# 2015-16 Year End Supplementary Accounting Guidance

This year end accounting guidance is being issued to supplement the *Department of Health Group Manual for Accounts 2015-16* and the *Foundation Trusts Annual Reporting Manual 2015-16*, and should be treated as having the same weight as those manuals.

Monitor and the NHS Trust Development Authority (TDA) issued a joint letter on 15 January 2016 on the 2015-16 Outturn and 2016-17 Plan. The letter required collective action by NHS Providers to ensure that the sector contains the aggregate deficit position to within a £1.8 billion control total in 2015-16. It outlined areas that included both operational efficiencies and technical and one-off measures to improve the financial position, while ensuring that safe care continues to be delivered.

We are now issuing guidance on associated financial accounting, aiming to provide a reminder of and to highlight correct treatment, including IFRS compliant valuations, and to achieve consistency of treatment across the Departmental Group.

## Ensuring consistency of treatment on the provisions/accruals boundary

All sectors should ensure that liabilities which are of uncertain timing or amount are included in provisions, not accruals.

IAS 37 defines provisions as liabilities of uncertain timing or amounts, to be recognised when there is a probable outflow of resources to settle a present obligation. The amount recognised is the best estimate of expenditure required to settle the obligation at the end of the reporting period, determined by management judgement including experience of similar transactions.

Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Amounts that should be treated as provisions may include:

- NHS Continuing Healthcare packages
- legal claims, where the outcome or amount of eventual settlement is uncertain.

Where the requirements for recognition of a provision are not met, it may be appropriate to disclose a contingent liability.

## Monthly review of accruals

The monthly financial control process should include a review and confirmation of accuracy of accruals. This should include system generated GRNI accruals, which can lead to invalid accruals, for instance if the whole purchase order has been marked as received immediately upon being raised regardless of actual receipt of goods or services.

## Accruals for locum / agency staff at year end

In February 2016 the caps on nurse agency spend (rates) were lowered by Monitor and NHS TDA. It is usual that the invoices for these staff are received one to two months later. It is important therefore that this is taken into consideration when accruals are established so as to ensure they are not overstated. Financial accountants should review management accounts accruals in this area.

## Accrual for unclaimed VAT

We are aware that HMRC are operating tighter enforcement of their tax point rules and the timing for reclaiming VAT. As a result entities should consider an accrual for unclaimed VAT on received but unapproved invoices at the year end, and consider processing timings to avoid being out of time for the claim.

We also advise that VAT reviews to look at what is recoverable should ideally be performed as part of the year end process, rather than waiting until July, to ensure that the accrual of unclaimed VAT is complete.

## Recognition of income and expenditure

Entities should ensure that their approach to recognising income and expenditure, and related assets and liabilities, is consistent with IFRS principles, including those set out in the Conceptual Framework. Recognition should be based on the probability of future economic benefits flowing to or from the entity and the reliability with which cost or value can be measured. This should be assessed using the evidence available when the financial statements are prepared. Estimates should represent a balanced view, which should aim to be accurate as far as possible, and not excessively prudent.

In particular:

- accrued expenditure should reflect goods that have actually been received and services that have been consumed. Where a degree of estimation is involved, this should be based on the most reliable evidence available
- income should be recognised in accordance with IAS 18 and should not be deferred where the recognition criteria in this standard are met.

## Pooled budgets & BCF

Chapter 3 Annex 1 of the *Department of Health Group Manual for Accounts 2015-16* sets out the accounting treatment for the Better Care Fund, and the principles are also relevant for other pooled budgets. For end of year considerations, paragraphs 31 to 38 in the Annex on cash and expenditure are particularly relevant and outline that funding should not be provided in advance of need and where it is provided it is recognised as a pre-payment.

Standard recognition practise also applies to expenditure, so that any payment made in advance of service being received would give rise to a pre-payment in the lead or joint commissioner(s) account. Individual participants in the pooled budget would then take their share of that pre-payment into their own SOFPs. This would apply equally to lead commissioner or joint operation arrangements. Funders of pooled budgets should therefore obtain information on what has been spent at year-end and ensure that any pre-payments are recognised and an underspend in a pool should be reflected with a receivable in the funder's accounts.

## Provision for impairment of receivables

Bad debt is not expected to arise between providers and commissioners and credit note adjustments should be agreed through the end of year agreement of balances exercise. Foundation trusts have scope, in principle, to recognise bad debt against NHS commissioners, but bad debt should not exist between other NHS bodies. Therefore NHS bad debt should be minimised overall.

In circumstances where NHS bad debt provisions are considered necessary, any impairment of an NHS receivable must not be recorded elsewhere in the accounts (for example as non-NHS receivables). Any bad debt provisions of this manner should be reversed.

## Asset Lives

IAS 16 requires that an annual review of the useful lives of assets is conducted, and that the recognisable life is until the item is derecognised, being either on disposal or when no future economic benefits are expected from the asset's use or disposal. In view of the overall future reductions in capital budgets, we advise that the useful lives of equipment and buildings should be reviewed and changes accounted for as a change in estimation.

## Asset revaluations and disposals

IFRS 5 sets out criteria to be met before a non-current asset can be reclassified as held for sale. This may require the asset to be impaired to the lower of carrying amount and fair value less costs to sell. Assets should not be treated as held for sale unless the IFRS 5 criteria are met in full.

As described in FAQ2 to the DH Group Manual for Accounts, entities should also not revalue an asset immediately prior to sale, but should dispose of the asset at its current carrying amount. Where there is a clear decision to change the basis on which an asset is held, e.g. an asset that was formerly in use but that has become surplus and is not held for sale, it should be valued according to the relevant standards.

## Revaluing net of VAT

Revaluation of assets should follow the methodology set out in the DH Group Manual for Accounts (Annual Reporting Manual for Foundation Trusts). This will normally be based on a replacement cost inclusive of VAT, since VAT is not recoverable on most asset purchases. Where assets are acquired through PFI, however, VAT is recoverable on the unitary payments. This may lead entities to consider revaluing these assets net of VAT, reflecting the cost at which the service potential would be replaced by the PFI operator.

Whilst valuation is ultimately a matter for local valuation experts, PFI assets should only be revalued exclusive of VAT where there is clear evidence that this is appropriate, which should be to the satisfaction of local auditors. Where the asset was not previously acquired through a route that permits VAT to be recoverable, the asset should be valued inclusive of VAT.

## Impairment categories

HMT Treasury has defined a number of categories of impairment (explained in more detail in Consolidated Budgeting Guidance 2015-16). These match the categories used in accounts summarisation schedules.

It is important to select the correct category in each case, as this determines the budgeting treatment. In general, impairments resulting from management decisions and actions score to Departmental Expenditure Limit (DEL) budgets, whilst impairments arising from circumstances outside management's control score to Annually Managed Expenditure (AME).

Categories that score to DEL are:

- loss or damage arising from normal business operations, including where an appropriate risk management strategy might have averted the loss
- abandonment of projects, e.g. where business case evaluation was insufficient
- gold plating, i.e. over-specification.

Categories that score to AME are:

- loss caused by catastrophe, i.e. outside the normal experience of the entity
- unforeseen obsolescence, i.e. due to unforeseeable circumstances and not simply a change of approach by management
- other (see Consolidated Budgeting Guidance 2015-16 for specific guidance – this is not a catch-all category)

- falls in value relating to changes in market price (after offsetting against any revaluation reserve balance).

## Impact of IFRS treatment of PFI/LIFT

PFI and LIFT schemes subject to IFRIC 12 are reported in accounts as being on-Statement of Financial Position (SoFP), with the recognition of an asset and a corresponding imputed finance lease liability. However, for budget purposes at the departmental level, these schemes are reported in accordance with European System of Accounts 2010 (ESA 10). This typically requires an off-SoFP treatment, similar to UK GAAP. Where this is the case, entities are asked to provide information setting out the difference between the two treatments and the resulting adjustment between accounts and budget positions.

Those entities with PFI and LIFT schemes should ensure they understand the treatment of these schemes under both IFRIC 12 and ESA 10, and that the appropriate entries are made in the related note. These entries are used to derive budget outturn from accounts figures, and it is therefore important they are accurate.

## Assets purchased from cash donations

Where entities receive donations to acquire non-current assets, these may take the form either of physical asset donations or of cash donations to enable assets to be purchased. In either case, the asset acquisition should be categorised under donated additions, with corresponding donation income.

In budget terms, both the addition and the matching income will score to Capital DEL, with neutral overall effect, whilst subsequent depreciation will score to AME. At the departmental level, both capital budget impacts are derived from the categorisation of the asset addition. It is important, therefore, that assets purchased from cash donations are recorded as donated, not purchased, assets. In summarisation schedules, the relevant row is described as ‘Additions – Purchases from cash donations and government grants’.

## Assets under construction

IAS 16 allows entities to recognise assets that are in the course of construction. Additions to such assets should follow the same recognition criteria that apply to any other item of expenditure. This might, for instance, follow delivery of a significant element of an asset under construction, or work carried out by a contractor towards its completion. Amounts recognised as additions should not anticipate progress towards completion, e.g. where a contractor has taken delivery of raw materials but has yet to make use of these in constructing the asset.

## Queries

If you have any queries on this guidance, please raise them with your sector leads in the first instance, or with the DH Accounts team.

April 2016