FINANCIAL AND PERFORMANCE REPORTING

December 2005
Diploma stage

MARKING SCHEME

Question 1

(a) Makine Unitary Authority: Consolidated Revenue Account for the year ending 31 March 2004

	£000	£000	£000	
Cost of services (See W1 for costs)				
Central services	3,105	0	3,105	
Environmental and planning	11,960	(6,790)	5,170	
Education	248,805	(123,905)	124,900	
Highways, roads and transport	27,260	(11,215)	16,045	
Social services	142,165	(70,590)	71,575	
Libraries and leisure	11,700	(3,960)	7,740	
Net cost of services	444,995	(216,460)	228,535	*1 ½*
Corporate income and expenditure				
Precepts			1,650	
AMRA (Working 2)			(7,950)	½
Interest receivable			(450)	
			221,785	
Appropriations				
Contributions to the capital financing reserve				
Direct revenue financing			2,000	½
MRP adjustment (3,900 – 8,040)			(4,140)	*1*
Government grants deferred (100 /10)			10	*1*
Amount to be met by the taxpayer			219,655	
Revenue support grant			(90,300)	
Council tax			(108,000)	
NNDR			(25,540)	
General fund surplus for the year			(4,185)	
General fund balance b/f			(6,500)	
General fund c/f			(10,685)	

Working 1: Costs of services

	£000 Per TB	£000 Asset rentals	£000 Total
Central services	2,350	755	3,105
Environmental and planning	10,450	1,510	11,960
Education	243,530	5,275	248,805
Highways, roads and transport	25,000	2,260	27,260
Social Services	138,750	3,415	142,165
Libraries and leisure	7,840	3,860	11,700

Working 2: AMRA

AMRA

	£000			£000	
Depreciation	8,040	½	Asset rentals	17,075	½
Interest payable	1,095	½	Grant	10	*1*
Transfer to CRA	$\boxed{7,950}$	½			
	17,085			17,085	

Makine Unitary Authority: Consolidated Balance sheet as at 31 March 2004

	£000	£000	£000	
Tangible fixed assets (Working 3)			192,195	
Long term investments			750	
			192,945	
Stock		250		
Debtors (24,560 – 55)		24,505		½
		24,755		
Overdraft (Working 4)	(7,965)			
Creditors (13,970 – 55)	(13,915)			½
		(21,880)		
Net current assets			2,875	
Total assets less current liabilities			195,820	
Long term borrowing (45,980 + 15,360 – 2,500)			(58,840)	½
Deferred grants (100 – 10)			(90)	½
Total net assets			136,890	
Financed by:				
Fixed asset restatement reserve	(working 5)		43,035	
Capital financing reserve	(working 6)		80,370	
Useable capital receipts	(working 7)		2,800	
General fund			10,685	
			136,890	

½ mark for presentation of statements

Working 3: Tangible fixed assets

	£000	
Per TB	190,985	
Additions	10,000	½
Disposals	(750)	½
Depreciation	(8,040)	½
	192,195	

Working 4: Bank overdraft

	£000	
Cash per TB	735	
Fixed asset additions	(10,000)	½
Fixed asset disposals	1,300	½
	(7,965)	

Note: Students may choose to recognise the £10,000,000 of additions as creditors. Credit to be awarded for this approach.

Working 5: Fixed Asset Restatement Reserve

	£000	
Per TB	43,785	
Disposals	(750)	½
	43,035	

Working 6: Capital financing reserve

	£000	
Per TB	79,500	
Additions: DRF	2,000	½
Additions: UCR	3,000	½
Deferred grant	10	½
MRP adjustment	(4,140)	½
	80,370	

Working 7: Useable capital receipts

	£000	
Per TB	4,500	
Used in year	(3,000)	½
Sales Proceeds	1,300	½
	2,800	

(b) SSAP 4 outlines how grants should be accounted for. Capital grants should be held on the balance sheet and released to the operating account over the life of the asset.

½ mark for identification of SSAP 4, ½ mark for explanation of capital grants

Local Authorities release the capital grant to AMRA since AMRA is used to account for depreciation. *1*

A transfer then needs to be made from the CRA to the capital financing reserve (account) to ensure that the council tax payer still funds MRP and external interest, as required in the LGHA 1989. This also ensures that capital financing is not included in the consolidated revenue account.

1 mark for explanation of transfer, 1 mark for identification/ linkage to LGHA 1989

(20)

Question 2

(a) Akhmatova PCT: Reconciliation of net operating cost to net cash outflow

		£000	
Net operating cost for the year	(Working 1)	(197,492)	
Depreciation	(339 + 670)	1,009	½
Notional charges	(Working 3)	680	½
Loss on fixed assets	(10 – 7)	3	½
Movements in:			
Stock	(15 – 20)	(5)	½
Debtors	(7,050 – 8,670)	(1,620)	½
Creditors	(Working 4)	(1,137)	
Provisions	No increase to be recognised since the increase is due to interest	0	
		(198,562)	

Note: the approach above of adjusting for the loss on fixed asset sales represents one of the two approaches outlined in the NHS MFA and study guides. Students may adopt the approach above or add back the loss to the net operating cost prior to commencing note 1.

Akhmatova PCT: Cash flow statement for the year ending 31 March 2004

Net cash outflow from operating activities			(198,562)	½
Returns on investment and servicing of finance				
Interest paid	(Working 2)	(17)		½
			(17)	
Capital activities				
Payments to acquire fixed assets	(Working 6)	(70)		
Receipts from sale of fixed assets		7		
			(63)	
Financing				
Parliamentary funding received	(Working 7)	198,800		
Finance lease principal repaid	(Working 2)	(23)		½
			198,777	
Increase in cash			135	

½ mark for presentation of cash flow statement and note 1

Working 1: Calculation of net operating cost before interest

		£000	
Net operating cost after interest	(N7)	(197,510)	
Interest for unwinding the discount on provisions	(16 -15)	1	½
Finance lease interest	(Working 2)	17	½
Net operating cost before interest		(197,492)	

Working 2: Calculation of finance lease interest and principal for 2003/04

Fair value of asset = £150,000
Total payments = £200,000 (£40,000 x 5)
Therefore interest = £50,000

Therefore for 2003/04 interest = 50,000 / 15 x 5 = <u>£16,667</u> (rounded to £17K) *½*
Therefore principal for 2003/04 = £40,000 - £17,000 = <u>£23,000</u> *½*

Note students may also use straight line allocation since the NHS capital accounting manual permits this approach

Working 3: Notional cost of capital charge

	2002/03 **£000**	**2003/04** **£000**	**£000**	
Revaluation reserve	2,345	3,474		
General fund	15,760	17,789		
Less: Cash	(185)	(320)		
	17,920	20,943		*1*
Average			19,432	*½*
Cost of capital at 3.5%			680	*½*

Working 4: Movement on creditors

Due within 1 year		8,080	7,000	
Less capital creditors		0	(30)	*½*
Less finance lease creditors	(Working 7)		(27)	*½*
		8,080	6,943	
Movement for note 1			(1,137)	

Working 5: Finance lease principal for 2004/05

Interest for 2004/05: £50,000 / 15 x 4 = £13,333 (rounded to £13K)
Therefore principal due = £40,000 - £13,000 = <u>£27,000</u> *1*

Note: students may also use straight line allocation since the NHS capital accounting manual permits this approach.

Working 6: Fixed asset additions

Fixed assets at NBV

	£000			**£000**	
b/f	18,950				
Indexation			Depreciation (399 + 690)	1,009	*½*
Land (2,500 x 9%)	225	*½*	Backlog depreciation (2,790 x 2%)	56	*½*
Buildings (12,670 x 7%)	887	*½*	Disposals	10	*½*
Other FAs	131	*½*	c/f	19,418	

(6,570 x 2%)					
Additions (balance)	300	*1*			
	20,493			20,493	

Cash flow from additions to fixed assets = £300,000 - £50,000 (donated additions) - £150,000 (finance lease additions) - £30,000 (capital creditors) = £70,000 *1*

Note: students should also be awarded full credit if they calculate net indexation on other fixed assets.

Working 7: Calculation of Parliamentary funding

General fund

	£000			**£000**	
Net operating cost for the year	197,510	½	b/f	15,760	
			Notional charges (W3)	680	½
			Parliamentary funding	198,800	*1*
c/f	17,788		Historic cost adjustment (Working 8)	58	½
	215,298			215,298	

Working 8: Calculation of historic cost adjustment

Revaluation Reserve

	£000			**£000**	
Historic cost adjustment	58	*1*	b/f	2,345	
Backlog depreciation (Working 6)	56	½	Indexation (225 + 887 + 131: Working 6)	1,243	½
c/f	3,474				
	3,588			3,588	

Note: students should also be awarded full credit if they calculate net indexation on other fixed assets.

(20)

Question 3

(a) Answer to be written in a report format. ½

Assessment of Agency's performance against its financial targets

- Generating a surplus over 3 years for investment:

  At face value a surplus has been generated of £8,000. ½

  Included in the financial performance for the year though is additional funding for transitional costs. Although this has largely been used to fund transitional costs in year, there is an effective £5,000 "surplus" on this funding. (£1,250K income less £1,245K costs). Therefore the underlying surplus is closer to £3,000. ½

  At either level the surpluses in future years would need to grow to allow for significant investment. ½

Recommendations

The Agency needs to look to generate more significant surpluses. This could be achieved through:

- Increasing prices for services (although this may reduce demand/competitiveness and therefore not increase the surplus)
- Reducing the Agency's cost base (although this may impact upon the quality of service provided)
- Expanding income streams by either providing new services or providing existing services to additional customers.

Other appropriate recommendations to gain credit,
1 mark awarded for recommendation explained

- Managing the cash position carefully

Ratio	Working	Result
Current ratio	CA / CL = 4,353 / 2,800	1.55
Quick ratio	CA – stock / CL = 4,353 – 300 / 2,800	1.45
Debtor days	Debtors / income x 365 = 2,760 / 24,150 x 365	42 days
Creditor days	Trade creditors / operating costs x 365 = 850 / 9,060 x 365	34 days

½ mark per ratio calculated

Comments on performance:

Current ratio is below the "standard benchmark" of 2:1, indicating that there is a short term cash liquidity problem. ½

As the quick ratio is above the benchmark 1: 1 holding stock is not a problem, therefore the agency needs to focus more on its management of debtors and creditors. *1*

This is enforced through the performance in relation to debtor and creditor days. Both are above the “standard” of 30 days. Of greater concern though is the fact that creditor days are less than debtor days, meaning that cash is being paid out faster than it is generated. *1*

Students should be awarded credit along the lines indicated above based on their ratio results.

Recommendations

- Action needs to be taken to collect debtors more quickly. Better credit control procedures could reduce late payment for the future. Debt chasing needs to be completed. Debt factoring may be good way of obtaining cash for the debts outstanding.
- Negotiation with creditors needs to take place to see if credit terms can be extended. Loss of goodwill from creditors though needs to be balanced against this.

Other appropriate recommendations to gain credit,
1 mark awarded for recommendations explained

<u>Assessment of Solvency</u>

Ratio	**Working**	**Results**
Interest cover	Operating surplus / interest cover= 915 / 175	5 times
Dividend cover	Surplus before dividends / PDC Dividend = 750 / 742	1 time

½ mark per ratio calculation

Interest cover appears adequate, but dividend cover is poor. This is particularly concerning, given the plan to increase dividends next year. *½*

Recommendations

The Agency needs to ensure that it can generate a higher level of surpluses and convert these surpluses into cash to pay interest/dividends. This should be achieved through a combination of the recommendations made above.

Other appropriate recommendations to gain credit,
1 mark awarded for recommendation explained
Students must relate their recommendation to a need to both improve on surplus and cash generation to gain credit

Students who do not provide recommendations for all three target areas but who provide more than one recommendation in a single area should score a maximum of 2 for recommendations

(b) Advantages of being a trading agency

- Surpluses can be retained by the Agency itself and do not need to be returned to the consolidated fund.
- Financing is available through the national loans fund and public dividend capital, meaning that the Agency is not dependant on funding through the consolidated fund.

Other appropriate comments to attract credit,
1 mark per advantage identified to a maximum of 2

(c) Adjustments to restate Net Current Assets as if the Agency was supply financed:

	Original £000	**Adjustments £000**		**Revised £000**	
Stock	300	0		300	
Debtors	2,760	0		2,760	
Cash	1,293	+ 100	(audit fee)		½
		+ 75	(insurance)		½
		+ 542	(cash dividends)		½
		+1,245	(transitional costs)		½
		- 2,500	(transitional funding)		½
		+ 175	(interest)		½
		-363		930	
Creditors	(2,800)	+ 200	(dividends payable)	(2,600)	½

Revised performance against current and quick ratios:

Current ratio = 300 + 2,760 + 930 / 2,600 = 1.53 ½
Quick ratio = 2,760 + 930 / 2,600 = 1.42 ½

Performance against creditor days target:

Revised operating costs = 9,060 – 175 = 8,885. Creditor days = 850 / 8,885 x 365 = 35 days ½

Performance would have worsened if the Agency was operating under the supply regime. The Agency would continue to burn cash quicker than it generates it. ½

Students to identify, based on their evaluation to date, if moving to trading status was wise
½ mark for statement of fact, 1 mark for explanation/agreement

(20)

Question 4

(a) Definition of value for money.

Value for money is about the economy, efficiency and effectiveness of service delivery.

1 mark for identifying the 3 E's

Economy: this relates to ensuring that inputs are as cheap as possible.
Efficiency: this means getting the maximum output at a given level of inputs.
Effectiveness: this is about ensuring that the service meets set targets.

½ mark per E for definition

Securing economy, efficiency and effectiveness will lead to excellence being achieved. *½*

Calculation of indicators

Students to be awarded 1 mark for calculation of indicators across all three Associations. Other appropriate indicators calculated should be awarded credit. Maximum marks for calculation of indicators to be set at 3 marks

Performance indicators			
Cost of function - rank	3	2	1
Cost per invoice	£1.43	£1.87	£1.89
Invoices per FTE	22,000	11,350	10,222
% invoices paid within 30 days	60%	88%	93%
Error rate – rank	3	= 1	= 1

Assessment of whether the creditor function offers VFM and recommendations:

Marks for this section to be awarded on the basis of 3 marks maximum per each of the Es reviewed

Students to be given credit based on their earlier calculations but where students have not used the information provided to calculate indicators and have taken data at face value, only 2 marks to be awarded as a maximum

Recommendations are explicitly asked for in the question. Where students do not make recommendations based on their assessment, a maximum of two marks to be awarded per section. If students do not make recommendations and have taken data at face value, only 1 mark to be awarded per section

Economy (total cost of function)

Harms HA has the most expensive creditor payments function. It also has the highest number of staff but the lowest number of FTEs. Having creditor payments in local offices may not be sustainable. The high level of staff numbers compared with FTEs may mean that management time is apportioned differently, or that we employ more part time workers.

Recommend => review how management time is apportioned to identify how far the staff numbers compared with FTE is due to apportionment of management time or high levels of part time working or if it is due to the devolved nature of the function.

Efficiency (cost per invoice)

Harms is the most efficient in that cost per invoice is lowest and invoices per FTE are highest. However, we also have a much higher number of invoices processed than other organisations. This could mean that we're not using the most efficient procurement and payment methods (eg using standing orders, direct debits or set contract payments). This is supported by the fact that the average invoice is lower – maybe Harms is paying lots of low value invoices to suppliers when they could arrange to pay a monthly contract invoice? The high number of invoices per FTE is, however, impacting on quality (see effectiveness).

Recommend => determine if further savings could be made by reducing cost and the number of invoices paid through use of direct debits.

Effectiveness (% of invoices paid within 30 days/error rate)

Harms performs worst here out of the three associations. This may indicate that the current structure of devolved creditors does not work well - do we have too many staff spending too little time on creditor payments duties to be effective? Are we not making adequate use of automated payment systems like direct debits? Does the devolved structure provide inadequate review of work?

Recommend => review whether more use should be made of automated payment methods. Review if hours spent by staff on creditor payments needs to be increased.

Centralising the creditors function?

Current performance against economy and effectiveness targets suggests centralisation of the creditor function may be wise, although the service could provide better value for money through other changes, for example through changing payment methods.

1 mark for recommendation, based on student's assessment to date

Need to collect similar information on debtors function before a decision is made to centralise this service. May need to retain a local office presence for this service to ensure that rents etc are collected efficiently.

1 mark for comment on whether debtor function should be centralised

Limitations to consider

Have costs and staff time been apportioned consistently across the three associations?

Do all associations use the same payment methods (eg use of standing orders/ direct debits/ contract payments)?

NB. Although the question indicates that one of the associations is city based, considering the nature of the service reviewed, there is unlikely to be a significant impact on the comparability of the organisations.

There is only one year's data – could this be an outlying year for one of the Associations?

Other valid comments to be given credit
1 mark to be awarded for limitations identified to a maximum of 2
Answer to be written in a report format 1

(20)

Question 5

Response to be written in a memo format. *1*

(a) When consolidated accounts should be produced

Consolidated accounts are required when there is a group relationship between entities as defined in FRS 2 and FRS 9. *1*

FRS 2 defines subsidiary relationships as where the one organisation controls another. *1*

FRS 9 defines an associate relationship, a joint venture and a joint venture that is not an entity. Associates exist where one organisation can operate significant influence over another (20% - 50% of the voting share capital/ votes). Joint ventures exist where there is an equal split of votes across parties. Joint arrangements that are not entities will exist where a formal entity is not created out of joint working arrangements. *2*

In this case, the Project classes as a joint venture as although the Council funds the majority of the Project's budget voting control is equally split across all three organisations. *1*

How accounts will be consolidated

FRS 9 requires that the Council, PCT and College consolidate the project into group accounts on a line by line basis taking $1/3^{rd}$ each of the income, expenditure, assets and liabilities. *1*

Transactions that take place between the Project and the other parties need to be removed prior to consolidation as the group accounts need to reflect the position of the group vis à vis the outside world. *1*

Adjustments may be required for accounting policies (see (c) below) as the group accounts need to present a consistent reporting position. *1*

The Project needs to prepare accounting statements with a consistent year end to its "parent". In the case of the PCT and the Council this will require adjustments. Adjustments may not be needed for the College since they are more likely to have a year end within 3 months of the Project's (ie 31/07/XX). *2*

As a charity the Project will report its financial performance through preparing a SOFA (Statement of Financial Activities). This will need to be converted into a revenue account format for consolidation. *1*

(b) Benefits of producing consolidated statements

The Project Board is an entity in its own right, so needs to report its financial performance to its stakeholders. This allows the Project's stakeholders to assess its own performance. *1*

As there is a group relationship in place it is important that consolidated accounts are produced to enable stakeholders in the PCT, College and Council to assess both the performance of these organisations individually and the group as a whole. *1*

Producing organisational and group accounts is important to all parties as it helps to demonstrate the extent to which any cross subsidisation has taken place across the group. *1*

Other valid points made should attract credit

(c) Adjustments required to fixed assets

Valuation of assets

Fixed assets will need to be valued at modified historic cost for the group accounts. The Project as a Charity may choose to value its fixed assets on a historical cost basis. *1*

Depreciation

Assets in the same class will need to be depreciated using the same useful economic lives and same depreciation base. *1*

To comply with Local Authority Capital Accounting requirements depreciation will need to be replaced with the minimum revenue provision that the Council Tax Payer needs to bear. *1*

Disposals

The Charity would account for any disposals on an accruals basis, calculating any profit or loss on sale. The Council would have accounted for its disposals on a financing basis, accounting for sales proceeds through the useable capital receipts account. A consistent method will need to be adopted. *1*

Notional interest

The Project will not have recognised notional interest in its accounts and the Council will have. The group accounts need to report on a consistent basis. *1*

Other valid points made should attract credit

(20)

Question 6

(a)

FRS 11 requirements per UK GAAP	**Local Authority Application**	**Central Government Department**
Definition of impairment An impairment occurs when the recoverable value or value in use of an asset falls below its carrying value on the balance sheet. Impairments can result from changing market prices (temporary impairments) or loss of economic benefit eg through obsolescence (permanent). *1 mark*	Same definition is applied in Local Authorities, although the SORP requires the valuation of the asset should be based on value in use. Since this shows the taxpayers the cost of replacing the asset as used. *1 mark for identification that same definition is applied, 1 mark for identification that value in use should be used*	Same definition is applied in Central Government, although RAM requires that the valuation of the asset should be based on value in use, unless the assets are heritage assets for which specific rules apply. *1 mark for identification that same definition is applied, 1 mark for identification that value in use should be used*
Accounting treatment: **Market prices impairments** Market prices impairments are initially charged through the revaluation reserve until the asset is returned to its historical cost. Any remaining impairment loss is then charged to the operating account. *1 mark*	The LG SORP allows local authorities to charge market prices impairments to the fixed asset restatement reserve (account) in full. No charge is made to the CRA. *1 mark* This deviates from UK GAAP and is acceptable since the FARR is a restatement reserve, not a revaluation reserve and is intended to account for movements in fixed assets resulting from changes in valuation or disposal and is not simply a revaluation	Market prices impairments are initially charged to the revaluation reserve until the asset is returned to its historical cost. Any remaining impairment loss is then charged to the operating account. This is compliant with UK GAAP. *1 mark*

FRS 11 requirements per UK GAAP	Local Authority Application	Central Government Department
	reserve. *1 mark*	
Loss of economic benefit impairments The impairment is charged in full to the operating account. Any value on the revaluation reserve is transferred to the profit and loss reserve. *1 mark*	The treatment per UK GAAP is not matched. *½ mark* The impairment is charged in full to the CRA through additional asset rentals charges borne by services to provide stewardship of assets. No transfers are made from the FARR to CRA since the FARR is a restatement reserve, not a revaluation reserve. *1 mark* The impairment value needs to be deducted from MRP when arriving at the MRP adjustment for the year. This is to ensure that the taxpayer bears the cost of MRP and depreciation only as per LGHA 1989. *1 mark*	The treatment is not fully consistent with UK GAAP. *½ mark* The impairment is charged in full to the operating account. Any value on the revaluation reserve is then released to the operating account to reduce the net operating cost for the year. This ensures that the outturn reported against the resource limit is only impacted upon by any net impairment value. *2 marks*

Other valid comments made should attract credit. 1 mark per point made and explained

(b) Accounting entries for the impairment:

Dr Service expenditure £100,000
Cr AMRA £100,000 *1*

Dr AMRA £100,000
Cr Fixed assets £100,000 *1*

Dr CFR £100,000
Cr CRA: Appropriations £100,000 (through the MRP adjustment) *1*

(c) The impact on the amount to be met by the taxpayer

Although the services will bear an additional charge through extra asset rentals for the impairment, the amount to be met by the taxpayer will not differ. The taxpayer needs to fund an amount equal to the Authority's minimum revenue provision and external interest only. The MRP adjustment made in the CRA needs to be reduced by the impairment value to ensure that the council tax payer is not double charged. *2*

(20)