Department of Health, Social Services & Public Safety
An Roinn Sláinte, Seirbhísí Sóisialta agus Sábháilteachta Poiblí

HSS(F) 25/2000

The Chief Executive of each HSS Board
The Director of Finance of each HSS Board
The Chief Executive of each HSS Trust
The Director of Finance of each HSS Trust
The Chief Executive of each HSS Agency/Special Agency
The Director of Finance of each HSS Agency/Special Agency

29 June 2000

Dear Sir/Madam

BREAK-EVEN DUTY, PROVISIONS AND ACCUMULATED DEFICITS

1. The purpose of this guidance is to:

   (a) Clarify the break even duty for HSS Trusts as outlined in HSS (F) 34/97;

   (b) Advise Trusts on the reporting of performance in their annual accounts following the introduction of FRS12;

   (c) Advise Trusts on the treatment of accumulated deficits;

   (d) Advise Boards and Agencies on the treatment of accumulated deficits and on the reporting of performance in their annual accounts following the introduction of FRS12.

SUMMARY

HSS bodies must comply with this guidance with effect from 1999/2000.

1. HSS Trusts must comply with the requirements of Appendix 1 when measuring and reporting on their break even performance.

2. All HSS bodies must comply with FRS12 as advised in circular HSS (F) 18/2000 and the earlier guidance on Accounting for Early Retirements as contained in HSS (F) 10/96 and Funding of Early Retirement Costs as contained in HSS (F) 17/97. HSS bodies must make a prior year adjustment and restate comparatives as necessary following the introduction of FRS 12.

To comply with the requirements of this Circular, HSS Trusts should have in place arrangements (para.33) to:

i. quantify and disclose the provision ("timing adjustment") required under FRS 12 and disclose their operational performance in the Income and Expenditure Account.

ii. identify the cause of any in year or accumulated operational deficit recognised in the annual accounts, and disclose the nature of proposed remedial action.

iii. ensure that the cash impact of accumulated deficits is fully taken into account in financial plans. Trusts should also take account of any cash impact on their statutory duty to breakeven; and

iv. comply with the disclosure requirements of Note 9 to their financial accounts. A proforma is included at Annex 2.

As advised in Appendix 2 of this Circular, HSS Boards and Agencies must

v. ensure that the cash impact of accumulated deficits is fully taken into account in financial plans (Para 38); and

vi. quantify the effect of the adjustment required in accordance with FRS 12 on their reported results and disclose the amount in the Income and Expenditure Account.

CONTACTS

Queries in relation to the break even duty and recovery plans should be directed to John McGinnity, Performance Review Unit, D3.16 Castle Buildings, ([redacted].
Queries in relation to the annual accounts should be directed to Wendy Thompson, Financial Accounting Unit, D3.11 Castle Buildings, ([redacted]

Yours faithfully

ANDREW HAMILTON

APPENDIX 1

HSS TRUSTS' BREAKEVEN DUTY

BACKGROUND

Statutory Duty

1. Each Trust board is responsible for planning and controlling the activities, costs and income of the Trust to ensure that it remains financially viable at all times. The board is accountable for financial control and for ensuring that the Trust meets its statutory duty to breakeven.

2. **Section 15(1) of the Health and Personal Social Services (NI) Order 1991 states that:**

   "Every HSS trust will ensure that its revenue is not less than sufficient, taking one financial year with another, to meet out-goings properly chargeable to revenue account".

   This is known as the breakeven duty.

3. Trusts should plan to meet this duty by achieving a balanced position on their Income and Expenditure account each and every year.

FINANCIAL REPORTING

4. The breakeven duty includes the phrase "taking one financial year with another". This provides some flexibility on the time-scale for matching income with those costs whose incidence is uneven; and when managing the recovery of a Trust with serious financial difficulties.

5. As outlined in HSS (F) 34/97, an agreement was reached in 1997 with Treasury and the Audit Commission that the duty will be assumed to have been met if expenditure is covered by income over a rolling three year period.

6. HSS (F) 34/97 advised that performance prior to 1997/98 is not taken into account when measuring and reporting breakeven performance (subject to paragraph 22 below). This was due to changes to the Trust financial regime prior to 1997/98 which made it difficult to compare financial performance from one year to the next.

7. This means that, **for breakeven duty purposes only**, any retained deficit built up prior to 1997/98 is ignored. As outlined in paragraph 22 below, any surplus built up prior to 1997/98 may be offset against a deficit arising from 1997/98 onwards, if approval for such an offset has been obtained from the DHSS&PS.

8. The performance of Trusts against the break even duty is disclosed in Note 9 to their annual accounts. From 1997/98, Trusts have been required to report income and expenditure performance over a three year period.

9. HSS (F) 34/97 advised that the figure to be reported in Note 9 to the accounts was the surplus/(deficit) for the year taken from the Income and Expenditure Account. A narrative explanation was required where the surplus/(deficit) for the year was material. The explanation had to identify any technical distortions of results e.g. timing differences between the accounting treatment and the cash outlay (see below).

Timing Differences (i.e. costs which are non-cash impacting in the year accrued)

10. Trusts are normally expected to achieve a balanced position on their income and expenditure account. Exceptions to this will be where there are technical adjustments. The main type of technical adjustment will be as a result of timing differences. This occurs as follows:

(a) A Trust is required under accounting rules to either charge amounts to its accounts significantly in advance of the associated cash outlay or where there is no foreseeable future cash outlay.

(b) An accounting or financial policy change has been introduced for financial reporting but too late to affect prices for the year in question.

11. Accounting practice requires the recognition of costs in advance of the anticipated cash payments. This could have implications for both the income & expenditure and cash positions of Trusts, depending on when these costs were reflected in service agreements. For example, if costs were reflected fully in prices in the year of cost recognition, this could result in excessive cash balances building up in the system. Conversely, if costs were fully reflected in prices in the year of cash settlement, this could result in income and expenditure deficits prior to the year of cash settlement.

12. It may therefore be unavoidable to run a planned deficit in one year, matched by surpluses in other years. **In these circumstances, costs which are "non-cash impacting" in the year accrued will not be taken into account when measuring Trusts' performance against the break even duty. Similarly, the subsequent income relating to these costs will not be taken into account when measuring Trusts' performance against the break even duty.**

13. Up to 1999/2000 "timing differences" related mainly to the change in accounting policy for early retirement costs, in accordance with HSS (F) 10/96. Trusts were required to account for early retirement costs at the time the Trust committed itself to the payment irrespective of the time when the payment was made. The requirement to account for the payment of these costs at the time of commitment did not correspond to the funding arrangements. As advised under HSS (F) 17/97 Trusts were funded for the payment at the time the payment was made. This resulted in a technical distortion of a Trusts results arising from the "timing difference" between accounting and funding arrangements. Trusts were required to identify this "timing difference" in Note 9 to their accounts.

14. However following the introduction of FRS 12 under HSS (F) 18/2000, HSS bodies will now be required to account for other significant costs in advance of the associated cash outlay and in advance of the receipt of the related funding. Therefore this could result in significant distortions of reported results. This will be particularly important for

Trusts given their statutory duty to break even and their requirement to report and explain their performance against this duty in Note 9 to the accounts.

15. Therefore from 1999/2000, Trusts are required to quantify the extent of the timing differences and disclose the amount in their Income and Expenditure Account so that their "operational performance" is reported in the Income and Expenditure Account. **The reported operational performance should in effect be the performance that will be measured against their break even duty. Trusts must ensure that they reduce "timing differences" each year by the amount of the income received in respect of previously accounted for timing differences.**

16. It is unlikely that there will be any other "technical distortions/timing differences" which will have to be identified in Note 9 to the accounts, but if a Trust considers that any particular circumstances arise which should be reported in Note 9 as a technical adjustment/timing difference, then this should be agreed in advance with the Department.

17. Guidance on future changes to accounting or financial policies which give rise to further technical adjustments/timing differences will be provided as appropriate.

18. Note 9 to the accounts therefore will disclose the Trust's break even position in year (operational surplus) and on a cumulative basis over a three year period commencing from 1997/98. Trusts will be required to explain any material variance from the break even duty.

19. As referred to in HSS (F) 34/97, a narrative explanation must be given for each year where the break even in-year or break even cumulative net surplus or deficit for the break even period exceeds 0.5% of the turnover of the reporting year. The explanation should make clear why the surplus/deficit has arisen and the plans (actions and time-scales included) to restore the Trusts's break even position. The explanation should identify those items that are technical distortions of the results. The explanation should also link current results with the plans for the year, including plans that were agreed with the DHSS&PS prior to the issue of HSS (F) 34/97.

Materiality

20. The Treasury and the Audit Commission have agreed that the break even duty is assumed to have been met if the break even cumulative net deficit is less than or equal to 0.5% of the turnover of the reporting year. Application of the materiality concept by a Trust should be with the prior agreement of the DHSS&PS.

Annex 2 gives the layout for Note 9 to the accounts.

MEASUREMENT OF BREAK EVEN DUTY

21. As stated in paragraph 5 above, under HSS (F) 34/97, a Trust will have achieved its break even position if it achieves a balanced position on its income and expenditure account each year over a three year period commencing from 1997/98. The following

paragraphs provide practical guidance on the treatment of surpluses accumulated prior to 1997/98 and on the application of the three year or exceptionally five year rolling period.

Surpluses prior to 1997/98

22. A deficit, arising from 1997/98 onwards, will not be considered a breach of the break even duty where a Trust can demonstrate that the deficit is being offset against a retained surplus position built up prior to 1997/98, and approval for such an offset has been obtained from the DHSS&PS.

Practical Examples of Three Year Rolling Measurement

23. Year 1 of the rolling 3 years will begin the first accounting year commencing from 1997/98 in which a cumulative deficit position arises. The break even duty will then be assumed to have been met if recovery of the Year 1 deficit occurs within the next 2 years. As stated in paragraphs 7 and 8, deficits prior to 1997/98 are not taken into account and surpluses built up prior to 1997/98 can only be taken into account with the approval of the DHSS&PS.

24. Annex 1 gives practical examples of the three-year rolling measurement.

Five Year Rolling Measurement - Exceptional Circumstances

25. Exceptionally, the break even duty will be assumed to have been met if the cumulative deficit being recovered is covered by subsequent surpluses over a 4 or 5 year period. Extension beyond the “normal” 3 years requires the express agreement of the DHSS&PS based on the knowledge of the Trust’s particular circumstances.

26. Exceptional circumstances may arise where:

- the 4/5 year period is consistent with the terms of, and targets included in, a financial recovery plan approved by the DHSS&PS; or
- there are other exceptional circumstances, defined and approved in writing by the DHSS&PS.

27. The DHSS&PS will take account of the following factors in determining “other exceptional circumstances”:

- Have detailed discussions with the host commissioner and other local parties concluded that financial recovery within three years would have unacceptable service consequences?
- Will insistence on a three-year recovery period seriously threaten the achievement of performance targets?
- Instances where service changes proposed as part of the Trust’s financial recovery plan necessitate public consultation, ie. is it likely that the public consultation process will extend recovery beyond the “normal” three years?

28. The above factors assume that:

- the Trust has examined all other reasonable options to achieve financial recovery; and

- the DHSS&PS is satisfied that there are no other possible alternatives that the Trust could reasonably pursue.

29. Trusts will need to provide documentary evidence to appointed auditors, which substantiates agreement by the DHSS&PS to a break even recovery period in excess of the "normal" three years.

Practical Examples of Five Year Rolling Measurement

30. The same practical implications as those outlined in paragraph 23 will apply - except that the framework is five years and not three. Annex 1 gives practical examples.

Income and Expenditure Surplus(es)

31. Paragraphs 6 to 30 assume that income and expenditure retained surpluses generated from 1997/98 onwards are not lost, but can be carried forward indefinitely and offset against future deficits.

32. A Trust may only plan to offset a deficit arising from 1997/98 onwards against a retained surplus brought forward from previous years (ie prior to 1997/98) with the approval of the DHSS&PS.

ACCUMULATED DEFICITS OF TRUSTS

33. To ensure that Trusts have access to the necessary funds to meet liabilities as they fall due, they should have in place arrangements to:

- identify the nature of any accumulated deficit and which elements of the deficit have a future cash impact;

- ascertain when the likely cash outflows will occur; and

- where appropriate, ensure that the cash impact of accumulated deficits is fully taken into account in financial plans. Trusts should also take account of any cash impact on their statutory duty to break even.

34. This means that all accumulated deficits arising since the formation of the Trust, (subject to timing difference adjustments) will need to form part of a Trust's recovery plan. Deficits prior to 1997/98 are only ignored for the purposes of the statutory duty to break even, but should be considered in the context of Trusts' financial recovery plans.

Further Guidance will be issued on Financial Recovery Plans in due course.

APPENDIX 2

ACCUMULATED DEFICITS OF BOARDS AND AGENCIES

BACKGROUND

1. Accumulated deficits may arise in Boards and Agencies as a result of either in-year expenditure exceeding income over an extended period (operational deficits) or because of the recognition of longer term liabilities which do not yet require cash settlement (timing differences). Often both contribute to the accumulated position.

2. Boards and Agencies are largely dependent for their income on cash allocations made by the DHSS&PS. Since this cash allocation is principally to fund Boards' expected in-year cash requirements, it does not cover longer term liabilities not yet due for payment, such as provisions for clinical negligence, early retirements etc. As a result a deficit may arise due to the timing difference between the recognition of the liability in the Accounts of the Board and cash settlement.

3. Recovery of an accumulated deficit for Boards therefore depends on the nature of the liabilities represented by that deficit and when settlement of such liabilities is required.

Guidance

4. To ensure that Boards and Agencies have access to the necessary funds to meet liabilities as they fall due, they should have in place arrangements to:

   - identify the nature of any accumulated deficit and which elements of the deficit have a future cash impact;

   - ascertain when the likely cash outflows will occur; and

   - where appropriate, ensure that the cash impact of accumulated deficits is fully taken into account in financial plans. Boards and Agencies should also take account of any cash impact on their break even position.

5. The introduction of FRS 12 to the accounts of Boards and Agencies will similarly have a significant effect on their reported performance. Therefore Boards and Agencies are required also to quantify the effect of the timing differences under FRS 12 in their Income and Expenditure Account and disclose their performance without the effect of FRS 12 ("operational performance").

ANNEX 1

APPLICATION OF ROLLING THREE YEAR DUTY

Example: HSS Trust 1

I&E Account Operational (deficit)/surplus £000	1997/98	1998/99	1999/00	2000/01	2001/02
Break even In-Year Position	400	200	(1000)		
Break even Cumulative Position	400	600	(400)		
See Annex 2 for calculation of break even positions			Year 1	Recovery of £400k deficit to take place over years 2000/01 and 2001/02	

Example: HSS Trust 2

I&E Account Operational (deficit)/surplus £000	1997/98	1998/99	1999/00	2000/01	2001/02
Break even In-Year Position	(100)	200	(1000)		
Break even Cumulative Position	(100)	100	(900)		
See Annex 2 for calculation of break even positions	Year 1	1997/98 deficit recovered	Year 1	Recovery of £900k deficit to take place over years 2000/01 and 2001/02	

Example: HSS Trust 3

I&E Account Operational (deficit)/surplus £000	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Break even In-Year Position	200	(100)	(50)	(120)		
Break even Cumulative Position	200	100	50	(70)		
See Annex 2 for calculation of break even positions				Year 1	Recovery of £70k deficit to take place over years 2001/02 and 2002/03	

ANNEX 1 (contd.)

APPLICATION OF ROLLING FIVE YEAR DUTY

Example: HSS Trust 4

I&E Account Operational (deficit)/surplus	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Break even In-Year Position	400	200	(1000)	(700)	900	300	(400)				
Break even Cumulative Position	400	600	(400)	(1100)	(200)	100	(300)				
See Annex 2 for calculation of break even positions			Year 1	Recovery of £400k deficit takes place over years 2000/01, 2001/02 and 2002/03			Year 1	Recovery of £300k deficit to take place over years 2004/05, 2005/06, 2006/07 and 2007/08			

ANNEX 1 (contd.)

APPLICATION OF ROLLING 5 YEAR DUTY

Example: HSS Trust 5

I&E Account Operational (deficit)/surplus	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Break even In-Year Position	1000	(100)	(100)	(100)	(100)	(100)	(900)				
Break even Cumulative Position	1000	900	800	700	600	500	(400)				
See Annex 2 for calculation of break even positions							Year 1	Recovery of £400k deficit to take place over years 2004/05, 2005/06, 2006/07 and 2007/08			

HSS TRUSTS BREAK EVEN DUTY
REPORTING FORMAT Note 9

Annex 2

	Name of Trust:	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
		£000	£000	£000	£000	£000	£000	£000
a	Turnover							
b	Income and Expenditure: Retained (deficit)/surplus for year (taken from Annual Accounts)							
c	Adjustment for:							
	Timing Differences: Provisions for future obligations Other adjustments							
	Approved offset of retained surplus built up prior to 1997/98							
	Prior Period Adjustments							
d	Break even In-Year Position (i.e. b + /- c)							
e	Break even Cumulative Position							
f	If a break even cumulative deficit - anticipated financial year of recovery							
g	If more than 2 years - what recovery period has DHSS&PS agreed							
	Materiality Test (i.e. is it equal to or less than 0.5%):	%	%	%	%	%	%	%
h	Breakeven In-Year Position (i.e. d/a x 100 rounded up to one decimal place)							

i	**Breakeven Cumulative Position (i.e. e/a x 100 rounded up to one decimal place)**							

ANNEX 2 (Contd)

HSS TRUSTS BREAK EVEN DUTY
REPORTING FORMAT NOTE 9

Line Reference	Item	Guidance
(a)	**Turnover**	**Taken from Annual Accounts** **- Income and Expenditure Account**
(b)	**Income and Expenditure Retained (deficit)/surplus for year**	**Taken from Annual Accounts** **- Income and Expenditure Account**
(c)	**Adjustment for:**	
	Timing Differences **i. Provisions for future obligations** **ii. Other differences/Adjustments**	**Guidance contained in paragraphs 15 of this circular.** **Taken from Income and Expenditure Account and analysis in note 9.3.** **With prior agreement of DHSSPS**.
	Approved offset of retained surplus built up prior to 1997/98	**Guidance contained in paragraph 22 of this circular.** **A deficit post 1996/97 can be offset against a retained surplus position built up prior to 1997/98 if approval has been obtained from the DHSS&PS.**
	1999/2000 Prior Period Adjustment (relating to 1997/98)	**That part of the prior period adjustment in the 1999/2000 Annual Accounts which relates to financial year 1997/98 should be adjusted for.**

ANNEX 2 (Contd.)

HSS TRUSTS BREAKEVEN DUTY
REPORTING FORMAT

Line Reference	Item	Guidance
(d)	Break even In-Year position (i.e. b + /- c)	Equals line (b) plus or minus line (c)
(e)	Break even Cumulative Position	Equals the cumulative totals produced by adding each successive year's figure at line (d)
(f)	If a break even cumulative deficit – anticipated financial year of recovery	Self-explanatory
(g)	If more than 2 years - what recovery period has the DHSS&PS agreed	Self-explanatory
	Materiality Test (i.e. is it equal to or less than 0.5%):	
(h)	- Break even In-Year Position (i.e. d/a x 100 rounded up to one decimal place)	Equals line (d) divided by line (a) times one hundred rounded up to one decimal place
(i)	- Break even Cumulative Position (i.e. e/a x 100 rounded up to one decimal place)	Equals line (e) divided by line (a) times one hundred rounded up to one decimal place.

ANNEX 2 (Contd.)

HSS TRUSTS BREAK EVEN DUTY
REPORTING FORMAT

Worked Example

A brief worked example is shown on the next page.

The turnover and I&E have been extracted from the Annual Accounts.

The assumptions contained within this example are:

- **there are no timing distortions;**
- **£1.7m of the I&E deficit for 1997/98 comes within the scope of paragraph 19 of this circular i.e. it is being offset against a retained surplus position built up prior to 1997/98, with the approval of the DHSS&PS;**
- **the Trust went into break even cumulative deficit in 1997/98 (see the detail over page);**
- **the Trust expects the break even cumulative deficit to be recovered in/by 2001/02;**
- **the Trust has an express agreement with the DHSS&PS to recover the break even cumulative deficit position over a 5 year period i.e. achieve recovery by 2001/02.**

ANNEX 2 (Contd.)

HSS TRUSTS BREAK EVEN DUTY REPORTING FORMAT

	Name of Trust: Worked example HSS Hospitals Trust	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
		£000	£000	£000	£000	£000	£000	£000
(a)	**Turnover**	**90,000**	**95,000**	**100,000**				
(b)	**Income and Expenditure: Retained (deficit)/surplus for year (taken from Annual Accounts)**	**(5,600)**	**(2,200)**	**4,900**				
(c)	**Adjustments for:**							
	Timing Differences			**0**				
	Approved offset of retained surplus built up prior to 1997/98	**1,700**	**0**	**0**				
(d)	**Break even In-Year Position (i.e. b + /- c)**	**(3,900)**	**(2,200)**	**4,900**				
(e)	**Break even Cumulative Position**	**(3,900)**	**(6,100)**	**(1,200)**				
(f)	**If a break even cumulative deficit - anticipated financial year of recovery**			**2001/02**				
(g)	**If more than 2 years - what recovery period has DHSS&PS agreed**			**2001/02**				
	Materiality Test (i.e. is it equal to or less than 0.5%):	**%**	**%**	**%**	**%**	**%**	**%**	**%**
(h)	**- Break even In-Year Position (i.e. d/a x 100 rounded up to one decimal place)**	**4.3**	**2.3**	**N/A**				
(i)	**- Break even Cumulative Position (i.e. e/a x 100 rounded up to one decimal place)**	**4.3**	**6.4**	**1.2**				

ANNEX 2 (Contd.)

HSS TRUSTS BREAK EVEN DUTY
REPORTING FORMAT

Worked Example (Contd.)

In the above circumstances the Worked Example HSS Trust will not report a break even duty failure within their 1999/2000 Annual Accounts - as (exceptionally) this Trust has an express agreement with the DHSS&PS to recover the break even cumulative deficit position over a 5 year period i.e. achieve recovery by 2001/02. (Note that the Trust went into break even cumulative deficit in 1997/98).

If this Trust did not have an express agreement (to a five year break even period) with the DHSS&PS then they will need to report break even duty failure in not only their 1999/2000 Annual Accounts - but also in each and every Annual Accounts in the future until the break even cumulative deficit position is recovered or the break even cumulative deficit position in a future accounting period is less than or equal to 0.5% of turnover.

Please also refer to Appendix 1 for guidance on measuring break even duty performance.