FINANCIAL AND PERFORMANCE REPORTING

Diploma stage examination

3 June 2008

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 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 examinations room.

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

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.

AT THE HEART OF
YOUR CAREER

SECTION A (Compulsory)

1

Apple County Council's balance sheets for the last two years were as follows:

	2007/08 £000	2006/07 £000
Fixed assets	42,466	41,245
Stock	314	306
Debtors	1,244	1,474
Cash	3,975	0
Short term investments	500	600
Creditors (all due within 1 year)	1,790	1,913
Overdraft	0	7,222
Pension reserve	(5,323)	(4,373)
Long term loans	23,245	21,110
Net assets	18,141	9,007
Revaluation reserve	12,467	3,977
Pension reserve	(5,323)	(4,373)
Capital adjustment account	5,132	5,901
Usable capital receipts	1,620	420
General fund	4,245	3,082
	18,141	9,007

Additional information

1. The income and expenditure deficit for the year ending 31st March 2008 was £866,000.

2. During the year ending 31st March 2008 the transfer from the pension reserve to the general fund in relation to FRS 17 pension cost was £4,150,000. The cash based cost to the Authority for the same year was £3,200,000.

3. During the year ending 31st March 2008, the capital programme for Apple County Council was partly financed as follows:

	£000
Revenue contributions	200
Usable capital receipts	300

The remaining additions for the year were financed through prudential borrowing.

4. During 2007/08 an office building was found to be impaired by £2,000,000. This was considered a permanent impairment.

5. Depreciation for the year ending 2007/08 was £8,279,000.

6. The Authority has a policy of revaluing its assets on a rolling programme and made some revaluations during 2007/08.

7. The charge made to the revaluation reserve for 2007/08 and written out to the capital adjustment account to ensure that unrealised gains on revalued assets were not overstated was £1,010,000.

8. During 2007/08 a library building was disposed of. As recommended by the Local Government Statement of Recommended Practice, Apple County Council revalued the building to the disposal value to show no profit or loss upon disposal. £500,000 was in the revaluation reserve immediately prior to disposal relating to this asset.

9. The Authority does **not** reserve any of its capital receipts.

10. The Minimum Revenue Provision amount for 2007/08 was £9,000,000.

11. The following information was available relating to payments and receipts for Apple County Council in 2007/08:

	£000
Council tax receipts	38,554
Government grants	61,977
Investment income receivable	2,318
Other income	1,112
External interest payable	1,236
Employee costs (including pension cost)	72,682
Other expenditure	19,581

- **Requirement for question 1**

(a) Reconstruct the capital adjustment account for the year ending 31st March 2008. *5*

(b) Prepare the cash flow statement and note 1 to the cash flow statement (the reconciliation of operating activities to the net operating cash flow for the year) for Apple County Council for the year ending 31st March 2008. *15*

(20)

2

Lenton NHS Trust is a large trust based in the north of England. The following trial balance has been prepared for Lenton NHS Trust for the year ended 31st March 2008:

	£000	£000
Income from activities		68,000
Private patient income		3,500
Salaries and wages	38,400	
Supplies and services	17,980	
Miscellaneous expenditure	6,146	
Dividends paid	1,100	
Interest		356
Land (at 1 April 07)	7,525	
Buildings (at 1 April 07)	45,690	
Equipment - NHS (at 1 April 07)	12,200	
Equipment - donated (at 1 April 07)	1,700	
Accumulated depreciation - NHS (at 1 April 07)		3,400
Accumulated depreciation - donated (at 1 April 07)		200
Stock	250	
Debtors	1,750	
Cash	140	
Creditors		2,560
Provisions for liabilities and charges		300
Public dividend capital		47,300
Revaluation reserve		5,690
Donation reserve		1,500
Income and expenditure reserve		250
Suspense account – capital expenditure	285	
Disposals		110
	133,166	133,166

Additional information

1. Indexation has not yet been applied and the following indices have been issued by Treasury:

	%
Land	0.5
Buildings	1.5
Equipment	2.0

2. Depreciation has also yet to be charged for the year. Buildings have a remaining useful economic life of 40 years, while equipment is to be calculated using a standard life of 5 years.

3. Additional dividends in respect of public dividend capital amounting to £1,100,000 are still owing at 31st March 2008.

4. Land was independently revalued during the year and found to have been impaired by £125,000. This was due to a general market trend in the area. A balance of £200,000 is held in the revaluation reserve in respect of this asset.

5. Debtors have been reviewed at year end, and private patient debtors of £30,000 and NHS debtors of £125,000 are disputed. All NHS debtors are held with English NHS organisations, none of which are NHS Foundation Trusts.

6. Acquisitions financed by NHS funds in the year were limited to the purchase of equipment in January 2008. This has so far been recorded only in the suspense account.

7. Equipment with a gross current cost of £300,000 at 31st March 2007 was sold on 1st January 2008 for £110,000. This has so far been recorded only in the disposals account within the trial balance. The equipment had been purchased by the Trust on 1st February 2007.

8. The provision in the trial balance was established in March 2007 for a liability expected to arise in three years time. The liability is still anticipated to arise, now in two years time.

9. The depreciation charges on an historical cost basis for 2007/08 have been calculated as £1,100,000 for buildings and £2,200,000 for equipment.

- **Requirement for question 2**

(a) Prepare the income and expenditure account for Lenton NHS Trust for the year ended 31st March 2008. *6*

(b) Prepare the balance sheet for Lenton NHS Trust as at 31st March 2008. *14*

(20)

SECTION B (Answer three from four questions)

3

You are the financial accountant at The Department of Research, a central government department responsible for completing research projects and providing research advice and guidance to other government departments. Your finance assistant has recently been recruited to the post and has limited prior accounting experience and no previous experience of central government accounting. He has sent you an email containing a series of issues on which he would like more information or clarification:

To: Financial accountant
From: Finance assistant
Subject: Queries

Hi there,

As you know I am still very much finding my feet with this new role, and am keen to make sure I understand what I am doing. I would appreciate your comments and guidance on the following issues:

a) I have come across a class of fixed assets (heritage assets) that I have not heard of before. I would appreciate you letting me know what this asset class is referring to, and how these assets should be treated in terms of their disclosure and valuation on the balance sheet.

b) I have been asked to calculate something called a 'cost of capital charge'. I would like to know what this is, and how and why I calculate it. Someone described it as a 'notional cost', but again I haven't come across this description before so am unsure what this means.

c) I understand that some of my central government colleagues work within Trading Agencies rather than Departments. I am interested in the differences between the financial statements produced in Trading Agencies and those we produce and why those differences would occur.

d) I have also been asked to prepare the journal entries for dealing with a fixed asset that has been impaired by £24k where a revaluation reserve of £12k is held against the asset. I have been told this impairment is considered to be permanent. Clarification of the journal entries and appropriate guidance to follow would be useful.

Thanks so much for helping me out while I get to grips with my new role, and I look forward to hearing from you soon.

- **Requirement for question 3**

Draft an email response to the finance assistant in which you respond to each of his queries and questions. You should refer to relevant accounting standards and other appropriate regulation and guidance in your response. The mark allocation is as follows:

(a) Heritage assets. *5*

(b) Notional cost of capital charge. *5*

(c) Trading Agencies vs. Departments. *6*

(d) Impairment. *3*

Presentation 1

(20)

4

You are the financial director of Samden University. The University runs the IMPALA Business Network, an informal educational facility for local businesses to enable conferences, networking and social events.

You have received the following email from one of the University Governors:

To: Director of Finance
From: Governor Singer
Date: 3 June 2008
Subject: University Finance

Can you please produce a report addressing the following three issues for the Board?

1. Please can you provide an analysis of the University's financial performance for the year ended 31 July 2007? We Governors are concerned about the University's future sustainability and are looking for reassurances that the University's financial position is viable for the future.
2. I'm aware that a restricted endowment generated £50,000 cash income to help improve our library facilities. I know, as a result of this, we spent £15,000 on a library assistant on a temporary contract for the year to review our holdings and identify gaps in our materials. How will this income and expenditure be recorded in our accounts?
3. I believe the IMPALA Business Network is a true success story, and the board has been considering making the network a company, and retaining control and 75% of the shares, while allowing our neighbouring college, Johnden College, to hold 25%. If we did this, how would the Network be represented in the accounts in the future?

You have access to the University's financial information, a summary of which is provided below:

Samden University: Consolidated income and expenditure account for the year ending 31 July 2007

	£000	£000
Income		
Funding council grants	40,570	
Tuition fees and education contracts	17,000	
Research grants and contracts	20,340	
Other income	25,670	
Endowment and investment income	13,120	
Total income		116,700
Expenditure		
Staff costs	(68,840)	
Other operating expenses	(25,090)	
Depreciation	(4,250)	
Interest payable	(3,860)	
Total expenditure		(102,040)
Surplus on continuing operations after depreciation of tangible fixed assets at valuation and before tax		14,660
Profit on disposal of fixed assets		1,260
Surplus on continuing operations after depreciation of tangible fixed assets at valuation and disposal of assets but before tax		15,920
Taxation		0
Surplus on continuing operations after depreciation of tangible fixed assets at valuation, disposal of assets and tax		15,920
Transfer to accumulated income within specific endowments		(12,030)

Retained surplus for the financial year	3,890

Samden University: Consolidated balance sheet as at 31 July 2007

	£000	**£000**	**£000**
Fixed assets			
Tangible fixed assets			81,300
Investments			4,000
Total fixed assets			85,300
Endowment assets			98,500
Current assets			
Stock	400		
Debtors	9,640		
Investments	2,300		
Cash at bank and in hand	200		
		12,540	
Creditors due within one year		(11,480)	
Net current assets/(liabilities)			1,060
Total assets less current liabilities			184,860
Creditors: Due greater than 1 year			(41,800)
Provisions for liabilities and charges			(1,390)
Net assets			141,670
Financed by:			
Endowments			
Specific		60,500	
General		38,000	
			98,500
Revaluation reserve			40,080
General reserve			3,090
Total			141,670

1. An analysis of other income has been completed as follows:

	£000
Income from renting student accommodation	3,500
Income from catering services	4,000
Income from The IMPALA Business Network	11,000
Miscellaneous income	7,170
	25,670

2. The University has identified relevant expenditure directly attributable to the University's non teaching and research activities as follows:

	£000
Renting accommodation	3,650
Catering services	3,000
The IMPALA Business Network	9,500
	16,150

3. This year saw the completion of a research project that attracted grants of £2m. The grant will not be paid in future years.

4. Samden University has four key financial performance targets.

- The general reserve should be maintained at 3.5% of annual expenditure.
- The retained surplus for the year should be at least 2% of operating income.
- Activities other than teaching and research are all expected to make a contribution towards the University's costs.
- The IMPALA Business Network is also expected to make a profit of at least 20% on costs.

- **Requirement for question 4**

Prepare a report to the Governing Body in which you:

(a) Assess the extent to which Samden University has met the four key financial performance targets for the year ended 31 July 2007, making recommendations on improving the financial position of the University and its long term sustainability. Include any other financial and non-financial factors which should be considered in order to assess the University's performance. *14*

(b) Answer the Governor's question in relation to endowments including any relevant journal entries. *4*

(c) Outline how the IMPALA Business Network would be included in the group accounts if the Governor's suggestion to make it a company and retain 75% of the shares is implemented. *2*

(20)

5

For financial statements to be of use to stakeholders they need to be consistently presented in a format that is understood by stakeholders and can be interpreted to provide the information that they are interested in. The regulation that underpins financial reporting provides this framework.

- **Requirement for question 5a**

(a) Describe the **four** broad areas of regulation which exist with regard to financial reporting in the public services. *4*

Performance measurement is an important part of monitoring service delivery in the public services, and the public sector is increasingly required to report on what it has achieved by producing performance measures and indicators. Performance indicators should be developed that provide an assessment of whether an organisation has met its service objectives and delivered a service that offers value for money. Performance measurement and reporting in the public sector also needs to consider the different types of accountability that public sector organisations may have.

- **Requirement for question 5b, 5c and 5d**

(b) Explain what the **three** elements of value for money (VFM) are, and explain why a VFM review may be more appropriate than financial ratio analysis for reviewing performance in public service organisations. *6*

(c) Identify **six** potential VFM performance indicators that could be used by a large housing association to help to measure performance. *3*

(d) Outline the **five** different forms of accountability that may be found in the public services. *7*

(20)

6

You work for Westmare Unitary Authority. A newly elected member with diverse interests has telephoned you with a number of financial queries after the publication of the accounts for the year ended 31st March 2008. Prepare a reponse to the key queries summarised below:

a) I am interested in the treatment of the Social Housing Grant (SHG) received by our neighbouring Housing Association. I believe it is different to our treatment of capital grants. A colleague has informed me that their housing stock is 50% funded by the SHG. I have looked at their accounts and at the start of the year the gross cost of housing stock was £4m and accumulated depreciation was £1.5m. I know it is their policy to depreciate over 50 years on a straight line basis and that they had no additions or disposals in the year.
   i) Can you confirm what the depreciation would be, and the closing Net Book Value of the assets?
   ii) How does this treatment of the SHG differ to the treatment of Local Authority capital grants?

b) I am also a trustee for Westmare Community, a charity providing community activities for disabled residents. We received a grant for £100,000 for additional specialist staff to attend activity breaks we run for our clients. We have spent £80,000 this year, and anticipate spending the remaining £20,000 next year on staff to attend a planned weekend break.
   i) What guidance does Westmare Community charity operate under for treatment of grants?
   ii) What will the accounting entries be to recognise the grant, and the expenditure at the end of this year?
   iii) What entries will be required for the grant when the remaining eligible expenditure is made next year?

c) I am very interested in the capital programme for the authority next year, and understand there are limited ways in which we can fund our capital programme.
   i) What possibilities are available to us to fund capital expenditure?
   ii) Are there any restrictions or controls on the amount we can spend on our capital programme?

d) I am confused about the value of Westmare Footpath Network on our balance sheet, which we are maintaining as part of our Green County Initiative to encourage walking in the community. I know we cannot sell it, or use it for any other purpose. Its depreciated historical cost is £0, and I know its net current replacement cost is £2,000,000.
   i) How is it valued on our balance sheet, and what class of asset is it?

e) I have heard from the Chief Executive that the organisation is using 'commitment accounting'.
   i) What is commitment accounting and how does this operate?
   ii) What are the benefits and drawbacks?

- **Requirement for question 6**

Prepare a set of notes addressing the key issues from the telephone call.

The mark allocation is as follows:

(a)	Social Housing Grant.	*5*
(b)	Charity grants.	*4*
(c)	Capital expenditure.	*5*
(d)	Asset recognition.	*2*
(e)	Commitment accounting.	*4*
		(20)