Operating and Financial Review

The Accounts presented on pages 183 to 218 reflect the finances of the Trust from inception as a Foundation Trust on 1st June 2006. The Trust has met or exceeded all of the required financial obligations as specified in the Financial Plan agreed by the Independent Regulator for the period and reports an overall Risk Rating score of 4.3. This is a very satisfactory result which demonstrates an above average performance.

It is important to view this satisfactory performance in the context of the forthcoming impact of the Transforming Newcastle Hospitals (TNH) investment programme, a £304 million PFI funded capital and service improvement investment. The Trust is committed to building up sufficient funds to ensure that there will be no adverse effect on financial stability as the value of the Unitary Payment due (or annual rent) for the TNH builds up over the next few years.

The period was challenging in terms of continuing to reinforce the climate of tight cost control and prudence in budget management. Despite the scale of the challenge the organisation has delivered a planned financial surplus of £6.1 million (before the impact of asset impairments[1]). This surplus was in line with the Financial Plan.

Overall, it was a successful trading year, with growth in activity exceeding planned expectations to the value of an additional £6.73 million. The activity associated with this growth reflects the service organisation and planning to effectively deliver the national 18 week waiting time targets.

In addition to delivering record level of activity, the Trust invested £1.7 million in local specialist service developments including Adult Cystic Fibrosis; Specialist Haematology; Genetics; Palliative Care; and Head & Neck Services. The Trust also extended the provision of the drug 'Herceptin' a development which was also underwritten by the Primary Care Organisations.

A balanced approach was maintained to the provision of fee paying non NHS Private Patient activity with income, i.e. 0.9%, remaining well within the regulated upper limit of 1.2% of overall patient care income. The level of private patient income earned in the 10 month period was £3.66 million.

To comply with a new accounting policy introduced by the Department of Health the Trust has had to account for NHS patients receiving treatment at both the start and end of the accounting period. This had the effect of reducing reported income by £645,000 in the 10 month period under review.

In relation to expenditure, the Trust was exposed to a number of cost pressures during the year, most significantly the cost consequence of extra ordinary 'Waiting List Initiative' payments and continued pressure relating to pay modernisation, as well as changes in clinical practices and related technology.

To balance the expenditure position, a full year cost efficiency programme of £13.3 million was required with £12.7 million (95%) of this being delivered recurrently, the greatest proportion in the ten month period operating as a Foundation Trust. This is a significant improvement on previous financial years and is a credit to how clinical directors, service managers and their teams have tackled this challenge, supported by a series of finance workshops and improvements in process and communication. Further contributions towards financial balance came from a pro-active and diligent approach to income recovery from all sources, slippage in expenditure on certain developments and a number of non–recurrent income benefits.

The Trust was successful in attracting external capital investment which allowed for an expansion in the planned 2007/08 capital programme from £16.4 to £23.5 million. In year i.e. 2006/07, spending on capital equipment and buildings amounted to £20.5 million (£19.7 million in the ten month period) against the funding available with the balance being taken up in the subsequent year.

Looking ahead to 2007/08, the Trust must build upon the initial platform of success as a Foundation Trust. The most important priority is to prepare the Trust for the financial consequences of the TNH investment programme. In this respect a 'headroom plan' comprising a co-ordinated programme to achieve cost base reduction, efficiency and productivity improvements in the short to medium term, to deliver recurring balance and contribute towards the enhanced cost of TNH from 2009/10 onwards has been produced. The headroom plan includes a balanced portfolio of departmental trading centre proposals, in terms of strategic versus immediate and corporate savings plans. The overall savings plan required for 2007/08 totals £14.4 million.

Recent years have seen a number of significant national policy changes which are intended to effect a major change in how and where health services are delivered. Whilst it is still too early to say with some measure of certainty as to how these will translate at a local level they have the cumulative affect of introducing some new risks that need to be considered in future business investment planning. Specifically Practice Based Commissioning; Patient Choice; contestability; potential changes to tariff (the price list that determines how Trusts are remunerated for the activity they undertake) and achieving and maintaining 18 week referral to treatment maximum waiting time targets will all impact in some way on future activity and income. Recent changes could lead to financial losses in how

[1] Impairments are a non-recurrent charge in respect of the value of property (land and buildings) that has been written off as a consequence of either demolition and/or disposal. The impairments effected in this period specifically related to the demolition of certain buildings as preparatory work for the TNH project.

NHS sponsored Research & Development is assessed and funded with the prospect of a similar set of circumstance prevailing in the short term in relation to educational and training revenue streams.

In summary we are in a period of significant change with the added financial and operational challenge of ensuring that we achieve without exception waiting time and quality standards as well as creating the essential financial headroom as described to ensure that the TNH investment programme delivers as a beneficial asset for the health economy.

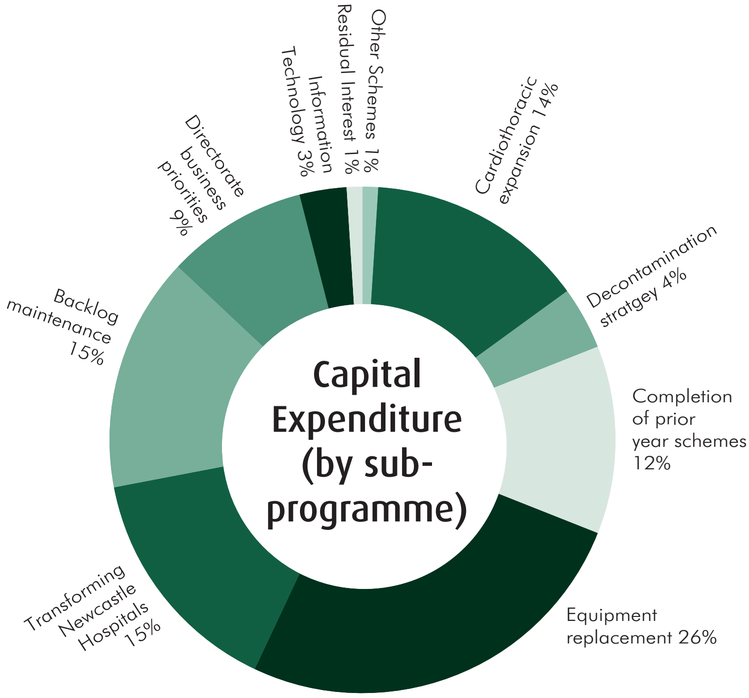
The Trust remains confident that it can rise to these challenges and sustain a policy of confidence and commitment in improving the quality and quantum of the services it offers whilst remaining financially viable.

The Accounts have been prepared on a going concern basis. This is a reasonable working assumption on the basis of the satisfactory financial performance in the period; the positive position on net current assets and total assets employed; the adequate cash position; and the satisfactory trading position as described in the 3-year Financial Plan.

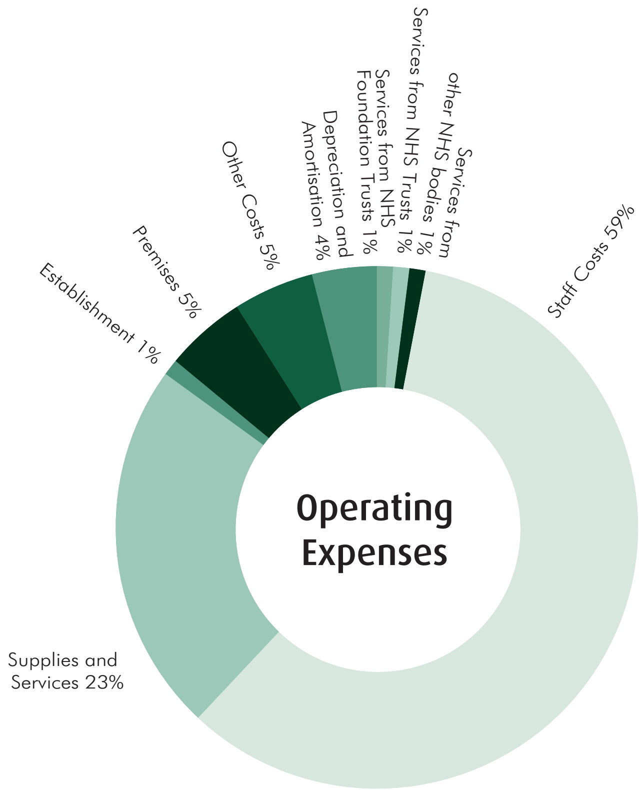
Management costs were comparatively low at 2.71% of income, thereby ensuring we maximise funds available to support patient care.

INCOME & EXPENDITURE ACCOUNT
FOR THE PERIOD ENDED 31 March 2007

	2006/07 (10 months) £000
Income	498,536
Expenses	(491,926)
OPERATING SURPLUS	**6,610**
Loss on disposal of fixed assets	(13)
Interest receivable	1,432
Other finance costs - unwinding of discount	(128)
SURPLUS FOR THE FINANCIAL PERIOD	**7,901**
Public Dividend Capital dividends payable	(9,723)
RETAINED DEFICIT FOR THE PERIOD	**(1,822)**
Add back Asset Impairment	7,950
SURPLUS before ASSET IMPAIRMENT	**6,128**



CAPITAL EXPENDITURE BY SUB-PROGRAMME	**£'000**
Cardiothoracic expansion	2,834
Decontamination strategy	793
Completion of prior year schemes	2,481
Equipment replacement	5,386
Transforming Newcastle Hospitals	3,165
Backlog Maintenance	3,106
Directorate Business Priorities	1,920
Information Technology	671
Residual Interest	141
Other Schemes	110
Total	20,607



OPERATING EXPENSES	**£'000**
Services from NHS Foundation Trusts	2,998
Services from NHS Trusts	6,625
Services from other NHS bodies	3,603
Purchase of healthcare from non-NHS bodies	605
Staff Costs	294,689
Supplies and Services	111,731
Establishment	4,987
Premises	22,762
Other Costs	22,455
Depreciation and Amortisation	21,471
Total	491,926

Breakdown of *Income by Source* and *Expenditure by Specialty* can be found on page 8.