

FINANCIAL AND PERFORMANCE REPORTING

Diploma stage examination

5 June 2007

From 2.00pm to 5.00pm
plus ten minutes reading time from 1.50pm to 2.00pm

Instructions to candidates

There are **six** questions on this question paper

Answer **five** questions in total

Both compulsory questions from **Section A**

Three of the four questions from **Section B**

The questions in Section A carry, in total, **40** marks

The questions in Section B each carry a total of **20** marks

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examination room.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

Formula sheets, Proforma booklets, graph paper and cash analysis paper are available from the invigilator, where applicable.

Candidates may use the proforma sheets provided and submit them as part of their answer.



SECTION A (Compulsory – answer both questions)

1 The Energy Research Agency is a non-supply financed central government agency that was set up five years ago to promote alternative energy sources. Its trial balance as at 31 March 2007 was as follows:

	Dr £'000	Cr £'000
Fixed assets as at 1 April 2006		
- Land	4,792	
- Buildings	3,460	
- Computers	764	
- Scientific equipment	1,658	
Accumulated depreciation as at 1 April 2006		
- Buildings		712
- Computers		514
- Scientific equipment		978
Creditors		550
Debtors	1,616	
Stock as at 1 April 2006	729	
Income from sale of solar energy technology to private companies		4,360
Income from secondment of agency staff to private companies		5,243
Fixed asset disposal proceeds		505
EU Green Energy grants received		2,521
Cash at bank	204	
Retained surplus as at 1 April 2006		853
Revaluation reserve as at 1 April 2006		2,459
Public dividend capital		1,764
Loan from National Loans Fund (repayable 2018)		500
Staff costs	4,920	
Repairs and maintenance	356	
Other operating expenses	2,460	
	20,959	20,959

Additional Information:

1 No entries have been made in relation to fixed assets.

Indexation rates for the year were as follows:

	31/03/06	31/03/07
Land	102	102
Buildings	100	112
Computers	95	88
Scientific equipment	103	103

The opening revaluation reserve relates to land and buildings only.

Fixed assets are depreciated over a 5-year useful economic life, except buildings, which all have an estimated life of 50 years.

On 1 April 2006, land was revalued upwards by £0.3m as part of the agency's rolling 5-year revaluation programme.

During the year:

- a rich benefactor donated her seaside home to the agency for use as a wave energy research facility. The building is valued at £0.5m;
 - buildings with a cost of £450,000 (before 06/07 indexation) which were purchased in May 2003 were sold for £505,000. As at 31 March 2006, the revaluation reserve included £104,000 in relation to this building.
- 2 Repairs and maintenance expenses consist of the cost of building an extension to one of the agency's buildings in order to accommodate a new research team.
 - 3 The grant income of £2,521,000 in the trial balance relates to an EU grant to fund research for two years into wind farm energy. The agency estimates that it spent £1.3m of the grant during 2006/7.
 - 4 Other operating expenses include £34,000 interest paid.
 - 5 The Department for Environment has informed the agency that they will be required to pay a PDC dividend for 2006/7 of £93,000.
 - 6 The stock held at 31 March 2007 was valued at £198,000.
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• **Requirement for question 1**

Prepare the Energy Research Agency's Income and Expenditure Account for the year ended 31 March 2007, and its Balance Sheet at that date.

(20)

2

Gannymeade City Council's balance sheets for the past two years were as follows:

	2002/3 £'000	2003/4 £'000
Fixed assets	130,002	130,900
Current assets:		
Stock and WIP	2,896	2,138
Debtors	2,999	3,177
Investments	1,038	1,038
	<u>6,933</u>	<u>6,353</u>
Current liabilities:		
Bank overdraft	(11,548)	(5,236)
Creditors	(1,772)	(1,908)
	<u>(13,320)</u>	<u>(7,144)</u>
Long term borrowing	(90,465)	(95,965)
Deferred liabilities	0	(167)
Net assets	<u>33,150</u>	<u>33,977</u>
Fixed asset restatement account	19,660	20,071
Capital financing account	5,241	11,515
Usable capital receipts	3,861	1,111
Balances	4,388	1,280
	<u>33,150</u>	<u>33,977</u>

Additional information:

- 1 The Asset Management Revenue Account for 2003/04 was as follows:

AMRA (£'000)			
Depreciation	6,383		
Actual interest (including finance lease)	517	Asset rentals	7,129
To consolidated revenue a/c	229		
	<u>7,129</u>		<u>7,129</u>

- 2 The minimum revenue provision for the year has been calculated as £6,004,000.
- 3 The creditors balance as at 31 March 2004 includes £345,000 in respect of a new computer system. There were no capital creditors as at 31 March 2003.
- 4 Additions to fixed assets during the year included £3,800,000 through direct revenue financing and £200,000 through a finance lease. The finance lease was for several new vehicles (total fair value £200,000) with five annual lease payments of £50,000.

5 Revenue cash flows for the year were as follows:

	£'000
Salary, tax, NI & pension payments	361,752
Other operating expenditure	78,581
Payment of non-domestic rates to national pool	74,123
Fees and charges received	51,508
Council tax received	159,314
Revenue support grant received	172,694
Receipt of non-domestic rates from pool	138,507

• **Requirement for question 2**

Prepare the following for Gannymeade City Council for the year ended 31 March 2004:

- | | |
|---|----|
| (a) Note 1, the reconciliation of surplus/deficit to net operating cash flow. | 6 |
| (b) The cash flow statement, using the direct method. | 12 |
| (c) The analysis of net debt. The reconciliation of net debt to cash flows is not required. | 2 |

(20)

SECTION B (Answer three from four questions)

3

The audited financial statements for Linhey PCT's 2006/7 financial year are as follows:

Linhey Primary Care Trust Operating Cost Statement for the year ended 31 March 2007

	£'000
Commissioning	
Gross operating costs	131,548
Less: Miscellaneous income	<u>(823)</u>
Net operating costs	130,725
Provider	
Gross operating costs	8,921
Less: Miscellaneous income	<u>(1,568)</u>
Net operating costs	7,353
Primary Care Trust net operating costs before interest	<u>138,078</u>
Interest payable	0
Primary care trust net operating costs	<u><u>138,078</u></u>

Linhey Primary Care Trust Balance Sheet as at 31 March 2007

	£'000
Fixed assets	
Intangible assets	40
Tangible assets	<u>7,658</u>
	7,698
Current assets	
Stocks and work in progress	40
Debtors	2,417
Cash at bank and in hand	<u>2</u>
	2,459
Total current assets	
Creditors: amounts falling due within one year	(7,648)
Net current assets/(liabilities)	(5,189)
Total assets less current liabilities	<u>2,509</u>
Creditors: amounts falling due after more than one year	0
Provisions for liabilities and charges	<u>(365)</u>
Total assets employed	<u><u>2,144</u></u>

Financed by:

Taxpayers' equity

General fund	414
Revaluation reserve	1,236
Donated asset reserve	494

Total taxpayers' equity	<u>2,144</u>
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**Linhey Primary Care Trust Cash Flow Statement for year ended 31
March 2007**

	£'000
Operating activities	
Net cash outflow from operating activities	(137,856)
Servicing of finance	0
Capital expenditure	
Payments to acquire intangible fixed assets	0
Payments to acquire tangible fixed assets	(1,382)
Receipts from sale of tangible assets	<u>811</u>
Net cash outflow from capital expenditure	(571)
Net cash outflow before financing	<u>(138,427)</u>
Financing	
Net parliamentary funding	138,205
Capital grants received	<u>367</u>
	138,572
Increase in cash	<u>145</u>

Additional Information:

- 1 Medical equipment used by the PCT's providing arm was found to be impaired by £79,000 during the year due to overuse and poor maintenance.
- 2 Fixed assets disposed of during the year yielded a net profit on disposal of £103,000.
- 3 The PCT commissioned £7.65m of healthcare services from itself during the year.
- 4 Included within gross operating costs are £3.2m in respect of non-cash limited General Medical Services payments.

- 5 The PCT was allocated the following limits by the Department of Health for the 2006/07 year:

	£'000
Resource limit (not yet adjusted)	133,133
Capital resource limit	850
Cash limit	136,995

- 6 The provisions balance of £365,000 in the balance sheet relates to a harassment claim brought about during the year by three midwives employed by the PCT. The PCT is unable to transfer the obligation to settle the claim to the NHS Litigation Authority.

• **Requirement for question 3**

- (a) Assess and provide a full interpretation of Linhey PCT's performance against the following four targets for the year:

1. Capital Resource Limit
2. Resource Limit
3. Cash Limit
4. Provider Arm Break-Even 15

- (b) Explain **two** other targets the PCT is required to report in its financial statements. 2

- (c) How would Linhey PCT's reporting of financial targets differ to that of the local unitary authority, Linhey Borough Council? 3

(20)

4

Sunhill Housing Association (SHA) was set up in 1989 to provide social housing in an extremely deprived area of London. During the 2006/07 financial year, it has experienced many problems due to the resignation of the Finance Director and most of the key finance and credit control personnel. Its financial statements for the past two years are as follows:

	31 March 2006 £'000	31 March 2007 £'000
Income and Expenditure Account		
Income		
Social housing lettings	2,667	2,647
Donations	354	301
	3,021	2,948
Expenditure		
Staff costs	(984)	(1,102)
Maintenance expenditure	(234)	(273)
Depreciation	(901)	(980)
Rent losses from bad debts	(152)	(701)
Other operating expenses	(351)	(735)
	(2,622)	(3,791)
Operating surplus / (deficit)	399	(843)
Interest receivable	3	0
Interest payable	0	(58)
Surplus / (deficit) for the year	402	(901)
Balance Sheet		
Fixed assets		
Housing properties - depreciated cost	8,465	8,501
Less social housing grant	(3,730)	(3,730)
	4,735	4,771
Other fixed assets	466	438
	5,201	5,209
Current assets		
Stocks	82	96
Debtors	431	883
Cash at bank and in hand	72	0
	585	979
Creditors amounts due within 1 year		
Trade creditors	(57)	(397)
Overdraft	0	(355)
	(57)	(752)
Total assets less current liabilities	5,729	5,436

Funded by:

Long term bank loan	0	250
Revenue reserve	1,983	1,082
Revaluation reserve	3,746	4,104
	<u>5,729</u>	<u>5,436</u>

You have recently been appointed as finance assistant to fill one of the staff vacancies and the new Finance Director has sent you the following e-mail:

To: Gina Gold, Finance Assistant
From: Adam Okaro, Finance Director
Subject: Analysis of 2006/7 Financial Statements

Gina,

The board of governors wants me to present this year's accounts to them at the board meeting next week. I need you to write me a memo that I can use to prepare for the meeting, which analyses SHA's financial performance.

I know this will be difficult as you and I have only recently joined SHA, so make sure that the memo includes a list of areas where we need further information in order to be able to draw conclusions.

Please focus your analysis on how SHA has performed against its 4 key financial targets, which are:

- 1) Earn a return on capital employed of at least 5%.
- 2) Maintain revenue reserves at a minimum level of 50% of the year's cash operating expenditure (defined as all operating expenses except depreciation).
- 3) Minimise bad debt write-offs by collecting 95% of rental income invoiced to tenants.
- 4) Pay trade suppliers within 30 days of invoice.

The governors are also keen to assess whether SHA should apply for a £3.2m bank loan in order to build some new flats for key workers on the Cole Lane Estate so please include any comments that you may have on whether this is a good idea at the present time.

Finally, could you also include any recommendations for improvements that we can make from 2007/08 onwards as I'm keen to show the board that the new finance team has lots of ideas on how to turn around SHA's financial performance.

Please send me the memo by the end of today. Many thanks,

Adam

• **Requirement for question 4**

Prepare the memo requested by the Finance Director, ensuring that you address all the issues raised in his e-mail.

(20)

5

You work in the finance department of Hockley Dogs Home, a registered charity. Mrs. Florence Cray, a retired veterinary surgeon who was recently appointed trustee of the charity, has left you a long telephone message with some queries on the Charity's draft accounts for the year-ended 31 July 2006.

- a) I seem to remember reading years ago that the government uses cash based accounting. I don't understand why the charity doesn't use this as it seems to be a lot easier to do and a lot simpler for people to understand when they read the accounts. What is this accruals based accounting that the accounting policies note talks about and how does it differ from cash accounting? Why are we wasting time with this complicated system?
- b) The charity's 100% owned trading arm, Hockley Canine Trading Ltd, has been included within the charity's consolidated accounts. Why is this? What rules are we following? Surely the reason that we set this up as a separate company was that they were to be run by different management as an arms length organisation, so it doesn't make sense to me to be showing their results as part of the charity.
- c) The accounting policies note talks about fund accounting – what is this? Private sector companies don't have different funds so I don't understand why a charity needs to complicate matters by having several funds.
- d) The accounts explain that a number of legacies left to us have been included in the accounts even though the charity received the money after the year-end. I don't understand why this is as it doesn't seem very prudent to recognise income before we receive it. What accounting rules are we following here?
- e) I was reading a very interesting article in the paper all about international accounting standards and how private companies are now using them instead of UK standards. I'd like to know whether the public sector in the UK is also using international standards, and what the charity follows when preparing its accounts.
- f) I've also been reading recently about the increasing amounts of corporate governance guidance and codes that private companies have to follow. Has all of this affected the public sector much? And do charities have lots of corporate governance rules to follow?

• **Requirement for question 5**

Write a letter to Mrs Cray in reply to her phone message. Ensure that you include explanations for all the questions that she has asked you.

Marks will be allocated as follows:

(a) Cash and accruals accounting	4
(b) Hockley Canine Trading Ltd	4
(c) Fund accounting	2
(d) Legacies	2
(e) International accounting standards	4
(f) Corporate governance	3 ½
	<i>Presentation ½</i>
	(20)

6

Beechwood University is preparing its accounts for the year ended 31 July 2006. The following items still have to be finalised in the university's consolidated accounts:

- a) The university's endowments generated income of £380,000 during the year. All endowments are restricted endowments, and of the £380,000 income received, £235,000 has been spent on eligible expenditure during the year. The full income and expenditure has been recognised in the accounts, and the finance assistant was not sure whether any other entries are required.
- b) The chemistry department performed a review of its equipment during the year, and discovered equipment with a book value of £106,000 which is obsolete and not being used. As the equipment has not yet been disposed of, no entries have been made. The head of the chemistry department believes the equipment will have to be scrapped with no sale proceeds.
- c) During the year, the university's IT department developed computer software which it has negotiated to sell through a local IT company. It expects to start selling the product in 2007 at a substantial profit and the university's senior management team wishes to capitalise the costs of developing the software, which total £98,000. The finance assistant wasn't sure whether this is permitted under UK GAAP, so £98,000 development costs incurred are currently included within operating expenditure.
- d) The university's 100% owned conference company Campus Conferences Ltd (CC Ltd) has been invoiced a total of £120,000 during the year for the cost of university staff spending part of their time running conferences. At the end of the year, £65,000 of these invoices remains unpaid. The transactions have been recognised in the individual accounts of the university and CC Ltd but the finance assistant could not remember how to treat this transaction in the consolidated accounts.
- e) The university has entered into an agreement with a local language school to jointly run a Russian language programme. Under the terms of the agreement, the university will provide Russian language teaching staff for eight hours per week and in return will receive a percentage of all student fees. The university estimates that the cost of providing the staff is £14,000. The finance assistant was not sure how to treat this as he thought that some kind of consolidation might be required.

• **Requirement for question 6**

For each item above, explain the accounting standards to be followed and the correct accounting treatment. Your answer should include any journal entries that are required in order to correct Beechwood University's draft accounts. Marks are allocated as follows:

- | | |
|--------------------------------|-------------|
| (a) Endowment income | 4 |
| (b) Obsolete equipment | 4 |
| (c) Software development costs | 3 |
| (d) Campus Conferences Limited | 5 |
| (e) Russian language programme | 4 |
| | (20) |
-