NORTHUMBERLAND, TYNE AND WEAR NHS FOUNDATION TRUST

BOARD OF DIRECTORS' MEETING

Meeting Date: 27 May 2015

Title and Author of Paper:
Annual Accounts 2014/15 and the Management Representation Letter
James Duncan, Deputy Chief Executive and Executive Director of Finance

Paper for Debate, Decision or Information: Decision

Key Points to Note:

The draft annual accounts 2014/15 were reviewed by the Audit Committee on 20 May 2015, along with the External Auditor's Completion Report 2013/14.

There will be a verbal update on the outcome of the Audit Committee and also the Management Representation Letter will be handed out at the Board meeting. Please note that the Letter cannot be completed until after the Audit Committee meeting.

Appendices are as follows:

1 Director of Finance's presentation
2 Draft Annual Accounts

Outcome required: The Board of Directors is asked to:
Approve the Annual Accounts
Sign off the Management Representation Letter

BOARD OF DIRECTORS

27 MAY 2015

PRESENTATION OF DRAFT ACCOUNTS 1 APRIL 2014 – 31 MARCH 2015

Introduction

The draft accounts for the period are attached in appendix 1. The draft accounts exclude any amendments agreed to be made within the Auditors Completion Report.

Statement of Comprehensive Income (Income and Expenditure) SOCI

A loss of £31.6m has been reported for the financial year. A surplus was generated of £5.4m prior to exceptional items (net impairments of £38.4m made up of impairment charges of £51.8m and reversals of impairments of £13.4m and a net profit on disposal of assets of £1.4m).

Other comprehensive income relates to the gains and losses charged to reserves. Revaluations relate to increases in valuations of £0.8m. This relates mainly to the valuation undertaken as at 31st March 2015 and relates to increases in buildings values above the amounts charged as reversals of impairments.

Impairments of (£0.2m) relate charges to the revaluation reserve for changes in the market price for land and buildings in accordance with the valuations provided by the District Valuer as at 31st March 2015.

Total other comprehensive expense is a net (£31.0m).

Income (Note 3)

- Overall income for the period is £314.0m (£301.2m 2013/14). This is an increase of £13.7m (5%) on 2013/14.
- The increase relates to the reversal of impairments of £13.5m and the profit on disposal of £1.5m. The reversal of impairments of property, plant and equipment is due to an increase in buildings values of up to 17% in some local areas which has resulted in a reversal of previously charged impairments and a profit on disposal of £1.5m in relation to the sale of Northgate Land.
- Income from activities and other operating income remain stable overall excluding the impairments and profit on disposal exceptional items.
- There is a fluctuation between cost and volume contract income and other clinical income of approximately £2.5m due to Ashby and Wilton wards being partly on block contract in 2014/15 due to realignment of the bed numbers and changes in occupancy since it was open in 2014/15.

Operating expenses (Note 4)

- Overall operating expenses for the period is £340.1m (£393.7m 2013/14). The most significant variance which is explains the £54.0m decrease from

2013/14 is the decrease in exceptional items of impairment charges of £51.8m (£104.8m 2013/14) which gives a variance of £53.0m.
- There are minimal other significant fluctuations. The £2m increase in Purchase of Healthcare from Non NHS bodies relates to the Trust taking on the management of the budgets from the CCGs to provide out of area treatment. The £2m relates to the costs of care providers external to the NHS. Employee Expenses for Executive Directors has decreased due to there being additional costs in 2013/14 for sickness cover and there is a part-year charge only for the Chief Executive's post in 2014/15 as well as a reduction in cost. The movement in legal fees relates to the reversal of the provision for equal pay. The provision for equal pay was previously charged to legal costs in 2007/08 as the provision was based on the cost of equal pay settlements or legal costs as a proxy to defend the cases.

Finance Costs

- Finance income generated from investments has decreased due to a reduction in cash balances from those held in 2013/14. The Trust continues to invest in the National Loans Fund which is part of the Government Banking Service (GBS) as it is more beneficial to invest in the GBS. Average daily cash balances held in GBS reduce the dividend payable of 3.5% of average net relevant assets, which is above rates available from high street banks at present.
- Finance expense has increased slightly due to additional interest costs for drawing down a further £4.6m of loans from the Foundation Trust Financing Facility in relation to the Autism and Transformation capital schemes in Q4 of 2014/15.
- PDC dividends payable have reduced significantly due to the full year effect of the Modern Equivalent Asset valuation carried out in 2013/14 and further significant impairments mainly due to Hopewood Park.

Share of Profit of Associates/Joint Ventures

- Surplus of £0.049m has been recognised for the 50% share of the profit in Newcastle Talking Therapies LLP joint venture (2013/14 £0.038m loss).

<u>Statement of Financial Position SOFP (Balance Sheet)</u>

<u>Non Current Assets</u>

Intangible Assets (Note 14)
- Intangible assets have increased in relation to the purchase of software licences and the purchase of software in relation to the Electronic Prescribing and Medicines Admin scheme.

Property, Plant and Equipment (Note 15)

- There is an overall decrease in property, plant and equipment values of (£28.1m). This relates to £15.5m increase from capital expenditure, (£38.5m) reduction from impairments charged against reserves and income and expenditure, £0.7m of revaluation gains and a reduction of (£5.8m) for depreciation charges.

Investments in Associates (Note 16)

- 50% share of the 2014/15 surplus from the LLP of £0.050m has been included in the accounts and £0.010m in cash was received as 50% share of profit from the final audited 2013/14 LLP accounts.

<u>Current Assets</u>

Net Current Assets and Net Current Liabilities (Notes 20, 21, 17, 22, 23, 24, 28 and 26)

- Working capital held (net current assets less net current liabilities) has decreased by (£2.0m), from £12.0m in 2013/14 to £10.0m in 2014/15. The significant movements in current assets and liabilities are:
- Increase in Trade and Other Receivables of £8.3m. This mainly relates to £6.9m being recognised as an Other Receivable for the second instalment of the Northgate Land sale due in December 2015. There is also a £3m increase in NHS Receivables. At 31st March 2015 the net outstanding debt owed was £4.3m. This includes credit notes raised for £2.9m to the CCGs in relation to underactivity on contracts. Due to the agreement of balances process, the treatment of these credit notes is to move the credit notes to NHS payables as there was no debt to offset these balances as at 31st March 2015.
- Decrease in assets held for sale (note 17) of £12.5m from £14.1m to £1.6m. This largely relates to sale of Northgate Land valued at £12m and other small property disposals in held for sale. The £1.6m as at 31st March relates to the Sunderland Social and Residential Homes. The sale is progressing and is planned in Q1 of 2015/16.
- Increase in cash and cash equivalents (note 22) of £5.3m from £15.3m as at 31st March 2014 to £20.6m as at 31st March 2015. Planned cash as at 31st March 2015 was £17.6m meaning cash was £3.0m above plan, mainly due to the surplus prior to exceptional items being £4.2m above plan.
- Current liabilities have increased by (£3.1m). Trade and Other Payables have increased by £4.1m and this relates to an increase in NHS payables detailed above of (£2.9m). Capital payables have also increased by £1.3m mainly due a number of retentions held. There are also compensating movements between Other Trade Payables – Revenue and Accruals. There is an increase in current borrowings due to the additional draw down of loans from the FT Financing Facility for the Autism Scheme £1.6m and Transformation £3m. Current provisions have decreased as a large employee litigation case was settled at £0.8m and the provision for equal pay as almost agreed, resulting in a reversal of an unused provision of £1.3m.Other liabilities consist of deferred income which has increased by £0.5m due to funding for specific activities which will be delivered in 2015/16.

Non-Current Liabilities

Borrowings (Note 24)

- Borrowings have decreased by £1.6m. This relates to the draw-down of loans of £4.6m agreed from the Foundation Trust Financing Facility and the repayment of loans of £4.5m. Other borrowings have reduced due to repayments made in relation to obligations under finance leases and PFI contracts.

- Provisions has increased due to the change in discount rate from 1.8% to 1.3% which increases the non-current costs of pension and injury benefit provisions and an increase in provisions for employee litigation cases.

Taxpayers Equity (as per the Statement of Changes in Taxpayers Equity)

Public Dividend Capital

- £1.634m of Public Dividend Capital was drawn down in relation to funding for the Electronic Prescribing and Medicines Admin Scheme and for Omnicell cabinets.

Income and expenditure reserve

- Income and expenditure reserve has decreased by (£20.9m). This relates to retained deficit for the year of (£31.6m) and transfer in relation to revaluation reserve balances on asset disposals of £10.6m which mainly relates to the disposal of Northgate land.

Revaluation reserve

- The decrease in revaluation reserve of (£10.0m) relates to (£10.6m) transferred to the Income and Expenditure Reserve, mainly relating to the disposal of Northgate land. There was also a net gain in amounts charged to the revaluation reserve for the valuation undertaken as at 31st March 2015, where increases in the value of assets have exceeded the amounts previously charged to I&E.

Cash Flow

- There is an increase in cash of £5.3m as per above in net current assets and liabilities.

Significant transactions and key accounting entries in the 2014/15 accounts

Equal Pay

As part of a national equal pay issue the Trust received in excess of 800 potential claims associated with equal pay. The Trust sought legal advice from Ward Hadaway Solicitors regarding the impact of these claims. This legal advice confirmed that

It would be highly unlikely that any costs incurred by the Trust would be recoverable
That it would be likely that the number of claims would translate into 80-100 test cases
That an estimate of £2m for defending these claims was reasonable and that if these costs were not incurred the Trust would be liable for payments in excess of this amount

The Audit Commission provided specific advice about the conditions under which a provision could be made for equal pay claims and on the basis of the legal advice received the Trust put forward a rationale for a provision which was accepted by our auditors. It should be noted that the guidance from the NHS Litigation Authority continues to be that these claims are defendable, and that the reliable estimate of legal costs remains the best proxy for the costs of concluding these claims. From the £2m estimate made in 2007/08 accounts, a provision of £1.6m remained at 31st March 2014. This provision equated to estimates provided by the Trust's legal advisor. During 2014/15 these legal cases have progressed significantly and a number of cases have now been closed. Estimated settlements as at 31st March 2015 are in the region of £0.2m. £0.1m of legal costs have been paid in year and (£1.3m) of the provision has been reversed as unused.

Holiday entitlement not taken

Accruals were made in the 2013/14 accounts for annual leave due but not taken of £1.1m and amounts recoverable for leave taken but not yet due of £0.2m. The accrual was based on data gathered from managers of leave carried forward and was based on an overall 54% response rate. The Trust has undertaken the same process to gather the data and the 2014/15 accrual is based on a response rate of 67% and is £1.2m and a receivable of annual leave taken in advance of £0.1m.

Provisions for Impairment of Receivables

Each year the Trust assesses all outstanding debts to consider whether a potential irrecoverable debt provision should be made. The provision as at 31st March 2014 was £0.8m. This included a provision for NHS Lothian of 0.4m. The provision for 31st March 2015 was £0.7m.

In accordance with accounting policies, the methodology the Trust has applied to the was to assess all outstanding debts as at 31st March and provide for all debts over 3 months old as potential irrecoverable debts unless there is a specific reason not to provide. Specific reasons may include debts subsequently paid or balances where assurances have been provided that the debts will be paid. Where disputes are known, it may also be appropriate to provide for certain debts less than 3 months old.

There is an £0.083m provision for impairment of receivables relating to a dispute of charges with the 2gether NHS Foundation Trust and a provision for £0.156m with NHS West Hampshire CCG due to a dispute over care package levels.

Redundancy provisions and employee claims

The Trust made redundancy provisions of £0.3m in the 2013/14 accounts in relation to expected redundancy costs and provisions of £0.8m were made in relation to employee litigation claims.

Redundancy provisions and employee litigation cases as at 31st March 2015 total £0.2m.

For employee litigation cases, legal advice has been provided to support the validity of any provisions made in the 2014/15 accounts. There was 1 significant employee litigation provision in 2013/14 which has been settled in 2014/15 for £0.8m.

Long-term pensions and injury benefit provisions

The provision for long-term pension liabilities as at 31st March 2014 was £1.5m. (£0.2m) has been utilised in 2014/15 in respect of payments made to the NHS Pensions Agency. Due to changes in the Treasury FReM, provisions for long-term pension liabilities have been revised to reflect the change in the discount rate from 1.8% to 1.3%. The impact of the revised provisions is £0.3m for the change in life expectancies and change in discount rate and (£0.1m) of cases have been reversed as unused. Pension provisions as at 31st March 2015 are £1.5m.

The injury benefits provision is made on the same basis as the long-term pension provisions. The discount rate for injury benefit provisions has also changed from 1.8% to 1.3%. The provision as at 31 March 2014 was £3.9m. (£0.2m) has been utilised in respect of payments made to the NHS Pensions Agency. The impact of the revised provisions is £0.4m for the change in life expectancies and change in discount rate and 2 new cases have arisen in the year for £0.5m and there are 2 cases where the provisions have increased due to a change in circumstances totalling £0.3m. Unwound discount of £0.1m takes the injury benefit provisions to a closing position of £5.0m.

Other legal cases

A provision for legal claims was made in the accounts as at 31st March 2014 for £0.3m. This provision is based on information provided from the NHS Litigation Authority in relation to public liability and employer liability claims. The Trust's provision for 2014/15 is £0.2m.

Prepayments

Each year the Trust accounts for a number of prepayments in the usual course of business. As at 31st March 2014 the Trust had made prepayments of £2.7m, £1.8m specifically related to prepayments in respect of leased car contracts. The Trust has identified prepaid invoices at the balance sheet date and the 2014/15 prepayments of £3.0m, £2.3m of which specifically related to prepayments in respect of leased car contracts.

Revaluations and Impairments

Revaluations

IAS 16 requires that the carrying value of property is not materially different to fair value at the balance sheet date. To ensure this reflected in the annual accounts a review was undertaken by the District Valuer as at 31st March 2015 of land and buildings.

Specialised NHS buildings are valued on the basis of depreciated replacement cost (DRC). The DRC approach is based on the economic theory of substitution and is used in situations where there is no directly comparable alternative. The comparison therefore has to be made with a hypothetical substitute, also described as the modern equivalent asset. Our accounting policies state that "HM Treasury has adopted a standard approach to depreciated replacement cost valuations based on modern equivalent assets and, where it would meet the location requirements of the service being provided, an alternative site can be valued."

Following the RICS Guidance Notes which provide the basis for the DRC method, the guidance states that although the ultimate objective of the DRC method is to produce a valuation of the actual property in its actual location, the initial stage of estimating the gross replacement cost has to reflect the cost of a site suitable for a modern equivalent facility. Often this will be a site of a similar size and in a similar location to the actual site. However, if the actual site is clearly one that a prudent buyer would no longer consider appropriate because it would be commercially wasteful or would be an inappropriate use of resources, the modern equivalent site is assumed to have the appropriate characteristics. The fundamental principle is that the hypothetical buyer would purchase the least expensive site that would be suitable and appropriate for its proposed operations.

Other factors need to be considered in addition to establishing the location of the modern equivalent site. The modern equivalent asset may not require a site as extensive as the actual site. In this respect land is no different to any other asset. If 2 hectares are now sufficient to provide the same service, the modern equivalent site will be 2 hectares, even if the actual site is 4 hectares.

Due to the commencement of the Trust's significant transformation, it was appropriate to review the basis of the Trust's modern equivalent asset methodology in 2013/14 applying the methodology above. Work was undertaken to map the Trust services and occupancy levels as at 31st March 2014 to a modern asset of equivalent capacity and function, capacity and function meaning able to deliver the same level of service. This work also included mapping these services to optimised sites and optimised locations. Changes in 2014/15 have been updated in the mapping.

In accordance with the Trust's accounting policies all non-operational properties which have not been reclassified as held for sale at 31st March were valued at market value and based on the market land value of their current locations. These assets have been valued outside of the Trust's modern equivalent asset methodology.

Work has been undertaken by the District Valuer to review the asset values as at 31st March 2015. This resulted in some significant increases in buildings values of as much as 17% in NHS specialised buildings. Revaluation gains are recognised in the revaluation reserve, except where, and to the extent that, they reverse a revaluation decrease that has previously been recognised in operating expenses, in which case they are recognised in operating income. A decrease in value is charged to the revaluation reserve, up to the point of previous year's gains until the revaluation reserve is fully utilised and then any further revaluation loss will be treated as an impairment charged to the Statement of Comprehensive Income.

<u>Impairments</u>

Up to month 11, the Trust had recognised impairments of £47.7m. This impairment related to Hopewood Park which was a newly constructed asset which cost £49.5m to construct and the building valuation from the District Valuer was £10.3m, resulting in an impairment of £39.2m. An impairment was also recognised to reclassify land as non-operational which totalled £8.5m.

Valuations on a Modern Equivalent asset basis assumes that no preparation is required to commence construction; therefore planning, design and enabling costs are not included in the construction costs applied to value the asset. Also, the valuation is based on the cost of a modern equivalent as detailed above, which would perform the same function, in possible a less costly location based on a limited range of Beacons, which may not reflect the same quality, capacity, configuration or even useful life as a constructed asset, including some of the costs of the specialist features in our buildings, for example for security or anti-ligature features.

Further impairments were recognised as part of the valuation as at 31st March 2015 of £4.1m in relation to capital expenditure which has not enhanced the value or life of the Modern Equivalent Assets.

Additions and disposals/assets held for sale

IFRS 5 states that an asset should be classified as held for sale at the lower of its carrying amount and fair value less costs to sell. Fair value is the amount an asset could be exchanged for between knowledgeable, willing parties in an arm's length transaction.

IFRS 5 also states that a non-current asset should be classified as held for sale if its carrying amount will be principally recovered through a sale transaction rather than through continuing use. Assets intended for disposal are reclassified as 'Held for Sale' once all of the following criteria are met:
- the asset must be available for immediate sale in any present condition subject only to terms that are usual and customary for sales of such assets
- it's sale must be highly probable, ie
- management are committed to a plan to sell the asset
- an active programme has begun to find a buyer and complete the sale
- the asset is being actively marketed at a reasonable price
- the sale is expected to be completed within 12 months of the date of classification as 'Held for Sale'; and
- the actions needed to complete the plan indicate it is unlikely that the plan will be dropped or significant changes made to it

Assets reclassified as held for sale totalled £14.1m at 31st March 2014. This includes £12.0m for Northgate Land sale, £0.2m for 78 Middleton Street, £0.2m for Acacia House and £1.7m for Sunderland Social and Residential Homes.

78 Middleton Street and Acacia House have been sold in year.

Northgate Land sale has also completed in year. The land was sold to Taylor Wimpey in December 2014 and £6.9m was received in year and a receivable has been recognised for the second instalment of 50% and £6.9m, which is to be received in approximately late Q3 to early Q4 of 2015/16.

The sale of the Social and Residential Homes are progressing and the sale is expected in Q1 of 2015/16. These assets were revalued to reflect the most up to date offer and the fair value less costs to sell and were £1.6m. The Social and Residential Homes are to be disposed of as a group of assets in a single transaction and are therefore classified as a disposal group under IFRS 5. The disposal group is measured at the lower of its carrying amount and fair value less costs to sell and an overall reduction in value applies to the disposal group of £0.1m. The reduction will apply to the group as a whole and will be charged against the revaluation reserve until the reserve is utilised and the remainder will be charged as an impairment to expenditure. Within the group, the majority of the properties have fallen in value, but 3 have increased in value.

Consolidated Accounts and Limited Liability Partnership Assessment

The Trust will continue to account for the Limited Liability Partnership arrangements on an equity basis and this will be reported as an investment in a joint venture.

From 2014/15, IFRS 11 Joint Arrangements applies (see paper 10.1). A joint arrangement is an arrangement of which two or more parties have joint control. A joint operation exists where the parties that have joint control has rights to the assets and obligations for the liabilities relating to the arrangement. A joint venture exists where the parties that have joint control have rights to the net assets of the arrangement. Where an NHS Foundation Trust is party to a joint venture, it should recognise its investment through the equity method in IAS 27.

The profit/loss in the investment in the LLP is £0.050m for the year 2014/15.

Recommendation

- Approval of the draft accounts
- Signing of the management representation letter

James Duncan
Director of Finance
May 2015