

NHS foundation trust accounts

A guide for non-executives

Revised 2010 edition



The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

The Healthcare Financial Management Association (HFMA) is the UK representative body for finance professionals working in the NHS and the wider healthcare sector. Its aim is to support the NHS finance function, to promote good practice in financial management and to improve the general understanding of NHS finance issues.

Its work is informed by a number of committees and special interest groups made up of healthcare finance practitioners. It publishes numerous guides and briefings aimed at finance professionals, non-executive directors and non-finance staff and provides training and development opportunities – including a suite of e-learning modules – across all of these groups.

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Foreword

Making sense of a set of accounts can be difficult in any sector. But in the NHS, where funding flows and reporting requirements are relatively complex and can be unfamiliar to those used to working in other sectors, the challenge can be particularly demanding. *Foundation Trust Accounts: A Guide for Non-executives* aims to make the task a little easier.

Produced as a companion to the well-established Healthcare Financial Management Association (HFMA) *Introductory Guide to NHS Finance* and the HFMA *Introductory Guide to NHS Foundation Trust Finance and Governance*, the guide steers the reader step by step through the annual accounts.

The guide is particularly aimed at non-executives, who, along with their executive board colleagues, are required to approve and adopt the annual accounts. Non-executives, therefore, not only need to understand the accounts, but must be able to ask pertinent questions and challenge colleagues over the various entries. The guides are intended to support non-executives in providing effective scrutiny and ensuring accountability and value for money are demonstrated. However they are likely to be of help to anyone with an interest in interpreting a foundation trust's accounts.

Earlier versions of this guide have proved popular, but this new guide has been rewritten to reflect the requirement to prepare accounts according to the rules set out in the newly adopted International Financial Reporting Standards. The changes to the primary statements and to the reporting rules – which apply to accounts from 2009/10 onwards – mean that these guides should be of interest to experienced non-executives and newcomers alike.

The guide provides the reader with plain English explanations of the primary statements and notes, with additional boxed text for key concepts. It clearly explains the role of the non-executive and the external auditor. It also suggests questions that non-executives may wish to ask to assure themselves that the financial statements represent a true and fair view of the foundation trust's finances. And a newly added glossary provides quick, simple access to key finance terms and commonly used jargon.

Both the HFMA and the Audit Commission are committed to improving accountability and good financial reporting across the NHS and commend this guide to you. We hope you will find it helpful.

Paul Assinder, HFMA President

Andy McKeon, Managing Director, Health, Audit Commission

Introduction

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NHS foundation trusts (FTs) have a statutory duty to produce an annual report and accounts, which is one of the main ways they discharge their accountability to their members, taxpayers and service users for their stewardship of public money.

1 The FT's board of directors must formally adopt the accounts, also known as the financial statements, once they have been audited so it is therefore essential that non-executive directors (NEDs) understand them and the information that they contain. Alongside this formal requirement, NEDs need to understand the annual accounts if they are to fully appreciate the financial health of their organisation. This is because, while the accounts reflect the immediate past performance, they also set out the financial platform on which the organisation will build its future performance.

2 In 2008, the HFMA, in conjunction with the Audit Commission, published *Foundation Trust Accounts: A Guide for Non-executives* (the guide) to take the reader through a set of FT accounts. The guide was designed to help NEDs and other users first understand and, more importantly, draw conclusions and ask pertinent questions about an FT's accounts.

3 An update was produced in April 2009 to complement the original guide, describing the main changes to the accounts since publication and including additional questions that NEDs could ask to assure themselves that the financial statements represented a true and fair view of the organisation's finances.

4 This new version of the guide describes a set of FT accounts prepared under International Financial Reporting Standards (IFRS). HM Treasury has required NHS organisations to prepare IFRS compliant accounts from 2009/10.

5 The guide provides the reader with easy-to-follow explanations of the primary statements and notes. It clearly explains the role of the NED and the external auditor. It also includes an invaluable list of questions for NEDs to help them gain assurance that the financial statements represent a true and fair view of the FT's finances.

International Financial Reporting Standards

6 The most significant changes to the accounts from the introduction of IFRS are:

- Private Finance Initiative (PFI) assets – PFI scheme assets and the associated liabilities are generally included on the Statement of Financial Position of FTs whereas previously under UK Generally Accepted Accounting Practice (UK GAAP) they were not included on the FT's Balance Sheet.
- Leases – More arrangements are being classified as leases, with a greater number of those arrangements being recognised as finance leases, and therefore being included on the Statement of Financial Position.
- Disclosures – IFRS contain a significant number of additional disclosure requirements over and above those required by UK GAAP.

Format of the annual report and accounts

7 FTs have some discretion over the exact format and content of their annual report and accounts. However, they need to exercise this discretion within the accounting requirements of the *NHS Foundation Trust Annual Reporting Manual* agreed with HM Treasury and issued by the FT regulator, Monitor. The *NHS Foundation Trust Annual Reporting Manual*, previously called the *NHS Foundation Trust Financial Reporting Manual*, now includes non-financial reporting requirements.

8 The annual report includes:

- a directors' report including a management commentary on the performance of the FT;
- a remuneration report, which discloses salaries of the FT's directors and senior managers;
- the disclosures set out in the *Code of Governance*;
- other disclosures in the public interest; and
- quality reports.

9 The accounts comprise:

- a foreword;
- four primary statements:
 - Statement of Comprehensive Income;
 - Statement of Financial Position (previously known as the Balance Sheet);
 - Statement of Changes in Taxpayers' Equity; and
 - Statement of Cash Flows;
- notes to the accounts;
- the directors' Statement of Responsibilities;
- the Statement on Internal Control; and
- the auditor's report.

10 This guide focuses on the four primary statements and the notes to the accounts. There is an example set of FT accounts, comprising all four primary statements and some of the more significant notes, with explanations and suggested questions that NEDs might wish to ask.

The primary statements

11 The **Statement of Comprehensive Income** combines into one statement the Income and Expenditure Account and Statement of Total Recognised Gains and Losses, which were previously prepared under UK GAAP. This statement records the FT's income and expenditure for the year together with any other recognised gains and losses in summary form. It includes cash-related items such as expenditure on staff and supplies, as well as non-cash items such as a change in value of the FT's assets. If income exceeds expenditure, the FT has a surplus for the year. If expenditure exceeds income, there is a deficit.

12 Generally, FTs should record income and expenditure gross and not net them off. For example, where an FT second staff to another body the FT needs to include the staff costs as expenditure and any reimbursement from the other body as income.

13 The **Statement of Financial Position**, formerly called the Balance Sheet under UK GAAP, provides a snapshot of the FT's financial position at a specific date – the end of the financial year. In simple terms it lists assets (what the FT owns or is owed), liabilities (what the FT owes) and taxpayers' equity (public funds invested in the FT). The Statement of Financial Position presents separately:

- non-current assets (assets the FT expects to hold or use for more than a year);
- current assets (assets the FT expects to use to carry out its operations in the coming year);
- current liabilities (financial obligations the FT expects to discharge in the coming year); and
- non-current liabilities (financial obligations the FT expects not to discharge in the short term).

14 At any given time, the FT's total assets less total liabilities must equal taxpayers' equity.

15 The **Statement of Changes in Taxpayers' Equity** combines the information previously presented in the Movement on Reserves note and the Movement in Public Dividend Capital note under UK GAAP. It essentially shows the changes in reserves and public dividend capital over the year in question. Public dividend capital is a type of public sector equity finance based on the excess of assets over liabilities at the time of establishment of the predecessor NHS trust. It is similar to a company's share capital.

16 There is no prescribed format for the Statement of Changes in Taxpayers' Equity but Monitor has included one possible approach in the *Foundation Trust Annual Reporting Manual*. This guide includes that approach.

17 The **Statement of Cash Flows**, formerly the Cash Flow Statement under UK GAAP, summarises the cash flows in and out of the FT during the accounting period. It analyses cash flows under the headings of operating, investing and financing cash flows. The Statement of Cash Flows differs from the Statement of Comprehensive Income by focusing on the cash implications of the actions taken by the FT during the year. The statement is useful in assessing whether the FT has enough cash to be able to pay its bills.

Notes to the accounts

18 The notes to the accounts provide additional details about the entries in the primary statements as well as additional disclosures, such as the accounting policies that the organisation follows when preparing its accounts.

Prior year comparators and analytical review

19 The accounts include figures for the year just ended alongside comparative figures for the prior year. This helps show how income, expenditure, assets and liabilities have changed in comparison with the previous year.

20 NEDs should ensure that they understand the reasons for changes in figures and can relate them to FT actions and activities. This process forms the basis of an analytical review, which involves the explanation of significant variances from what was expected, for example from budget, or from the prior year. NEDs can do this by asking the questions included in this guide or alternatively management could provide NEDs with an analytical review. Even if figures are the same for two years, it may be useful to probe deeper. For instance, steady expenditure in a particular area could indicate a failure to deliver on a savings programme.

21 In the case of first-year FTs, the opening balances in the Statement of Financial Position and related notes are as at the date of the FT's establishment. However the *Foundation Trust Annual Reporting Manual* does not require new FTs to disclose comparative figures in the Statement of Comprehensive Income.

Non-executive directors' responsibilities

22 A critical aspect of an NED's role is to provide constructive challenge and scrutiny of the organisation's financial information and systems of control. To fulfil their responsibilities, NEDs need to satisfy themselves that the organisation's financial management arrangements are operating effectively and that the financial reporting and the Statement on Internal Control are both accurate. The Statement on Internal Control provides assurance about the system of internal control and demonstrates that the

accounting officer (chief executive) is managing the principal risks to the organisation achieving its objectives.

23 The board of directors also has responsibility for approving the annual report and accounts. This is the key document in which FTs demonstrate their accountability to members, patients, commissioners and taxpayers.

Going concern

24 The *Foundation Trust Annual Reporting Manual* expects that FTs will record the assets and liabilities in their accounts on a going concern basis. For an FT to be a going concern there must be the expectation that it will continue to operate for at least the foreseeable future, taken to be 12 months from the date the accounts are approved. In approving the annual accounts the board of directors is implicitly agreeing with the decision made by management to prepare them on a going concern basis.

25 To enable NEDs to agree this, management should report to them the process it has followed in forming their view on going concern and the assumptions on which that view is based. NEDs should, where appropriate, challenge those assumptions, particularly where they are aware of any significant issues that management do not appear to have taken into account. To help them form a view on the appropriateness of the going concern assumption, NEDs may wish to consider the following questions.

Questions

Are the financial assumptions in the report (for example, future levels of income and expenditure) consistent with the FT's annual plan and the financial information provided to the board throughout the year?

Have there been any significant issues raised with the board during the year (for example significant weaknesses in systems, or variances between planned and actual activity) that could cast doubts on the assumptions made?

Does a review of available financial information (annual accounts, in-year financial monitoring reports, future year financial forecasts) identify any of the following:

- liquidity problems (cash inflows in the year less than cash outflows);
- poor or deteriorating performance against the *Better Payment Practice Code*; or
- delay or deferral of public dividend capital or other loan repayments?

Financial risk rating

26 When assessing financial risk, Monitor assigns a risk rating using a scorecard that compares key financial metrics on a consistent basis across all FTs. The risk rating is an indication of the likelihood of a financial breach of the FT's terms of authorisation. The financial indicators used to derive the risk rating incorporate four key criteria:

- achievement of plan;
- underlying performance;
- financial efficiency; and
- liquidity.

27 Appendix 2 to this guide explains the financial risk rating. You can find more details on the metrics used in Monitor's Compliance Framework.

28 An FT must comply with Monitor's *Prudential Borrowing Code*. To do this it must remain within a prudential borrowing limit agreed with Monitor. This guide also outlines the financial ratios relating to the calculation of the FT's performance against its prudential borrowing limit.

The role of the external auditor

29 The external auditor has two main responsibilities, which are to satisfy themselves that the FT has:

- prepared its accounts properly; and
- made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

30 The auditor must also review the annual report to assess whether the information in it is consistent with the financial statements.

31 The *Audit Code for Foundation Trusts* published by Monitor and International Standards on Auditing (United Kingdom and Ireland) (ISAs (UK&I)) require auditors to issue two reports during the audit, namely:

- an opinion on the accounts stating whether the accounts give a true and fair view of the FT's income and expenditure for the financial year and of its financial position at the year-end, and
- a report to those charged with governance, under ISA (UK&I) 260, of the main findings from their audit.ⁱ

32 In addition to the annual report and accounts, an FT may choose to publish its annual report with summary financial statements. If it does, the external auditor must review these summary financial statements and give an opinion on whether they are consistent with the annual report and full financial statements.

ⁱ It is for the auditors to determine who 'those charged with governance' are at an FT. It is expected, however, that this will be the audit committee in the first instance and the board of governors if the auditors feel that the issue is significant.

Timetable

33 Each year Monitor sets the timetable for FTs to prepare and auditors to audit the accounts, and publishes it in the *Foundation Trust Annual Reporting Manual*. For 2009/10, Monitor has set the following deadlines:

- Draft annual accounts to be with auditors and Monitor by 22 April 2010.
- Audited accounts and final text of the annual report to be with Monitor by midday 8 June 2010. For this deadline to be achieved, the following needs to have happened:
 - the auditor needs to present their report to those charged with governance;
 - the board of directors must approve the annual report and accounts;
 - the chief executive, as the accounting officer, must sign and date the accounts as evidence of their adoption; and
 - the auditor has to sign their opinion on the accounts.
- FT to post hard copies of the annual report and accounts to the Parliamentary Clerk at the Department of Health by 7 July 2010.
- FT to send annual reports and accounts as laid before parliament to Monitor by last post 20 July 2010.

34 The FT can only publish its annual report and accounts to the wider public once the Parliamentary Clerk has laid the annual report and accounts before parliament.

The primary statements

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Statement of Comprehensive Income

| | Note | Current year £000 | Prior year £000 |
|--|------|----------------------|--------------------|
| Operating income from continuing operations | 3 | 259,035 | 225,404 |
| Operating expenses of continuing operations | 4 | (255,720) | (223,333) |
| Operating surplus (deficit) | | 3,315 | 2,071 |
| Finance costs | | | |
| Finance income | 7 | 514 | 603 |
| Finance expenses – financial liabilities | 8 | (43) | (41) |
| Finance expenses – unwinding of discount on provisions | | (2) | (2) |
| Public dividend capital dividends payable | | (3,517) | (3,001) |
| Net finance costs | | (3,048) | (2,441) |
| Share of profit/(loss) from associates and joint ventures | | 0 | 0 |
| Corporation tax | | 0 | 0 |
| Surplus (deficit) from continuing operations | | 267 | (370) |
| Surplus/(deficit) of discontinued operations and the gain/(loss) on disposal of discontinued operations | | 0 | 0 |
| Surplus (deficit) for the year | | 267 | (370) |
| Other comprehensive income | | | |
| Revaluation gains/(losses) and impairment losses on intangible assets | | 0 | 0 |
| Revaluation gains/(losses) and impairment losses on property, plant and equipment | | (2,879) | 3,666 |
| Revaluation gains/(losses) and impairment losses arising from classifying non-current assets as assets held for sale | | 0 | 0 |
| Fair value gains/(losses) on available for sale financial investments | | 0 | 0 |
| Recycling gains/(losses) on available for sale financial investments | | 0 | 0 |
| Increase in the donated asset reserve due to receipt of donated assets | | 2,770 | 1,002 |
| Reduction in the donated asset reserve in respect of depreciation, impairment and/or disposal of donated assets | | (2,542) | (2,042) |
| Additions/(reductions) in other reserves | | 0 | 0 |
| Other recognised gains and losses | | 0 | 0 |
| Actuarial gains/(losses) on defined benefit pension schemes | | 0 | 0 |
| Total comprehensive income (expense) for the period | | (2,384) | 2,256 |
| Prior period adjustment | | 0 | 0 |
| Total comprehensive income (expense) for the year | | (2,384) | 2,256 |

The Statement of Comprehensive Income records the FT's income and expenditure for the year together with any other recognised gains and losses. It includes both cash and non cash items. These other recognised gains and losses are those that the FT has made but not yet realised, for example, if the value of assets has increased, but the assets have not been sold so there is no cash profit. In essence the gain is only potential.

All operating income for patient care and non-patient care such as education and research. It also includes any profit on disposal of assets.

All operating costs including impairments and loss on disposal of assets.

FTs have limited freedom to invest within certain rules. Interest on investments and deposits is recorded here. Interest payable may include that payable on loans or charges on finance leases.

A financing charge relating to provisions falling due in over a year's time. The unwinding charge entered here reflects the difference between this year's and last year's estimates for the current cost of future payments (see Box A on Page 16).

A charge, reflecting the cost of capital, is payable as a public dividend capital dividend. The charge is calculated at the rate set by HM Treasury (currently 3.5 per cent of average net relevant assets held by the FT). For more on public dividend capital see the Statement of Financial Position.

If an FT has significant influence over another entity that entity is an associate and the FT must account for its share of the associate's profit or loss and other gains and losses.

FTs become liable for corporation tax on some of their own surpluses in 2011/12. However, they might own subsidiaries that already incur corporation tax.

Discontinued operations occur where an FT ceases an operation or transfers it to an entity outside the public sector. For example if an FT were to sell or otherwise transfer its private sector operations to a private company the FT would record its surplus from those operations here and not in the lines above.

The surplus/deficit for the year is a key measure of the overall financial performance of the FT. The FT can use any retained surplus to develop its business.

Gains or losses arising as a result of a change in asset values, but where the assets have not been sold. An impairment is a reduction in an asset's value, a loss, compared with the value recorded in the Statement of Financial Position. Some impairments result in an operating expense however others are charged to the revaluation reserve and these are included in this line. See Box C on Page 40.

Assets are classed as available for sale if they are held neither for trading nor to maturity. An example of this would be an investment without a maturity date such as an ordinary share. This is more likely to be used should an FT consolidate its charitable funds.

Any other gains and losses not recorded elsewhere in the Statement of Comprehensive Income. Movement in the actuarial value of the FT's share of a defined benefit scheme other than the NHS scheme.

The current year figures in one set of accounts become the prior year comparators in the next year accounts. Under normal circumstances, they are not adjusted at all. FTs can only make prior period adjustments for two reasons: to correct a material accounting error in a prior year or because of a material change in accounting policy.

Questions

Do the figures seem reasonable and complete, including those entries that are zero?

Do changes from the prior year correspond with your knowledge of the FT's activities?

What do you know about how the FT's activities have changed over the last two years? Do the figures correspond with your knowledge?

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| Note | Current year £000 | Prior year £000 |
|--|----------------------|--------------------|
| Allocation of profits/(losses) for the period | | |
| Surplus/(deficit) for the period attributable to: | | |
| - minority interest | 0 | 0 |
| - owners of the parent | 267 | (370) |
| Total | 267 | (370) |
| Total comprehensive income/(expense) for the period attributable to: | | |
| - minority interest | 0 | 0 |
| - owners of the parent | (2,384) | 2,256 |
| Total | (2,384) | 2,256 |

If an FT has the power to control another entity, that entity is a subsidiary of the FT. The minority interest is based on the element of the subsidiary not controlled by the FT. For example, if the FT owned 95 per cent of the shares in a company, the minority interest would be based on 5 per cent of the company's results. In this example there is no subsidiary so there is no minority interest and the entire surplus and comprehensive income for the period are attributable to the NHS as 'owners of the parent'.

Questions

Is the surplus or deficit consistent with forecasts made during the year?

Do you know why there has been an impairment of property, plant and equipment in the year? Does it seem reasonable based on your knowledge of the FT and the prevailing economic climate?

Does the FT have a subsidiary, associate or joint venture that it has not accounted for in this statement?

Box A

Provisions

FTs make provisions for expected future liabilities when the action giving rise to the expense has already occurred, but the amount and timing of the expenditure are uncertain. The FT knows that there will be a cost at some point in the future but not exactly when nor how much it will be.

For example, as the result of an expected personal injury claim made by a member of staff, the FT may expect to make a future payout. Similarly, the FT may be responsible for future pension payments to staff who are injured at work and retire on ill health grounds. The full cost of likely future payouts such as these has to be included as an operating expense within the Statement of Comprehensive Income in the year in which the incident relating to the claim occurred. This is called making a provision.

The provision also has to be shown in the Statement of Financial Position to reflect the fact that, even though no money has yet been paid out, the FT's assets have reduced as this money is effectively already earmarked for payment. It is shown as either a current or non-current liability or split between the two, according to when it is likely to be paid.

Some legal claims can take a long time to resolve. If it is likely that a claim will not be resolved within a year, the FT needs to take into account the time value of money: a payment in five years' time is worth less than the same payment made now, because of the impact of inflation. To take account of this, provisions in the accounts are discounted. This discount, currently set at 2.2 per cent, reduces the value of the provision in the accounts. As time passes and the expected settlement date gets closer, this discount is gradually reversed, so that eventually there is no reduction to allow for the time

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value of money, and the full amount of the provision is reflected in the accounts. The FT does this by charging the increase in the provision to expenses every year. This is known as unwinding the discount.

An example is shown below. An organisation expects to pay £100,000 in five year's time to a member of staff for an anticipated personal injury claim. For ease, assume the discount rate would mean that the value of £100,000 in year 1 was £91,500, £93,550 in year 2, £95,650 in year 3, £97,800 in year 4 and £100,000 in year 5. The impact on the Statement of Comprehensive Income and Statement of Financial Position over the five years would be as in Figure 1.

No provision is recorded in year 5, however the actual payout would reduce the cash held by £100,000 and will be recorded in the Statement of Cash Flows as a non-cash income and expense as a decrease in provisions.

Figure 1

| | Year 1 The member of staff makes a claim against the FT | Year 2 | Year 3 | Year 4 | Year 5 The FT pays out £100,000 |
|---|--|---------|---------|---------|------------------------------------|
| Statement of Comprehensive Income operating expenses | £91,500 | £2,050 | £2,100 | £2,150 | £2,200 |
| Statement of Financial Position – Non-current liability | £91,500 | £93,550 | £95,650 | | |
| Current liability | | | | £97,800 | |

Statement of Financial Position

| | Note | Current year £000 | Prior year £000 |
|---|------|----------------------|--------------------|
| Non-current assets | | | |
| Intangible assets | 9 | 1,506 | 1,215 |
| Property, plant and equipment | 10 | 206,720 | 209,424 |
| Investment property | 11 | 0 | 0 |
| Investments in associates (and other jointly controlled operations) | 11 | 0 | 0 |
| Other investments | 11 | 0 | 0 |
| Trade and other receivables | | 2,200 | 2,000 |
| Other financial assets | | 0 | 0 |
| Tax receivable | | 0 | 0 |
| Other assets | | 0 | 0 |
| Total non-current assets | | 210,426 | 212,639 |
| Current assets | | | |
| Inventories | 12 | 1,300 | 1,009 |
| Trade and other receivables | 13 | 8,262 | 8,149 |
| Other financial assets | | 0 | 0 |
| Tax receivable | | 0 | 0 |
| Non-current assets for sale and assets in disposal groups | | 0 | 0 |
| Cash and cash equivalents | | 20,775 | 16,980 |
| Total current assets | | 30,337 | 26,138 |
| Current liabilities | | | |
| Trade and other payables | 14 | (16,674) | (10,515) |
| Borrowings | 15 | (330) | (320) |
| Other financial liabilities | | 0 | 0 |
| Provisions | 17 | (1,151) | (1,897) |
| Tax payable | | (1,500) | (1,500) |
| Other liabilities | | (1,381) | (1,957) |
| Liabilities in disposal groups | | 0 | 0 |
| Total current liabilities | | (21,036) | (16,189) |
| Total assets less current liabilities | | 219,727 | 222,588 |
| Non-current liabilities | | | |
| Trade and other payables | | 0 | 0 |
| Borrowings | | (277) | (608) |
| Other financial liabilities | | 0 | 0 |
| Provisions | | (508) | (836) |
| Tax payable | | 0 | 0 |
| Other liabilities | | (2,570) | (2,388) |
| Total non-current liabilities | | (3,355) | (3,832) |
| Total assets employed | | 216,372 | 218,756 |

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This statement provides a snapshot of the FT's financial position at a point in time. The top half shows the FT's total net assets (assets minus liabilities). The bottom half shows the taxpayer's equity, or investment, in the FT, and must equal the top half.

Non-current assets are those that the FT expects to keep for more than one year.

Computer software, licences, other licences, patents and development expenditure.

Land, buildings, dwellings, assets under construction plant and machinery, transport, IT and furniture and fittings. See Box B on Page 22.

Property held for commercial return and not used or occupied by the FT.

FTs have freedom to make investments, which can generate income for the FT. Investments that will be held for less than one year are classified as current assets while investments to be held for more than one year are fixed asset investments. An associate is an entity over which the FT has significant control.

Amounts owed to the FT analysed between that due within 12 months (in current assets) and over 12 months from the date of the accounts (in non-current assets). Previously known as debtors.

Other financial assets are non-physical assets that don't fit any other category, they can include pension scheme assets in relation to staff in a defined benefit scheme other than the NHS scheme (for example a local government scheme).

Any repayment of tax due in over 12 months time. This is unusual but could include deferred tax assets on retirement benefit liabilities.

Other assets held by the FT in the long term that do not fit into any other heading.

Current assets are those that the FT expects to keep for less than one year.

Inventories usually only include stock such as medicines but may also include work in progress, for example if the FT is involved in producing its own medicines. Partially completed spells of healthcare do not count as work in progress.

A non-current asset, business or other group of assets that the FT is selling.

Includes all cash balances and also deposits and investments that can be readily converted into known amounts of cash at their value in the accounts.

Trade and other payables represent money owed by the FT, for example for supplies and services it has purchased. Previously known as creditors.

Bank overdrafts, amounts due on loans, finance leases and PFI contracts.

A provision is a liability where the action given rise to the expense has already occurred but the amount and timing are uncertain. While there has been no cash payment at this point, the FT anticipates making a payment at a future date and so its net assets need to be reduced accordingly. See Box A on Page 16.

Including income tax deducted from employees due to be paid to HMRC.

Other liabilities include deferred income and the balance of government grants to be released to revenue within 12 months.

Liabilities associated with a business or group of assets the FT is selling.

Liabilities due in over a year's time are non-current liabilities. They are analysed over the same categories as current liabilities.

This can include pension scheme liabilities in relation to staff in a defined benefit scheme other than the NHS scheme.

| | Note | Current year £000 | Prior year £000 |
|--|------|----------------------|--------------------|
| Financed by taxpayers' equity | | | |
| Minority interest | | 0 | 0 |
| Public dividend capital | | 72,480 | 72,480 |
| Revaluation reserve | 18 | 65,490 | 69,403 |
| Donated asset reserve | | 3,134 | 2,906 |
| Available for sale investments reserve | | 0 | 0 |
| Other reserves | | 0 | 0 |
| Merger reserve | | 0 | 0 |
| Pensions reserve | | 0 | 0 |
| Income and expenditure reserve | | 75,268 | 73,967 |
| Total taxpayers' equity | | 216,372 | 218,756 |

The top and bottom halves of the statement have to balance showing how the total assets employed have been financed for instance through public dividend capital or from previous retained surpluses. An asset that increases in value as the result of a valuation has not required any additional real cash financing. Instead the balance is maintained by creating a reserve for that asset. This revaluation reserve shows the value of total assets that have been 'financed' from changes in value identified during revaluations. Similarly the donated asset reserve shows assets recorded in the top half of the statement that were funded by donations.

The minority interest is based on the element of a subsidiary not controlled by the FT. For example, if the FT owned 95 per cent of the shares in a company, the minority interest would be based on 5 per cent of the company's net assets.

Public dividend capital is a type of public sector equity finance based on the excess of assets over liabilities at the time of establishment of the predecessor NHS Trust. It is similar to a company's share capital.

The revaluation reserve is a measure of the net increase in the value of property plant and equipment over its historic cost.

The donated asset reserve should equal the value of donated assets.

This is the net gain or loss on investments still held by the FT.

Other reserves are unusual and require explanation.

Where an FT purchases another trust or FT it records any difference between the consideration given (amount paid) and the existing public dividend capital of the acquired body as a merger reserve.

This is the net actuarial gains or losses in relation to staff in a defined benefit pension scheme other than the NHS scheme.

The cumulative surplus/deficit reported by the FT, including amounts brought forward from when it was an NHS trust.

Questions

If provisions have increased, why is this? Does this correspond with your knowledge of the FT's affairs?

If there are large borrowings, do you know what they are?

Does the FT have any loans which it is in the process of repaying?

Has it made the repayments it should have done during the year?

Can the fall in the value of property, plant and equipment be explained by asset disposals?

Do you know the reason for the increase in trade payables?

Are receivables significantly different to the amount shown for last year?

Does the FT have more money tied up in debtors?

Do you know why the cash balance has changed?

Does the Statement of Financial Position balance?

Non-current assets: valuation and valuation basis

Property

The FT's asset values recorded in the Statement of Financial Position, known as their net book value, are governed by a number of rules. They are initially measured at cost but as soon as they are available for use they are revalued to their fair value. Fair value is the value for which the asset could be exchanged in an arm's length transaction. If an open market value – what it could be sold for – can be established for a building for its existing use, this is the value that should be used. This would be determined by professional valuers.

However, most FT buildings are specialised in nature and there is no real open market. Instead the valuation is based on depreciated replacement cost which involves establishing the cost of replacing the building and then reducing its value to reflect its condition and age. This value is determined by professional valuers, who have to apply prescribed rules and methodologies. A full revaluation of the land and buildings must be undertaken every five years with a three-yearly interim valuation also carried out.

The rules for the valuation of assets have changed: NHS bodies are required (as of 31 March 2010) to use a modern equivalent asset approach when determining depreciated replacement cost.

This means that instead of replacing the asset as it exists with a like-for-like replacement (current cost), the replacement cost of an asset built with modern materials to produce the same throughput should be used. So for instance instead of valuing the asset on the basis of the cost of building a hospital block with original materials such as stone and slate, an equivalent building using glass and plastics might be used. Consideration may also be given to the use of a different site. (For impairment of assets see Box C on Page 40).

Non-property assets

For non-property assets (equipment), the requirement continues to be for valuations to be at current cost. However, as most non-property assets have a relatively short useful life (compared to property) it is acceptable for equipment to be included at depreciated historic cost as this should not be significantly different to current cost. The main consideration is that no material difference should arise in the annual accounts as a consequence of the use of depreciated historic cost in preference to other possible measures of current cost, including indexing the assets to update asset values.



The cost of day-to-day servicing, repairs and maintenance of assets appears as expenditure in the Statement of Comprehensive Income as it is incurred. Additions or enhancements to existing assets are also expensed in the Statement of Comprehensive Income as they are acquired. If they increase either the useful life of the asset or otherwise increase the benefits the FT can obtain from using the asset then the cost is added to the value of the asset.

Example of how a new non-current property asset would be shown in the accounts

| Activity by FT | Accounting for the transaction |
|--|--|
| FT builds a small clinic at a construction cost of £1.2 million. | The cash payments to build the asset of £1.2 million are shown in the Statement of Cash Flows as purchase of property, plant and equipment under cash flows from investment activities. The asset would be added to the Statement of Financial Position under property at £1.2 million. |
| The FT arranges for the unit, which is a specialised building, to be professionally valued on a depreciated replacement cost basis at the first valuation after the asset is brought into use. | The clinic is included in the Statement of Financial Position in the non-current assets category – property, plant and equipment at £1.1 million. |
| On the first valuation of the new asset after it has been brought into use, the valuer will value it as a single asset, and will not take separate account of the additional costs incurred. | The difference between the valuation and build costs (£0.1 million) is treated as an impairment and charged to the Statement of Comprehensive Income. The building is depreciated, for example, £0.03 million per year over its expected lifetime of 40 years, once it starts being used, and the charge is taken to the Statement of Comprehensive Income as operating expenses and this reduces the asset value in the Statement of Financial Position (year-end value £1.07 million). |
| The value assigned by the valuer is £1.1 million. | |

Statement of Cash Flows

| | Current year £000 | Prior year £000 |
|--|-------------------------|-----------------------|
| Cash flows from operating activities | | |
| Operating surplus/(deficit) from continuing operations | 3,315 | 2,071 |
| Operating surplus/(deficit) of discontinued operations | 0 | 0 |
| Operating surplus/(deficit): | 3,315 | 2,071 |
| Non-cash income and expense | | |
| Depreciation and amortisation | 4,929 | 4,585 |
| Impairments | 2,501 | 0 |
| Reversals of impairments | 0 | 0 |
| Transfer from the donated asset reserve | (53) | (51) |
| Amortisation of government grants | 0 | 0 |
| Amortisation of PFI credit | 0 | 0 |
| (Increase)/Decrease in trade and other receivables | (313) | 528 |
| (Increase)/decrease in other assets | 0 | 0 |
| (Increase)/decrease in inventories | (291) | 222 |
| Increase/(decrease) in trade and other payables | 6,159 | (1,033) |
| (Decrease)/increase in other liabilities | (394) | 333 |
| (Decrease)/increase in provisions | (1,074) | 225 |
| Tax (paid)/received | 0 | (1,502) |
| Movements in operating cashflow of discontinued operations | 0 | 0 |
| Other movements in operating cashflows | 0 | 0 |
| Net cash generated from/(used in) operations | 14,779 | 5,378 |

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This statement summarises the cash flows of the FT during the accounting period; that is, actual cash flowing in or out of the organisation.

This is the operating surplus taken from the Statement of Comprehensive Income. But an operating surplus /deficit cannot be transferred into an increase/decrease in actual cash held by the FT as it includes cash and non-cash transactions. The rest of this statement strips out the non-cash transactions – adding back expenditure such as depreciation that did not involve a real cash outlay and subtracting non-cash income to leave just the change in cash during the year.

Included in the operating surplus above is income transferred from the donated asset reserve to match depreciation on donated assets. This is a non-cash item and therefore needs to be deducted to calculate the cash flow. The associated depreciation is also a non-cash item but this has already been addressed in the depreciation line above.

Changes in the levels of any of these impact on the amount of cash the NHS trust has, so they need to be accounted for here. For instance stock is only charged to the Statement of Comprehensive Income as it is used, so an increase in stock compared with the previous year means that more cash has been tied up in stock. The value of this increase needs to be subtracted from the operating surplus/deficit to give the cash impact of this increase in stock. It is similar for receivables, in other words, money owed to the NHS trust. The money owed to the NHS trust will already have been recorded as income in the Statement of Comprehensive Income, despite the cash not having been received yet. To understand the cash impact, the operating surplus/deficit has to be reduced by the amount of cash the NHS trust is still waiting to receive. However, the receivables due at the end of the previous year are likely to have been received during the year, and these will not be reflected in the Statement of Comprehensive Income or in the operating surplus/deficit. So it is the difference between the receivables owing at the end of the current and previous years that will impact on the cash held. An increase in receivables (more cash owing) means the operating surplus/deficit has to be reduced to understand the cash impact.

| | Current year £000 | Prior year £000 |
|--|----------------------|--------------------|
| Cash flows from investing activities | | |
| Interest received | 514 | 603 |
| Purchase of financial assets | 0 | 550 |
| Sales of financial assets | 0 | 0 |
| Purchase of intangible assets | (321) | (256) |
| Sales of intangible assets | 0 | 0 |
| Purchases of property, plant and equipment | (7,398) | (5,628) |
| Sales of property, plant and equipment | 0 | 0 |
| Cash flows attributable to investing activities of discontinued operations | 0 | 0 |
| Cash flows from acquisition of business units and subsidiaries | 0 | 0 |
| Cash flows from disposal of business units and subsidiaries | 0 | 0 |
| Net cash generated from/(used in) investing activities | (7,205) | (4,731) |
| Cash flows from financing activities | | |
| Public dividend capital received | 0 | 3,550 |
| Public dividend capital repaid | 0 | 0 |
| Loans received | 0 | 0 |
| Loans repaid | 0 | 0 |
| Capital element of finance lease rental payments | 0 | 0 |
| Capital element of PFI obligations | (219) | (321) |
| Interest paid | 0 | 0 |
| Interest element of finance leases | 0 | 0 |
| Interest element of PFI obligations | (43) | (41) |
| Public dividend capital dividend paid | (3,517) | (3,001) |
| Cash flows attributable to financing activities of discontinued operations | 0 | 0 |
| Cash flows from (used in) other financing activities | 0 | 0 |
| Net cash generated from (used in) financing activities | (3,779) | 187 |
| Increase/(decrease) in cash and cash equivalents | 3,795 | 834 |
| Cash and cash equivalents at 1 April | 16,980 | 16,146 |
| Cash and cash equivalents at 31 March | 20,775 | 16,980 |

Cash received on short-term deposits and paid out relating to costs of financing the FT. For example, interest received from cash on short-term interest bearing accounts and interest paid on any loans and interest charges under finance leases.

Payments for new capital assets and receipts from assets sales.

New public dividend capital is available to finance capital expenditure on schemes supported by DH central capital budgets. To qualify for public dividend capital, an FT must usually demonstrate that it has a financing requirement after utilising all its cash from depreciation and fixed asset disposals. Public dividend capital is also available to finance the purchase of assets from other NHS organisations using a circular flow of funds arrangement. Public dividend capital transactions are unusual.

Public dividend capital has no fixed repayment period, but the Department of Health can require public dividend capital repayments for example for excess capital receipts.

This includes all loans received by an FT.

Finance lease payments are split between the amount which represents buying the asset and the interest charged. There is a similar disclosure for PFI payments.

The public divided capital dividend paid to the Department of Health.

This is the total of the cashflows from the FT's operating, investing and financing activities. This figure represents a net cash inflow. A bracketed figure would mean that the FT's holding of cash and equivalents had reduced in the year as more cash flowed out of the FT than in.

A cash equivalent is a short-term investment that can be turned into cash within 24 hours without penalty.

Adding the net increase in cash to the previous year's cash held figure gives the new figure for cash held at the end of the year.

Questions

Do the figures seem reasonable and complete, including those entries that are zero?

Does the FT's reported cash flow position correspond with that reported during the financial year?

Are you satisfied with the reasons for negative cash flow (more cash flowing out of the FT than in) in respect of investing and financing operations?

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Questions

Has the FT made any loan repayments during the year?

Are you aware as to why the FT has a loan and what its repayment profile is?

Has the FT bought any assets during the year? Can you see them in the payments for property, plant and equipment?

Has the FT bought any subsidiaries or other organisations during the year? Can you identify the cash outflows that resulted?

Do the changes in cash and cash equivalents match the movement in cash and cash equivalents on the Statement of Financial Position?

Have the FT's cash balances increased overall during the year? Is there a long-term plan as to how to use these balances?

Statement of Changes in Taxpayers' Equity

| | Total | Minority interest | Public dividend capital | Revaluation reserve | Donated assets reserve | | Available for sale investment reserve | Other reserves | Merger reserve | Pension reserve | Income and expenditure reserve |
|---|----------------|-------------------|-------------------------|---------------------|------------------------|--|---------------------------------------|----------------|----------------|-----------------|--------------------------------|
| | £000 | £000 | £000 | £000 | £000 | | £000 | £000 | £000 | £000 | £000 |
| Taxpayers' Equity at 1 April – as previously stated | 218,756 | 0 | 72,480 | 69,403 | 2,906 | | 0 | 0 | 0 | 0 | 73,967 |
| Prior period adjustment | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Taxpayers' Equity at 1 April – restated | 218,756 | 0 | 72,480 | 69,403 | 2,906 | | 0 | 0 | 0 | 0 | 73,967 |
| Surplus/(deficit) for the year | 267 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 267 |
| Share of comprehensive income from associates and joint ventures | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Revaluation gains/(losses) and impairment losses on intangible assets | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Revaluation gains/(losses) and impairment losses property, plant and equipment | (2,879) | 0 | 0 | (2,879) | | | 0 | 0 | 0 | 0 | 0 |
| Revaluation gains/(losses) and impairment losses arising from classifying non-current assets as Assets Held for Sale | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Fair Value gains/(losses) on Available-for-sale financial investments | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Recycling gains/(losses) on Available-for-sale financial investments | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Increase in the donated asset reserve due to receipt of donated assets | 2,770 | 0 | 0 | 0 | 2,770 | | 0 | 0 | 0 | 0 | 0 |
| Reduction in the donated asset reserve in respect of depreciation, impairment, and/or disposal of on donated assets | (2,542) | 0 | 0 | 0 | (2,542) | | 0 | 0 | 0 | 0 | 0 |
| Additions/(reduction) in Other reserves | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Other recognised gains and losses | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Actuarial gains/(losses) on defined benefit pension schemes | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Transfers to the income and expenditure account in respect of assets disposed of | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Transfer of the excess of current cost depreciation over historical cost depreciation to the Income and Expenditure Reserve | 0 | 0 | 0 | (1,034) | 0 | | 0 | 0 | 0 | 0 | 1,034 |
| Public Dividend Capital received | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Public Dividend Capital repaid | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Public Dividend Capital repayable (creditor) | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Public Dividend Capital written off | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Other transfers between reserves | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Movements on other reserves | 0 | 0 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Taxpayers' Equity at 31 March | 216,372 | 0 | 72,480 | 65,490 | 3,134 | | 0 | 0 | 0 | 0 | 75,268 |

A comparative note showing the changes in taxpayers' equity in the previous year is also required.

This statement shows the movement in reserves in the period. It shows in greater detail how taxpayers' equity, used to finance the total assets employed, changed between the current and previous year.

You should see these figures on the Statement of Comprehensive Income.

You should see each of the figures on these rows in the taxpayers' equity section of the Statement of Financial Position.

When an item of purchased property, plant and equipment is revalued upwards, there is a corresponding increase in the revaluation reserve. To write out this balance over the life of the asset it is depreciated at the same rate as the asset and that depreciation is accounted for as a transfer from the revaluation reserve to the income and expenditure reserve. The depreciation is still charged to the Statement of Comprehensive Income.

These lines should each net to zero.

Questions

Do the figures that come from the Statement of Comprehensive Income and Statement of Financial Position agree with those statements?

Do the lines that should net to zero when added together do so?

Has there been a prior period adjustment? Is this due to a change in accounting policy which should be reflected in the opening note to the accounts?

Are there any large changes to the revaluation reserve?

Have these been explained and does the reason fit with what you know?

Has there been a transfer between reserves? Has this been explained?

Notes to the accounts

1 Accounting policies

This section sets out the accounting rules, which the FT follows when preparing its accounts. This forms the basis on which all entries in the accounts are made. These policies are largely dictated by IFRS and the *Foundation Trust Annual Reporting Manual*.

One of the main policies is that the FT recognises income and expenditure on an accruals basis, meaning the FT records it in the period in which services are provided and not necessarily when it receives or pays out cash. Where the FT receives income for an activity it is to deliver in the following year, it defers that income. This means it does not record it as income in the Statement of Comprehensive Income in that year but in the following year when it delivers the activity. However, the cash received will be included in the FT's bank account, reported on the Statement of Financial Position, in the year it is received and so the FT recognises a liability on the Statement of Financial Position to acknowledge that it has yet to carry out the activity related to the income. The liability is removed when the FT delivers the service and the income is recognised.

The accounting policy note also sets out the FT's approach to when purchases should be recorded as capital rather than revenue expenditure and how assets should be valued and depreciated.

1.1 Critical accounting estimates and judgements

The preparation of annual accounts requires FTs to make estimates and assumptions that affect the application of policies and reported amounts. Accounting standards require estimates and judgements to be continually evaluated and to be based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The estimates and assumptions which have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year need to be discussed here.

Examples could include assumptions in relation to post employment benefits, material provisions and revenue recognition in respect of incomplete patient spells.

2 Segmental analysis

FTs need to disclose financial information not just for the FT as a whole but also on significant segments of their operations. These disclosures reflect the way that management runs the FT. The basis of the disclosure is therefore the financial reports the FT uses to manage its business and allocate its resources. The disclosure needs to include the income and expenditure, profit or loss and, in some circumstances, assets and liabilities of each significant segment as the FT reports them internally. A significant segment is one whose revenue, or if this is not routinely used then its expenditure, is at least 10 per cent of that of the FT as a whole.

The information disclosed in the accounts must reflect exactly that reported internally, for example if internal reports include internal recharges then the FT must include these figures in the segmental analysis. As the FT may not prepare its internal financial reports on an IFRS basis, the FT must also include a reconciliation of the segmental analysis to the total amounts it is reporting in the accounts.

An FT may, however, aggregate the financial information for operating segments that have similar characteristics in respect of the following:

- nature of services;
- type or class of customer, for example NHS or private; and
- methods used to provide the services.

Questions

Are the segments shown in this note consistent with the categories reported to the board and governors?

If there is only one segment, (healthcare), are you aware of any other segments that should be reported here?

If another segment is reported, does it correspond to what you know of the FT?

3 Operating income

This note gives a more detailed breakdown of the FT's operating income by type (Note 3.1) and by source (Note 3.4). It also gives more information on the level of private patient income earned by the FT (Note 3.2) and the income the FT has earned by leasing out an asset under an operating lease agreement (Note 3.3). An operating lease is a lease using an asset for only a proportion of the asset's useful life and value. It is distinct from a finance lease which is defined as a lease where the risks and rewards of ownership transfer to the lessee. An asset rented out under an operating lease appears on the FT's Statement of Financial Position whereas an asset rented out under a finance lease would appear on the lessee's Statement of Financial Position.

3.1 Operating income (by classification)

| Income from activities | Current year £000 | Prior year £000 | |
|--|----------------------|--------------------|---|
| Elective income | 38,767 | 33,990 | |
| Non-elective income | 78,848 | 70,464 | Income from planned admissions. |
| Outpatient income | 21,713 | 17,444 | Income from unplanned or emergency admissions. |
| A&E income | 17,000 | 12,596 | Income from providing outpatient services. |
| Other NHS clinical income | 42,156 | 39,885 | Income from providing A&E services. |
| Private patient income | 15,640 | 10,060 | Income from healthcare that does not fit into the categories above. Examples include income from providing intensive care and high dependency care. |
| Other non protected clinical income | 1,516 | 998 | Includes income from UK private patients and from overseas patients not covered by reciprocal arrangements. |
| Total income from activities | 215,640 | 185,437 | |
| Other operating income | | | |
| Research and development | 3,312 | 2,863 | The main element of this is usually amounts the FT has charged to insurance companies for treating patients injured in car accidents and other insured injuries. |
| Education and training | 10,676 | 10,121 | Income received from NHS and other bodies for research and development. |
| Charitable and other contributions to expenditure | 5,796 | 5,056 | Funds to cover the costs of providing education and training come from medical and professional education and training levies. These funds are allocated by the Department of Health. |
| Transfer from donated asset reserve in respect of depreciation on donated assets | 53 | 51 | Contributions from charitable funds to the FT's expenditure. |
| | | | Notional income to balance out the depreciation charge relating to donated assets. |

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3.1 Operating income (by classification)

| Income from activities | Current year £000 | Prior year £000 |
|---|----------------------|--------------------|
| Non-patient care services to other bodies | 15,718 | 14,880 |
| Other | 7,840 | 6,996 |
| Profit on disposal of fixed asset investments | 0 | 0 |
| Profit on disposal of intangible assets | 0 | 0 |
| Profit on disposal of land and buildings | 0 | 0 |
| Profit on disposal of other non-current assets | 0 | 0 |
| Gain on disposal of assets held for sale | 0 | 0 |
| Reversal of impairments of assets held for sale | 0 | 0 |
| Amortisation of PFI deferred credits – main scheme | 0 | 0 |
| Amortisation of PFI deferred credits – additional life-cycle assets | 0 | 0 |
| Total other operating income | 43,395 | 39,967 |
| Total operating income | 259,035 | 225,404 |

Examples include laundry, pathology, payroll, and training.

Income from non-patient care activities such as car parking and catering.

A further analysis of other operating income is required if the total is material.

These amounts represent the excess of the amount received on disposal of the asset over its final value in the accounts.

This represents the reversal of a previously recognised fall in value of the asset held for sale.

3.2 Private patient income

| Income from activities | Current year £000 | Prior year £000 | Base year 2002/03 £000 |
|------------------------------|----------------------|--------------------|------------------------------|
| Private patient income | 15,640 | 10,060 | 9,525 |
| Total patient related income | 215,640 | 185,437 | 104,674 |
| Proportion as a percentage | 7.3% | 5.4% | 9.1% |

The proportion of private patient income in relation to the total patient related income must not exceed the equivalent percentage earned as an NHS trust in 2002/03. This is called the private patient cap. Private patient income includes income arising from goods and services provided by the FT directly to private patients and its share of any income from private patients earned by its subsidiaries, jointly controlled operations or associates. The private patient cap forms part of the FT's terms of authorisation. In this example the FT has met the requirement as it has not exceeded the base year percentage.

3.3 Operating lease income

| Income from activities | Current year £000 | Prior year £000 |
|---|----------------------|--------------------|
| Operating lease income | | |
| Rents recognised as income in the period | 229 | 209 |
| Contingent rents recognised as income in the period | 0 | 0 |
| Total | 229 | 209 |
| Future minimum lease payments due | | |
| Not later than one year | 436 | 229 |
| Later than one year but not later than five years | 2,000 | 2,000 |
| Later than five years | 2,800 | 2,800 |
| Total | 5,236 | 5,029 |

The income due in the year from operating leases.

Contingent rent is the portion of the lease income that is not fixed but based on a variable factor such as inflation.

This is the total amount of income due under an operating lease split by the timing of when it is due.

3.4 Income from activities

| Income from activities | Current year £000 | Prior year £000 |
|--|----------------------|--------------------|
| NHS FTs | 1,009 | 507 |
| NHS trusts | 1,890 | 2,217 |
| Strategic health authorities | 3,527 | 3,065 |
| Primary care trusts | 190,490 | 167,038 |
| Local authorities | 0 | 0 |
| Department of Health – grants | 0 | 0 |
| Department of Health – other | 0 | 0 |
| NHS other | 1,568 | 1,552 |
| Non-NHS private patients | 15,640 | 10,060 |
| Non-NHS overseas patients (non-reciprocal) | 0 | 0 |
| NHS injury costs recovery scheme | 1,516 | 998 |
| Non NHS other | 0 | 0 |
| Total income from activities | 215,640 | 185,437 |

The main source of income is for work commissioned by PCTs.

Income received for joint care arrangements with local authorities or for delayed discharges.

Income from the Department of Health for patient care services.

Includes Scottish and Welsh health bodies.

If someone is injured in a road traffic accident, or they incur another insured injury and require hospital treatment the hospital is able to charge a standard accident and emergency attendance fee and claim some of the cost of any inpatient care.

FTs should also disclose the source of each category of other operating income.

Questions

Do the income figures appear reasonable and can officers explain the reasons for the significant changes from the previous year?

How has income from patient care activities changed during the year?
Does it fit with previous reports on performance against contracts?
Can the PCTs concerned pay for any over performance?

Consider how much income the FT receives through research and development. Does it contain any significant time-limited amounts?

Has there been an increase in income through the NHS Injury Cost Recovery Scheme? Is it a one-off increase in a trend?

Does the level of private patient income look reasonable? If it is not within the cap based on the base year percentage, you should ask further questions and ensure the FT has informed Monitor as this is a breach of its terms of authorisation.

4 Operating expenses

This note gives a more detailed breakdown of the FT's operating expenses (Note 4.1). It also gives more information on the expenditure the FT has incurred renting assets under operating leases (Notes 4.2 and 4.3).

It should be noted that some arrangements that do not take the legal form of a lease will need to be accounted for in the same way as a lease.

The key factors are whether the agreement:

- depends on the use of a specific asset; and
- conveys to the FT the right to use that asset.

4.1 Operating expenditure

| | Current year £000 | Prior year £000 | |
|---|----------------------|--------------------|---|
| Services from FTs | 1,094 | 0 | These three lines list the FT's expenditure under contracts with other FTs, NHS trusts and other NHS bodies, including PCTs. It might typically include services such as pathology, speech therapy, occupational health services or back office functions such as payroll. |
| Services from NHS trusts | 1,504 | 1,763 | This is the FT's expenditure on patient care provided by non NHS bodies such as private hospitals. |
| Services from other NHS bodies | 936 | 930 | Employment costs are split between NEDs, executive directors and other staff including agency and other temporary staff. |
| Purchase of healthcare from non NHS bodies | 0 | 0 | The cost of supplies is split between drugs, other clinical supplies and general supplies. |
| Employees expenses – executive directors | 1,224 | 1,212 | Establishment includes items such as printing, postage, telephone, advertising and travel expenses. Transport includes vehicle insurance, fuel and oil, maintenance equipment and hire of transport. Premises include all the FT's utility costs, furniture and other property related revenue expenditure such as rates, rent and insurance. |
| Employees expenses – non executive directors | 183 | 180 | Depreciation is an accounting charge recognising that capital assets are consumed over their useful lives. There is no cash outlay to this expenditure, the retained cash generated from depreciation charges is used to fund capital expenditure or repay amounts of public dividend capital. Amortisation is the equivalent charge for intangible assets. |
| Employee expenses – staff | 122,172 | 106,772 | These are debts written off during the year because they will not be paid and provision for other debts, which are unlikely to be paid in the future including road traffic accident claims. |
| Drugs costs | 38,631 | 35,876 | A fall in the value of the asset that is not matched by a balance in the revaluation reserve. See Box C on Page 40. |
| Supplies and services – clinical (excluding drugs) | 52,841 | 46,678 | An increase in the value of an asset reversing an impairment previously charged to expenditure. |
| Supplies and services – general | 8,456 | 5,487 | |
| Establishment | 3,877 | 3,580 | |
| Research and development | 3,312 | 2,863 | |
| Transport | 577 | 560 | |
| Premises | 9,531 | 9,121 | |
| Increase/(decrease) in bad debt provision | 22 | 12 | |
| Other impairment of financial assets | 0 | 0 | |
| Depreciation on property plant and equipment | 4,899 | 4,555 | |
| Amortisation of intangible assets | 30 | 30 | |
| Impairments of property plant and equipment | 2,501 | 0 | |
| Impairments of intangible assets | 0 | 0 | |
| Reversal of impairments of property plant and equipment | 0 | 0 | |
| Reversal of impairments of intangible assets | 0 | 0 | |

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| | Current year £000 | Prior year £000 |
|--|----------------------|--------------------|
| Audit fees | | |
| - audit services – statutory audit | 86 | 88 |
| - audit services – regulatory reporting | 0 | |
| Other auditors remuneration | | |
| - further assurance services | 2 | 0 |
| -other services * | 0 | 0 |
| Clinical negligence | 800 | 780 |
| Loss on disposal of investments | 0 | 0 |
| Loss on disposal of intangible assets | 0 | 0 |
| Loss on disposal of land and buildings | 0 | 0 |
| Loss on disposal of other property plant and equipment | 2 | 0 |
| Loss on disposal of assets held for sale | 0 | 0 |
| Impairment of assets held for sale | 0 | 0 |
| Other ** | 3,040 | 2,846 |
| Total | 255,720 | 223,333 |

Amounts paid to the external auditors are analysed over the services they provided.

The FT pays an annual premium to the NHS Litigation Authority as part of the Clinical Negligence Scheme for Trusts.

These amounts represent a deficit in the amount received on disposal of the asset when compared with its last recorded value in the accounts.

A fall in value of assets held for sale.

All other expenditure – if it is material the FT will need to provide a further analysis of this figure.

* Other audit services needs to be further analysed for example taxation services, IT services or corporate finance.

** Where other costs are significant they should be further analysed for example consultancy fees, car parking and security, training courses and conferences.

4.2 Arrangements containing an operating lease

| | Current year £000 | Prior year £000 |
|---------------------------------|----------------------|--------------------|
| Minimum lease payments | 368 | 368 |
| Contingent rents | 0 | 0 |
| Less sublease payments received | 0 | 0 |
| Total | 368 | 368 |

These are payments made under operating leases in the year. These costs will be included in the appropriate section of operating expenses, for example premises or transport.

4.3 Arrangements containing an operating lease of land and buildings

| | Current year £000 | Prior year £000 |
|--|----------------------|--------------------|
| Future minimum lease payments due | | |
| - not later than one year | 272 | 368 |
| - later than one year but not later than five years | 938 | 1,210 |
| - later than five years | 0 | 0 |
| Total | 1,210 | 1,578 |
| Total of future minimum sublease lease payments to be received at the reporting date | 0 | 0 |

This is the total amount of expenditure that the FT is committed to under operating leases, split by the timing of when it is due.

4.4 Limitation on auditor's liability

The FT needs to disclose any limitation of the auditor's liability. This will be zero unless the auditor has agreed a limitation with the FT and its members.

4.5 Late payment of commercial debts

The note also shows any interest and compensation the FT has incurred under the Late Payment of Commercial Debts (interest) Act 1988.

Box C

Impairments of non-current assets

Impairment is the reduction in an asset's value, or loss compared with the value recorded in the Statement of Financial Position. Impairments occur for a variety of reasons and can arise from:

- a loss of economic benefit to an asset itself, for example, physical damage or an asset becoming obsolete;
- an asset becoming surplus to requirement; or
- a change in the asset or the business environment that has permanently reduced its capacity to generate revenue.

Alternatively, impairments may come to light as a result of the routine five-yearly revaluation of NHS assets or as part of a valuation in preparation for redevelopment or disposal of property assets.

If something happens to the asset or the environment in which it is used that could indicate a loss of economic value. NHS bodies are required to undertake an impairment review.

If an impairment in an asset value is identified then the first action is to reduce the value of the asset in the top half of Statement of Financial Position. The top and bottom halves of the Statement of Financial Position must remain in balance. If the asset in question has previously been subject to increases in valuation, these increases will have been added to the revaluation reserve. Therefore, if the revaluation reserve for this asset is greater than or equal to the impairment then the FT simply makes a corresponding reduction in the revaluation reserve, so keeping the Statement of Financial Position in balance. However, if the impairment is greater than the revaluation reserve for that asset then the excess amount is recorded as expenditure in the Statement of Comprehensive Income. This expenditure would then impact on the balance transferred to the income and expenditure reserve, again keeping the two halves of the Statement of Financial Position in balance.

As land and buildings are reported separately in the notes to the Statement of Financial Position, impairments and revaluations need to be analysed between them.

Gains and losses recognised in the revaluation reserve are reported as other comprehensive income which features on the bottom half of the Statement of Comprehensive Income and features on the Statement of Changes in Taxpayers' Equity.

As impairments do not involve a cash payment they are excluded from the Statement of Cash Flows.

Questions

Do the expenditure figures appear reasonable and can officers explain the reasons for any significant changes from the previous year?

Directors' and staff costs are often of interest to users of the accounts. Are you satisfied that these are correct?

Can officers explain the level of bad debts that have been provided for and written off?

What expenditure has been included in the 'other' category?

Can officers explain the reasons for any significant changes in leasing costs and or commitments?

Is the auditor's limitation of liability disclosed as zero? If not, do you know why?

Can you see the impact of any savings schemes?

Has the FT purchased additional capacity from a private hospital? Can officers explain why this activity could not be done within the FT's own resources?

Has the FT incurred any expense under the Late Payment of Commercial Debts (Interest) Act 1998? If so do you know why? For example does it indicate a cash flow difficulty or possibly a temporary shortage of staff processing invoices?

Has there been a loss on the disposal or sale of an asset? Was this expected?

5 Directors' remuneration, staff costs and numbers

5.1 Directors' remuneration

The *Annual Reporting Manual* requires FTs to include a remuneration report in their annual report and accounts. The remuneration report discloses information on the remuneration of those people having the authority or responsibility for directing or controlling the FT.

In addition to the remuneration report the FT must disclose, in a note to the accounts, the aggregate of remuneration and other benefits received by directors during the financial year under the headings of:

- directors' remuneration;
- gains made by directors on the exercise of share options;

- money paid and the net value of assets receivable by directors, under long-term incentive schemes;
- employer contributions to a pension scheme in respect of directors;
- the total number of directors to whom benefits are accruing under money purchase schemes and defined benefit schemes;
- all advances to directors and repayments of advances; and
- the maximum liabilities under guarantees and amounts paid under such guarantees.

5.2 Employee expenses

IFRS require further analysis between: short-term employee benefits, for example, salaries, allowances and employer's National Insurance; post-employment benefits, for example, employer pension contributions; other long-term benefits; termination benefits; and share-based payments.

This note also gives details about the cost of employees employed by the FT including executive directors but excluding NEDs. It includes short-term contract, agency and other temporary staff and also the cost of inward secondments. Where a member of staff is employed jointly with another NHS body the FT only records as expenditure its share of the employee's salary.

5.3 Employee numbers

This note corresponds to Note 5.2 and therefore includes the same staff. It measures whole-time equivalents.

5.4 Employee benefits

FTs need to disclose the total amount spent on employee benefits during the year.

5.5 Pension costs

The note details the valuation and scheme provisions of the NHS pension scheme.

5.4 Retirements due to ill health

This note is a Treasury requirement in which the FT must set out both the number and estimated additional pension liabilities that have occurred during the year. This information is provided by the NHS Pensions Agency.

Questions

To the best of your knowledge, does the disclosure in relation to directors' remuneration appear complete?

Does any movement in staff costs correspond to the change in staff numbers? If there are significantly more people in post compared to this time last year, has a new service come on stream?

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Questions

Has management reconciled staff costs in this note to staff costs per the operating expenses note?

Do any material amounts of employee benefits and early retirements due to ill health correspond with your expectations?

Can you see the impact of any savings programmes during the year which may have included a reduction in headcount?

6 Profits and losses on disposal of fixed assets

The accounts should analyse any profits and losses on disposal of non-current assets between those arising from the disposal of protected and non-protected assets. Protected assets are those used in the delivery of the FT's mandatory services; the FT cannot dispose of these assets without permission from Monitor.

The profit or loss is the difference between the sale proceeds (less any costs incurred in disposing of the asset) and the net book value of the asset.

7 Finance income

Finance income is analysed by source:

- interest from loans and receivables;
- interest from financial assets available for sale;
- interest from financial assets held to maturity; and
- other gains and losses on financial assets.

8 Finance expenditure

Similarly, finance expenditure is also analysed by type:

- interest on loans from the FT financing facility;
- interest on commercial loans;
- interest on overdrafts;
- finance lease interest;
- PFI finance costs (see Box D on Page 52); and
- other.

9 Intangible fixed assets

An intangible asset is defined as an identifiable non-monetary asset that does not have physical substance such as software licences, trademarks, patents, EU emission allowances, goodwill and internally generated intangible assets.

Expenditure involved in the internal generation of an intangible asset falls into two phases – research and development. The FT cannot recognise an intangible asset during the research phase and must recognise these costs as operating expenses. The FT recognises an intangible asset in the development phase only if it can demonstrate that it can and will complete the asset then use it to generate future economic benefits.

A table tracks through the value of intangible fixed assets from their value at the beginning of the year, taking account of additional purchases, donations, disposals, revaluations and amortisation to arrive at the new total value for the year-end.

The note also shows the value of intangible assets purchased using a government grant and, for each type of intangible asset, the minimum and maximum periods over which the assets are amortised (the expense charged to the statement of comprehensive income).

10 Property, plant and equipment

Under the broad heading of property, plant and equipment, this section analyses asset values in the following areas: land; buildings; dwellings; assets under construction; plant and machinery; transport equipment; information technology; and furniture and fittings. They are recorded in the accounts at fair value. For non-specialised property, such as office buildings, this means they are valued at the market value for buildings with similar use. Specialised properties are valued at depreciated replacement cost where the cost is that of a modern equivalent. See Box B on Page 22.

There are a number of disclosures required for property, plant and equipment. First, a table shows the changes in each category of property, plant and equipment during the year. Opposite is an example for buildings.

A further table with the same headings is required for any assets held by the FT under finance leases.

The split of net book value for land, buildings and dwellings is also analysed here between protected and non-protected assets.

As for intangible assets the FT must also disclose, for each category of property, plant and equipment, the minimum and maximum economic life over which it is depreciating them. The accounts also show the reason for any impairment of intangible assets, property, plant and equipment.

The FT must disclose details of any non-current assets held for sale. The note sets out the values associated with assets held for sale within the year by asset group. It shows the balances brought forward for each, the movements in the year and the balances carried forward as at the 31 March. Where assets have been impaired the FT must disclose the reasons for the impairment such as loss or damage, abandonment or changes in the market place.

Property, plant and equipment

| | Buildings excluding dwellings £000 |
|--|---------------------------------------|
| Cost or valuation | |
| At 1 April | 129,022 |
| Prior period adjustment | 0 |
| Cost or valuation as restated | 129,022 |
| Additions purchased | 2,339 |
| Additions donated | 0 |
| Acquisition through business combination | 0 |
| Impairments charged to the revaluation reserve | (2,879) |
| Reclassifications | 1,590 |
| Revaluation surpluses | 0 |
| Transferred to disposal group as asset held for sale | 0 |
| Disposals | 0 |
| Cost or valuation at end of year | 130,072 |
| Depreciation | |
| Accumulated depreciation at start of year | 0 |
| Provided during the year | 3,395 |
| Acquisition through business combination | 0 |
| Impairments recognised in operating expenses | 2,501 |
| Reversal of Impairments | 0 |
| Reclassifications | 0 |
| Revaluation surpluses | 0 |
| Transferred to disposal group as asset held for sale | 0 |
| Disposals | 0 |
| Accumulated depreciation at end of year | 5,896 |
| Net book value | |
| - Purchased at beginning of year | 123,516 |
| - Donated at beginning of year | 5,506 |
| Total at beginning of year | 129,022 |
| - Purchased at end of year | 121,584 |
| - Donated at end of year | 2,592 |
| Total at end of year | 124,176 |

This is the gross value of assets (see Box B on Page 22 for more detail).

These are buildings that the FT has acquired as a result of taking over or merging with another business rather than specifically purchased.

Impairments are charged to the revaluation reserve up to the value in the reserve for that asset with any excess recognised in operating expenses. Like depreciation, impairment reduces the value of an asset and so impairments are considered in determining the total accumulated depreciation. See Note 18 for a more detailed explanation of the revaluation reserve.

Reclassifications should net to zero across property, plant and equipment as a whole.

This FT has recently revalued its assets. Following a revaluation accumulated depreciation is netted off the valuation figure so is shown as zero here.

An asset's net book value – is the value it is recorded at in the Statement of Financial Position. The net book value is equal to the cost or valuation less accumulated depreciation.

Questions

Does the asset classification agree with your knowledge of the FT's assets?

Are additions and disposals consistent with your knowledge of the FT's capital programme?

Has there been a reclassification out of assets under construction into property, plant and equipment? Does the FT have a new building that has just become operational?

Has there been an impairment of any intangible asset or item of property plant and equipment? If so do you understand why and does the explanation make sense in the light of your knowledge of the activities of the FT and the economic climate?

11 Non-current investments

There are two categories of investments: non-current and current. FTs hold non-current investments for the longer term, over one year, whereas they hold current investments for less than one year.

This note gives details of the FT's non-current investments between investments in property, associates and jointly controlled operations and other investments.

Only those assets which the FT holds solely to generate a commercial return are considered to be investment properties. Properties occupied by employees, whether or not they pay rent at market rates, are not investment properties.

An associate is an entity over which the FT has significant control and a jointly controlled operation is one where it shares control with one or more other bodies in accordance with an agreed contract.

12 Inventories

This section analyses the FT's stock and any work in progress. Work in progress relates only to stock items and not partially completed spells of healthcare and as such should be rare.

This note also discloses the amount of inventories charged to expenditure in the year and the amount written off the value of inventories in the year, for example drugs past their use-by date.

Questions

If the figures are significant, what do they relate to? Is this consistent with what you know of the FT?

If the stock figure is different to last year why is this?

13 Trade and other receivables

This note analyses trade and other receivables between current amounts (the amounts falling due within one year) and non-current amounts (those due after more than one year).

Receivables include income which the FT has recorded in its Statement of Comprehensive Income for goods or services it provided in the year but for which it has not received payment at the reporting date. These amounts are also known as debts.

Receivables also include prepayments. These are amounts the FT paid in the year for goods or services it will receive after the period end. The FT will record these amounts as operating expenses in the following year's Statement of Comprehensive Income. Prepayments should only be made to organisations that have sound financial standing and where the FT gains value from the prepayment, for example, a discount for early payment.

The note also identifies any provision for potential bad debts (that is, the debts the FT does not expect to be paid) and the movement in the provision over the year. In addition, the FT must show the age of receivables that are impaired in this way and also those that are past their due date but which the FT does not consider to be impaired.

Questions

Are there any particularly large receivables this year, or significant changes from the prior year? Can officers explain the reasons for these?

Have prepayments only been made to organisations that have sound financial standing and where the FT gains value from the prepayment?

Does the provision for impairment of receivables look reasonable?

If there are any large amounts, what do they relate to and why does the FT not expect to be paid?

14 Trade and other payables

Trade and other payables, also known as creditors, represent money owed by the FT but as yet unpaid or goods and services paid for in advance but not yet delivered by the FT at the reporting date. They are analysed into two groups: current (those due within one year) and non-current (those due after more than one year).

The FT also discloses other liabilities which are deferred income (money received in the year which relate to goods or services to be provided by the FT in the next year), deferred PFI credits, deferred government grants and any net pension scheme liability in relations to a defined benefit scheme other than the NHS scheme.

Questions

Are there any particularly large trade or other payables this year, or significant changes from the prior year? Can officers explain the reasons for these?

Can officers explain significant receipts in advance and deferred income?

15 Borrowings

The FT must provide separate disclosure of its borrowings analysed by type such as overdrafts, loans and amounts due under finance leases. It must also provide further analysis of its finance lease obligations, including obligations under PFI schemes, analysed by when they will fall due. For more on accounting for PFI schemes see Box D on Page 52.

Questions

If there is any significant entry here, what does it relate to?

Does it reflect what has been agreed?

16 Prudential borrowing limit

Monitor is required to devise a code to determine a limit on the total amount of borrowing by an FT. This is known as the prudential borrowing code. An FT is required to comply with and remain within a prudential borrowing limit based on that code. The prudential borrowing limit is reviewed at least annually and is part of the FT's terms of authorisation. It is made up of two elements:

- The long-term borrowing limit. Monitor sets this annually based on an assessment of the FT's financial risk and it forms part of the FT's terms of authorisation. Monitor sets what is known as a tier 1 limit for FTs, based on their annual plans and in accordance with certain ratios. In certain appropriate circumstances however, Monitor may set a tier 2 limit to allow for affordable major investments such as PFI schemes. FTs may apply to Monitor for a tier 2 limit if their plans suggest that they will breach their tier 1 limit.
- The amount of any working capital facility approved by Monitor. This is an additional level of short-term borrowing which may be used for short-term cash flow management. It should not be treated as prudential borrowing for other uses. The size of the facility will vary according to the individual circumstances of each FT although, as guidance, a working capital facility equivalent to 30 days' operating expenditure would not be seen as unreasonable.

17 Provisions for liabilities and charges

A provision is a liability where the amount and the timing are uncertain. Box A on Page 16 provides further information as to what constitutes a provision. The main types of provision are for pensions and legal claims. This note shows the movements in each type of provision in the year.

If it is more likely that the claim will fail and the FT will not have to make a payment it should not make a provision but disclose a contingent liability (see Note 22).

The FT also needs to disclose how much is included in the provisions of the NHS Litigation Authority in respect of clinical negligence liabilities of the FT.

Questions

Are provisions reasonable to cover the FT against future liabilities?

Are there any other potential liabilities that you know of that might be missing from this note?

18 Revaluation reserve

When an item of property, plant and equipment (other than one that has been donated) is revalued upwards, there is a corresponding increase in the revaluation reserve, so keeping the two halves of the Statement of Financial Position in balance. There has been no additional external financing involved to boost the value of the asset, so the increased value is matched by an increase in the revaluation reserve for that asset. When an item of property, plant and equipment (other than one that has been donated) is revalued downwards (impaired) the fall is charged to the revaluation reserve up to the value in the reserve for that asset, with any excess recognised in operating expenses. When the FT disposes of an item of property plant and equipment (other than one that has been donated) it transfers any balance remaining in the revaluation reserve for that asset to the income and expenditure reserve.

Any upward revaluation of property, plant and equipment is depreciated in the same way that the original cost is. The FT may, however, transfer an amount equal to this depreciation from the revaluation reserve to the income and expenditure reserve on an annual basis. This is described as 'transfer of the excess of current cost depreciation over historic cost depreciation'. The effect of this is to match the balance on the revaluation reserve with the unused element of any revaluation by reducing the revaluation reserve balance over the remaining useful life of the asset.

This note analyses the movements on the revaluation reserve in the year. When the FT disposes of an asset, any associated balance remaining in the revaluation reserve is transferred to the income and expenditure reserve.

19 Cash and cash equivalents

The FT has to analyse its cash and cash equivalents between amounts held in the Government Banking Service, commercial banks and other current investments.

The figure must exclude any cash held on behalf of patients (see Note 26).

Questions

If the FT is holding significant amount of cash or cash equivalents, do you know what plans the FT has for investing that cash?

20 Capital commitments

This provides details of future capital expenditure that the FT is committed to make, that is, contracted at the reporting date. For instance a contract may be in place to undertake future building works.

Questions

Is this note consistent with what you know of the FT's activities?

Are there any commitments you know of that are missing?

21 Events after the Balance Sheet date

If, in the period between preparing and adopting the financial statements, an event takes place that could have a bearing on the interpretation or understanding of the accounts, this is known as a post Balance Sheet event. If the event provides more information about the position at the reporting date, for example the decision on a legal case, then the FT should amend the statements to take it into account. If the event does not relate to the year of the accounts, for example a building is burned down in the new financial year, the FT should not amend the statements but should disclose the details in a note to the accounts.

22 Contingencies

Contingent liabilities

Where an event has happened before the year-end that may give rise to a future liability, but it is not possible to place a financial valuation on the outcome or it is only possible and not probable that the FT will have to make a payment, the FT is required to disclose this in the accounts as a contingent liability.

Contingent assets

An event may arise that gives rise to the possibility of income in the future. This is a contingent asset. The FT should not recognise a contingent asset in its accounts unless the receipt is virtually certain. If the inflow is probable, the FT should disclose the details in this note.

23 Related party disclosures

A related party is:

- an entity which the FT controls, is controlled by, or is under common control with or over which the FT has significant influence or joint control over;
- a member of the key management team of the FT or the Department of Health or a close member of the family of one of these people; or
- a pension plan for the benefit of employees of the FT.

This note provides details of any material transactions and balances between the FT and related parties. The FT will need to consider whether or not the working relationships it has with any charity, government departments, agencies, or other health bodies meet the definition of a related party and require the disclosure of any transactions here.

Questions

Does the disclosure in this note agree with your knowledge of the FT?

24 Private finance initiative transactions

Under IFRS, most PFI schemes should be on the FT's Statement of Financial Position. The treatment for these schemes is similar to that of a finance lease although further disclosure is required in relation to the risks associated with the scheme. The disclosure required is:

- a description of the arrangement;
- significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (for example, the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);
- the nature and extent (for example, quantity, time period or amount as appropriate) of:
 - rights to use specified assets;
 - obligations to provide or rights to expect provision of services;
 - obligations to acquire or build items of property, plant and equipment;
 - obligations to deliver or rights to receive specified assets at the end of the concession period;
 - renewal and termination options; and
 - other rights and obligations (for example, major overhauls);
- changes in the arrangement occurring during the period; and
- how the service arrangement has been classified.

Exceptionally, some PFI schemes may not result in the FT recording an asset on its Statement of Financial Position. The FT must disclose details of such schemes and the payments it is committed to under them.

Box D

Accounting for PFI schemes

PFI schemes are arrangements between the FT and a private sector body. The private sector body provides an asset and a service to the FT in return for payment, usually an annual unitary payment for both the asset and the service.

To determine the appropriate accounting treatment of a PFI scheme, the FT needs to consider the following:

- Does the FT control or regulate what services the operator must provide with the asset, to whom and at what price?
- Is the FT entitled to any value left in the asset at the end of the arrangement?

If the answer to both of these questions is yes, the FT should account for the asset as part of its property, plant and equipment and should also record a corresponding financial liability (payable or creditor). Each year the FT should split its annual unitary payment on the scheme between an amount for services and an amount for the property. The services element is charged to operating expenses. The property element is split between an amount to reduce the financial liability and an annual finance charge.

Questions

If the FT has a PFI scheme, is it disclosed here? Are the details of the scheme consistent with what you know?

25 Financial instruments

A financial instrument is a contract that gives rise to a financial asset in one entity and a financial liability in another. The disclosure covers financial assets and financial liabilities. The most likely financial assets that an FT may have are cash, shares and receivables and the most likely financial liabilities are trade and other payables. The FT may take advantage of the option not to disclose any short-term (due in less than one year) receivables and payables. This note also discloses the risks arising from financial instruments that the FT is invested in. It provides details of any currency, credit and interest rate risks that the FT is exposed to.

26 Third party assets

Assets belonging to third parties, such as money held on behalf of patients, are not recognised in the accounts since the FT has no beneficial interest in them. However, they are disclosed in a separate note to the accounts in accordance with the requirements of the *HM Treasury Financial Reporting Manual*.

27 Losses and special payments

Any losses or special payments are disclosed here. These are payments that Parliament would not have envisaged healthcare funds being spent on when it originally provided the funds such as fraudulent payments, personal injury payments and legal compensation.

Questions

If significant losses or special payments are disclosed here:

- were you aware of them and could they have been avoided; and
- what plans has the FT made to ensure that they will be avoided in the future?

28 Corporation tax

Guidance on the tax treatment of non-core healthcare (commercial) activities of FTs can be found at www.hmrc.gov.uk. The guidance is currently under review but it is anticipated that the current legislation will remain in place to at least to 31 March 2011. If an FT deems that it does not have a corporation tax liability it should disclose the basis of how that decision was made.

29 First time adoption of IFRS

This note will only be relevant for 2009/10. It reconciles key data reported for the organisation under IFRS with the corresponding data reported under UK GAAP. All adjustments made need to be explained.

30 Other notes

Where relevant circumstances exist, some FTs may need to make further disclosures to give a true and fair view of their activities and financial position to the user of its accounts. The most common of these notes may cover:

- investment property income and expenses;
- investments in associates and jointly controlled operations;
- further analysis of other financial assets and other assets;
- liabilities in disposal groups;
- further analysis of other financial liabilities and other liabilities;
- finance lease receivables and finance lease obligations;
- pooled budgets;
- defined benefit pensions;
- prior period adjustments;
- merger accounting adjustments; and
- discontinued operations.

Glossary

Accruals

Under the accruals concept, expenses are recognised when incurred, not when the cash is actually paid out, and income is recognised when it is earned, not when the cash is actually received.

Amortisation

The term used for depreciation of intangible assets, an example is the annual charge in respect of the use of some computer software the FT has purchased.

Annual accounts

Documents prepared by the FT to show its financial position. Detailed requirements for the annual accounts are set out in the *NHS Foundation Trust Annual Reporting Manual*, published by Monitor. The *Annual Reporting Manual* was previously called the *Foundation Trust Financial Reporting Manual*.

Annual report

A document produced by the FT that summarises the FT's performance during the year, including the annual accounts.

Annual reporting manual

The key document published annually by Monitor setting out the framework for the FT's accounts.

Asset

Something the FT owns – for example a building, some cash, or an amount of money owed to it.

Associate

An entity over which the FT has a significant influence, for example because they appoint some of its directors. If there is so much influence that the FT is able to control the other entity, then it is a subsidiary rather than an associate.

Audit Code for Foundation Trusts

A document issued by Monitor, which sets out how FT audits must be conducted.

Audit opinion

The auditor's opinion of whether the FT's accounts show a true and fair view of its financial affairs. If the auditors are satisfied with the accounts, they will issue an unqualified audit opinion.

Available for sale

Assets are classed as available for sale if they are held neither for trading nor to maturity. An example of this would be an investment without a maturity date such as an ordinary share.

Balance Sheet

A year-end statement prepared by all public and private sector organisations, which shows the net assets controlled by the organisation and how these have been funded. The Balance Sheet is known as the Statement of Financial Position under IFRS.

Breakeven

An FT has achieved breakeven if its income is greater than or equal to its expenditure.

Cash and cash equivalents

Cash includes cash in hand and cash at the bank. Cash equivalents are any other deposits that can be converted to cash straight away.

Contingent asset or liability

An asset or liability that is too uncertain to be included in the accounts.

Corporation tax

A tax payable on a company's profits. FTs may have to pay corporation tax in the future. The legislation introducing corporation tax to FTs has been deferred and 2011/12 will be the first year that government will have chance to introduce corporation tax to FTs.

Current asset or current liability

An asset or liability the FT expects to hold for less than one year.

Depreciation

An accounting charge to represent the use, or wearing out, of assets. As a result the cost of an asset is spread over its useful life.

Earnings before interest, tax, depreciation and amortisation (EBITDA)

A measure of an FT's financial performance excluding interest, tax, depreciation and amortisation. Earnings before interest, tax, depreciation and amortisation is used to calculate some of Monitor's risk ratings.

External auditor

The independent professional auditor who reviews the accounts and issues an opinion on whether the accounts present a true and fair view.

External financing limit

A measure of the movement in cash an FT is allowed in the year, which is set by the government.

Finance lease

An arrangement whereby the party leasing the asset has most or all of the use of an asset, and the lease payments are akin to repayments on a loan.

Financial asset

The definition of a financial asset is very complex. Examples include investments.

Financial statements

Another term for the annual accounts.

Foundation Trust Financial Reporting Manual

The key document, published annually by Monitor, setting out the framework for the FT's accounts. Now called the *Annual Reporting Manual*.

Going concern

The accounts are prepared on a going concern basis, in other words with the expectation that the FT will continue to operate for at least the next 12 months.

Impairment

A decrease in the value of an asset.

Intangible asset

An asset that is without substance, for example computer software.

International Financial Reporting Standards (IFRS)

The new accounting standards that the NHS has adopted from April 2009.

International Standards on Auditing (United Kingdom and Ireland) (ISAs (UK&I))

The professional standards external auditors must comply with when carrying out audits.

Inventories

Stock, such as clinical supplies.

Joint venture

A contractual arrangement where there is a contractually agreed sharing of control, for example a pooled budget arrangement.

Liability

Something the FT owes, for example an overdraft, a loan, or a bill it has not yet paid.

Liquidity ratio

Liquidity is a measure of how easily an asset can be converted into cash. Bank deposits are very liquid, debtors less so. The liquidity ratio is a measure of an entity's ability to meet its obligations, in other words how well it can pay its bills from what it owns.

Minority interest

The part of a subsidiary that is not controlled by the FT. This applies where the FT owns enough of an entity to control it, but less than 100 per cent.

Non-current asset or liability

An asset or liability the FT expects to hold for more than one year.

Non-executive director

Non-executive directors are members of the FT's board of directors but do not have any involvement in day-to-day management of the FT. They provide the board with independent challenge and scrutiny.

Operating lease

An arrangement whereby the party leasing the asset is paying for the provision of a service (the use of the asset) rather than exclusive use of the asset.

Payables

Amounts the FT owes.

Primary care trust

The body responsible for commissioning all types of healthcare services across a specific locality.

Primary statements

The four main statements that make up the accounts: the Statement of Comprehensive Income; Statement of Financial Position; Statement of Change in Taxpayers' Equity; and Statement of Cash Flows.

Private Finance Initiative (PFI)

A way of funding major capital investments, without immediate recourse to the public purse. Private consortia, usually involving large construction firms, are contracted to design, build, and in some cases manage new projects. Contracts typically last for 30 years, during which time the building is leased by the FT.

Provision

A liability of uncertain timing or amount.

Prudential Borrowing Code

Monitor's mechanism to limit the total amount an FT is allowed to borrow. The Code sets out how to determine an FT's prudential borrowing limit.

Prudential borrowing limit

The amount of money an FT is allowed to borrow, as agreed with Monitor.

Public dividend capital

Taxpayers' equity, or the taxpayers' stake in the FT, arising from the government's original investments in NHS trusts when they were first created.

Receivables

Amounts owed to the FT.

Remuneration report

The part of the annual report that discloses senior officers' salary and pension information.

Reserves

Reserves represent the increase in overall value of the organisation since it was first created.

Statement of Cash Flows

The name for the cash flow statement under IFRS. It shows cash flows in and out of the FT during the period.

Statement of Change in Taxpayers' Equity

One of the primary statements that shows the changes in reserves and public dividend capital in the period.

Statement of Comprehensive Income

The new name for the income and expenditure account, and the public sector equivalent of the profit and loss account. It shows what income has been earned in the year, what expenditure has been incurred and hence the surplus or deficit for the year.

Statement of Financial Position

Year-end statement prepared by all public and private sector organisations, which shows the net assets controlled by the organisation and how these have been funded. It is also known as the Balance Sheet.

Statement on Internal Control

A statement about the controls the FT has in place to manage risk.

Subsidiary

An entity over which the FT has control, for example because they appoint more than half of the directors.

Those charged with governance

Auditors' terminology for those people who are responsible for the governance of the FT, usually the audit committee.

True and fair

It is the aim of the accounts to show a true and fair view of the FT's financial position, that is they should faithfully represent what has happened in practice.

UK GAAP (Generally Accepted Accounting Practice)

The standard basis of accounting in the UK before international standards were adopted.

Unrealised Gains and losses

Gains and losses may be realised or unrealised. Unrealised gains and losses are gains or losses that the trust has recognised in its accounts but which are potential as they have not been realised. An example of a gain that is recognised but unrealised is where the value of assets has increased. This gain is realised when the assets are sold or otherwise used.

Sources of further information

Sources of further information

Monitor

- *NHS Foundation Trust Annual Reporting Manual, 2009/10*
 - *Code of Governance for NHS Foundation Trusts, 2006*
 - *Compliance Framework, 2010/11*
 - *Prudential Borrowing Code for NHS Foundation Trusts, 2009*
 - *Transactions manual for providers and commissioners of NHS services, 2009*
 - *Audit Code for NHS Foundation Trusts, 2007*
- www.monitor-nhsft.gov.uk

HFMA

- *Annual Accounts Planning Guide 2009/10, 2010*
 - *Effective Governance in Healthcare: An Introductory Guide, 2006*
 - *Introductory Guide to NHS Finance, 2008 (to be updated in 2010)*
 - *Introductory Guide to NHS Foundation Trust Finance and Governance, 2007*
- www.hfma.org.uk

Audit Commission

- *A Guide to Finance for Hospital Doctors, 2009 (produced jointly with the Academy of Medical Royal Colleges)*
 - *World-class Financial Management, 2005*
- www.audit-commission.gov.uk

Monitor's financial risk ratios

Financial risk ratings

When assessing financial risk, Monitor assigns a risk rating using a scorecard that compares key financial metrics on a consistent basis across all FTs. The risk rating is an indication of the likelihood of a financial breach of the FT's terms of authorisation. The financial indicators used to derive the risk rating incorporate four key criteria:

- achievement of plan;
- underlying performance;
- financial efficiency; and
- liquidity.

The better the overall financial rating is for an FT, the more an FT will be allowed to borrow. A brief outline of the four financial risk criteria is set out below. A more detailed explanation of Monitor's risk rating scorecard and how the individual metrics are calculated can be found in Monitor's Compliance Framework.

Achievement of plan

The ratio measured is Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) (see Box E on Page 64) achieved as a percentage of that planned by the FT. This measure is an indication how sound an FT's financial planning and financial management is. The closer it is to 100 per cent the better and this metric has a 10 per cent weighting in Monitor's overall financial risk rating.

Underlying performance

Underlying performance has a weighting of 25 per cent in Monitor's overall financial risk rating. It is an FT's EBITDA as a percentage of an FT's income.

This ratio is an indication of how profitable the activities of the FT are and the greater the percentage, the more profitable an FT is.

Financial efficiency

The financial efficiency criterion has the biggest weighting (40 per cent) in Monitor's overall financial risk rating. It is measured by reference to two metrics that have an equal weighting of 20 per cent.

The first metric is the FT's return on assets, which is the surplus achieved divided by the average total assets employed (adding back loans) by the FT.

This ratio is an indication of how efficiently the FT uses its assets. The higher the percentage the greater the efficiency.

The second metric is the income and expenditure surplus margin, which is the surplus for the year adjusted for exceptional items, divided by the operating income of the FT.

This ratio is another measure of efficiency as it measures the percentage of each £1 earned that is surplus to the amount needed to generate that income. The higher the percentage the greater the efficiency.

Liquidity

Liquidity has a 25 per cent weighting in the calculation of Monitor's overall financial risk rating. It is measured using the liquidity ratio, which shows how many days the FT could continue to fund its operations based on the current level of cash and borrowing available to it.

Overall financial risk rating

The four weighted ratings are then aggregated and the rating calculated is rounded to the nearest whole number.

There is also a series of overriding rules that are applied to the risk rating. For example, if the FT does not submit its annual plan on time it cannot score better than a 3. Further details of the financial risk rating regime applied to FTs are included within Monitor's Compliance Framework.

Box E

Earning before interest, taxes, depreciation and amortisation (EBITDA)

EBITDA is featured in two of the five metrics in the financial risk ratings, covering the two financial criteria: achievement of plan and underlying performance.

Looking at EBITDA gives a different perspective on an FT's performance than simply looking at the bottom line surplus or deficit. It is regarded as a good proxy for operating cash flow generated by the FT. As such it provides an indication of the FT's ability to reinvest in asset replacement and service innovation and to meet financing charges and dividends.

Unlike the overall operating surplus, it measures performance before depreciation, a non-cash accounting charge to reflect the consumption of capital, which can be influenced by matters such as asset life and other accounting treatments.

EBITDA cannot be read directly from the Statement of Comprehensive Income. The starting point is the operating surplus/ (deficit) before the payment of exceptional items and before the impact of interest paid or received. This figure is known as EBIT. The charges made for depreciation and amortisation, which can be read from the operating expenditure note (Note 4.1) are then added back to give EBITDA.

Prudential borrowing code ratio tests

Prudential borrowing code ratio tests

An FT must comply with Monitor's Prudential Borrowing Code for NHS Foundation Trusts (the Code). The objective of the Code is to enable FTs to borrow from commercial sources at affordable rates. To comply with the Code an FT must remain within a prudential borrowing limit agreed with Monitor.

Based on the financial projections in its annual plan an FT applies for a Long-Term Borrowing limit that would not breach any of the ratio tests set out below. This is known as the Tier 1 limit. Monitor may also approve a Tier 2 limit to accommodate affordable 'major investments', including PFI schemes.

Prudential borrowing code key ratios

Minimum dividend cover

Revenue available for debt service is a measure of how easily the FT met its required dividend payment from revenue earned in the year.

The ratio is calculated as revenue available for debt service less annual interest (on long-term borrowing) divided by the public dividend capital dividend.

The minimum dividend cover permitted by Monitor is 1.

Minimum interest cover

This is a measure of how easily the FT met its obligations to pay the interest due on outstanding amounts from revenue earned in the year.

The ratio is calculated as revenue available for debt service divided by maximum annual interest.

For the Tier 1 limit the minimum interest cover must be 3.

If the FT has a Tier 2 limit the minimum interest cover must be 2.

Minimum debt service cover

This is a measure of how easily the FT met its obligations to pay both the interest and principal repayments due on loans from revenue earned in the year.

The ratio is calculated as revenue available for debt service divided by maximum annual debt service.

For the Tier 1 limit the minimum debt service cover is 2.

If the FT has a Tier 2 limit the minimum debt service cover is 1.5.

Maximum debt service to Revenue

This is a measure of how much of the revenue the FT earned in the year was committed to the payment of loan interest and principal repayments. It is an indication of how close the FT is to borrowing the maximum amount it can.

The ratio is calculated as maximum annual debt service divided by revenue.

For the Tier 1 limit the maximum debt service to revenue is 2.5 per cent.

If the FT has a Tier 2 limit the maximum debt service to revenue is 10 per cent.

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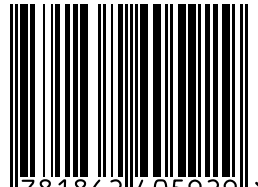
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