Portsmouth Hospitals NHS
NHS Trust

AUDIT COMMITTEE – 19th MARCH 2015

Subject	**2014/15 Technical Accounting Treatment**
Prepared by: **Sponsored by:** **Presented by:**	Lee Williams, Head of Financial Accounting Brian Maxton, Deputy Director of Finance Ben Lloyd, Director of Finance & Investment Lee Williams, Head of Financial Accounting
Purpose of paper	For Audit Committee approval.
Key points for Finance Committee members	The 2014/15 anticipated technical accounting treatments have been highlighted to the Trust Board on a monthly basis as part of the Integrated Performance Report (IPR) and regular discussions have taken place with the Trust's External Auditors, Ernst & Young, regarding the accounting principles being applied. The purpose of this paper is to set those treatments out in more detail to allow fuller consideration by the Committee. Whilst the Trust's Auditors will comment on the principle relating to technical adjustments, they are unable to comment on the result of calculations or to provide their final audit opinion, which will only occur once they have completed their audit of the Trust's annual accounts.
Options and decisions required	The Audit Committee is asked to confirm their support to the technical adjustments as presented and to approve their adoption for the 2014/15 accounts.
Next steps / future actions:	N/A
Consideration of legal issues (including Equality Impact Assessment)?	N/A
Consideration of Public and Patient Involvement and Communications Implications?	N/A

2014/15 PHT Technical Accounting Treatments

INTRODUCTION

During the course of 2014/15 a number of technical accounting treatments have required consideration to ensure that the Trust Accounts comply with appropriate accounting practice and provide a true and fair view of the transactions, assets and liabilities of the Trust.

Discussions and disclosure has taken place with the Trust's External Auditors, Ernst & Young, throughout the year and the Trust Board has been kept informed, via the Integrated Performance Report, of the nature and extent of the adjustments.

The technical accounting treatments cover the estimation basis for Information and Communications Technology (ICT) and Plant & Equipment, along with the treatment of income relating to Research & Development. Each of these is considered in turn below.

Whilst the Trust's Auditors will comment on the principle of the proposed technical adjustments, they are unable to comment on the result of calculations or their final audit opinion, which will only occur once they have completed their audit of the Trust's annual accounts.

As in previous years, the Trust will make a technical adjustment where PFI costs under IFRS are in excess of those under UKGAAP. The value of this has yet to be determined but is likely to be in the region of £0.3m to £1.5m, dependent upon the extent of the pre-payment element of lifecycle work within the unitary payment. As no change is proposed in the methodology for determining this adjustment, from that used for 2013/14, it is outside of the scope of this paper.

In addition, for the information of the Audit Committee, an update has been provided at Annex 'A' on accounting for the Estate Revaluation and for Nurse Rostering.

1. Asset Lives – Information and Communications Technology (ICT)

The Trust's current accounting policy is for ICT assets to be depreciated over their estimated useful life. The policy does not specify the life but says the lives are assessed annually. In applying this policy, In practice, the Trust depreciates ICT assets over a five to ten year period.

IAS8 states, 'A change in accounting estimate is an adjustment of the carrying amount of an asset or liability, or related expense, resulting from reassessing the expected future benefits and obligations associated with that asset or liability'.

Under IAS16 - The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, any change is accounted for prospectively as a change in estimate under IAS8.

The Trust has ICT network equipment on the capital equipment register with a nil or short remaining life. As at 31st March 2014 there were 115 ICT assets with a current replacement value of £6.9m that were fully depreciated and still in use; out of a total of 238 ICT assets with current replacement cost of £18.2m.

Given the number of ICT assets that are fully depreciated but still in use, the Trust is proposing to increase the useful lives of ICT assets by two years, up to a maximum of ten years. This excludes ICT Network Investment added in 2008/09, as this was a project of work involving the purchase of many smaller assets that were capitalised as a networked asset and it would not be possible to verify that every component of this investment program was still in use.

It is anticipated that if the asset life of all post 2008/09 ICT assets were extended by two years, assuming there are no known disposal or replacement plans, the financial impact to 2014/15 depreciation would be c£2.0m. A prior year adjustment (PPA) is not appropriate because this is not a national change in accounting policy or a correction to a material error (2014-15 Manual for Accounts P.77).

2. Asset Lives – Plant and equipment

The Trust currently depreciates plant and equipment assets for between five and fifteen years. There are currently some assets that are similar in nature but have varying useful lives and assets in use but with a nil or very short remaining life.

IAS 8 states, ‘A change in accounting estimate is an adjustment of the carrying amount of an asset or liability, or related expense, resulting from re-assessing the expected future benefits and obligations associated with that asset or liability.

Under IAS16 the residual life of an asset should be reviewed at least at each financial year end and, if expectations differ from previous estimates, any change is accounted for prospectively as a change in estimate under IAS8.

An exercise has been undertaken to group plant and equipment assets similar in nature and to review their useful asset lives. This review has included the identification of those assets with a nil or short remaining life and those which have incurred a loss on disposal (potentially indicating too long an asset life). As a consequence the asset life of assets that are similar in nature have been aligned and, where appropriate, the life of assets in use with a nil or short remaining life increased; by a further two years to a maximum of ten years, assuming there are no known disposal or replacement plans. There will remain be some unique assets that do not become part of a group due to the nature of the asset (for example the birthing pool).

The current plant and equipment depreciation treatment, which depreciates assets between five and fifteen years, will be maintained and no asset has had its life extended under this review to more than ten years; meaning assets initially given a ten to fifteen year life would not have their lives extended.

An initial review has shown the impact of this in 2014/15 would be a credit to depreciation of c£1.8m. A prior year adjustment (PPA) is not appropriate because this is not a national change in accounting policy or a correction to a material error (2014-15 Manual for Accounts P.77).

3. Research and Development – Income advances

The Trust’s accounting policy on Revenue, note 1.7, states, ‘where income is received for a specific activity that is to be delivered in the following year, that income is deferred’.

The accounting policy on Research and Development, note 1.36, states, ‘expenditure is charged against income in the year in which it is incurred, except insofar as development expenditure relates to a clearly defined project and the benefits of it can reasonably be regarded as assured’.

In practice, where research and development projects have a duration of greater than one year, the Trust has historically treated the associated income as deferred income in the accounts. This has led to a build up of deferred income recorded on the Statement of Financial Position (SOFP) under Current Payables totalling approximately £1m.

During 2014/15 the Trust has conducted an extensive review of research and development deferred income and strengthened procedures to ensure that deferred income only consists of income with an on-going defined project associated against it.

It would not have been appropriate to reverse the deferred income in previous years because at that time the Trust did not have sufficient robust information to confirm no further expenditure would be incurred against it. This also ensures the Trust complied with it's accounting policy on revenue recognition (note 1.7 in 2013/14 Accounts) whereby income received for a specific activity to be delivered in the following year is deferred. Until such time as the Trust could assure itself that there was no further spending plans or on-going project against income it would have been incorrect to recognise the income in the accounts. Therefore this proposed adjustment does not generate a prior year adjustment.

From 2014/15, where the Trust holds deferred income on the SOFP and there is no project or expenditure plan in place to spend the funds, the deferred income will be reversed out from the SOFP to the Statement of Comprehensive Income (SOCI). This is considered to be in compliance with the Trust's accounting policies.

As a result of the proposed treatment there will only be deferred income on the SOFP which has an identify expenditure plan against it. This is not considered to be a change to the accounting policies, but compliance with existing policy.

REFERENCES

International Accounting Standard (IAS) 8 – Accounting Policies, Changes in Accounting Estimates and Errors:
http://www.iasplus.com/en-gb/standards/ias/ias8

IAS 16 – Property, Plant and Equipment:
http://www.iasplus.com/en-gb/standards/ias/ias16

Department of Health Group Manual for Accounts 2014-15:
http://www.info.doh.gov.uk/doh/finman.nsf/4db79df91d978b6c00256728004f9d6b/75334ce516e12ab280257d9d004144b3?OpenDocument

For information an update has been provided below on accounting for the Estate Revaluation and Nurse Rostering.

Estate Re-valuation

The Trust's accounting policy (1.10) states that, 'revaluations are performed with sufficient regularity to ensure that carrying amounts are not materially different from those that would be determined at the end of the reporting period'. This is in accordance with IAS16, the relevant accounting standard, which states that, 'revaluations should be carried out regularly so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date'.

Whilst the NHS 'Manual For Accounts' has no definition of 'sufficient regularity' for revaluation purposes, the generally accepted maximum gap is 5 years as long as intermediate valuations are done in between. The Trust has undertaken intermediate valuations, via desktop District Valuer (DV) exercises, which provides an update on values but not an inspection and on site assessment. This has resulted in a £14.9m upward revaluation in 2013/14, £1.7m upward revaluation in 2012/13 and £1.8m upward revaluation in 2011/12.

Looking at Monitor's guidance, their '2014/15 Annual Reporting Manual for FT's states, 'There is no pre-determined frequency with which assets must be re-valued. Instead, the standard requires that asset values should be kept up to date and that the frequency of revaluation will need to reflect the volatility of asset values. Where assets are subject to significant volatility, then annual revaluations may be required. Conversely, where changes in asset values are insignificant then a revaluation may be necessary only every 3 or 5 years. In Monitor's view, property assets are likely to require revaluation at least every 5 years.'

The issue of valuation was raised in the audit of 2013/14 accounts but was not an issue of much discussion; as the Trust was still within five years of its previous valuation, carried out in April 2009 and implemented in 2009/10.

The Trust has recently received from the DV an option appraisal valuation of £305.1m, an increase of £30m from current anticipated year-end book value. The Trust intention is to implement this as at 31st March 2015, ensuring the closing balances within the accounts reflect the DV revaluation.

The revaluation increases the Trust required 3.5% rate of return with an adverse financial consequence of £0.5m, which has already been factored into the Trust year-end financial forecast. This will have a further full year effect in 2015/16.

Nurse Rostering - Accrued hours paid not worked

The Trust uses the 'Barnacles' rostering system for the management of nursing staff rotas. The system maintains a record for each individual of the cumulative hours rostered and worked.

Over the last eighteen months the data on the system has been reviewed and validated and has revealed a number of cases where nurses have been paid for more hours than they have been rostered to work.

This has arisen due to the nature of the rota planning. For example, a full time nurse may be rostered to work three twelve hour shifts in a week. This means they will be paid 37.5 hours but only work 36. The plan would be that, over a period of time, this would be netted off by working in excess of rostered hours or working a shift without receiving payment.

If there are any cases where the employee has worked more hours than they have been paid for these will be reflected in the accrual made, i.e. the net effect of over and under payments will be accounted for.

Work is ongoing with the CSC's to manage this process better and to ensure that the balance of over/under worked hours is managed to a minimal level in the longer term.

The Trust is proposing to treat the net over/under payment of nursing hours as a prepayment/creditor in the accounts each year. The current net estimated effect of the over/under paid hours on 2014/15 expenditure is a credit of £0.3m. This is not considered to be a change to the accounting policies, but compliance with existing policy and accounting principles.