/2
Provision	(vii)	35	
Employee provision	(ix)	68	2
Depreciation buildings	(cap charges)	1,493	1/2
Depreciation equipment	(cap charges)	1,017	1/2
Depn donated equipment	(cap charges)	<u>65</u>	1/2
		<u>73,363</u>	

Employee provision

Probability	Payout	Expected Value
	£000	£000
0.2	10	2
0.1	40	4
0.7	100	70
Total		<u>76</u>

Discount for 2 years at 6% = 67.64 provision

Working 4

	£000	
Opening GCC	97	
Indexation at 1%	<u>0.97</u>	
Disposal GCC	97.97	1/2
Accumulated depreciation 11 quarters out of 48	11/48 x 97.97	
	<u>(22.45)</u>	1
Disposal NBV	75.52	
Proceeds	<u>58.00</u>	
Loss on disposal	<u>17.52</u>	1/2

Working 5

	(T.B.)	£000	
Dividends paid	(viii)	3,800	
Dividends owed at end of year		<u>1,200</u>	
		<u>5,000</u>	1/2

(b)

Muntford NHS Trust
Balance Sheet as at 31 March 2000

		£000	£000	
Fixed Assets				
Land	(Cap charges)	8,840		1
Buildings	(Cap charges)	74,648		1
Equipment	(W.1)	<u>8,629</u>		4
			92,117	
Current Assets				
Stock	(ix)	150		1/2
Debtors	(T.B.)	2,050		
Cash	(T.B.)	<u>230</u>		
		2,430		
Creditors < 1 year	(W2)	<u>(7,400)</u>		1/2
Net current assets			(4,970)	
Total assets less current liabilities			87,147	
Provisions	(W3)		<u>(283)</u>	2
Total assets employed			<u>86,864</u>	
Public dividend capital	(T.B.)		74,620	
Revaluation reserve	(W4)		11,582	3 1/2
Donation reserve	(W5)		533	2
Income and expenditure reserve	(W6)		<u>129</u>	1/2
Total capital and reserves			<u>86,864</u>	
				<i>Presentation</i> 1
				(16)
				(25)

Working 1

		£000		
NHS - GCC	(Cap charges)	12,222.53		
NHS – Acc Depn	(Cap charges)	(4,125.88)		
Donated GCC	(Cap charges)	799.60		
Donated acc depn	(Cap charge s)	<u>(266.63)</u>		
		<u>8,629.62</u>		

Working 2

		£000		
Creditors < 1yr	(T.B.)	6,200		
PDC dividends owed	(vii)	<u>1,200</u>		1/2
		<u>7,400</u>		

Working 3

Opening balance	(T.B.)	180	<i>1/2</i>
Euro provision	(vi)	35	<i>1/2</i>
Unfair dismissal	(ix)	<u>67.64</u>	<i>1</i>
		<u>282.64</u>	

Working 4

Revaluation reserve	(T.B.)	9,562	
Revaluations			
Land	(cap charges)	(250)	<i>1</i>
Buildings	(cap charges)	320	<i>1/2</i>
Indexation			
Land	(cap charges)	39.75	<i>1/2</i>
Buildings	(cap charges)	1,820.50	<i>1/2</i>
Equipment	(cap charges)	120.5	<i>1/2</i>
Equipment depreciation	(cap charges)	<u>(31)</u>	<i>1/2</i>
		<u>11,581.75</u>	

Working 5

Donation reserve	(T.B.)	560	
Addition	(iii)	32	<i>1/2</i>
Release to other income	(cap charges)	(64.63)	<i>1/2</i>
Indexation	(cap charges)	7.6	<i>1/2</i>
Depreciation	(cap charges)	<u>(2)</u>	<i>1/2</i>
		<u>532.97</u>	

Working 6

Brought forward I&E reserve	(T.B.)	200	
1999/2000		<u>(71)</u>	<i>1/2</i>
		<u>129</u>	

Capital charges (all £000)

Land	Q1	Q2	Q3	Q4	Total	
Opening NBV	8,200	7,989.75	8,839.75	8,839.75	8,200	
Revalue	(250)				(250)	1/2
Index	39.75				39.75	1/2
Depreciation						
Addition		850			850	1/2
Disposal						
Closing NBV	7,989.75	8,839.75	8,839.75	8,839.75	8,839.75	1/2

Buildings	Q1	Q2	Q3	Q4	Total	
Opening NBV	72,500	74,267.30	73,894.10	73,520.89	72,500	
Revalue	320				320	1/2
Index	1,820.50				1,820.50	1/2
Depreciation	(373.20)	(373.20)	(373.20)	(373.20)	(1,492.81)	1/2
Addition				1,500	1,500.00	1/2
Disposal						
Closing NBV	74,267.30	73,894.10	73,520.89	74,647.6	74,647.69	1/2

Equipment NHS	Q1	Q2	Q3	Q4	Total	
Opening GCC	12,050	12,170.50	12,170.50	12,320.50	12,050	
Index	120.50				120.50	1/2
Addition			150		150	1/2
Disposal				(97.97)	(97.97)	1/2
Closing GCC	12,170.50	12,170.50	12,320.50	12,222.53	12,222.53	1/2

Accum depn NHS	Q1	Q2	Q3	Q4	Total	
Opening GCC	3,100	3,384.55	3,638.10	3,891.66	3,100	
Index	31				31	1/2
Disposal				(22.45)	(22.45)	1/2
Charge for quarter	253.55	253.55	253.55	256.68	1,017.33	1/2
Closing GCC	3,384.55	3,638.10	3,891.66	4,125.88	4,125.88	1/2

Equipment donated	Q1	Q2	Q3	Q4	Total	
Opening GCC	760	767.60	767.60	799.60	760	
Index	7.60				7.60	½
Addition			32		32	½
Disposal					0.00	
Closing GCC	<u>767.60</u>	<u>767.60</u>	<u>799.60</u>	<u>799.60</u>	<u>799.60</u>	½

Accum depn donated	Q1	Q2	Q3	Q4	Total	
Opening GCC	200	217.99	233.98	249.98	200	
Index	2				2	½
Disposal					0.00	
Charge for quarter	15.99	15.99	15.99	16.66	64.63	½
Closing GCC	<u>217.99</u>	<u>233.98</u>	<u>249.98</u>	<u>266.63</u>	<u>266.63</u>	½

Question 2

(a) **Note 1 of cash flow statement**

Reconciliation of operating surplus to net cash flow from operating activities:

	£000	
Total operating surplus (i)	3,835	2½
Add depreciation	2,950	½
Less transfer from donation reserve	(105)	1
Increase in stocks (850–750)	(100)	½
Decrease in debtors (2,420 – 2,650)	230	½
Decrease in creditors (3,650 – 3,980)	(330)	½
Increase in provisions (690 – 380)	310	½
Net Cash inflow from operating activities	<u>6,790</u>	

(6)

(i) Calculation of operating surplus:

	£000
Deficit for year (625 – 695)	(70)
Add back PDC dividends payable	4,000
Add back interest payable	80
Take off interest receivable	(135)
Take off profit on disposal	<u>(40)</u>
Operating surplus	<u>3,835</u>

(b)

Oldhampton NHS Trust
Cash Flow Statement for the year ended 31 March 2001

	£000	£000	
Operating Activities			
Net cash inflow from operating activities		6,790	½
Returns on investments and servicing of finance			
Interest received [135+5-25]	115		1
Interest element of finance leases <u>(80)</u>		½	
Net cash inflow from returns on investments and servicing of finance		35	
Capital Expenditure			
Payments to acquire tangible fixed assets	(2,435)		½
Receipts from sales [350+40] <u>390</u>		1	
Net cash outflow from capital expenditure		(2,045)	
Dividends paid [4,000+300-200]	<u>(4,100)</u>	1	
Net cash outflow before management of liquid resources and financing		680	
Financing			
PDC capital repaid	(500)		½
Principal repayment of finance lease	<u>(200)</u>		½
Net cash outflow from financing	<u>(700)</u>		
Decrease in cash		<u>(20)</u>	½
		<i>Presentation</i>	1
			(7)

(c)

Reconciliation of net cash flow to movement in net debt (Note 2)

	£000	
Decrease in cash in the period	-20	½
Cash out flow from capital lease payment	200	½
Change in net debt resulting from cash flows	<u>180</u>	½
Net debt at 1 April 1999	-950	1
Net debt at 31 March 2000	<u>-770</u>	1
Presentation		½

Analysis of changes in net debt (note 3)

	As at 1 April 1999 £000	Cash Flow £000	As at 31 March 2000 £000	
Cash at bank and in hand	50	-20	30	1
Finance Lease	-1,000	200	-800	½
Debt due after one year	<u>-950</u>	<u>180</u>	<u>-770</u>	½

(6)

(d) External Financing Limit

The external financing limit is set by the Regional Office of the NHS Executive. The EFL is set in relation to the agreed capital programme for the coming year. The difference between the agreed capital programme and the internally generated cash (from depreciation charges, sales of fixed assets, working capital management) is the EFL. If the EFL is negative, the Trust should generate more cash internally than it needs for its agreed capital programme. Cash is likely to need to be repaid to the NHSE through repayment of Public Dividend Capital. If the EFL is positive, cash needs to be provided to the Trust in the form of additional PDC.

3

EFL

From Cash (inflow) before financing -680

OR

Decrease in PDC -500

Decrease in Finance Lease -200

Decrease in cash 20

EFL -680

2

The external financing requirement was in fact less than the EFL £(500,000), so more cash was generated internally than was predicted so the EFL has been undershot.

1

(6)

(25)

Question 3

(a)

Year	Discount Factor		Patient Admin System				Microbiology System				Payroll System			
	Real	Nominal	Rental		Purchase		Rental		Purchase		Rental		Purchase	
			Real	Discount	Cashflow	Discount	Real	Discount	Cashflow	Discount	Nominal	Discount	Cashflow	Discount
			£	£	£	£	£	£	£	£	£	£	£	£
0	1	1	135000	135000	850000	850000	35000	35000	225000	225000	28000	28000	135000	135000
1	0.9434	0.9174	135000	127359			35000	33019			28000	25687.2		
2	0.89	0.8417	135000	120150			35000	31150			28000	23567.6		
3	0.8396	0.7722	135000	113346			35000	29386			28000	21621.6		
4	0.7921	0.7084	135000	106933.5			35000	27723.5			28000	19835.2		
5	0.7473	0.6499	135000	100885.5			35000	26155.5						
6	0.705	0.5963	135000	95175			35000	24675	-20000	-14100				
7	0.6651	0.547	135000	89788.5	-70000	-46557								
Total NPV				888637.5		803443		207109		210900		118711.6		135000

Transfer of risk

0.920484

0.879345

Better value to purchase Patient Administration System

Better VFM to lease the Microbiology system. Should be treated as a finance lease because the present rate of discounted lease payments is > 90% of fair value of the asset (SSAP 21)

Better VFM to lease the Payroll System. Should be treated as an operating lease because the present value of discounted lease payments is < 90% of fair value of the asset (SSAP 21)

Should use a real discount rate (6%) for cashflows which are stated in real terms and a nominal discount rate for cashflows stated in cash (nominal) terms.

Nominal discount rate = $1.06 \times 1.0283 = 1.09$ (9%)

See schedule:

Patient Administration system - purchase	3
Microbiology system - operating lease	3½
Payroll system - finance lease	4½

(11)

(b) Accounting entries for finance lease:

Lease amounts to pay	£380,000	(10 years at £38,000)
Fair Value of asset	£300,000	
Financing element	£80,000	(10 years at £8,000 pa)

Principal £38,000 - £8,000 = £30,000 pa

Capitalise asset at inception of lease

DR	Fixed Asset	300,000
CR	Creditors > 1 yr	270,000
CR	Creditors < 1 yr	30,000

Depreciation for year (£300,000 / 10yrs)

DR	Depreciation expense	30,000
CR	Acc Depn	30,000

Lease payment

DR	I&E interest payable	8,000
DR	Creditors < 1year	30,000
CR	Cash	38,000

DR	Creditors due > 1yr	30,000
CR	Creditors due < 1yr	30,000

(next year's principal payment)

May index equipment each year too.

(5)

(c) Private Finance Initiative

- Private sector partner designs, builds and possibly operates facility
- Private sector provides the capital
- Public sector pays for access to the facility or for the whole service over a number of future years. The asset payment is like an operating lease

- Advantages
 - Private sector expertise
 - Risk managed by party best able to reduce the cost of that risk
 - Lower cost
 - Innovative construction
 - Innovative additional income generation expertise
 - Access to scarce capital resources

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(d) Accounting Standards

SSAP 21 (Accounting for leases and hire purchase contracts)

- Defines operating and finance leases (PFI arrangements often include an operating lease arrangement).
- Describes a “transfer of risk” test which can help define leases. If the net present value of the minimum lease payments is less than 90% of the fair value of the lease, the lease may be an operating lease.

FRS 5 (Reporting the substance of transactions)– plus PFI application note

- Re-iterates importance of the substance of the transaction rather than the legal form.
- Expands on risk and requires the party which suffers substantially all of the risks and rewards of ownership to capitalise the asset on their balance sheet.
- The application note gives a flow chart which helps explain how to account for the asset.
- Arrangements which are defined as operating leases under SSAP 21 may (once a detailed risk analysis has been carried out) be defined as a finance lease under FRS 5 – and vice versa.

4

(25)

Question 4

Humbug Health Authority

(a) Depreciation - see schedule

Interest

	Opening £000	Closing £000	
Total fixed assets		1,722.225	<i>1</i>
Land (after revaluation but before indexation)	600		
Buildings (ditto)	900		}
Equipment			
GRC	400		
Depreciation	(200)		<i>½</i>
	1,700	1,722.225	
Average	1,711.11		
Interest at 6%	102.667		<i>1</i>

Schedule for parts (a), (b) and (c)

	Land £000	Buildgs £000	Equip £000	Total £000
Replacement cost				
Opening balances 1/4/99	540	810	400	1,750
Revaluation	60	90		150
Indexation	6	27	8	41
Additions		150	60	210
Disposals	(120)			(120)
Closing Balance	486	1,077	468	2,031
Depreciation				
Opening Value			200	200
Indexation			4	4
Annual Charge		23.175	81.6	104.775
Closing Value		231.75	285.6	308.775
Closing NBV	486	1,053.825	182.4	1,722.225

Marks

½

1

1

(5)

(b)

Humbug Health Authority
Income and expenditure account for the year ended 31 March 2000

	Working	£000	
Income			
Department of Health Income	1	196,485	<i>1</i>
Miscellaneous income		75	
Total income		<u>196,560</u>	
Expenditure			
Healthcare of related services programme expenditure		193,280	
Authority administration	2	2,698	<i>1/2</i>
Authority programme expenditure		892	
Total expenditure		<u>196,870</u>	
Authority surplus/deficit		<u>(310)</u>	

Balance Sheet as at 31 March 2000

	Workings	£000	
Fixed assets			
Land	see schedule	486	<i>1</i>
Buildings	see schedule	1,053.825	<i>1</i>
Equipment			
GRC	see schedule	468	<i>1</i>
Depreciation	see schedule	(285.6)	<i>1</i>
		<u>1,722.225</u>	
Current assets			
Debtors	3	8,350	<i>1/2</i>
Cash in hand and in bank		120	
Creditors: amounts falling due within one year	4	(7,160)	<i>1</i>
		<u>1,310</u>	
Net current assets/liabilities		1,310	
Provision for liabilities		(1,300)	
Total net assets		<u>1,732.225</u>	
Financed by			
Capital account	5	1,495.225	<i>1/2</i>
Revaluation account	6	227	<i>2</i>
Income and expenditure account	7	10	<i>1/2</i>
Total		<u>1,732.225</u>	

Presentation 1
(13)

Workings

		£000	
1	Department of Health Income		
	Per trial balance	196,265	
	Capital charges estimate (i)	220	
		<u>196,485</u>	
2	Authority administration and purchasing		
	Establishment expenses	974	
	Salaries and wages	1,496	
	Supplies and services	8	
	Actual capital charges	207.442	
	Capital charges or charges adjustment (220-207.442)	12.558	
	Total	<u>2,698</u>	
3	Debtors		
	Per trial balance	8,140	
	Due from Dept of Health for fixed assets (iv)	210	
		<u>8,350</u>	
4	Creditors		
	Per trial balance	6,830	
	Disposal proceeds (iii)	120	
	Payable for fixed assets (iv)	210	
		<u>7,160</u>	
5	Capital account		
	Per trial balance	1,475	
	Purchases	210	½
	Disposals (120-35)	(85)	½
	Less depreciation	(104.775)	½
		<u>1,495.225</u>	
6	Revaluation account		
	Per trial balance	75	
	Add revaluation on land	60	} ½
	Add revaluation of buildings	90	}
	Add: indexation on land	6	} ½
	Add: indexation on buildings	27	}
	Add: indexation on equipment	8	} ½
	Less: indexation on equipment depreciation	(4)	}
	Less: accumulated revaluation on disposal	(35)	} ½
		<u>227</u>	
7	I and E account		
	Per trial balance	320	
	Per I & E this year	(310)	
		<u>10</u>	
(c)			
(i)	Health Improvement Programme		

- Responsibility of the Health Authority, but drawn up in conjunction with PCGs and Trusts.
- Plan for addressing the health needs of the local population.
- Drawn up with reference to national priorities and local specific needs.
- Achievement of priority targets is monitored.

3

(ii) PCG / PCT

- PCG – Primary Care Group. Groups of GPs and other primary care practitioners which have responsibility for commissioning care from providers.
- Have an input into the HiMP, work closely with the Health Authority.
- PCT – Primary Care Trust. Are responsible for commissioning healthcare for a resident population and for providing primary care services (community services like community nursing).

4

(7)

(25)

Question 5

Should be presented as a memo:

To
From
Date
Subject

(a) Revenue funds flow from Parliament to Green Trees NHS Trust

- Comprehensive Spending Review plus subsequent Budgets identify the total NHS allocation split between capital and revenue and between general allocations and earmarked allocations
- Earmarked allocations may flow directly to the Trust on the basis of bids to the Regional Office
- General revenue is allocated to Health Authorities on the basis of a weighted capitation formula (RAWP). This formula allocates more resources to high population areas and less to low populations. Additional factors affect the allocation such as health needs, ethnicity, age and market forces factors.
- The Health Authority does not necessarily receive its calculated fair allocation. The baseline funding position is examined and authorities currently funded above their RAWP allocation will receive less development / growth monies than those below. Exactly how this is implemented depends on the pace of change policy. Gradually health authorities are converging on their fair capitation share of resources.
- Health authorities pass their allocations straight to PCGs with a top-slice to fund health authority specific activities. The allocation to PCGs is done in a similar way to the allocation to health authorities.
- PCGs have service level agreements with providers which detail amounts to be paid in respect of services provided. The Health Authority pays over the money to providers usually monthly.

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(b) 4 other sources of revenue funding

- Charitable donations
- Private fees charged
- Services commissioned by local authorities
- Interest earned on investments

4

(c) Capital funds

- Capital and revenue allocations are agreed by parliament
- Capital is allocated to Regional Offices of the NHSE on a capitation formula basis similar to revenue funding.
- The Trust submits a bid for its capital programme to the NHSE Regional Office.
- The Regional Office agrees a certain level of capital expenditure for the year and sets an appropriate external financing limit (taking into account predicted internally generated cash)
- The cash is paid over the Trusts via the local health authority.

4

(d) Main items in the Annual Report

Mandatory

- Accounts (I&E, B/S, SRGL, Cash Flow) either in summary or full form

- Narrative commentary on activities
- Operational and Financial review
- Code of conduct and accountability
- Public Sector Payment Policy
- Management and Admin costs
- Board Members remuneration
- Service / Quality improvements
- Mission statement
- PFI details
- Controls assurance statement

Recommended

- Membership of committees
- Service quality improvements
- Equal opportunity targets
- Waiting list information and times
- Performance on Patient Charter standards
- Our Healthier Nation targets
- History of Trust
- VFM initiatives

½ mark per relevant point to a maximum of 6

(e) In year monitoring and other means of being held accountable

- Returns to the NHS Executive (usually quarterly, detailing financial position capital and revenue) for in year monitoring.
- Internal and external audit
- Measurement against service level agreements
- Achievement of HiMP targets
- Reference cost database
- Performance indicators (published in the press and on the NHS web site)
- Monitoring of achievement against business plan
- Patient carer questionnaire

5

(25)