

# **Improving the quality of NHS annual report and accounts – Reporting financial performance Good practice note**



Prepared for NHS boards and appointed auditors

8 November 2017

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# Introduction

## Purpose

1. The annual report and accounts are a public report on the financial, performance and governance affairs of each NHS board for the financial year and are laid in the Scottish Parliament. As such they should be prepared to the highest standards and presented in a way that is helpful, accessible and informative to the user.
2. In our good practice note [Improving the NHS annual report and accounts - Performance report](#) we highlighted that the standard table disclosing boards' financial performance is complicated and that not all boards provided the user with any explanation of what the table meant.
3. This good practice note, which considers the reporting of financial performance and outturn in the performance report, is designed to build on previous good practice notes to help all boards meet the applicable requirements and reach the standard of the best seen in 2016/17.

## Background

4. It is the responsibility of the Accountable Officer and board members to prepare the annual report and accounts (the accounts). The accounts are an important method of communicating effectively with stakeholders on issues of finance and governance.
5. Boards are required to prepare their accounts in accordance with a direction issued by Scottish Ministers. The direction requires compliance with the accounting principles and disclosure requirements of the *Government financial reporting manual* (the FReM) and with the requirements of the *NHS boards' accounts manual for annual report and accounts* (the accounts manual).
6. Boards are required by the accounts manual to include specific disclosures on financial performance and outturn in their performance report.
7. Auditors have a role in assisting boards to produce relevant, concise and clear accounts which provide the users with an understandable and balanced assessment of the performance and financial position of the board.

## Summary of key messages and recommendations

8. Audit Scotland's Professional Support Team has reviewed all twenty three boards' 2016/17 financial performance and outturn disclosures within the performance reports to identify instances of good practice and areas for improvement. The main messages from this review are summarised in the following table:

All boards included the disclosure of financial performance and clearly presented the performance against their three resource limits

Some boards presented their in year outturn incorrectly

Most boards did not present the brought forward surplus in accordance with the accounts manual

Narrative disclosures could be improved by using clear and consistent wording and providing contextual or explanatory information

9. On the basis of these messages, we have made recommendations throughout the report and included these in an improvement checklist to assist boards in the preparation of their financial performance and outturn disclosures.
10. There are lessons for boards, auditors and the Scottish Government to ensure that in future information disclosed meets disclosure requirements, is presented consistently, and is clear, concise, and free from misstatement.
11. The remainder of this good practice note discusses these messages and recommendations further and highlights some of the good practice adopted by boards. The examples used are all taken from boards' 2016/17 accounts.

## Contact point

12. The contact point in Audit Scotland's Professional Support Team for this good practice note is Neil Cameron - 0131 625 1797

# Reporting financial performance

## Introduction

13. The accounts manual requires boards to disclose their financial performance and in year outturn in their performance report and sets out the required format for the disclosure (see paragraph 20). Financial performance is reported in terms of whether boards have met three resource limits set for them each year by the Scottish Government.
14. The three resource limits are
- the revenue resource limit (RRL), split into a core and non-core element
  - the capital resource limit (CRL), split into a core and non-core element
  - a cash requirement.
15. Boards are required to ensure their expenditure (or spend for the cash requirement) remains within each of these resource limits on an annual basis. The core and non core elements of the RRL and CRL were introduced in 2010 and the requirements set out in two Dear colleague letters dated 2 September and 6 October 2010. Features of the RRL and CRL are summarised in the following table:

Element/Limit	RRL	CRL
Core	Day-to-day expenditure such as supplies and services and payroll  Underspends against the limit can be carried forward to future years	Acquisition and improvement of land, buildings, plant equipment, etc  Underspends against the limit can be carried forward to future years
Non-core	Accounting adjustments, such as impairment of assets or the recognition of provisions for future liabilities  Underspends against the limit cannot be carried forward to future years or transferred to fund a core overspend  Overspends against the non-core element must be funded from the core element	Capital expenditure on service concession arrangements  Underspends against the limit cannot be carried forward to future years or transferred to fund a core overspend

16. Where a board expects to overspend on either core or non core limits, it should contact the Scottish Government who may be able to help manage the position. However, where a non core overspend is disclosed in the accounts, boards should adjust the core underspend to show that it is being funded. From a budgeting perspective, the Scottish Government may be able to allow a board to carry forward the full core underspend, but this will be subject to the management of the overall NHS budget.
17. Auditors are required to report in their independent auditor's report any
- material misstatements in boards' financial performance disclosures
  - failure to meet a set resource limit.
18. Auditors did not report any material misstatements or failure to meet any resource limit in 2016/17.

## Providing an explanation of resource limits

19. The accounts manual does not specifically require the disclosure of an explanation of the resource limits or the board's performance. However, there is a general requirement that disclosures provide the user with relevant, clear and concise information. Although the use of resource limits is common across the public sector bodies, it may not be understood by the user of the accounts. The NHS also uses sector specific terminology for these resource limits which may require explanation. The best disclosures in the 2016/17 accounts included some explanation of the resource limits.

### NHS Lanarkshire explained what the non core element is used for

The non-core revenue resource limit provides funding for more technical accounting entries that do not directly trigger a cash payment such as the depreciation or impairment of an asset or the creation of a provision for a future liability. The Core Capital Resource Limit covers additions to land and buildings or intangible assets or new equipment with a life greater than 1 year and a value greater than £5,000. The Core Revenue Resource Limit is the Scottish Government funding the Board receives to cover all its other activities, excluding certain Family Health services payments which are covered centrally by the Scottish Government.

In respect of financial position and performance:

- The Scottish Ambulance Service achieved an underspend against Non-Core Revenue Resource Limit at the year-end of £5k and generated a surplus against Core Revenue Resource Limit at the year-end of £50k resulting in an overall underspend of £55k. The non-core surplus of £5k will be returned to the government;

**SAS explained that their non core surplus was not available for carry forward to future years**

**NHS Lothian took a different approach to explain the impact on cash**

Details of NHS Lothian's Net Operating Costs and RRL outturn are set out in Notes 2 to 8 to the Accounts. The Board's Revenue and Capital Resource limits have been split between two component elements. Core revenue and capital have a cash or near-cash impact on the Board's net expenditure. Non cash revenue and capital elements of net expenditure such as impairments, provisions and depreciation on assets have a non-core impact.

**Boards should be careful to avoid using complex language or jargon**

received non-core revenue funding of £39.483m to cover Depreciation (£13.020m), ODEL PPP (£7.653m), AME Provisions (£14.798m), Additional non-core funding (£2.825m), AME Impairments (£0.942m), Capital grants to Other Bodies (£0.143m) and AME Donated Asset Depreciation (£0.102m).

We recommend that boards provide the user with a clear explanation of what the resource limits mean, including what is chargeable against the core and non core elements. Explanations should use plain English, avoiding unexplained acronyms and jargon.

**Format of financial performance disclosure**

- 20. The accounts manual requires the disclosure of financial performance to include the following analysis:

Financial Performance [Required Disclosure]			
	Limit as set by SGHSCD £'000	Actual Outturn £'000	Variance (Over)/Under £'000
	(1)	(2)	(3)
1 Core Revenue Resource Limit	X	X	X
Non-core Revenue Resource Limit	X	X	X
2 Core Capital Resource Limit	X	X	X
Non-core Capital Resource Limit	X	X	X
3 Cash Requirement	X	X	X
<b>MEMORANDUM FOR IN YEAR OUTTURN</b>			£'000
Brought forward deficit/(surplus) from previous financial year			X
Saving/(excess) against in year total Revenue Resource Limit			X

All boards used this required format, and the performance against each target was clear and consistent

However, the memorandum for in year outturn was not consistent across all boards

**Memorandum for in year outturn**

- 21. The memorandum of outturn disclosure is part of the disclosure of financial performance. It attempts to show how the board would have performed against its RRL allocation in each year if it did not have access to any amounts brought forward from previous years. It does this by removing the underspend or overspend shown in the previous year's accounts from the underspend or overspend for the current financial year.

## How the memorandum of outturn should work

Example - The board underspent against its core RRL by £100,000 in 2015/16. This underspend is available to the board to carry forward and use in future years (described in the accounts manual as 'Brought-forward surplus'). In 2016/17 the board achieved a cumulative underspend of £150,000. However, if the board had not had the £100,000 brought-forward from 2015/16 to use in 2016/17, the underspend would have been £50,000. This £50,000 is their in-year underspend (described in the accounts manual as 'Saving against the in year RRL').

## Required format for memorandum for in year outturn

22. The format of the memorandum for in year outturn required by the accounts direction is confusing and no explanation of the disclosure is included in the accounts manual to assist boards. This lack of guidance explains some of the inconsistent reporting by boards. Using the example provided, the disclosure would be as follows:

	£,000
Brought forward surplus from previous financial year	(100)
Saving against in year revenue resource limit	50

**The use of brackets is inconsistent and confusing**

We recommend that the Scottish Government review the disclosure requirement and provide guidance within the accounts manual to ensure that disclosures are prepared consistently.

## Adding to the required format

23. Half of boards added a line to the required format to arrive back at the total underspend against the core RRL shown in the financial performance disclosure. Boards which added a line adopted differing presentations, including different use of brackets.

Memorandum for in-year outturn	£'000
Revenue Resource Limit surplus	1,154
Less: brought forward core surplus from previous financial year	(240)
Surplus against in year Revenue Resource Limit	914

**Some boards started with the cumulative underspend**

**While others arrived at the cumulative underspend as the bottom line**

Memorandum of In Year Outturn	
Brought forward surplus from previous financial year	349
Deficit against in year total Revenue Resource Limit	(10)
Net Savings against RRL	339

We recommend that boards include the cumulative under/overspend as part of the memorandum for in year outturn to provide the user with a clear link back to the financial performance disclosure.

## Explanation of the memorandum for in year outturn

24. A few boards included an explanation of what the memorandum for in year outturn is intended to describe. The best disclosures attempted to explain the purpose of the memorandum:

MEMORANDUM FOR IN YEAR OUT-TURN	£'000	NHS Shetland explain that the 2015/16 underspend is added to the 2016/17 budget
Brought forward surplus from previous financial year	(396)	
Excess against in year total Revenue Resource Limit	(84)	
<b>Revenue Resource Limit</b>		
<p>The Board delivered an under spend against its Core Revenue Resource Limit (RRL) of £312k for 2016/17. This compares with an under spend of £396k in 2015/16. The under spend from 2015/16 was carried forward and added to the Board's RRL in 2016/17. The 2016-17 under spend includes a non-recurring surplus generated on the planned sale of residential properties of £136k.</p>		

We recommend that all boards provide the user with a clear explanation of the purpose of the memorandum for in year outturn.

## Amounts disclosed in the memorandum for in year outturn

25. Eight boards did not present the figures in accordance with the requirements of the accounts manual. The main reasons for the resulting misstatements are
- amounts brought-forward not agreeing to previous year's accounts
  - the carry-forward of non-core underspends
  - in year underspends/overspends being confused with the cumulative position.
26. These are illustrated in more detail in the following examples

### Example 1 Brought forward did not agree with previous year

27. This board reported a cumulative underspend of £60,000 in their 2015/16 accounts. In 2016/17 they have incorrectly identified the brought forward balance as nil and this has resulted in the in year surplus also being misstated.

Memorandum for in year outturn	£000's
Brought forward surplus from previous financial year	0
Surplus against in year Revenue Resource Limit	77
<b>Total</b>	<b>77</b>

Brought forward should equal the RRL underspend from last year. Total should equal the core RRL underspend in this year's accounts. Surplus against in year RRL is the core RRL underspend, less the brought forward surplus

28. The board should have disclosed the outturn as:

Brought forward surplus from previous year	60
Surplus against in year revenue resource limit	17
Cumulative underspend	77

Boards must ensure that the amount brought forward from the previous financial year agrees to the amount reported in the previous year's accounts.

**Example 2 Non core overspend not reflected in amount brought forward**

29. This board did not reduce the amount brought forward from 2015/16 for a non-core overspend.

**The board would have had to fund the non-core overspend from core RRL. The amount available for carry forward should have been £403**

	Limit as set by SGHSCD	Actual outturn	Variance (over)/under
	£'000	£'000	£'000
Revenue resource limit – core	431,181	430,750	431
Revenue resource limit – non-core	1,594	1,622	(28)

Memorandum for In Year Outturn		£'000
Brought forward surplus from previous financial year		431
Increase against in year revenue resource limit		114
<b>Total saving against in year revenue resource limit</b>		<b>545</b>

**Brought forward surplus should not include the non core element as this is not available for carry forward**

30. The board should have disclosed the outturn as

Brought forward surplus from previous year	403
Surplus against in year revenue resource limit	142
Cumulative underspend	545

31. It is unusual for a board to overspend against their non core RRL. However, one other board has recorded an overspend against the non core element in 2016/17 and did not deduct this from the in year outturn position in the memorandum of outturn.

2015/16 £000		2016/17 £000
(59)	Brought forward surplus from previous financial year	(54)
5	(Savings) /Deficit against in year revenue resource limit	(1)
<b>(54)</b>	<b>TOTAL Surplus for year</b>	<b>(55)</b>
0	Non Core Surplus returned to government	5
<b>(54)</b>	<b>Carried forward Core surplus to next year</b>	<b>(50)</b>

**This board removed the non-core surplus from the amount to carry forward instead of removing it from the in year surplus**

32. The board should have disclosed the outturn as

Brought forward surplus from previous year	(54)
Deficit against in year revenue resource limit	4
Cumulative underspend	(50)

Boards must ensure that any under or overspend on non core RRL is not reported as available for carry forward.

**Example 3 In year under/over spend confused with cumulative position**

33. This board appears to have confused an in year overspend with a cumulative underspend.

	Financial Target	Limit as set by SGHSCD	Actual Outturn	Variance (Over)/Under
		£'000	£'000	£'000
1	Core Revenue Resource Limit	803,246	803,129	117
	Non Core Revenue Resource Limit	50,354	50,354	0
2	Core Capital Resource Limit	10,355	10,355	0
	Non Core Capital Resource Limit	4,339	4,339	0
3	Cash Requirement	862,430	862,430	0
<b>Memorandum for in-year outturn</b>				<b>£'000</b>
Brought forward surplus from previous financial year				145
Surplus against in-year Revenue Resource Limit				117

**Total cumulative underspend against core RRL is £117,000**

**Brought forward surplus agrees to previous year**

**The in year result should have been disclosed as an overspend of £28,000**

34. This board should have disclosed the outturn as

Brought forward surplus from previous year	145
Deficit against in year revenue resource limit	(28)
Cumulative underspend	117

Boards must ensure that the in year under/overspend is not confused with the cumulative position.

### Example 4 Unclear where the figures used come from

From 2015/16 accounts		Limit as set by SGHSCD £'000 (1)	Actual Outturn £'000 (2)	Variance (Over)/Under £'000 (3)			Limit as set by SGHSCD £'000 (1)	Actual Outturn £'000 (2)	Variance (Over)/Under £'000 (3)
1	Revenue Resource Limit - core	63,721	63,721	-	1	Revenue Resource Limit - core	65,128	65,128	-
	Revenue Resource Limit - non-core	6,391	6,391	-		Revenue Resource Limit - non-core	7,247	7,247	-
2	Capital Resource Limit - core	6,387	6,387	-	2	Capital Resource Limit - core	4,947	4,947	-
3	Cash Requirement	69,679	69,679	-	3	Cash Requirement	64,796	64,796	-

The 2015/16 accounts report a break even position. There should be no underspend available to carry forward

The 2016/17 accounts also report a break even position

MEMORANDUM FOR IN YEAR OUTTURN	£'000
Brought forward surplus from previous financial year	250
Saving against in year Core Revenue Resource Limit (core funding)	-

The 2016/17 outturn shows a brought forward surplus of £250,000 and the saving against in year core RRL is disclosed as nil

35. From the information included in the accounts, it is unclear what the correct position is.

We recommend that boards ensure that all figures disclosed are consistent.

## Other issues identified

### Additional disclosure inconsistent with the memorandum

36. Additional disclosures can be used to assist the user to understand the board's financial performance. It is important that information in any additional disclosures is consistent with the memorandum for in year outturn. However, if information is provided on a different basis, this should be highlighted and explained.

Memorandum for In Year Outturn				£'000
Brought forward surplus from previous financial year				431
Increase against in year revenue resource limit				114
Total saving against in year revenue resource limit				545
The carry forward at the yearend is made up as follows:				
	Carry forward in 2016/17 £'000	Movement in year £'000	Carry forward to 2017/18 £'000	
General under spend	400	(400)	0	
Total	400	(400)	0	
The value of carry forward into 2017/18 is agreed with SGHSCD during the year.				

The outturn memorandum identifies £545,000 as available for carry forward in 2017/18

There is no explanation why the carry forward figures in the additional disclosure differ from the outturn memorandum

Where figures are prepared on a different basis to other figures in the accounts, this must be clearly highlighted and explained.

### Descriptions used do not agree to the figures disclosed

37. The accounts manual provides suggested descriptions to explain the figures used in the disclosure. This suggested wording should be tailored by boards to apply to their specific circumstances. Most boards have amended the wording, for example, by specifically referring to either a saving or excess as appropriate.
38. This board has not amended the descriptions which results in the figure being disclosed as a brought forward deficit. This is incorrect as the 2015/16 accounts show a surplus.

MEMORANDUM FOR IN YEAR OUTTURN		£'000
Brought forward deficit/(surplus) from previous financial year		281
Saving/(excess) against in year total Revenue Resource Limit		(71)

**Incorrect signage results in this brought forward being disclosed as a deficit rather than a surplus**

Financial Performance:

	Limit as set by SGHSCD £'000	Actual Outturn £'000	Variance (over)/under £'000
Core revenue resource limit	28,101	27,554	547
Non – core revenue resource limit	156	156	0
Core capital resource limit	194	189	5
Cash requirement	27,063	27,063	0

All cash balances are held in accounts that form part of the Government Banking Services, with the likelihood of monies being irrecoverable considered to be minimal.

Memorandum for In Year Outturn

	£'000
Brought forward surplus from previous financial year	405
Excess against in year revenue resource limit	142

**This board ended 2016/17 with a £547,000 cumulative underspend against the core RRL**

**The memorandum of outturn incorrectly describes a surplus against in year RRL of £142,000 as an excess**

**This would result in a cumulative underspend of £263,000 when added to the £405,000 balance**

The descriptions used in the memorandum for in year outturn should be consistent with the figures being described.

### Narrative used does not clearly explain the figures disclosed

39. The narrative used to support and explain the figures disclosed in the memorandum for in year outturn and in the accounts more widely is fundamental to the users' understanding of the information presented.
40. Although this board has presented the figures correctly, the language used could be improved to help the user interpret the disclosure more easily.

b) MEMORANDUM FOR IN YEAR OUTTURN

Brought forward surplus from previous financial year	(181)
Outturn against in year Revenue Resource Limit	72
Total Savings against in year Revenue Resource Limit	(89)

Outturn against in year RRL is an overspend.

Total savings against in year RRL are actually cumulative savings including amounts brought forward

We recommend that boards use consistent terminology to ensure the user can easily identify whether the in year position was an underspend or overspend and can distinguish between the in year and cumulative position.

Inconsistency with summary of resource outturn

- 41. The figures used to prepare the financial performance disclosure originate in the summary of resource outturn (SoRO), which provides further detail of the expenditure against the core and non core RRL.

Total Core Expenditure	743,700
Core Revenue Resource Limit	743,836
Saving against Core Revenue Resource Limit (RRL)	136

The underspend against core RRL on the SoRO should equal the figure reported in the financial performance disclosure

Financial performance and position				
		Limit as set by SGHSCD	Actual Outturn	Variance (over)/Under
		£000	£000	£000
1	Revenue Resource limit:			
	Core	743,836	743,700	137
	Non-core	42,529	42,531	(2)
2	Capital Resource Limit:			
	Core	13,643	13,642	1
	Non-core	74	74	0
3	Cash Requirement	812,364	812,361	3

The underspend against the core RRL does not agree with the SORO

The board has also failed to strip out the non core overspend which would need to be funded from core RRL. The cumulative savings against RRL should be £134,000.

Memorandum for in-year outturn		£000
Brought forward surplus from previous financial year		65
Surplus against in year Revenue Resource Limit		72
Cumulative savings against revenue resource limit		137

# Improvement checklist

42. We have recommended that the Scottish Government review the disclosure requirements and provide guidance in the accounts manual to improve the reporting of financial performance. The disclosures of all boards can consistently provide clear information to allow the user to understand how it has performed during the year.
43. The following checklist lists some simple actions to assist boards improve their reporting of financial performance. Auditors may also want to use the checklist to ensure that financial performance is reported in accordance with the guidance in the accounts manual.

	Yes	No
1. Have you provided a clear explanation of what the resource limits mean, including what is chargeable against the core and non core elements?		
2. Have you ensured that explanations of resource limits are written in plain English?		
3. Have you reviewed the disclosure requirement and guidance within the accounts manual to ensure that disclosures are clear and brackets used consistently?		
3. Have you considered including the cumulative under/overspend as part of the memorandum for in year outturn to provide the user with a clear link back to the financial performance?		
4. Have you provided the user with a clear explanation of the purpose of the memorandum for in year outturn?		
5. Have you satisfied yourself that the amount disclosed as brought forward from the previous financial year in the memorandum for in year outturn agrees to the amount reported in the previous year's accounts?		
6. Have you confirmed that any under or overspend on non core RRL has not been reported as available for carry forward?		

7. Have you confirmed that the in year under/overspend has not been confused with the cumulative position?		
8. Have you checked that all the figures disclosed are consistent?		
9. Have you clearly highlighted and explained any cases where certain figures are prepared on a different bases to other figures?		
10. Have you checked that the descriptions used in the memorandum for in year outturn are consistent with the figures being described?		
11. Have you confirmed that the language used in the memorandum for in year outturn is clear and used consistently?		