FINANCIAL REPORTING IN THE HEALTH SERVICE

Professional 2
June 1999

MARKING SCHEME

CIPFA

Question 1

(a) The cash flow statement takes on a particular importance in NHS Trusts because of the EFL which is a government control on borrowing *1*

It is calculated as new loans less loans repaid plus/minus cash *1*

The EFL is agreed by the trust and the NHS each year. The amount achieved by the Trust is clearly disclosed in the cash-flow statement as net cash flow before financing and management of liquid resources. *1*

(3)

(b) See spreadsheet

(c) to (e) see spreadsheet

Part (b)
BILLWORTH NHS TRUST
CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 1999

	£000	£000	
Operating activities			
Net cash inflow from operating activities		4,910	½
Returns on investments and servicing of finance			
Interest received (110+10-20)	100		½
Interest paid (3400+150-150)	-3,400		½
Net cash (outflow) from returns on investments and servicing of finance		-3,300	
Capital expenditure			
Payments to acquire fixed assets 67520-(68500-650-2430-380)	-2,480		*2*
Receipts from sale of fixed assets (380-200)	180		½
Net cash (outflow) from capital expenditure		-2,300	
Dividends paid		0	
Net cash inflow/(outflow) before financing		-690	
Financing			
Government loans received (33400-(32750-1760)	2,410		*1*
Government loans repaid (from note 4)	-1,680		*1*
Net cash inflow/(outflow) from financing		730	
Increase in cash		40	
Presentation			*1*
			(7)

Part (c)

Reconciling of operating surplus to net cash inflow from operating activities

	£000		
Operating surplus before interest	1,190	See working	
Loss on disposal	200		½
Depreciation charge	2,430		½
Decrease in stocks (1420-1150)	270		½
Decrease in debtors (2780-2010)	770		½
Increase in provisions (980-150)	830		½
Decrease in creditors (4690-5470)	(780)		½
Net cash inflow from operating activities	4,910		

Working	**£000**		
Extract of income and expenditure account			
Surplus before interest	1,190		½
Interest receivable	110		½
Interest payable	-3,400		½
PDC dividends	0		
Deficit for year (2320-220)	-2,100		½

(5)

Part (d)
Reconciliation of net cash flow to movement in net debt

	£000	
Increase in cash in the period	40	*½*
Cash inflow from new debt	-2410	*½*
Cash outflow from debt repaid	1,680	*½*
Change in net debt resulting from cash flows	-690	
Net debt at 1 April	-34,270	*1*
Net debt at 31 March	-34,960	*1*
Presentation		*½*
		(4)

Part (e)
Analysis of changes in net debt

	As at 1 April 1998 £000	**Cash flows £000**	**Other changes £000**	**As at 31 March 1999 £000**	
Cash at bank and in hand	160	40		200	*1*
Debt due within one year	-1,680	1,680	-1,760	-1,760	*1½*
Debt due after one year	-32,750	-2,410	1,760	-33,400	*1½*
	-34,270	-690	0	-34,960	
					(4)

(f) The reconciliations are required in order to allow the cash-flow to be interpreted in the context of the other primary financial statements i.e. the income and expenditure account and the balance sheet. *(2)*

(25)

Question 2
Part (a)

Equipment	**q1**	**q2**	**q3**	**q4**	**Total**	
Gross Replacement cost						
Opening balance	26,500	28,030	28,430	28,430	26,500	
Indexation	530				530	½
Purchases	1,000	400			1,400	½
Disposals				-918	-918	½
Closing balance	28,030	28,430	28,430	27,512	27,512	
Depreciation						
Opening value	18,500	19,715	20,585	21,475	18,500	
Indexation	370				370	½
Depreciation for year on assets held	845	845	845	845	3,380	½
Depreciation on £1,000,000 acquired		25	25	25	75	½
Depreciation on £400,000 acquired			20	20	40	½
Disposals				-258	-258	*1*
Closing value	19,715	20,585	21,475	22,107	22,107	
Closing NBV	8,315	7,845	6,955	5,405	5,405	½

Depreciation on assets held
(26500+530)/(8*4)=845

Depreciation on assets acquired
1000/(10*4)=25
400/(5*4)=20

GRC on asset disposed
900*1.02=918
Depreciation on assets disposed
918/(8*4)*9=258

(5)

(b)

Pencaster NHS Trust
Income and expenditure account
For the year ended 31 March 1999

		£000	
Income for activities	per trial balance	98,000	
Other operating income	working 1	13,405	½
		111,405	
Operating expenses	working 2	111,215	1½
Operating surplus		190	
Loss on disposal of fixed asset	working 3	(10)	1½
Surplus before interest		180	
Interest receivable	per trial balance	650	½
Interest payable per trial balance		(1,110)	½
Deficit for the financial year		280	
Public dividend capital dividend	per trial balance	(1,540)	½
Retained for the year		1,820	

Presentation 1
(6)

Working1

	£000
Per trial balance	13400
Release from donation reserve	5
	13405

Working 2

	£000	
Increase in provision	1,790	
Salaries	60,800	
Supplies	40,600	
Other expenditure	1,500	
Depreciation on buildings	3,025	½
Depreciation on donated buildings	5	½
Depreciation on equipment	3,495	½
	111,215	

Working 3

	£000
Capital receipt	650
Net replacement cost (918-258)	660
	10

Part (c)

Pencaster NHS Trust
Balance Sheet as at 31 March 1999

	Working	£000	£000	
Fixed assets				
Land	1		6,650	*1½*
Buildings	2		45,650	*3*
Equipment				
- GCC			27,512	
- Depreciation			(22,107)	
			57,705	
Current Assets				
Stocks	trial balance	2,940		
Debtors	trial balance	5,570		
Cash	3	3,330		*2*
		11,840		
Current Liabilities				
Creditors less than one year	4	(7,340)		*1*
Net current assets			4,500	
Long term Liabilities				
Creditors more than one year	5		(24,100)	*½*
Provisions for liabilities and charges	6		(4,160)	*½*
			33,945	
Net Assets				
Financed by				
Public dividend capital	trial balance		29,600	
Revaluation reserve	7		3,405	*3*
Donation reserve	8		1,305	*1*
Income and expenditure reserve	(1,455 - 1,820)		(365)	*½*
			33,945	

Presentation 1

(14)

Working 1

Per trial balance	6,570	
Indexation (note 2)	155	½
Additions (note 2)	*150*	½
Revaluation (note2)	(225)	½
	6650	

Working 2

Per trial balance	45,550	
Indexation (note 2)	1,770	½
Additions (note 2)	1,870	½
Revaluation (note2)	(520)	½
Depreciation	(3,025)	½
Indexation on donation	10	½
Depreciation on donation	(5)	½
	45,650	

Working 3

`	**£000**	
Per trial balance	5,100	
Per note 4	(400)	½
Per note 5	650	½
Per note 2	(150)	½
Per note 2	(1,870)	½
	3,330	

Working 4

	£000	
Per trial balance		
Instalments due on loans	1,190	
Interest payable	1,110	*1 mark for all items*
NHS creditors	1,590	
Other creditors	3,450	
	7,340	

Working 5

	£000
Per trial balance	
Long term loans	23,100
Note 4	1,000
	24,100

Working 6

	£000
Per trial balance	2,370
Note 1	1,790
	4,160

Working 7

	£000	
Per trial balance	2,065	
Indexation from note 2 (155+1770)	1,925	*1*
Revaluation from note 2 (225+520)	(745)	*1*
Indexation on equipment from note 3	530	*½*
Indexation on depreciation equip from note 3	(370)	*½*
	3,405	

Working 8

	£000	
Per trial balance	1,300	
Release of building deprec	(5)	*½*
Indexation	10	*½*
	1,305	

Question 3

The student should produce a report to include the following:

(a) **Source of finance available to the Trust:**

Outright Purchase

- Internal resources (depreciation and surpluses)
- Interest bearing debt (Government)
- Private sector borrowing
- Public dividend capital *1*

Lease

- Operating lease
- Finance lease *1*

Donation *1*

(3)

(b) **The financial implications should be considered as follows:**

Purchase

Internal Resources

- Appropriate if a Trust has a zero or a negative EFL.
- A rate of return of 6% will be incurred in the form of capital charge equivalents each year. The capital charge equivalents (depreciation and interest) will be taken into account in the calculation of the Trusts external financing requirement and will result in a lower EFL.

- The accounting entries are:

On acquisition:

Dr. Fixed assets	£1,200,000
Cr. Cash/creditors	£1,200,000

Each year the asset would be depreciated on a straight line basis over the 10 year life.

Dr. Income and Expenditure account	£120,000	
Cr. Accumulated depreciation	£120,000	*1*

The asset will be indexed each year in accordance with nationally prescribed indices. The entries will be

Dr. Fixed assets
Cr. Revaluation reserve

With the amount of the increase in the value of fixed assets (note entries would be reversed if the asset re-valuation is downward.)

Dr. Revaluation reserve
Cr. Accumulated depreciation

With the amount of the backlog depreciation *3*

Interest Bearing Debt

- Must be within the EFL.
- Will incur interest charges at the government rate and is repaid over a defined term eg 20 years.

The trust must make a 6% rate of return on the asset.

- Interest will be charged to the Income and expenditure account
- Accounting entries are:

Upon acquisition:

Dr. Fixed assets	£1,200,000
Cr. Interest bearing debt	£1,200,000

Each year the asset would be depreciated on a straight line basis over the 10 year life.

Dr. Income and Expenditure account	£120,000
Cr. Accumulated depreciation	£120,000

The asset will be indexed each year in accordance with nationally prescibed indices. The entries will be

Dr. Fixed assets
Cr. Revaluation reserve

With the amount increase in the value of fixed assets (note entries would be reversed if the asset re-valuation is downward.)

Dr. Revaluation reserve
Cr. Accumulated depreciation

With the amount of the backlog depreciation *3*

Private sector borrowing

- Will have to be within the EFL
- Usually poorer value than borrowing from the government
- The trust must make a 6% rate of return on the asset.
- Only allowed if the Trust can demonstrate that this is better value for money

- On acquisition:

Dr. Fixed assets	£1,200,000
Cr. Long term loans	£1,200,000

Each year the asset would be depreciated on a straight line basis over the 10 year life.

Dr Income and Expenditure account	£120,000
Cr. Accumulated depreciation	£120,000

The asset will be indexed each year in accordance with nationally prescibed indices. The entries will be

Dr. Fixed assets
Cr. Revaluation reserve

With the amount increase in the value of fixed assets (note entries would be reversed if the asset re-valuation is downward.)

Dr. Revaluation reserve
Cr. Accumulated depreciation

With the amount of the backlog depreciation *3*

Public Dividend capital

- It is unlikely that PDC could be used in this case because of the size of the capital scheme. *1*

Lease

Operating Lease

- If the asset is leased form a leasing company in the form of an operating lease, it will be financed form revenue and the asset will not be capitalised.
- The asset will not be depreciated.
- The Trust will pay an annual lease charge to the lessor, which will be charged against the income and expenditure account.
- The asset will be no requirement for the Trust to make a 6% rate of return.
- It will not count against EFL.

- The accounting entries are:

  Dr Income and Expenditure account
  Cr Cash

With the amount of the lease charge each year. *3*

Finance Lease

- The lease will be classed as a finance lease if the discounted lease payments are more than 90% of the fair asset value.
- A rate of return will not be charged.
- If the asset is financed by finance lease, it will be capitalised on the balance sheet.
- It will be counted against the EFL of the trust.
- The accounting treatment is as follows (during the primary lease term):

Capitalisation:

Dr. Fixed assets	£1,200,000
Cr. Creditors	£1,200,000

With the fair value of the total minimum lease payments.

Depreciation:

Dr. Income and expenditure account	£120,000
Cr. Provision for depreciation account	£120,000

with the depreciation for the period.

Payment of the rental to the lessor:

Dr. Finance charges
Cr. Bank/Cash

Dr. Income and expenditure account
Cr. Finance charges

with the finance charge element of the rental payment

Dr. Creditors
Cr. Cash/Bank

with the capital element of the rental payment for the period *4*

Donation

- The donation is treated as deferred income, which is gradually released to meet the annual cost of using the asset, depreciation.
- Will not count against the EFL.
- The accounting treatment is as follows.

Acquisition:

Dr. Fixed assets	£1,200,000
Cr. Donation reserve	£1,200,000

Depreciation:

Dr. Income and expenditure account	£120,000
Cr. Accumulated depreciation	£120,000
Dr. Donation reserve	£120,000
Cr. Income and expenditure account	£120,000

with the release of deferred income to the I and E account equal to the depreciation amount.

The asset will be indexed each year in accordance with nationally prescibed indices. The entries will be

Dr. Fixed assets
Cr. Revaluation reserve

With the amount o the increase in the value of fixed assets (note entries would be reversed if the asset re-valuation is downward.)

Dr. Revaluation reserve Cr. Accumulated depreciation	
With the amount of the backlog depreciation	*4*
Report format	*1*
	(22) *(25)*

Question 4

(a)

The candidate is expected to consider the users and uses of the external financial information only. Particularly the Trust Financial statements and the AGM. The candidate must consider both the users and the potential uses of the information to gain maximum marks. (ref: SU 1 OLM)
Possible users and uses are suggested below but appropriate credit should given for other relevant examples.

User	**Use**
Central government	Legitimate expenditure Statutory duties have been met Compliance with targets Minimum service provisions met
General public	To assess performance of Trust as voters and potential patients To confirm that taxes are justified
Employees	Scope for salary increases Assess performance
Managers of the Trust	Budget preparation Strategic planning Assessing performance and efficiency
Suppliers	To assess whether services and goods will still be required To assess whether the Trust will continue to be a good payer
Purchasers (GPFHs, HAs)	Prices and cost of service provision Cost effectiveness
Competitors (other trusts, Private health care)	Information that may help them gain a competitive advantage
Regulators (ombudsman)	The organisation has met service commitments effectively
Private finance providers	Organisation is well managed and investment is secure Information to compare their return with alternative sources of finance

Pressure groups (trade Unions) Equity of service provision

(½ mark for each user and ½ mark for each use to a maximum of 4 for uses and 4 for users) *8*

(b)

The candidate should address all the issues in the memo and respond using a memo or letter format gain full marks.

Memo point 1: Ref SU 9 Block 2 OLM

- The EFL is the 'External Financing Limit'. It limits a Trusts access to external finance. It is in effect 'permission to borrow to finance capital spending'.
- Calculated as new loans taken out, less repayments of loans during the year, plus or minus net changes in deposits and other holdings of liquid assets.
- National target for EFLs set through the PES process.
- In order to meet the target trusts must monitor debt repayment and borrowing (should borrow and repay according to levels set in EFL calculation), capital expenditure (and therefore slippage on capital schemes), and working capital elements particularly at year end.
- Trusts can have positive, negative or zero EFLs. A positive EFL means that capital spending for a trust exceeds internally generated resources (i.e. depreciation or retained surplus's), and so will have to borrow to finance capital expenditure. A negative EFL means that capital spending for a trust is less than internally generated resources. A trust is not allowed to spend all on capital but must use some to repay loans.

(4)

Memo point 2: Ref SU8 Block 2 OLM

- Calculation of rate of return

Relevant surplus/average relevant net assets x 100%

- Relevant surplus is the surplus as per I&E account less finance charge element of finance lease payments.
- Relevant assets are Total capital and reserves
  less
  Donation reserve
  Assets in the course of construction
  Cash invested
  Plus
  Short term loans and overdrafts
- Reasons for over or under achieving may include, not breaking even on I&E, revaluation of assets.

(4)

Memo point 3:

- Deliver strategic aims of trust.
- Meet legislative requirements. e.g. Health & Safety etc.
- Maintain competitive advantage. e.g. Medical Technological Develop.
- Changing medical demands.
- Separate revenue and capital.

(4)

Memo point 4: SU9 , Block 2 OLM

- Definitions of Interest bearing debt and public dividend capital (as per page 48 OLM)
- Identification of the repayment terms of IBD and PDC and the difference between them.

1 for presentation

(4)
(25)

Question 5

(a) **Revised budgetary control statement**

SEAGRAVE NHS TRUST
RADIOLOGY DEPARTMENT
Budgetary Control Statement for the period to the end of August

	Annual Budget £	Budget to date £	Exp to date £	Variance £	Working
Pay					
Chief Radiographer	40,667	16,750	17,120	370	2
Senior Radiographers	83,367	34,338	34,340	2	2
Basic radiographers	105,733	43,550	55,520	11,970	2
Nursing	33,063	13,776	13,770	(6)	1
Admin and clerical	20,050	8,354	8,320	(34)	
Total Pay	282,880	116,768	129,070	12,302	
Non Pay					
MSSE	41,000	17,083	16,900	(183)	6
Drugs	54,090	22,538	26,120	3,582	5
Pathology tests	12,000	5,000	1,010	(3,990)	
Printing					4
Office equipment	500	208	300	92	
Disposable dressings	4,780	1,992	2,251	259	
Computer hardware and software	15,000	6,250	6,500	250	3
Maintenance contracts	2,500	1,042	1,042		7
Travel	600	250	300	50	
Books and periodicals	50	21	0	(21)	
X Ray film	2,680	1,117	1,300	183	
X Ray chemicals	3,000	1,250	1,115	(135)	
Recharges					
Capital charges	48,000	20,000	20,000		8
Total Non Pay	184,200	76,751	76,838	87	
Total Expenditure	467,080	193,519	205,908	12,389	

Workings

1. Nursing pay award not included. Adjustment of budget required

   32100*1.03 = 33063 Annual budget
   13375*1.03 = 13776 Budget to date
   Revised variance = 13770-13776=(6) *1*

2. PAMS pay award not included. Adjustment of budget required

Chief radiographer =	(40000*0.025*8/12) + 40000 = 40667 annual budget
	(16667/5*0.025)+16667 =16750 budget to date
	Revised variance = 17120-16750=370
Senior radiographer =	(82000*0.025*8/12) + 82000 = 83367 annual budget
	(34167/5*0.025)+34167 =34338 budget to date
	Revised variance = 34340-34338=2
Basic radiographers =	(104000*0.025*8/12) + 104000 = 105733 annual budget
	(43333/5*0.025)+43333 =43550 budget to date
	Revised variance = 55520-43550=11970

   2

3. Software received to be accrued for in expenditure *1*

4. Printing expenditure journalled to another budget centre *1*

5. Drug budget to be adjusted for prices increase

   53000*1.03=54590 Annual budget
   54590/12*5 = 22746 Budget to date *1*

   Budget virement of £500 to be transferred to surgery

   budget to date = 54090/12*5=22538 *1*

6. Miscoding of MSSE

   Exp to date = 16500+400 = 16900 *1*

7. Maintenance contract, adjustment made for effect of part year

   2500/12*5 = 1042 *1*

8. Capital charges accrual

   48000/12*5=20000, accrual of 8000 required *1*

(10)

(b) The report should include the following:

- A statement of what the revised position of the department is, i.e. £12,389 overspent at month 5, and the significance of this if it continues to year end. *1*

- Analysis of the variance caused by the position regarding the radiographers.

The senior grade is still being paid a salary therefore no spare money available on senior radiographer line.

The basic grade that is acting up and so being paid the difference between the two grades. The effect of this would be

Cost of senior grade = 83367/3=27789 per annum
Cost by month 5 = 11579
Cost of basic grade = 105733/5=21147
Cost by month 5 = 8811

Difference = 11579-8811=2768

NB: Students may calculate the effect of months 1-4 and then month 5 separately due to the pay award. The difference is not considered to be material and students that do not calculate the effect of this should not be penalised.

2

The agency staff is causing overspend also on the basic grade line.

Cost of agency staff
Cost of basic grade radiographer 21147 * 1.1 = 23262
Cost by month 5 = 23262/12*5=9692

Total overspend = 9692+2768 = 12460, this accounts for all overspend on this line.

2

- A comment on the overspending drugs line or the under-spend on the pathology tests line (reasons may include a reduced amount of activity) *1*

(c) How the budget report could be improved upon

- Inclusion of budgeted WTE figures to indicate the establishment
- Inclusion of actual WTE to indicate number of staff in post
- Inclusion of a budget and actual for the month in question
- Separation of the agency staff by creating a separate line on the budget report

Credit should be given for each valid point up to a maximum of 4 marks *4*

Additional information that could also be provided would relate to activity. For example:

- Number of patients
- Number of x rays performed
- Number of pathology tests requested

2

(d) Inclusion of capital charges for equipment

- Makes the budget holder aware of full cost of equipment used i.e. capital charges that are payable
- Impact on prices
- Capital charges that may be incurred if disposals of equipment occur that still have a net book value.
- Impact of expensive new equipment

1 mark is available for each point up to a maximum of 3 marks. *3*

(15)
(25)