Foundation trust accounts
A guide for non-executives 2008/09 update
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.
Introduction

In 2008, the Healthcare Financial Management Association (HFMA), in conjunction with the Audit Commission published *Foundation Trust Accounts: A Guide for Non-executives and Governors* to guide the reader step-by-step through the annual accounts. The guide was designed to help non-executive directors (NEDs) and other users first understand and, more importantly, draw conclusions and ask pertinent questions about a foundation trust’s (FT’s) accounts.

The guide remains relevant today and is a useful tool in getting to grips with an FT’s primary financial statements. However, the original guide was based on Monitor’s *NHS Foundation Trust Financial Reporting Manual 2007/08* (NHS FT FReM) and since then there have been changes to the accounts. This update complements the guide describing the main changes since last year and includes additional questions for NEDs to assure themselves that the financial statements represent a true and fair view of the FT’s finances. Readers should read this update alongside the original guide where clarification of terms is required. Relevant references to the existing guide have been made in boxes in the text. Copies of the original guide are available from either the Audit Commission or the HFMA.

Timetable

Monitor is committed to bringing forward the deadlines for submission of unaudited and audited accounts for FTs with the aim of laying consolidated accounts before Parliament prior to the summer recess.

For the 2008/09 financial year, the following deadlines have been set by Monitor:

- Deadline for unaudited accounts to be with auditors and Monitor – *23 April 2009*
- Deadline for submitting audited accounts to Monitor – *8 June 2009*

The submission deadline for both the unaudited and audited accounts is eight days earlier than last year.
Adoption of International Financial Reporting Standards (IFRS)

To date, the NHS has largely followed rules set out in UK Generally Accepted Accounting Practice when preparing accounts. However, in the 2007 budget report it was announced that all public bodies following the Treasury’s Financial Reporting Manual would follow IFRS from 2008/09. Subsequently the 2008 budget report announced the government’s decision to defer the implementation of IFRS for public sector accounting from 2008/09 to 2009/10. The decision reflects concerns expressed by a number of government departments that they were unable to address the IFRS accounting and funding issues within the existing timetable.

As a result, FTs’ accounts for 2009/10 will need to be in the new IFRS format. However, this effectively means a transition date of 1 April 2008, as their 2009/10 IFRS-based accounts will have to include comparative figures for 2008/09. This will require a restatement – using the new IFRS rules – of FTs’ balance sheets as at 1 April 2008. Monitor requires all full-year FTs (in other words, having FT status before 1 April 2008) to submit their 1 April 2008 balance sheet restated in accordance with IFRS accompanied by a statement signed by the board by 1 May 2009. This statement must confirm that the board is satisfied that the FT’s balance sheet as at 1 April 2008 has been restated in accordance with the requirements of the NHS FT FReM 2009/10 and that the board has received and considered appropriate independent assurance. The degree of independent assurance received and the extent of work undertaken to support such assurance is not defined, but is to reflect the size and complexity of any adjustments required.

The transition to IFRS accounts is a significant change in both accounting and the format of the accounts. The HFMA, in conjunction with the Audit Commission will produce a new guide for the 2009/10 IFRS-based accounts.
Quality accounts

High Quality Care for All proposes quality accounts as the main way the NHS will report publicly on quality. The purpose is to enable:

- boards of provider organisations to focus on quality improvement;
- the public to hold providers to account for the quality of NHS healthcare; and
- patients and carers to make better informed choices.

The intention, subject to the successful passing of legislation, is that NHS providers, will produce quality accounts for 2009/10. In preparation for this the DH, Monitor, Care Quality Commission and NHS East of England are consulting on proposals that the approach be introduced in 2008/09 by all NHS foundation trusts and those organisations in the East of England Strategic Health Authority area. If the proposals are implemented, those organisations will be required to include a quality reporting framework in their 2008/09 annual report and accounts. At the time of printing a decision had yet to be made so non-executives are advised to ask their executive director colleagues to give them an update on progress with this initiative.

Main changes to the accounts since the guide was published

Fixed asset valuation

Valuations are explained in Box D, Page 32

The Treasury has decided that the NHS should value its property assets in line with the Royal Institution of Chartered Surveyors (RICS) Red Book standards. This means that specialised property, for which market value cannot be readily determined, should be valued at depreciated replacement cost (DRC) on a modern equivalent asset basis. There is no change in the use of DRC – that is the cost of replacing the asset with a new one, depreciated to reflect the age and use of the existing asset, in effect the current cost. However, the key change is the move to modern equivalent asset valuation. Previously values of specialised property, such as hospitals and other healthcare premises, were determined on a like-for-like basis. This assumed that any replacement asset would be identical to the existing asset. In many cases this assumption is unrealistic as any replacement would in practice be a modern equivalent. A modern equivalent asset may not need to be as big, for instance, to produce the same throughput or deliver the same amount of care and might be built of different materials. For example, a Victorian-built hospital constructed from stone and slate might be replaced by a modern building using glass and plastics. In determining current replacement cost, consideration may also be given to use of a different site.
Adoption of the RICS valuation standards means that a specialised property is valued at the cost of replacing the service potential of the existing asset with a modern equivalent asset adjusted to take account of depreciation on the existing asset. The Treasury has agreed that the new valuation methodology can be adopted by NHS bodies in 2008/09 or the following year but must be in place by 1 April 2010.

Where the changed valuation methodology is applied for 2008/09, the wording of the FT’s accounting policies needs to be revised to reflect the changed approach to valuation. As this is a change in valuation methodology rather than a change in accounting policy no prior period adjustment arises.

Any losses on revaluation should in the first instance be dealt with in the revaluation reserve for the asset with any excess loss treated as a cost to the income and expenditure account. This means that the loss is set against any past revaluation gains for the asset, but once the revaluation gains have been used up any remaining loss is a cost to the income and expenditure account.

Questions

Have arrangements been made to revalue the estate using the changed valuation methodology by 1 April 2010?

Does the wording of the FT’s accounting policies match the approach to fixed asset valuation followed?

How has the FT ensured that fixed assets are carried at current cost in the balance sheet?

Private patient income cap

The private patient income cap is explained on Page 23

The amount of private patient income that a FT can earn in any year is capped by legislation to the proportion of its income that it earned from private patient charges in 2002/03. If an FT was to exceed its private patient income cap it would breach the terms of its authorisation as an FT.

UNISON has challenged Monitor’s approach in applying the cap. In response, Monitor opened consultation in June 2008 on its approach to the cap. Following the consultation Monitor has decided that the definition of private patient income will change from 1 April 2009 to include the relevant share of any private patient income earned by the FT’s joint ventures and associates. Monitor’s approach to the cap is still subject to legal challenge and it is possible that further changes to the definition of private patient income may occur. This does not affect the 2008/09 accounts.
Off-balance sheet disclosure

Where an FT is party to an arrangement, which under accounting rules is not shown on its balance sheet, and where the risks and benefits of the arrangement are material, the arrangement should be disclosed in a note to the accounts. This disclosure covers off-balance sheet private finance initiative (PFI) schemes.

However, from next year it is likely that PFI schemes will be brought on balance sheet under the move to IFRS. Under PFI, NHS bodies effectively pay an annual fee for a service – the provision of a maintained asset – rather than buying an asset outright. As such this has been treated as a revenue expense rather than the purchase of an asset which needs to be recorded on the balance sheet. This treatment is expected to be changed from next year, with PFI schemes being brought onto the balance sheet.

Matters from last year

Financial instruments

New accounting standards on financial instruments were applied for 2007/08 and some FTs experienced difficulty implementing the standards. In particular there were some instances where the wording of the FT’s accounting policies had not been revised to match the new financial instruments standards and disclosures did not always comply with the requirements of the standards.

Financial instruments are a broad range of assets and liabilities that arise from contracts and result in a financial asset being created in one entity and a financial liability in another. In essence they are documents or agreements that have financial value and will be settled in cash. The following are, or could be, financial instruments:

- cash at bank;
- debtors and creditors;
- loans;
- investments;
- provisions arising under contract;
- finance leases;
- PFI contracts; and
- interests in subsidiaries, associates and in some cases joint ventures.
In practice, accounting for simple short-term financial instruments, for example debtors and creditors due within 12 months, will remain unchanged. The standards require that financial instruments are recognised in the accounts initially at fair value, which in most cases is the transaction value so the accounting is the same as before.

The standards require that some financial instruments, for example derivatives and embedded derivatives, may need to be included in the accounts. The rules for recognising these items in the accounts are complex, but the FT should check whether it has financial instruments of this type which meet the rules for recognition.

A derivative is a financial instrument whose value depends on an underlying variable such as an exchange rate or retail price index. For example, a separate contract to buy foreign currency at a future date at an agreed rate to pay for the purchase of imported medical equipment is a derivative. Examples of derivatives such as this are rare in the NHS. However, it is more likely that a derivative may be embedded in a contract, for example a clause in a PFI scheme that future payments will vary in line with the UK retail price index.

**Questions**

**Does the FT have effective arrangements for identifying financial instruments which may need to be included in the accounts?**

**Have the FT’s accounting policies been updated to match the new standards?**
Sources of information

Audit Commission
(Published jointly with NAO)

HFMA

Monitor
www.monitor-nhsft.gov.uk
*NHS Foundation Trust Financial Reporting Manual 2008/09*