CIPFA

FINANCIAL AND PERFORMANCE REPORTING

Diploma stage examination

4 December 2007

MARKING SCHEME

AT THE HEART OF
YOUR CAREER

Question 1

Altonborough Unitary Authority
Consolidated revenue account for the year ended 31 March 2004

		£000	
Central services	*(w5)*	56,475	
Education	*(w5)*	920,372	
Cultural, environmental & planning	*(w5)*	128,635	
Social services	*(w5)*	182,378	
Highways, roads & transport	*(w5)*	49,259	
		1,337,119	
Net cost of services			
Corporate income and expenditure			
- Interest received		(1,002)	
- Asset management revenue account *(w1)*		12,978	*½*
Net operating expenditure		1,349,095	
Appropriations			
Contributions to capital financing account			
- MRP adjustment *(w4)*		1,433	*1*
- DRF		1,980	*½*
- Government grant deferred		100	*1*
Finance lease interest *(w3)*		(33)	*1 ½*
Amount to be met from government grant and local taxpayers		1,352,575	
Demands on collection fund (council tax)		(756,974)	
Revenue support grant		(424,924)	
Contributions from NNDR pool		(185,134)	
(Surplus) / deficit for year		(14,457)	
General fund balance brought forward		(29,658)	
General fund balance carried forward		**(44,115)**	*½*

Correct format/presentation ½

(w1) AMRA

	£000		£000	
Dep'n (18,803 – 471)	18,332			1
		Asset rentals (50,035 – 764)	49,271	1
External interest (TB)	43,984			½
		Tfr from govt grants deferred (4000 / 40)	100	1
Finance Lease Interest *(w3)*	33			½
		Transfer to CRA	12,978	
	62,349		62,349	

(w2) Adjustment to asset rentals

Reduce depreciation by £471,000 on disposed asset

Reduce notional interest by (£8,850,000 - £471,000) x 3.5% = £293,265

Total adjustment = £764,265

(w3) Calculation of finance lease interest

Annual payment per suspense account:
£3,860,000 - £4,000,000 = £140,000

Total payments = £140,000 x 5 = £700,000

Fair value = £600,000, therefore total interest on finance lease = £100,000

Using sum of the digits = 1 + 2 + 3 + 4 + 5 = 15

Interest for 2003/04 = £100,000 / 15 x 5 = £33,333K

(w4) Minimum Revenue Provision

Depreciation = £18,803,000 - £471,000 (w2) = £18,332,000

MRP adjustment = £19,765,000 - £18,332,000 = £1,433,000

(w5) Net service costs

	TB £'000	(iv) £'000	Adj (w2) £'000	Net £'000	
Central services	55,580	895		56,475	
Education	890,352	30,784	(764)	920,372	1
Cultural, environmental and planning	115,068	13,567		128,635	
Social Services	180,378	2,000		182,378	
Highways, roads & transport	46,470	2,789		49,259	
	1,287,848	50,035	(764)	1,337,119	1

Altonborough Unitary Authority
Consolidated balance sheet as at 31 March 2004

	£000	£000	
Net operational assets *(w6)*		964,458	*1 ½*
Current assets:			
Stock and WIP	14,480		
Debtors (15,196 – 123)	15,073		*¼*
Short Term Investments	5,188		
Cash in hand	174		
	34,915		
Creditors due within one year			
Creditors (8,858 – 123)	(8,735)		*¼*
Net current assets		26,180	
Total assets less current liabilities		990,638	
Long term borrowing (452,326 -196,020 + 235,204)		(491,510)	*1*
Finance lease (600 – (140-33 *(w3)*))		(493)	*1*
Government grants deferred (4,000 – 100)		(3,900)	*½*
Net assets		**494,735**	
Financed by:			
Fixed Asset Restatement Account (397,960 – 8,850)		389,110	*½*
Capital Financing Account *(w7)*		35,282	*2*
Useable Capital Receipts *(w8)*		26,228	*1*
General Fund		44,115	
		494,735	

Correct format/presentation ½

(w6) Net Operational Assets

	£'000	
Trial balance	991,640	
Less disposal	(8,850)	*½*
Less depreciation (18,803 – 471)	(18,332)	*1*
	964,458	

(w7) Capital Financing Account

	£'000	
Trial balance	25,802	
Government grant written back	100	*½*
Finance lease interest	(33)	*½*
DRF	1,980)	
Use of capital receipts	6,000)	*½*
MRP Adj	1,433	*½*
	35,282	

(w8) Usable Capital Receipts

	£'000	
Trial balance	23,166	
Disposal proceeds	9,062	½
Use of capital receipts	(6,000)	½
	26,228	

(20)

Question 2

Rural Regeneration Agency
Cash flow Statement for Year ended 31 March 2007

	£'000	
Net cash outflow on operating activities (note 1)	(2,571)	½
Capital expenditure (note 2)	(2,812)	½
Payments to the consolidated fund	0	
Financing (note 3)	6,002	½
Net cash inflow for the year	**619**	
		Presentation ½

Note 1
Reconciliation of Net Operating Cost to Net Cash Outflow on Operations

	£'000	
Net operating cost (w1)	(7,310)	½
Add back depreciation	2,230	½
Less profit on disposal	(15)	½
Less depreciation transfer on donated assets	(40)	½
Plus notional costs (w2)	942	½
Increase in stock	(38)	½
Increase in debtors	(130)	½
Increase in creditors (w3)	1,790	*1*
Net cash outflow on operations	(2,571)	

Note 2
Analysis of Capital Expenditure

	£'000	
Payments to acquire fixed assets (w4)	(2,907)	½
Proceeds from disposal of fixed assets (80+15)	95	*1*
	(2,812)	

Note 3
Analysis of financing and reconciliation to net cash requirement

	£'000	
Net supply voted	6,994	½
Less excess A-in-A (4,890-4,678)	(212)	*1*
Less surplus to surrender	(780)	½
Parliamentary funding	6,002	
Increase in cash	(619)	½
Net cash requirement	5,383	

Presentation of notes to the cash flow statement 1

(w1) Net Operating Cost

General Fund

	£'000		£'000	
		b/f	21,500	
Net Op Cost (*Bal figure)*	7,310			*1*
		Notionals (w2)	942	*½*
		Parl. funding (note 3)	6,002	*½*
c/f	21,195	Disposal transfer (80-19)	61	*1*
	28,505		28,505	

(w2) Notional Costs

	2,007 £'000	2,006 £'000	
Net assets	28,730	27,690	
Less cash	(1,019)	(400)	
Less D.A.R.	(1,587)	(1,500)	
	26,124	25,790	
Average		25,957	
3.5%		908	
Plus audit fee		34	
Total notional costs		942	*2½*

(w3) Increase in trade creditors

	£'000
Opening	2,960
Closing (4,823 - 73 capital)	4,750
Increase	1,790

(w4) Payments to acquire fixed assets

Fixed assets (NBV)

	£'000		£'000	
b/f	28,700			
		Disposal	80	*½*
Net reval./indexation	1,446			*½*
		Depreciation	2,230	*½*
Additions (*Bal figure)*	2,980			*1*
		c/f	30,816	
	30,146		33,126	

Additions to fixed assets	2,980	
Less capital creditor	(73)	*½*
Cash payments	2,907	

(20)

Question 3

Department of Corporate Affairs
Wryley City Council

Mr. G. Edalji
The Old Vicarage
Upper Wryley

Dear Mr. Edalji

Thank you very much for your letter. I have set out below an explanation for the queries that you raised.

Letter format 1

(a) Corporate Governance Developments

In response to the developments that you mentioned in your letter in establishing good corporate governance in the private sector, CIPFA published a discussion paper 'Corporate Governance in the Public Services' which concluded that the principles established by one of the main private sector corporate governance projects (the Cadbury Committee) were equally relevant in the public sector.

However, there are of course a number of distinctive characteristics which must be taken into account when considering corporate governance issues in the public sector. These include the fact that a public sector organisation's objectives tend to be multifarious, and the unique public service ethic and motivation which does not apply to the private sector.

A further development in public sector corporate governance was the Committee on Standards in Public Life, which produced six reports that you may have heard referred to as the Nolan Reports. These reports outlined principles and best practices that should govern public sector organisations.

Up to 1 mark per well explained point regarding the application of corporate governance principles to the public sector up to a maximum of 3
Credit to be given for other relevant points

In terms of developments specifically in the local government sector, in May 2001 CIPFA and SOLACE (the Society of Local Authority Chief Executives) published a framework for corporate governance in local government. This placed particular emphasis on five areas of governance in local authorities:

- Community focus
- Structures and processes
- Risk management
- Service delivery
- Standards of conduct.

Under the terms of the framework, all authorities are required to review their corporate governance arrangement, prepare an up-to-date code of their own (based on the framework) and to publish an annual statement on governance arrangements. If you look at a recent set of Wryley Council accounts, you will see this statement.

Up to 1 mark per well explained point regarding the corporate governance developments affecting local authorities up to a maximum of 3
Credit to be given for other relevant points

(7)

(b) Benchmarking

Benchmarking involves comparing our performance in a particular area to that of other similar organisations in order to identify areas of best practice and areas where we can learn from other organisations and improve.

Obviously comparisons have to be with other similar organisations for the comparison to be meaningful, so the benchmarking club means that we have joined with a number of authorities with comparable leisure facilities in order to share data to our mutual benefit.

Up to 2 marks for explanation of benchmarking

The benchmarking process has to follow a systematic and planned approach as follows:

1) Agree a structured approach across the benchmarking club.
2) Identify areas where performance could be improved.
3) Compare similar practices and process in other parts of the organisation or other organisations to identify good and best practice.
4) Identify the changes in procedures and process which must be made to improve performance.
5) Generate ownership of the process and recognition of the need for change amongst staff and other stakeholders.

Up to 3 marks for explanation of the benchmarking process

The advantage of benchmarking is that it will usually highlight areas where other organisations are performing better than us and so will highlight a need for improvement in some areas of performance, such as cost reduction or improving service quality.

It can also provide motivation among officers and members to improve performance in specific areas.

1 mark per advantage up to a maximum of 2

(7)

(c) Housing Revenue Account

Local authorities are required to maintain a separate Housing Revenue Account (HRA) because statute requires that users of the accounts can segregate the financial activity in relation to the provision of housing from other services. Fund accounting theory suggests that income and expenditure relating to specific activities should be earmarked. Producing a separate HRA demonstrates this.

This is a statutory requirement because it is not lawful to reduce rents by making contributions from council tax or vice versa.

The HRA balances are also included with the Consolidated Revenue Account, which gives users of the accounts a full picture of all income and expenditure incurred by the authority for the year.

(2)

(d) Credit Approvals and the Prudential Code

Credit Approvals (CAs) were issued by central government and allow a local authority to borrow money to invest in capital projects (e.g. building a new school or social housing).

The CA system was replaced in April 2004 by the Prudential Code.

The Prudential Code now plays a key role in the capital financing of local authorities, and was developed by CIPFA. Under the Code, authorities are no longer subject to credit approvals but instead determine their own borrowing limits by putting into place a capital investment plan which is affordable, prudent and sustainable.

Authorities have to set prudential indicators, which must then be reviewed regularly to ensure that borrowing remains affordable and doesn't adversely affect Council Tax and rents.

1 mark maximum for explaining CAs (as no longer in use a longer explanation would not be appropriate) and up to 2 marks for explanation of Prudential Code up to a maximum of 3

Borrowing is often required to finance a capital expenditure, especially if there are no receipts from sale of old capital assets.

Council tax rises are not usually borne lightly by council tax payers and an excessive increase to cover a big capital project would also risk having our council tax capped by central government.

Borrowing to fund the project means that the cost can be spread over many years.

1 mark for explanation of why capital expenditure cannot be financed by council tax increases
(4)

I hope that you find this useful. Please don't hesitate to let me know if I can be of further assistance.

Yours sincerely,
Ms L. Doyle

Director of Corporate Affairs ***(20)***

Question 4

(a)

£000	Land	Build's	Equip't 5 yr	Equip't 5 yr (donated)	Equip't 7 yr	Equip't 10 yr	AUC	Total	
Cost									
Opening balance	85,500	72,000	12,500	0	25,000	10,500	2,500	208,000	
Revaluation	45							45	*½*
	85,545	72,000	12,500		25,000	10,500	2,500	208,045	
Indexation	-1,584	679	238	0	476	200	0	9	*2½*
Depreciable amount	83,961	72,679	12,738		25,476	10,700	2,500	208,054	
Depreciation *(w1)*		-1,621						-1,621	*1*
Additions		347		33	52	24		456	*1*
Disposals *(w2)*					-49			-49	*1*
Closing balance	83,961	71,405	12,738	33	25,479	10,724	2,500	206,840	
Depreciation									
Opening balance			3,750		7,500	2,750		14,000	
Backlog dep'n			71		143	52		266	*1*
Charge for year (W1)			2,548		3,638	1,071		7,257	*1 ½*
Disposals					-18			-18	*1*
Closing balance			6,369	0	11,263	3,873		21,505	
Net book value	83,961	71,405	6,369	33	14,216	6,851	2,500	185,335	

Presentation 1
Donated assets separate ½

(W1) Depreciation	Buildings	5 yr	Donated	7 yr	10 yr
Assets held at beginning	1,615	2,548		3,640	1,070
Additions	6				1
Disposals	0			(2)	
	1,621	2,548	0	3,638	1,071

(W2) Disposal			
	Cost	48 * 1.07/1.05	49
	Dep'n	52*10/28	18

(11)

(b) Revaluation – FRS 15:

- All NHS fixed assets are revalued every five years in a national exercise.
- May be more frequent to comply with FRS 15.

Indexation – Capital Accounting Manual:

- Assets are indexed annually.
- Indexation is applied to any revalued asset since revaluation is considered to bring the asset up to the value at the end of the financial year.

For both revaluation and indexation there is an impact on the revaluation reserve (e.g. Dr Fixed Assets and Cr Revaluation Reserve for positive revaluation, also Dr Revaluation Reserve and Cr Accumulated Depreciation for backlog depreciation on equipment.

Revaluation and indexation – ½ marks per point, up to a maximum of 3

Depreciation:

- Accounted for in accordance with FRS 15.
- Charged on a quarterly basis (ie in relation to financial year) in NHS.
- Straight line method.
- Asset lives guided by NHS Capital Accounting Manual.
- No depreciation in first quarter.
- Full depreciation in quarter of disposal.
- Charged on all operational assets except land.
- No charge on Assets Under Construction (because not yet operational).
- Donated assets are depreciated (but example in this question has no charge as only owned for one quarter).
- Charge on donated assets will be offset by transfer from donated assets reserve.
- Shown separately on balance sheet for equipment, but net current cost for land and buildings.

Depreciation – ½ marks per point up to a maximum of 4

Additions:

- Included at cost as per FRS 15.
- £5000 de minimis per NHS Capital Accounting Manual.

Disposals:

- Cost and depreciation need to be written out of accounts as per FRS 15.
- The cost needs to be at current value (including any indexation at the beginning of the year).
- Schedule shows additions then disposals as final adjustments.

Additions and disposals – ½ marks per point up to a maximum of 1 ½
Capital accounting manual prescribes order as above – ½
(9)

(20)

Question 5

(a) Achievement of financial targets and factors affecting this year's performance

1 mark to be awarded for suitable report format, structure and tone

*Comments on targets for this year are indicative only
Marks will be awarded for other appropriate
comments up to the maximum allowed
by the marking scheme*

Target 1: Retained surplus for the year to equal at least 2.5 per cent of total income

	2007	2006
Retained Surplus	**755**	**1,089**
Total income	**40,962**	**40,878**
Achievement	**1.8%**	**2.7%**
Target met?	**No**	**Yes**

Comment:

The target was not met in 2007 largely owing to a fall in funding and tuition fees (down by about 5 per cent). This is likely to continue unless student numbers increase.

The fall in funding and tuition fee income was partly offset by increases in other income and endowment income.

Costs were held broadly in line with last year overall but a large repairs bill helped contribute to the fall in surplus.

The transfer of endowment income to reserves is not a factor, since the only way to reduce this is for there to be less income to transfer or more expenditure on eligible projects which would have a net nil effect.

Target 2: Staff costs not to exceed 80 per cent of total costs (excluding depreciation)

	2007	2006
Staff costs	**27,061**	**29,806**
Total Cost less depreciation	**34,896**	**35,216**
Achievement	**77.5%**	**84.6%**
Target met?	**Yes**	**No**

Comment:

The target has been met for this year (it was not met in 2006) partly owing to a fall in staff costs of 9 per cent. This may represent a reduction in staff commensurate with declining student numbers.

Another factor in achieving this year's target was a rise in other expenditure following one-off repairs expenditure. If this is excluded, staff costs would be 83 per cent – above the required target.

Target 3: Endowment income to equal at least 5.5 per cent of the total value of endowment assets

	2007	2006
Endowment income	**4,239**	**3,338**
Value of endowment assets	**53,336**	**50,507**
Achievement	**7.9%**	**6.6%**
Target met?	**Yes**	**Yes**

Comment:

The target has been met for both years and in fact 2007 is up on the previous year.

However, analysis of the performance of the restricted and unrestricted funds reveals that whilst the restricted funds have produced a return of 10.5% [2829/27032], unrestricted funds have only achieved 5.3% [1410/26604], below the required target.

Furthermore, none of the income from restricted endowments was used in the year. This represents a resource of which the University is failing to make full use.

½ mark for each target correctly calculated and whether achieved or not
1 mark per appropriate comment to a maximum of 3 marks per target

(10)

(b) Other significant matters

Whilst income from research and teaching grants has stayed steady recently, this might be expected to fall as student and staff numbers decline.

Interest of £20,000 was paid on the overdraft of £405,000 at the same time that the University had over £2 million in short term investments. Since it is unlikely that we are getting a better return on these than we are paying the bank, this could be an indication of poor treasury management at the University.

Debtors have risen steeply in the last year, probably owing to the amounts of rent withheld as part of the rent strike. Some consideration should be given as to whether or not all of this is likely to be recovered.

1 mark per appropriate comment to a maximum of (3)
Other valid points will attract credit

(c) Recommendations for improving the University's financial performance

The key to improving the financial performance of the University is to increase student enrolments and thus boost the main sources of income ie funding council grants and tuition fees.

The proposed centre of excellence would appear to be a likely prospect for achieving this, but staff costs in particular will need to be kept under control if targets are to be met in the future.

A wider review of the courses offered should be undertaken to make the University more attractive. The fact that no expenditure has been incurred in the Egyptology department for two years indicates that this is not an area which is attractive to potential students.

It may be possible to vary the terms of the endowment to allow it to be used to support other areas of the University. Whilst extra expenditure of the investment income would not have a direct effect on the surplus, if it results in attracting more students the resultant Funding council grants and fees would.

Whilst pursuing an improvement in financial performance the University should not ignore non-financial factors such as the quality of teaching and other issues which might affect student recruitment, eg the rent strike caused by the rise in student rents last year.

1 mark per appropriate comment to a maximum of (4)
Credit to be given for other relevant points

(d) Ways in which additional funds might be raised

After paying off the overdraft there is about £1.5 million in short term investments which could be used in the first instance.

Whilst endowment assets cannot (usually) be sold to raise capital funds the University could consider selling the student accommodation it currently owns. The income they would lose would have to be set against the costs of other sources of finance as well as the potential returns in increased grants and fees generated by the expansion.

The University could borrow the money. With a considerable asset base on which to secure a loan and provided sufficient extra revenue could be generated to service the loan (interest and capital), this is an option.

A combination of the above, eg:

- Realise the short term investments £1.5 million
- Sell half the accommodation £7.0 million
- Borrow the remainder £1.5 million

A full investment appraisal should be undertaken to evaluate all the options before a course of action is decided upon.

1 mark per appropriate comment to a maximum of (3)
Credit to be given for other relevant points

(20)

Question 6

(a) (i) Under *FRS 2 Accounting For Subsidiary Undertakings*, MSL is a subsidiary of GHA as GHA owns 90% of its share capital and hence controls MSL.

FRS 2 requires that where an organisation controls another organisation, group accounts need to be produced. The financial results of the subsidiary need to be reported in the group accounts.

Under FRS 2, all the assets, liabilities, incomes and expenditures of MSL should be consolidated into the group's balance sheet regardless of the fact that GHA does not own 100% of its share capital.

The 10% interest owned by the employees will then be shown as a minority interest at the bottom of the balance sheet and income and expenditure account.

1 mark per relevant point to a maximum of 3

(ii) FRS 2 requires that any transactions between organisations within the group need to be adjusted so that only transactions between the group and the outside world are reported in the group accounts. Therefore, whilst MSL's own individual accounts will include all transactions that it entered into in the year, the transactions between GHA and MSL will need to be eliminated in the consolidated group accounts.

Up to 1 mark for explanation of elimination

£207,000 income invoiced by MSL to GHA needs to be eliminated via the following consolidation adjustment:

Dr Income £207,000
Cr Maintenance Expenditure £207,000

The £84,000 unpaid invoices need to be eliminated from MSL's debtors and GHA's creditors as follows:

Dr Trade creditors £84,000
Cr Trade debtors £84,000

1 ½ marks for journal entries

These journal entries have no impact on the group's reported surplus or net assets ½

(iii) Under *FRS 9 Associates and Joint Ventures* Good as New Limited is a Joint Venture as it is jointly controlled by GHA and another party.

Under FRS 9, joint ventures must be consolidated into group accounts, but unlike consolidating a subsidiary where all the assets, liabilities, incomes and expenditures are included, the stakeholder in a joint venture will only consolidate a proportional value of the joint venture.

Therefore, GHA's consolidated accounts will include only 50% of Good As New Ltd's assets + liabilities + income + expenditure and no minority interest is included.

1 mark per relevant point up to a maximum of 3

(iv) Credit to be given for all reasonable examples, eg adjustments to align accounting policies if parent and subsidiary have for example different policies regarding revaluing fixed assets, eg adjustments for alignments of year-ends if the subsidiary does not have the same year-end as parent. *1*

(10)

(b) (i) Under *SSAP 4 Accounting for Government Grants*, grants received to fund capital expenditure should be included within deferred income in the balance sheet and then released over the life of the asset to which it relates.

However, the *Statement of Recommended Practice (SORP) for Registered Social Landlords* requires that housing associations depart from the benchmark treatment in SSAP 4 and to net the Social Housing Grant (SHG) off the value of housing stock held in the balance sheet. The grant remains in the balance sheet until the housing stock is sold, at which point it is either repaid to the Housing Corporation or recycled against new housing stock purchases.

This treatment is considered appropriate as the accounts of a housing association would not provide a 'true and fair view' if the SSAP was applied conventionally. This treatment does contradict best practice indicated by SSAP4 and the requirements of the Companies Act to show income and expenditure gross.

1 mark per relevant point to a maximum of 3

(ii) **2006/07 depreciation charge:**

	£
Gross cost of housing stock	3,200,000
Less 25% SHG	(800,000)
Net cost of housing stock	2,400,000
30 years straight line depreciation	80,000

1

Net book value as at 31 March 2007:

	£
Net cost of housing stock	2,400,000
Accumulated depreciation:	
Opening	(1,900,000)
Charge for year	(80,000)
Closing net book value	420,000

1

(5)

(c) Advantages include:

- Greater comparisons can be made both across the UK public services and as WGA extends across over organisations.
- Provides for the first time a complete picture of the financial performance of the public services.
- Aid financial planning and monitoring. Will also be able to support better non-financial planning as it will be clearer where investment is needed.
- Increase accountability to stakeholders as it will become clearer to stakeholders where funds have been spent and what has resulted from this investment.
- Encourage more unified approach to financial reporting across the UK public sector, where different sectors (eg central government and local government) currently have significant differences. This in turn should enhance the usefulness of the financial statements of individual organisations and aid decision making.
- Improve capital planning as a comprehensive set of information on fixed assets will be available.
- Provide Parliament and other users with an overall audited view of the performance of the public services.

Disadvantages

- Time and cost taken, both by individual organisations providing the information required and the consolidation process itself.

1 mark per advantage or disadvantage up to a maximum of 5

(20)