CIPFA

FINANCIAL AND PERFORMANCE REPORTING

Diploma stage examination

3 June 2008

MARKING SCHEME

AT THE HEART OF YOUR CAREER

Question 1

(a) Capital adjustment account

			5,901	Opening balance	
½	Disposal (GF)	1,500	1,010	Write out additional depreciation (RR)	*1*
½	Depreciation (GF)	8,279	500	Write out revaluation on disposed asset (RR)	*1*
½	Permanent impairment (GF)	2,000	9,000	MRP (GF)	½
			300	Capital receipts applied (UCR)	½
			200	Direct revenue funding (GF)	½
	Closing	5,132			

(5)

(b) Cash flow statement for the year ending 31 March 2008 for Apple County Council

	£000	£000	
Revenue Activities			
Cash outflows			
Employees	72,682		
Other expenses	19,581		
		92,263	
Cash inflows			
Council tax receipts	(38,554)		
Government grants	(61,977)		
Other income	(1,112)		
		(101,643)	
Net cash inflow from revenue activities		**(9,380)**	
Returns on investment and servicing of finance			
Interest paid	1,236		½
Interest received	(2,318)		½
		(1,082)	
Capital activities			
Purchase of fixed assets (w2&3)	3,000		
Disposal of fixed assets (w1 or part a)	(1,500)		
		1,500	
Management of liquid resources			
Decrease in short term investments (500-600)		(100)	½
Financing		(2,135)	½
(Increase)/Decrease in cash		**(11,197)**	

Apple County Council: Reconciliation of revenue activities to net cash flow.

		£000	
Deficit for the year		866	
Add Depreciation		(8,279)	½
Non cash pension costs		(4,150)	½
Add impairment		(2,000)	½
Interest payable		(1,236)	½
Interest receivable		2,318	½
Pension cash paid		3,200	½
Movement in stock	(314-306)	8	½
Movement in debtors	(1,244-1,474)	(230)	½
Movement in creditors	(1,913-1,790)	123	½
Net cash flow from revenue activities		(9,380)	

Presentation of statements 1

Working 1: Usable Capital Receipts Reserve

			420 Opening balance	
	Used in the year (CAA)	300	1,500 Disposal (GF – balancing figure)	
	Closing	1,620		

(Students may calculate disposals through the CAA)

Working 2: Revaluation Reserve

			3,977 Opening balance	
1	Write out additional depreciation (CAA) 1,010		10,000 Revaluation (FA – balancing figure)	*1*
1	Write out revaluation on disposal asset (CAA)	500		
	Closing	12,467		

Working 3: Fixed asset account

	Opening balance	41,245		
			8,279 Depreciation (I&E)	½
½	Revaluation (RR)	10,000	2,000 Impairment (I&E)	½
1	Purchases (cash – Balancing figure) 3,000		1,500 Disposals (I&E)	½
			42,466 Closing	

(15)
(20)

Question 2

(a) Lenton NHS Trust: Income and expenditure account for the year ended 31 March 2008

		£'000	
Income from activities	(68,000+3,500 - 125)	71,375	½
Other income	Transfer from donation reserve	347	½
Operating expenses	Working 1	(66,551)	
Operating surplus		5,171	
Loss on the sale of fixed assets	Working 2	(135)	½
Surplus before interest		5,036	
Interest receivable		356	
Interest payable: unwinding the discount	Working 3	(6)	½
Surplus before dividends		5,386	
Public dividend capital dividends payable	(1,100 + 1,100)	(2,200)	½
Retained surplus for the year		3,186	

Working 1: Operating expenses

		£'000	
Per TB		38,400	
Per TB		17,980	
Per TB		6,146	
Depreciation	Working 4	3,995	½
Write off of debt	(from N5)	30	½
		66,551	

Working 2: Loss of disposal

NBV of disposal: 306k – 61k = £245k *1*

Proceeds received = 110k, therefore loss of £135k

Working 3: Charge for unwinding the discount

Discount rate for 2 years' time: $(1/1.022)^2 = 0.96$ (to 2dp)

Discount rate for 3 years' time: $(1/1.022)^3 = 0.94$ (to 2dp)

Provision required = (300/0.94) x 0.96 = £306k *1*

Therefore adjust provision by £6k

(b) Lenton NHS Trust: Balance sheet as at 31 March 2008

		£'000	£'000	
Land	Working 4		7,437	
Buildings			45,216	
NHS equipment			6,527	
Donated equipment			1,183	
			60,363	
Current assets				
Stock		250		
Debtors	(1,750 – 30 – 125)	1,595		*1*
Cash		140		
		1,985		
Creditors	(2,560 + 1,100)	(3,660)		*½*
Net current assets			(1,675)	
Total assets less current liabilities			58,688	
Provisions for liabilities and charges	(300 + 16)		(306)	*½*
Total net assets			58,382	
Taxpayers' Equity				
Public Dividend Capital			47,300	
Revaluation reserve	Working 5		6,110	
Donation reserve	Working 6		1,183	
Income and expenditure reserve	Working 7		3,789	
			58,382	

Working 4: Depreciation and fixed asset entries

	£'000 Land	£'000 Buildings	£'000 Equipment (NHS)	£'000 Equipment (donated)	
Opening balance	7,525	45,690	12,200	1,700	
Impairment	(125)				*½*
	7,400				
Indexation	37	685	244	34	*1*
Total	7,437	46,375	12,444	1,734	
Additions			285		*½*
Disposals			(306)		*½*
Total	7,437	46,375	12,423	1,734	
Accumulated depreciation opening balance			3,400	200	
Backlog depreciation			68	4	*½*
Depreciation for year		1,159	2,489	347	*1 ½*
Depreciation on disposals			(61)		*1*
Total		1,159	5,896	551	
NBV	7,437	45,216	6,527	1,183	

Depreciation charge 1,159 + 2,489 + 347 = 3,995

Working 5: Revaluation reserve

		£'000	
Per TB		5,690	
Impairment		(125)	½
Indexation - land		37	
Indexation - buildings		685	½
Indexation - equipment		244	
Backlog depreciation		(68)	½
Historic cost depreciation adjustment - buildings	(1,159 – 1,100)	(59)	½
Historic cost depreciation adjustment - equipment	(2,489 – 2,200)	(289)	
Realised revaluation on sale of equipment (W8)		(5)	½
		6,110	

Working 6: Donation reserve

	£'000	
Per TB	1,500	
Indexation – equipment donated	34	½
Backlog depreciation	(4)	½
Depreciation transfer	(347)	½
	1,183	

Working 7: Income and expenditure reserve

	£'000	
Per TB	250	
Historic cost depreciation adjustment - buildings	59	½
Historic cost depreciation adjustment - equipment	289	
Retained surplus for year	3,186	½
Realised revaluation on sale of equipment (W8)	5	½
	3,7989	

Working 8: Realised revaluation reserve on sale of equipment

	£'000	
Revaluation reserve for disposed asset (indexation)	6	½
Historic cost depreciation adjustment ((306/5) – (300/5))	(1)	½
	5	

Presentation of I&E account and balance sheet ½

(20)

Question 3

(a) Heritage assets are those that are held for the nation's heritage. They can be either operational, for example, 10 Downing Street or The Admiralty, or non-operational, for example, archaeological sites. They are disclosed on central government balance sheets within the appropriate classes of asset, for instance, land and buildings excluding dwellings, or antiques and works of art. The Financial Reporting Manual specifies how fixed assets should be grouped on central government balance sheets.

2

Under FRS 15 organisations have the choice of valuing their tangible fixed assets at historical cost or revaluing each class of asset on a five-yearly basis and recording assets at current valuation. The Financial Reporting Manual requires that central government bodies adopt the revaluation approach and that tangible fixed assets should be disclosed at the lower of replacement cost or recoverable amount.

1

Operational heritage assets are valued according to their asset class and depreciated. Non-operational assets are valued on one of two bases. Where there is a market in the type of asset, the asset should be valued at the lower of net realisable value or depreciated replacement cost.

1

If there is no market available to determine replacement cost the Financial Reporting Manual requires that they should be valued at the depreciated replacement cost or if the asset would not be rebuilt the asset should be shown as nil on the balance sheet. *1*

Other valid comments should attract credit

(5)

(b) Central government organisations need to demonstrate efficient use of public funds in the way they produce and manage their fixed assets. Many public service organisations, including central government ones, make a charge on the value of some or all of their assets in their accounts called the cost of capital charge. It attempts to represent the opportunity cost of tying up resources in fixed assets as opposed to other areas, and can be seen as a comparable equivalent to the private sector's Return on Capital Employed ratio.

1

The charge is calculated as notional interest rate (3.5%) x average relevant net assets.

1

Relevant net assets are defined as total net assets less the net book value of donated assets, less cash held with the OPG, less debtor balances in respect of amounts due from, or creditor balances in respect of amounts due to, the Consolidated fund, less investments in other bodies where a higher rate of return on the assets of the fund has been specified.

2

This is a notional figure which means that no cash actually passes in respect of the charge. *1*

Other valid comments should attract credit

(5)

(c)

Differences	Why they occur
Trading funds produce an Income and Expenditure Account.	Trading Funds are quasi-commercial, self-financing organizations, so need to show whether they have achieved a surplus or deficit. The identified surplus/deficit can be used as a performance measure. Comparison with private providers can more easily take place with an I&E account.
Departments produce Operating Cost Statements.	Meet requirements of Government Resource and Accounts Act 2000. Shows net cost to taxpayer of providing service, or running department. The net cost shows the amount of resource invested in the department for the year.
Departments' OCS show performance on a segmental basis.	This shows how resources have been spent on different programmes/meeting different objectives.
Trading funds produce a balance sheet showing they are largely financed by PDC and loans.	Trading Funds are quasi-commercial and can access loans.
Departments produce a balance sheet largely financed by the General Fund.	Department will receive an allocation of resources each year through the Parliamentary vote system (accounted for through the General Fund).
Trading funds produce a statement of total recognised gains and losses.	Trading funds are responsible for their bottom line and don't receive additional funding from the consolidated fund, therefore surplus/deficit for the year needs to be reported in the STRGL.
Departments produce a statement of gains and losses.	The net cost for departments is not a 'loss' and is therefore excluded from the statement.
The cash-flow statement for trading funds follows FRS1.	The statement mirrors the format required by companies and may include all applicable headings under FRS 1.
The cash-flow statement for Department complies with FRS 1 but with fewer headings.	Departments comply with FRS 1, but are only required to show cash-flows from operating activities, capital activities, payments to the Consolidated Fund and financing from the Consolidated Fund.
Additional statements required by Department – Statement of operating costs by Departmental Aim and Objectives, and Statement of Parliamentary Supply.	These demonstrate the Department's accountability and stewardship of funds and are required per the Government Resource and Accounts Act 2000.

(1 mark for each point made where both a difference and the reason for the difference are identified, up to a maximum of (6)

Other valid comments should attract credit

(d) The central government sector complies with FRS 11 in relation to accounting for impairments. *1*

Dr Operating Account £24k
Cr Fixed Assets £24k *1*

Dr Revaluation Reserve £12k
Cr General Fund £12k *1*

(3)

Presentation *(1)*

(20)

Question 4

Presentation and answer written as report format ½

(a) Analysis of financial performance for the year

Calculation of whether 3.5% target has been met

3,090/102,040=3.0% ½

This target has not been met. The University is therefore at risk of fluctuating expenditure and may not have sufficient resources to cope with increases in expenditure or decreases in income in the future. ½

Calculation of whether 2% target has been met

On the face of it the University seems to have met the target:

3,890 / 116,700 = 3.3% ½

Full credit given to students removing investment income and/or endowment transfer

There should be caution exercised, however, because £2m income received this year will not be received in the future. There has also been sale of fixed assets, which may not recur in the future. ½

"True" performance against the 2% target is as follows to better assess future sustainability:

	£000	
Surplus for the year	3,890	
Less: grant no longer received	(2,000)	½
Less: Profit on sale of fixed assets	(1,260)	½
Revised surplus for the year	630	
Assessment of achievement of the 2% target	0.54%	

This re-analysis shows the University is in danger of not meeting its targets in the future and will not have funds available to reinvest in the University.

Sensible comment ½

Review of non teaching activities

Negative contribution from accommodation = £3,650 – 3,500 = (£150)

Contribution from catering = £4,000 - £3,000 = £1,000

Contribution from IMPALA Business School = £11,000 - £9,500 = £1,500

Three calculations gives 1

Overall non teaching activities are making a contribution, but provision of student accommodation is operating at a loss. ½

The IMPALA Business Network is making a profit mark-up margin of 15.8%, less than the 20% target. (1,500 / 9,500 = 15.8%) ½

Although the IMPALA Business Network is not achieving the desired profit, it has contributed an additional £1,500,000 of net income to the University, so should not be stopped on the basis of not meeting their performance target. This may affect the Governors thoughts on making the network a business. ½

Other valid points to attract credit
Marks for calculation/ review of financial performance up to a maximum of 6

Other financial factors to consider

Additional information that may be required include the cash flow statement and statement of gains and losses.

Financial performance can be better assessed when compared to others, so information from other organisations would be useful. How well does Samden compare?

To make an assessment of the University previous financial information is required to identify trends and see if performance is improving and analyse if this year was an exceptional year.

Other valid points to attract credit
1 mark per point up to a maximum of 2 marks to be given for additional financial analysis

Other non financial factors to consider

The financial analysis does not consider the quality of the University's provision. Any performance indicators for the University should be reviewed and analysed.

The University's performance in league tables would indicate good performance.

As the University's customer, student surveys would indicate the quality of provision.

Other valid points to attract credit
1 mark per point to be given for non financial factors up to a maximum of 2

Conclusion

Conclusion that the University's long term financial sustainability is in doubt without the £2m research grant. ½

Recommendations / Actions

Is it possible to charge more for services? Will additional charges affect the demand for courses? A market analysis would be required to determine if prices should be raised. Consideration should be given to reputation, legality and market, when raising prices.

Can we reduce our costs further? A review of costs would identify scope for savings.

Can any activities be outsourced to save money?

Is it possible to merge with or go into partnership with any neighbouring Universities to share costs and increase provision?

Can we reclassify our endowment expenditure to meet costs and maximise our endowment income?

Now that the research project has been stopped and the grant no longer received, do we have spare capacity to bid for more research funding?

Other explained and relevant recommendations/ actions should attract credit 1 point per relevant comment up to a maximum of 3

(14)

(b) Explanation of endowments

Endowments are given to the University for use and generation of income. Endowments can be restricted or unrestricted. Income can only be recognised in the income and expenditure account to the level to which conditions have been met. *1*

In the case outlined, restricted cash has been received for £50,000, but eligible expenditure has been made for only £15,000. This would have been recognised in the accounts as:

Dr Cash	50,000	½
Cr I&E account: Endowment and Investment Income	50,000	½
For the receipt of income		
Dr I&E account: Expenditure (staff)	15,000	½
Cr Endowment Assets: Cash	15,000	½
For eligible expenditure		
Dr I&E account: Appropriations	35,000	½
Cr Endowment Reserve: Restricted	35,000	½
To account for income exceeding eligible expenditure		

(4)

(c) IMPALA Business Network

In this case the IMPALA Business Network would be a subsidiary under FRS 2: Accounting for Subsidiary Undertakings. *1*

100% of the Network's assets would be included in the accounts, and Johnden's element would be shown as a minority interest. *1*

(2)

(20)

Question 5

(a) The four broad areas of regulation are:

Parliamentary legislation: this defines the purpose and aims of an organisation as well as outlining what an organisation can or cannot do and how its financial performance should be reported. *1*

Accounting standards (SSAPs and FRSs): these do apply to the public services (although sometimes their application will differ slightly from the private sector application). *1*

Accounting practice: this includes statements of recommended practice (SORPs) or sector specific manuals that identify how accounting standards should be applied to each sector. *1*

Specific rules: each sector may develop rules to cover specific areas of reporting financial performance. These may exist as part of sector specific manuals or SORPs or may be published separately. *1*

(4)

(b) The three elements of VFM are Economy (costs of inputs to a service), Efficiency (getting the maximum outputs from a given level of resources), and Effectiveness (how well are we delivering the service in terms of what is (achieved). *3*

Ratio analysis concentrates on profit and is predominantly used in the private sector where profit generation is usually the prime objective.
In the public sector profit does not represent the key objective of the organisations. VFM analysis considers the quality of service delivery as well as the cost of the service. *3*

(6)

(c) **Economy**
Cost of maintenance function
Cost of materials employed

Efficiency
Number of repairs per maintenance team
Complaints dealt with per member of staff

Effectiveness
Amount of time properties are left void
% of rent collected within 30 days
Score of above average on tenant satisfaction surveys

½ mark per PI up to a maximum of (3)
Other relevant PIs to attract credit

(d) The five types of accountability are:

Financial accountability
One of the most obvious areas of accountability is financial accountability or stewardship. Stewardship is a very old concept and refers to the entrustment of assets to a steward. Stewardship (financial) accountability involves the demonstration that these assets have not been misappropriated, but have been put to proper use. Stewardship accounting, therefore, entails the production of a balance sheet and income statement and the validation of these financial statements by an independent auditor who certifies their truth and fairness.

Financial accountability is not considered solely through published statements. Many public bodies such as local authorities must also publish their operational and strategic plans that are open to public scrutiny. *2*

Parliamentary accountability
The oldest form of accountability in Britain is Parliamentary accountability. This is a series of procedures whereby Parliament is able to carry out a post-event check on the expenditure of public monies to ensure that the expenditure has been in accordance with the purposes approved by Parliament. All public sector bodies derive their authority from Parliament and are ultimately accountable to Parliament. *1*

Political accountability
Accountability can also be seen in the context of representative democracy. Elected politicians are given a mandate to govern by the electorate. In order to operate they will delegate duties and the authority to take action and decisions to civil servants or officials. This produces a hierarchy of accountability where the officials are accountable for their actions to elected politicians and the politicians are, in turn, accountable to the people at elections. This political accountability has tiers of accountability to ministers, to local authorities and devolved administrations, to Parliament and ultimately to the electorate. *1*

Legal accountability
This is the duty of entities and officials to ensure that their actions remain within the law and to avoid activity by those with delegated authority which goes beyond their legal powers. *1*

Managerial accountability
In recent years, in the light of new public management and consumerism, public services have also been seen as being accountable to individual customers for the quality of service delivered. This, together with increased decentralisation, has led to a higher profile being given to managerial accountability. Managerial accountability has grown in significance, particularly since the introduction of such programmes as the Financial Management Initiative (1982) and the Next Steps Initiative (1988), both of which sought to promote accountable management in the civil service.

Managerial accountability can also embrace the concept of ethical accountability. This covers broad issues, from being seen to do the most appropriate thing for the community to demonstrating transparency of decisions. This is a significant area of management where we must work closely with other professions such as personnel development, communications and health and safety.

Perhaps the most important aspect of managerial accountability in the context of the Financial and Performance Reporting module is that which requires public bodies to demonstrate that they have achieved their policy objectives while also

attaining value for money (VFM). The absence in the public sector of profit as a convenient indicator of performance has enhanced the importance of this aspect of managerial accountability in a vital complementary role to financial accountability. Those who have responsibility delegated to them are required to evidence the delivery of agreed tasks while meeting agreed (or imposed) targets or other measures of performance. *2*

(7)

1 mark for point well explained
Other relevant points to attract credit

(20)

Question 6

(a) (i)

	4,000,000	Gross value	
Less	2,000,000	SHG (4,000,000*50%)	*1*
Depreciable amount	2,000,000		*1*
2,000,000/50	40,000	Depreciation for the year	*1*
4,000,000-1,500,000-40,000	2,460,000	Closing NBV	*1*

(ii) SHG are not amortised over the life of the asset. Assets are depreciated net SHG. SHG repaid or recycled when stock is sold. *1*

(5)

(b) (i) Charities broadly apply SSAP 4: Accounting for government grants. Where conditions are not met in full, the amount is transferred to the balance sheet as deferred income. *1*

(ii)

DR	Cash	100,000	
CR	SOFA: incoming resources (Grants)	100,000	*1*
DR	SOFA: Expenditure	80,000	
CR	Cash	80,000	½
DR	SOFA: incoming resources (transfer to deferred income)	20,000	
CR	Deferred income	20,000	½

(iii)

DR	Deferred income	20,000	
CR	SOFA: incoming resources (transfer to deferred income)	20,000	*1*

(4)

(c) (i) A local authority can finance its capital expenditure through:

- Prudential borrowing (loans)
- Prudential borrowing (leases)
- Capital receipts
- Capital grants
- Direct revenue finance
- PFI. *3*

(ii) Before 1 April 2004 capital expenditure was controlled through the credit approvals system.
Since the Local Government Act 2003, supported by the Prudential Code, came into effect on 1 April 2004 Local Authorities have been able to determine their own levels of borrowing. They need to demonstrate that their borrowing is prudent, sustainable and affordable.
They are also controlled by the revenue effect of financing on the levels of council tax. *2*

(5)

(d) This is an Infrastructure Asset, held on the balance sheet at depreciated historical cost, so it is on the balance sheet at £0. *(2)*

(e) (i) Commitment accounting relates primarily to non-employee costs. Transactions are recognised when organisations are committed to spending on them. This is usually when an order is issued or received.

Commitment accounting is primarily a function of budgetary control to allow an organisation a clear view of its financial position.

1 mark per well described relevant point up to a maximum of 2

(ii) Commitment accounting systems are complex to run. When the actual invoice is received adjustments may have to be made for the actual amount, which may differ from the order.

At the year end, any outstanding commitments will have to be removed in order to present the accounts on an accruals basis, which adds to time, complexity and cost.
It provides budget holders with a clearer idea of their expenditure to manage their costs more effectively.

1 mark per well described relevant point up to a maximum of 2

(4)

(20)