CIPFA

FINANCIAL AND PERFORMANCE REPORTING REPUBLIC OF IRELAND

Diploma Stage Examination

5 June 2007

MARKING SCHEME

AT THE HEART OF YOUR CAREER

Question 1

The Fairfield Local Authority Income and Expenditure Account for year ended 31 December 2006

	€	
Income		
Grants and subsidies	149,284	
Goods and services	32,548	
Local government fund – general purpose grant	156,325	
Rates	77,311	
Total Income	**415,468**	
Expenditure		
Payroll expenses	16,490	
Operational expenses 6,393 + 2,464	8,857	*2*
Administration expenses	2,938	
Establishment expenses	10,715	
Financial expenses 645 + 5,000 + 120	5,765	*2*
Miscellaneous Expenses	1,335	
Total expenditure	**46,100**	
Surplus/(deficit) for the year before transfers	**369,368**	
Transfer (to)/from reserves	**(30,100)**	*2*
Overall surplus	**339,268**	
General reserve 1/1/06	**585,315**	
General reserves 31/12/06	**924,583**	

Fairfield Local Authority Balance Sheet At 31 December 2006

	€	€	
Fixed assets			
Land		551,017	
Buildings		1,713,429	*2*
Housing		4,687,914	*½*
Plant & machinery		1,684,477	*½*
		8,636,837	
Long term debtors		**421,935**	
Current assets			
Stocks	115,000		
Trade debtors & prepayments 615,450 – 18,464 + 11,938	608,924		*2*
Bank investments	Nil		
Cash at bank	Nil		
Cash on hand	1,438		
	725,362		
Current liabilities (amounts falling due within one year)			
Bank overdraft	(2,100)		
Creditors & accruals	(165,994)		
Finance leases	(30,000)		*1*
	(198,094)		
Net current assets / (liabilities)		**527,268**	
Provisions for liabilities and charges		Nil	*1*
Creditors (amounts falling due after more than one year)			
Loans payable	(118,900)		
Finance leases	(240,000)		*1*
Other	nil	(358,900)	
Net assets		**9,227,140**	
Financed by			
Capitalisation account 8,764,858 + 300,000 – 120 – 427,901		(8,636,837)	*3*
Income WIP		Nil	
Specific revenue reserve		(120)	*1*
General revenue reserve		(924,583)	
Other balances 64,500 + 300,000 –30,100		334,400	*2*
Total reserves		**9,227,140**	

Working 1 Finance Lease

	DR	CR
Buildings	300,000	
Capitalisation a/c		300,000
Lease liability		300,000
Lease repayment reserve	300,000	
Bank		35,000
I&E	5,000	
Lease liability	30,000	
Transfer from I&E	30,000	
Lease repayment reserve		30,000

Working 2 Suspense Account

	€	€
Dr: Suspense account	120	
Cr: Usable capital receipts Show under specific revenue reserve account		120

Working 3 Legal Action

The outcome of the claim is deemed to be possible – therefore, in line with the Accounting Code of Practice, a note is to be made to the accounts with no provision made in the accounts.

Working 4 Depreciation

	Land	Buildings	Housing	Plant and Mach
Op. NBV	551,017	1,448,517	4,783,586	1,981,738
Additions		300,000		
Disposal		(120)		
	551,017	1,748,397	4,783,586	1,981,738
Depreciation	Nil	2%	2%	15%
	Nil	34,968	95,672	297,261
Cl. NBV	551,017	1,713,429	4,687,914	1,684,477

Working 5 Provision for bad debts

Debtors:	615,450
Provision @ 3%	18,464
Existing provision	16,000
Adjustment to I&E	2,464

Working 6 Non- mortgage Loan Payments

	€	€
Dr: I&E financing expenses	120	
Transfer to Other balances – unfounded loans to be amortised		120

(20)

Question 2

(a) Minority Interest of Tea Limited

20% * (1,000,000 + 400,000 + 5,600,000) = €1,400,000 *(5)*

(b) Reference to Accounting Standards

FRS 2 Accounting for subsidiary undertakings
FRS 6 Acquisitions and mergers
FRS 7 Fair values in acquisition accounting
FRS 9 Associates and joint ventures
FRS 10 Goodwill and intangible assets

1 mark each to a maximum of 4

Definitions of

Parent Company
Subsidiary company
Group companies
Consolidated Accounts
Minority Interests

1 mark each to a maximum of 4

(8)

(c) UK Whole of Government Accounting programme

WGA intiative aims to produce a full set of consolidated accounts for the entire UK Public Service. Whole of Government Accounts (WGA) will be audited consolidated accounts for the whole of the public sector, prepared in accordance with UK Generally Accepted Accounting Practice (GAAP). WGA is being introduced in stages, starting with Central Government Accounts (CGA), which were audited and published for 2003-04 onwards. WGA will be published for 2006-07 onwards, after two dry run years. The Comptroller and Auditor General is the auditor of WGA and CGA.

(7)

(20)

Question 3

(a) The distinctive characteristics of Public Services in the context of Corporate Governance are:

- The political dimension in the management and delivery of services.
- The organisation's objectives are multi-various and difficult to quantify.
- The public sector has loosely defined accountability to stakeholders given that the level of accountability will vary across services and across stakeholders.
- There is uncertainty regarding proprietors and stakeholders and how the roles of these groups are defined and separated within the public sector context.
- The role of chief executive officer is different in the public sector.
- Parallels for chairman and board between the public and private sectors are hard to identify.
- The public service ethic and motivation in interests of public good are unique concepts.
- Auditors in the public sector play a wider audit role.
- The presence of regulators and ombudsmen in some sectors also enhances the corporate governance environment within the public sector when compared with the private sector.
- There is a lack of one universally accepted motivational objective in the public sector, which makes it harder to focus and contextualise corporate governance.
- There is a lack of a single regulatory environment
- Companies Act and Stock Exchange Rules do not apply to the public sector. No single reporting or regulatory body replaces them within the public sector.

1 mark each to a maximum of (10)

(b) The specific recommendations of the Mullarkey Report are:

1 The respective roles of the Secretary General and the Accounting Officer, and the framework and processes of accountability should be set down in writing. This would be facilitated by the preparation of guidance by the Department of Finance.

2 Secretaries General should give priority to the implementation of the MIF in their Departments.

3 Accounting Officers evaluate their systems of internal financial control with a view to ensuring that they have:

4 Clearly defined responsibilities at management level with corresponding accountability.

5 Clear reporting arrangements at all levels where responsibility for financial management has been assigned.

6 Staff in Finance Units/Accounts Branches with skills commensurate with their responsibilities.

7 Staff throughout the Department who are appropriately trained in the management of public funds (including the requirements of public financial procedures) and, when they become available, in the use of management accounts.

8 Appropriate controls including the segregation of duties particularly where the processing of transactions/receipts is involved; systems of delegation including authorisation limits for the making of payments.

9 Documented procedures for internal financial control (including desk instructions for staff that translate statutory and other requirements into a set of operating procedures).

10 Adequate systems for budgetary control (including systems for comparing results with budgets throughout the year).

11 Systems for monitoring the effectiveness of internal financial control including internal audit and audit committees, management reviews etc.

12 An assessment of significant financial risks.

13 Accounting Officers, submit with the Appropriation Accounts, a descriptive Statement on Internal Financial Control, broadly similar to the format required for the Chairperson of State Bodies. The Statement should be reviewed by the Comptroller and Auditor General for consistency with information of which he was aware from the audit of the financial statements.

14 Any such statement would have to be qualified to the effect that the systems of internal financial control can provide only reasonable and not absolute assurance against material error

15 There be a formally constituted Audit Committee in each Department/Office

16 Each Audit Committee should

17 Operate under a written charter.

18 Have significant external representation (at least 2 members), including, in the normal course, representatives from the private sector with appropriate expertise. The Chairperson of the Committee should come from outside the Department.

19 Prepare an annual report to the Accounting Officer reviewing its operations.

20 Invite the Comptroller and Auditor General, or his nominee, to meet the Committee at least once a year

21 A separate Accounting Officer Memorandum should issue to Accounting Officers on appointment. The memorandum should be an expanded version of the material contained in Public Financial Procedures and drawing, where relevant, on the clarifications and contents of this report.

1 mark each to a maximum of (10)

(20)

Question 4

MEMORANDUM

To: Adele Golding, Finance Director
From: Moira Shannon, Finance Assistant
Subject: Analysis of 2006 Financial Statements – Barrettstown Housing Agency

1 Introduction

The purpose of this memo is to analyse the financial performance and position of Barrettstown Housing Association (BHA) for the year-ended 31 December 2006.

Please refer to Appendix I for all ratio calculations referred to in this memo.

2 Analysis of financial performance and position

BHA's performance and position has deteriorated significantly during the 2006/07 financial year. It has failed to meet all 4 of its key financial targets.

(a) *Earn a return on capital employed of at least 5%*

SHA has made an operating deficit this year due largely to increases in debt write-offs and other expenses, which means that it has failed to meet is ROCE target of 5%, as its ROCE is –16%.

(b) *Maintain revenue reserves at a minimum level of 50% of the year's cash operating expenditure*

The increases in operating expenses also mean that it has failed to meet the target of maintaining revenue reserves of at least 50% of cash operating expenditure, as its reserves as at 31 Dec 2006 only cover 38.5% of cash operating expenditure, a significant decrease from 115.2% last year. Failing to meet this target indicates that the level of expenditure this year is not sustainable in the long term.

(c) *Minimise bad debt write-offs by collecting 95% of rental income invoiced to tenants.*

BHA aims to minimise bad debt write-offs by collecting 95% of rental income invoiced. The calculation in Appendix I show that only 73.5% has been collected this year, a significant decline since last year. Since debtor days have risen from 59 last year to 122 this year, it is possible that there will be further amounts of uncollectible debt that will need to be written off, decreasing the percentage collected even further.

The large bad debt expense in 2006 is one of the main contributors to the deficit for the year, and the lack of cash flows from debtors is putting pressure on our working capital.

(d) Pay trade suppliers within 30 days of invoice

BHA aims to pay its trade suppliers within 30 days of invoice, and the calculation of creditor days of 144 indicates that BHA is far from meeting this target. This is probably because the debt collection problems mean that BHA has no cash to pay its suppliers. BHA risks the good relationships that it has built up with its suppliers of maintenance and other services, and these suppliers could claim interest for late paid invoices from us or even stop doing work for us in the future. Also, prompt payments penalties will be substantial.

Up to 1 ½ marks per target explained up to a maximum of 6

3 Application for bank loan

BHA currently has significant financial problems. The failure to control operating expenses means that it has no surplus to be able to afford the additional expense of interest payments, and the working capital pressures caused by debt collection problems means that it has no cash available to make interest and principal repayments on the loan.

I recommend that BHA defer applying for the loan until the financial position has been brought under control and we have prepared adequate long-term forecasts to assess the affordability of the loan. I also recommend that BHA investigate grants available from the Housing Corporation and other bodies to assist with building the key worker homes, as this would reduce the amount of money that BHA need to borrow, as €3.2m is probably too much for us when our total capital employed is only €5.4m at the moment.

Up to a maximum of 2

4 Recommendations

The following steps must be taken as soon as possible:

- Proper budgeting procedures must be put in place to control operating expenditure, and expenditure must be analysed and questioned each month to ensure that it is kept under control.
- Strong credit control procedures need to be put in place by the new credit control staff in order to collect as much of the outstanding rent as possible and to minimise future problems. Looking at best practice among other Dublin Housing Associations will help us to develop good procedures for collecting rent on a timely basis.
- The overdraft of €355,000 as at 31 Dec 2006 needs to be investigated to ensure that this is at a competitive rate of interest and that we have not exceeded our limit.
- We need to perform a review of all outstanding trade creditors and ensure that we communicate to all our suppliers when we will pay them in order to ensure continuity of service from them and minimize prompt payments charges.
- Income from donations has fallen from €354,000 last year to €301,000 this year. We should ensure that we are maximising donations income and may need to consider appointing a dedicated fundraising team.

Up to 1 mark per point explained up to a maximum of 3

5 Further information required

This memo has been prepared using only the 2005 + 2006 published financial statements as its basis, and the following further information is required in order to draw conclusions:

- Financial statements and key ratios for comparable housing associations. For example, we could determine what are normal bad debt write-off levels for other housing associations operating in similarly deprived areas.
- Analysis of the other operating expenses balance to determine if this includes any one-off items (such as legal costs relating to the staff problems in the year).
- Non-financial information such as tenant satisfaction levels determine whether the financial problems have also led to failures in service provision.
- The reason for the resignation of key financial and credit control staff during the year. Proper financial control cannot be maintained if staff are constantly being replaced, and we should ask the Human Resources department to investigate the reasons for the problems.

Up to 1 mark per point explained up to a maximum of 3

6 Conclusion

SHA has failed to meet all of its key financial targets this year, probably due to a breakdown in control as a result of staffing problems. BHA needs to put effective credit control procedures in place in order to collect outstanding rent quicker and minimise bad debt write-offs, and bring operating expenditure under control.

½ mark for conclusion and ½ mark for Presentation / Memo format to a maximum of 1

Appendix 1 – Ratio Calculations

	31 Dec 2006 €'000	**31 Dec 2005 €'000**
1 Return on Capital Employed		
Surplus before interest payable:		
Retained surplus / (deficit)	(901)	402
Plus interest payable	58	-
	(843)	402
Capital employed	5,436	5,729
	-16%	**7%**

2 Revenue reserve as a percentage of cash operating expenses

Closing revenue reserve	1,082	1,983
Total operating expenses for year	3,791	2,622
Less depreciation	(980)	(901)
Cash operating expenses	2,811	1,721
	38.5%	**115.2%**

3 Creditor days

Trade creditors	397	57
As a proxy for purchases:		
Maintenance expenses	273	234
Other operating expenses	735	351
	1,008	585
x 365 =	**144 days**	**36 days**

4 Percentage of rental income collected

Gross social housing lettings income	2,647	2,667
Bad debt expense	(701)	(152)
Net income after write-offs	1,946	2,515
	73.5%	**94.3%**

5 Debtor days

Debtors	883	431
Social housing income	2,647	2,667
x 365 =	**122 days**	**59 days**

1 mark per correct pair of ratios up to a maximum of 5

(20)

Question 5

Finance Department
Crumlin Dogs Home
Dublin 12

Dear Mrs Jordan,

Thank you for your telephone message that you left for me this morning. Please find below my responses to your questions.

(a) Cash and accruals accounting

Cash accounting systems are used by many of the world's central governments, including the ROI. Cash based financial statements are easy to prepare and simple to understand because they are simply a list of all payments and receipts – in effect, a summarised cashbook. *1*

However, there are several disadvantages of cash accounting. Cash accounting does not distinguish between payments of day-to-day expenses, such as salaries, and payments to acquire long lasting fixed assets. As a result, cash accounting systems take no account of outstanding items at year-end and so users of the accounts cannot determine what assets and liabilities the organisation has. It also means that an organisation could manipulate its accounts by holding off payments until after the year-end so that they aren't recognised in the accounts. *1*

Because of the disadvantages of cash-based accounting, all ROI public and private sector organizations (excluding central gov. and gov. (ROI) departments) used accruals based accounting. Under accruals accounting, income is recognised when it is earned and expenditure when resources are used. So for example, we recognise an annual depreciation charge on our dogs home building rather than recognising the entire cost of building it the first year of its life. This gives a much fairer presentation and means that the cost of buying a fixed asset is matched to the benefit received from using it. *1*

The other advantage of accruals accounting is that a year-end balance sheet is prepared, showing users of the accounts the assets and liabilities the organisation has, and a surplus or deficit can be calculated, meaning that performance can be evaluated and compared to earlier years and to other organisations. *1*

(4)

(b) Consolidation of Crumlin Canine Trading Limited

Crumlin Canine Trading Limited (CCT) has to be consolidated under the rules prescribed by the Accounting Standards Board's *Financial Reporting Standard* (*FRS) 2 Accounting for Subsidiary Undertakings. The Statement of Recommended Practice (SORP) for Charities*, published by the Charities Commission, in the UK, also exerts an influence on best practice accounting. *1*

FRS 2 requires that consolidation occurs whenever an organisation controls another organisation. *1*

As the charity owns 100% of CCT, it clearly controls the company, regardless of whether it is supposed to operate at arms length. *1*

The reason for preparing consolidated accounts for the charity and CCT is in order to show a true and fair view of the whole group, i.e. to reflect the performance of the group as a whole and not just one part of it. *1*

(4)

(c) Fund accounting

Fund accounting underpins accounting in many public sector organisations. Public sector organisations such as charities use fund accounting to maintain accountability for identified resources. For example, Crumlin Dogs Home may have a fundraising campaign to raise funds to build a new vetinary surgery for sick dogs and would be required to keep a separate fund for these funds to show users of the accounts that it has used the funds raised only for this project. *2*

This is in contrast to private sector companies, where there is less need to focus on individual funds because their accounts are not primarily focused on showing the stewardship of funds. *1*

(3)

(d) International Accounting Standards

From 2005 onwards, all large EU companies have to prepare accounts following International Accounting Standards (IAS) instead of their country's own standards. *1*

International Public Sector Accounting Standards (IPSAS) have been developed which take the principals of IAS and apply them to the situation of public sector. *1*

The UK public sector has not yet agreed to adopt these. The rollout of full accrual accounts must be completed first. The SORP's produced buy the ASB are still based on national GAAP. *1*

In the UK, the accounting standards board is currently implementing a convergence project, which means that UK accounting standards are gradually being brought into line with IAS. Hence eventually all the UK standards which the Charities SORP is based on will be the same as IAS anyway. *1*

(4)

(e) Corporate Governance

The public sector has responded to developments in corporate governance in the private sector by adapting the private sector principles to the public sector. *½*

For example, when the Cadbury Committee focused its report on the issue of corporate governance in listed private sector companies, CIPFA published a discussion paper "Corporate Governance in the Public Services" which concluded that the recommendations of the Cadbury Report were equally relevant to the public services but identified a number of distinctive characteristics which have to be taken into account when considering corporate governance issues, such as the many objectives of public sector organisations and the wider remit of auditors in the public sector. *2*

Each sector within the public sector has adopted its own corporate governance rules and best practice. The level of mandatory reporting for charities is less than that for other public sector organizations. In the UK, the Charity Commission in its role as regulator has produced several reports as part of its annual review process covering governance issues. These reports have included trustee recruitment and selection, and charities and commercial partners. *1*

The Charity Commission has also undertaken reviews of the effectiveness of boards and the remuneration of trustees. Discussion is ongoing as to the best way in which large charities can be regulated to ensure that the public trusts them. *1*

(4 ½)

Letter format ½

(20)

Question 6

(a) Leased Fixed Assets

SSAP 21: Fixed assets purchased via a Finance Lease are recognised as Fixed Assets in the Balance Sheet. A creditor for the lease payments due is set up in the balance sheet and recorded under Current Liabilities and Long term liabilities. Each lease payment is divided between the finance charge and capital payment. The Finance Charge is included in the P&L and the Capital charge reduces the lease creditor.

Health Sector: Fixed Assets purchased on leases are recognised as Fixed Assets in the Balance Sheet. The assets are capitalised at fair value using the capitalisation account. The lease creditor is accounted for by recording the fair value of the asset in the capital income and expenditure and recording the lease creditor in the Balance Sheet. The finance charges are recorded as deferred finance charges in the balance sheet and obligations under finance leases in the balance sheet.

(4)

(b) Disposals and Depreciation of Fixed Assets

FRS 15: Represents the loss in value an asset as a result of use. Method chosen should reflect the pattern of loss and the annual charge is recognised in the P&L.
On disposal of an asset the difference between the NBV of the asset and the proceeds of sale of that asset is known as a profit or loss on disposal. This is recognised in the P&L.

In Health: Depreciation is regarded as a non-funded expenditure item and is not charged against the I&E account. The depreciation charge is credited to Fixed Assets and Debited to the capitalisation account.

The disposal of the asset is recorded through the capitalisation account. The proceeds of the disposal are held in a “proceeds from disposals account” and held for purchase against future capital assets.

(4)

(c) Post Balance Sheet Events

FRS 21: Defines both adjusting and non-adjusting events. Adjusting material events after the balance sheet date should be recognised in the Financial Statements. Material non-adjusting events should be disclosed where material.

The Accounting Code of Practice for Health Boards makes no reference to the treatment of post balance sheet events other than it is the responsibility of the CEO/Finance Officer to review post period events.

(3)

(d) Revaluation and impairment of Fixed Assets

FRS 15: Valued using market value where possible or at depreciated replacement cost. A loss or gain on revaluation is recorded in the P&L or STRGL depending on the value of the gain or loss.

FRS 11: Impairment
An impairment occurs when the recoverable value or value in use of an asset falls below its carrying value on the balance sheet. Impairment losses are recognised in either the P&L or STRGL.

In Health: Revaluation of Buildings is recommended to occur every 5 years. Land, which is deemed by the board to be surplus to requirements, should be revalued on the basis of market value. All other land should be valued for balance sheet purposes at year-end at standard valuation. Any increase on revaluation is included in the capitalisation account.

(4)

(e) Contingencies and provisions

FRS 12: Where it has been ascertained that there is an expected transfer of economic benefits the likelihood of this transfer determines the accounting treatment. Where there is a possible or probable contingent loss, then a provision is made – otherwise the contingent liability is disclosed. Only if a contingent assets is virtually certain is a provision made.

In Health: In this context, contingencies refer to conditions that exist at the balance sheet date that depend on the occurrence of one or more future events. A material contingent loss should be disclosed except where the possibility of loss is remote. Contingencies are not included in the compilation of expenditure in the expenditure for the year. Following from that, no provisions are made.

(3)

(f) Subsidiaries

FRS 2: The definition of a subsidiary is based on control, not ownership. Consolidation is the process of presenting financial information of parents and subsidiaries as one economic entity to show the group resources, obligations and income generation with its combined resources. The key requirements are that all entities operate the same accounting policies, year end date and that intra-group transactions are excluded from the financial statements.

In Health: Where the company is a subsidiary or quasi-subsidiary of the health board the income and expenditure of the company and its assets and liabilities at the year-end should be consolidated into the main accounts of the health board. Where a company is neither a subsidiary nor a quasi-subsidiary of the health board, GAAP should apply in determining how the results of the company should be reflected in the Health Board's AFS.

(2)

(20)