FINANCIAL REPORTING IN THE HEALTH SERVICE

Professional 2 examination
5 December 2000

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

Instructions to candidates

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

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

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

SECTION A (Answer both questions)

1

The following trial balance relates to Carfield NHS Trust for the year ended 31 March 2000.

	£000	£000
NHS patient care income		50,900
Private patient income		200
Other income		13,500
Salaries and wages	34,100	
Supplies and services	11,000	
Establishment expenses	8,300	
Other expenditure	5,300	
Dividends paid	2,400	
Interest paid (originating interest bearing debt)	800	
Interest received		40
Land	9,500	
Buildings	65,200	
Equipment – NHS	7,700	
Equipment – donated	550	
Accumulated depreciation – NHS		3,800
Accumulated depreciation – donated		135
Short-term investments (as at 31 March 2000)	85	
Stock (as at 31 March 2000)	300	
Capital expenditure	2,100	
Capital receipts		42
Creditors < 1 year		5,400
Debtors	1,900	
Cash	75	
Public dividend capital		65,778
Revaluation reserve		8,100
Donation reserve		700
Income and expenditure reserve		715
	149,310	149,310

Additional information

(i) The following capital purchases occurred during the year.

Item	**£000**	**Notes**
Land	150	Purchased July 1999
Buildings	1,300	Purchased October 1999
Assets under construction	450	Work started January 2000

Equipment – purchased	200	Purchased November 1999
	2,100	

(ii) During August 1999, equipment valued at £25,000 was donated to the Trust. This is not recorded in the trial balance.

(iii) The capital receipt in the trial balance relates to equipment which was sold in September 1999 for £42,000. This equipment was originally purchased in July 1996 and had a gross current cost on 31 March 1999 of £60,000.

(iv) Indexation has not yet been applied. The following indices should be used:

Land	1%
Buildings	3%
Equipment	2%

(v) A building, which has changed its use since last being independently valued, was revalued at the start of the year. The brought forward net book value was £1.2 million and it was revalued on 1 April 1999 to £1.4 million. This is not reflected in the trial balance.

(vi) Depreciation for 1999/2000 is not included in the trial balance. Buildings are depreciated using a remaining life of 60 years and all equipment is depreciated over a 15 year standard life.

(vii) On 1 April 1999, medical equipment with a 15 year life and fair value of £800,000 was leased by the Trust. This equipment was originally treated as an operating lease and the first year lease payment of £75,000 was paid during the year. The payment was included within "other expenditure". Subsequently, the lease was found to be a finance lease and the accounting entries need to be adjusted to reflect this.

(viii) Public Dividend Capital dividends still owed at the end of the year amount to £1,100,000. This is not reflected in the trial balance.

(ix) After the trial balance had been completed, the year-end reconciliation of debtors' and creditors' balances took place. As a consequence it was necessary to issue credit notes to the value of £30,000 to commissioners.

- **Requirement for question 1**

(a) Prepare the income and expenditure account for the year ended 31 March 2000. *9*

(b) Prepare the balance sheet as at 31 March 2000. *16*

(25)

2

The following information relates to funds held on trust at Freeway NHS Trust.

The balances as at 1 April 1999 were as follows:

	£	£
Investment property (endowment, restricted)	780,000	
Investments (wider range)	357,000	
Investments (narrower range)	63,000	
Stock	800	
Debtors	17,500	
Cash in hand	5,000	
Creditors		3,800
Endowment: unrestricted		810,000
Income: restricted		137,000
Income: unrestricted		272,500
	1,223,300	1,223,300

Additional information

(i) The portfolio of investments at 1 April 1999 was:

	Number of shares	Market value £
Narrower range		
Treasury gilts		63,000
Wider range		
Amble plc	47,200	118,000
Bumble plc	10,000	28,000
Cantor plc	28,750	92,000
Dream plc	8,000	54,000
Escape plc	13,000	65,000

(ii) Investment transactions during the year:

	Purchases		Sales	
Share	**Units**	**£**	**Units**	**£**
Bumble plc			3,500	10,500
Dream plc			8,000	52,000
Escape plc			3,000	15,600
Flash plc	9,000	29,700		

Total	9,000	29,700	14,500	78,100

(iii) The investment property was revalued to £810,000 on 31 March 2000.

(iv) Receipts and payments for the year ended 31 March 2000 were:

	Unrestricted £	Restricted £	Endowment £
Receipts			
Donations	125,000	16,000	
Legacies		45,000	
Dividends	23,900	12,200	
Interest	3,500	1,600	
Property rental			24,000
Sponsored fun run	4,600		
Fete		1,200	
General fund raising	2,800	1,300	
Sales of investments	54,000	27,100	
Total receipts	213,800	104,400	24,000
Payments			
Patients welfare and amenities	92,200	98,300	29,500
Staff welfare and amenities	14,000	2,800	
Research	12,300	3,000	
Contribution to Trust capital projects	21,000		
Other direct charitable expenditure	2,900	1,500	
Fund raising and publicity	900	1,200	
Management and administration	18,500	9,100	3,000
Purchases of investments	22,300	11,200	
Total payments	184,100	127,100	32,500

(v) Debtors are made up of the following:

	As at 1 April 1999		As at 31 March 2000	
	Unrestricted £	Restricted £	Unrestricted £	Restricted £
Proceeds from sales of investments	15,400		12,400	
Dividends and interest		2,100		2,300

(vi) Creditors at 1 April 1999 all relate to purchases of Treasury gilts. Creditors at 31 March 2000 total £2,900. £2,100 of the year-end creditors relates to the NHS Trust capital project contribution. £800 relates to promotional fund raising expenditure (unrestricted).

(vii) Opening and closing stocks all related to the management of the investment property. Stock at 31 March 2000 was £200.

(viii) The market price of investments at 31 March 2000 was:

Amble plc	£2.70	Escape plc	£4.90
Bumble plc	£3.10	Flash plc	£3.50
Cantor plc	£2.90		

Treasury gilts at the year end were valued at £63,200

- **Requirement for question 2**

(a) Prepare the statement of financial activities for the funds held on trust of Freeway NHS Trust, for the year ending 31 March 2000. *17*

(b) Prepare the balance sheet as at 31 March 2000. *8*

(25)

SECTION B (Answer two questions)

3 You are assisting in the preparation of the 1999/2000 final accounts for Highport NHS Trust. A number of outstanding items have been brought to your attention and your opinion on how to treat them is now being sought. The items are as follows:

(i) Goods valued at £24,000 were received by the Trust on 27 March 2000. £5,000 worth of these goods were used immediately, and the remaining goods were placed in stores. The invoice has not yet been received.

(ii) The Trust charges expectant mothers £5 for an enlarged ultrasound photograph of their baby. £8,000 of income in total has been raised in this way for the financial year, and this has been netted off against the ultrasound department's non-pay expenditure.

(iii) Investigation of disputed debtor invoices has identified that a total of £17,000 of private patient income and £28,000 of health authority invoices will not be collected.

(iv) £35,000 was contributed from the Trust's charitable funds to help fund a major capital refurbishment of the outpatient waiting area. The work was all completed in the final quarter of the 1999/2000 financial year.

(v) The Trust has spent £28,000 on research during the year. The expenditure has been capitalised and it has been proposed to write this off over 15 years.

(vi) During 1999/2000, eight members of staff took early retirement. The total additional pension costs relating to these retirements amounts to £39,000.

(vii) Impairment reviews were carried out on a number of assets by an independent valuer just prior to the year-end. The following impairments were identified:

- Equipment valued at £120,000 was down-valued to £95,000 due to its unexpectedly high usage. The revaluation reserve has a credit balance of £9,000 relating to these assets.

- A building was revalued at £180,000 following changes in the general price levels of property in the area. The net book value of the building was £230,000 prior to the revaluation, with an associated credit on the revaluation reserve of £40,000.

(viii) Legal advice has been received concerning a clinical negligence case which arose at the start of 1999/2000. The likely outcomes and associated probabilities are as follows:

Outcome	**Probability**
Trust liable, settlement £50,000	40%
Trust not liable, costs incurred £8,000	60%

The maximum liability is below the Clinical Negligence Scheme for Trusts (CNST) excess level, so the scheme will not make any payment to the Trust in respect of this case. The Trust wishes to make a provision for 1999/2000 and expects the case to take a total of three years to resolve.

- **Requirement for question 3**

(a) For each of the areas of concern identified in (i) to (vii) above:

- Explain the required accounting treatment, by relating to the relevant accounting standard; and
- Show the appropriate action (if any) to take in the accounts. *18*

(b) For item (viii):

- Explain how accounting standards require the provision to be accounted for.
- Calculate the discounted provision and demonstrate how the provision is unwound over following years. *7*

(25)

4 Heddon NHS Trust are currently involved in the process of tendering two services, cleaning and internal audit. The cleaning contract is in the early stages of the tendering process and the interested parties must now be financially vetted. Bids have already been received for the internal audit service and now need to be evaluated.

Three companies have expressed an interest in the cleaning contract. They must meet the requirements for admission to the Trust's approved contractors list, although they need not be on the list currently. To achieve this the contractor must supply three years' audited accounts to demonstrate:

- reasonable liquidity over the three years;
- that they have made a profit in each of the last three years.

Reasonable liquidity for the industry has been independently assessed as a current ratio of 1:1 or better, and a quick (or acid test) ratio of 0.9:1 or better. For the purposes of financial vetting each company is awarded points for the number of these requirements that it is able to satisfy. A company is awarded one point for each requirement it meets and there are nine points available – one for each liquidity ratio for each of the last three years, and one for earning post-tax profits for each of the last three years. To be accepted the contractor must achieve at least two thirds of the available points. Extracts from the accounts of the three companies are attached.

Three tenders have been submitted for the internal audit contract. Each tender is to be evaluated on both financial and non-financial criteria. There are two non-financial factors:

(i) The ratio of qualified to unqualified staff. It is considered that at least 20% of the audit staff should be qualified. The following have been submitted as the numbers of staff and their qualifications:

	X Ltd	**Y Ltd**	**Z Ltd**
Unqualified staff	24	49	78
Qualified staff	6	10	21

Weightings are to be attributed and marked as follows:

0 points if <15% of the audit staff are qualified
5 points if 15-20% of the audit staff are qualified
10 points if >20% of the audit staff are qualified

(ii) The number of other contracts they are currently operating. This is considered important as an indicator of not only experience and ability but also capacity. The following have been submitted as the number of contracts they operate:

	X Ltd	Y Ltd	Z Ltd
No of internal audit contracts	2	15	10

Weightings are to be attributed and marked as follows:

0 points if 0-2 contracts
5 points if 3-6 contracts
10 points if 7-10 contracts
5 points if >10 contracts

The prices submitted by the companies are as follows:

	X Ltd	Y Ltd	Z Ltd
Price	£225,375	£241,095	£283,530

For price they are to be scored out of a total of 30 points. Half of the available points are achieved at the mean price. For prices below the mean, add 2% of the total points for each percent below the mean price, and for prices above the mean, deduct 2% of the total points for each percent above the mean price.

- **Requirement for question 4**

(a) For the cleaning contract, evaluate the three companies financially and recommend which should be invited to tender. *11*

(b) For the internal audit contract, evaluate the bids and recommend who should be awarded the contract. *7*

(c) Detail the client responsibilities in relation to the tendering process. *7*

(25)

Extracts from the accounts of the three companies for the cleaning contract:

	1999/2000 £000	1998/99 £000	1997/98 £000
Company A:			
Turnover	1,090	1,135	1,024
Profit after tax	105	112	(69)
Stock	22	18	28
Debtors	65	68	73
Cash & bank	49	32	17
Current liabilities	123	132	113
Company B:			
Turnover	1,350	1,302	1,180
Profit after tax	52	41	38
Stock	30	28	26
Debtors	59	52	48
Cash & bank	28	24	28
Current liabilities	89	90	84
Company C:			
Turnover	2,580	2,700	2,100
Profit after tax	72	75	69
Stock	35	34	30
Debtors	68	74	61
Cash & bank	29	24	24
Current liabilities	91	108	92

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- **Requirement for question 5**

(a) Outline the main role and responsibilities of the Director of Finance in an NHS Trust. *19*

(b) What is meant by devolved financial management? *2*

(c) What are the advantages and disadvantages of devolved financial management? *4*

(25)