FINANCIAL REPORTING AND ACCOUNTABILITY

Professional 2
December 2004

MARKING SCHEME

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Question 1

Workings

1 Holdings
Homer and Socrates: 4.5/6 = 75%
Homer and Plato: 1.2/1.5 = 80%

2 Proposed dividends
Homer and Socrates: 75% x £100k = £75k cancelling item, MI in proposed dividend is therefore £(100 - 75)k = £25k
Homer and Plato: Preference dividend is 5% x £1,500k = £75k
Homer's share is: 1/1.5 x £75k = £50k cancelling item, MI in proposed preference dividend is therefore £(75 - 50)k = £25k
Ordinary dividend of Plato is £(85 - 75)k = £10k. Homer's share is 80% x £10k = £8k cancelling item, minority interest is therefore £(10 - 8)k = £2k

Summary:

Cancelling debtor of Homer with proposed dividend CL in Socrates and Plato as follows:

	£k	
Homer's share of Socrates' proposed ordinary dividend	75	½
Homer's share of Plato's proposed preference dividend	50	½
Homer's share of Plato's proposed ordinary dividend	8	½
	133	

MI share of proposed dividends is: £(25 + 25 + 2)k = £52k ½

3 Inter-company trading
28 Nov 2004 cash in transit. Adjust in books of Socrates:

Dr:	Bank £5K	½
Cr:	Plato debtor £5K	½

29 Nov 2004 goods in transit. Adjust in books of Homer:

Dr:	Closing stock £10K	½
Cr:	Socrates creditor £10K	½

All inter-company balances now agree and are completely cancelling items.

4 Unrealised stock profit.
Stock unsold in Homer's accounts at y/e is £150K + £10K = £160K
Unrealised profit element is: £160K/1.25 = £128K cost. £(160K – 128K) = £32K profit. *1*

Homer's share is 75% x £32k = £24K and MI share is £8K. *1*

5 Post acquisition profits:
Socrates: Pre acquisition revenue reserve (PRE) = £680K.
Post acquisition revenue reserve (POST) = £2,495k - £680k = £1,815k.
Plato: PRE = £500K. POST = £(710 – 500)k = £210k.

6 Fair value adjustment:
HC of Plato's land = £900k, fair value = £1,700k. Therefore revaluation adjustment is £(1,700 - 900)k = £800k ½

Correct adjustment ½

7 Investment = £10,045k - preference shares £1,000k - loan £45k = £9,000k.
Preference shares and loan of Plato are both cancelling items.

8

Cost of control account

Dr	£000	Cr	£000
Socrates (75%)			
Cost of investment	6,000	75% ordinary shares	4,500*
		75% PRE	510*
		Goodwill (Bal fig)	990*
	6,000		6,000
Plato (80%)			
Cost of investment	3,000	80% ordinary shares	1,200*
		80% share premium	320*
		80% fair value adj	640*
		80% PRE	400*
		Goodwill (Bal fig)	440*
	3,000		3,000

** = ½ mark per figure, up to a maximum of 4*

Minority Interest account

Dr	£000	Cr	£000
Socrates (25%)		25% ordinary shares	1,500*
		25% PRE	170*
		25% POST	454*
Unrealised stock profit	8*		
Plato (20%)		20% ordinary shares	300*
		20% share premium	80*
		20% fair value adj	160*
		1/3 preference shares	500*
		20% PRE	100*
Minority interest		20% POST	42*
(Bal fig)	3,298		
	3,306		3,306

** = ½ mark per figure, up to a maximum of 5*

Goodwill amortisation is:
Socrates: £990k/10 = £99k pa x 5 years = £495k ½

Plato: £440k/10 = £44k ½

Consolidated revenue reserve account

Dr	£000	Cr	£000
Socrates:		Homer's	7,055*
Goodwill w/o	495*	75% Socrates POST	1,361*
Plato:		80% Plato's POST	168*
Goodwill w/o	44*		
Unrealised stock Profit	24*		
Consolidated revenue Reserve (bal fig)	8,021		
	8,584		8,584

** = ½ mark per figure, up to a maximum of 3*

Homer Group
Consolidated Balance Sheet as at November 2004

	£000	£000	£000
Fixed assets:			
Intangibles - goodwill			891
Tangibles			27,700
			28,591
Current assets:			
Stock		5,858	
Debtors		2,977	
Bank		765	
		9,600	
Creditors less than 1 year:			
Creditors	3,245		
Bank overdraft	120		
Taxation	830		
Proposed dividends	600		
Minority interest in proposed dividends	52		
		(4,847)	
Net current assets:			4,753
Total assets minus current liabilities			33,344
Creditors greater than 1 year:			
Loan			(25)
			33,319
Capital and reserves:			
Ordinary shares			18,000
Share premium			4,000
Revenue reserve			8,021
Minority interest			3,298
			33,319

Marking summary – see workings above for detailed allocation of marks:
Cost of control 4
Minority interests 5
Consolidated revenue reserve 3
Goodwill amortisation 1
Correct calculation and treatment of proposed dividends 2
Correct calculation and treatment of unrealised stock profit 2
Correct treatment of cash in transit 1
Correct treatment of goods in transit 1
Correct calculation and treatment of fair value adjustment 1

(20)

Question 2

(a) Williamstown College

(i) Reconciliation of operating surplus/deficit to net cash flow from operating activities.

Reconciliation of operating surplus to net cash flow from operating activities

Operating surplus	**£000**	
Retained surplus/deficit for the year (1,040 + 940)	(1,980)	½
Taxation *(Note 6)*	390	½
Interest received *(Note 3)*	(390)	½
Interest paid *(Note 5)*	1,495	½
Operating deficit for the year	(485)	

Reconciliation of operating surplus to net cash flow from operating activities

	£000	
Operating deficit	(485)	
Depreciation charged for year (*W1)*	5,785	2
Profit on disposal of land *(W2)*	(195)	½
Profit on disposal of buildings *(W2)*	(910)	½
Loss on disposal of equipment *(W2)*	520	½
Decrease in stock (975 - 910)	10	½
Increase in debtors (390 - 585)	(1,150)	½
Increase in creditors (1,105 - 325) - (780 - 260) (*Note 5)*	260	½
Net cash inflow from operating activities	3,835	
		(7)

Working 1

Land	**£000**
Balance 1/8/03	2,925
Disposal	(845)
Additions (balancing figure)	1,170
Balance 31/7/04	3,250

Buildings	**£000**
Balance 1/8/03	19,500
Disposal	(8,775)
Additions (balancing figure)	11,700
Balance 31/7/04	22,425

Accumulated depreciation - buildings	
Balance 1/8/03	5,850
Disposal	(2,925)
Charge for year (balancing figure)	4,420
Balance 31/7/04	7,345

Equipment	**£000**
Balance 1/8/03	11,700
Disposal	(1,950)
Additions (balancing figure)	3,900

Balance 31/7/04	13,650
Accumulated depreciation - equipment	
Balance 1/8/03	6,825
Disposal	(1,170)
Charge for year (balancing figure)	1,365
Balance 31/7/04	7,020

Working 2

Disposals	**Land**	**Buildings**	**Equipment**
	£000	**£000**	**£000**
Cost	845	8,775	1,950
Accumulated depreciation		2,925	1,170
NBV	845	5,850	780
Sale proceeds	1,040	6,760	260
Profit/(loss) on disposal	195	910	(520)

(ii)

Cash flow statement for the year ended 31 July 2004

	£000	£000	
Operating activities			
Net cash inflow from operating activities		3,835	
Returns on investment & servicing of finance			
Interest received *(Note 3)*	390		½
Interest paid (1,495 + 260 - 325) (*Note 5)*	(1,430)	(1,040)	½
Taxation (390 + 195 - 325) *(Note 6 and BS)*		(260)	½
Capital Expenditure and financial investments			
Payments to acquire fixed assets *(W1 and BS)*	(16,770)		3
Receipts from sale of fixed assets *(W2)*	8,060	(8,710)	½
Net cash outflow before management of liquid resources and financing		(6,175)	
Management of liquid resources			
Short term investments made (3,900 + 1,170 - 4,095) *(BS and Note 4)*	(975)		1
Short term investments realised *(Note 4)*	1,170	195	½
Financing			
Loans raised (29,900 + 3,900 - 24,700) *(BS and Note 7)*	9,100		1
Loans repaid *(Note 7)*	(3,900)	5,200	½
Net cash flow		**(780)**	
Decrease in cash (BS) (+130 to - 650)		(780)	

General presentation 1
(9)

(b) Many fixed assets can be financed by leases, of which there are two types;

Finance Leases

SSAP 21 defines a finance lease as a 'lease that transfers substantially all the risks and rewards of ownership to the lessee'. Also role of FRS5 in defining substance over form. *1*

A finance lease means that both the ownership of the asset and the outstanding liability lies with the institution. It is necessary to identify the principal and interest elements of the lease payments and should be depreciated over the shorter of the lease term or the useful economic life of the asset. *2*

On acquisition:

DR Fixed Assets with fair value
CR Creditors less than 1 year with principal for current year *1*
CR Creditors greater than one year with remaining principal

During the life of the lease:

Principal repayment -
DR Creditors less than one year with principal for current year
CR Cash *1*

DR Creditors greater than one year with principal for next year
CR Creditors less than one year with principal for next year *1*

Interest payments -
DR Income & Expenditure Account
CR Cash *1*

Operating Leases

An operating lease effectively means that the institution is renting the asset and does not own it.

Accounting treatment: no principal repayment. *1*
Lease rental charge:
DR Income & Expenditure Account
CR Cash *1*

(9)

(25)

Question 3

(a) Williamstown NHS Trust

(i) Reconciliation of operating surplus/deficit to net cash flow from operating activities.

Operating surplus	**£000**	
Retained surplus/deficit for the year (-129-561)	(690)	½
PDC dividend paid *(Note 4)*	10,455	½
Interest received *(Note 4)*	(20)	½
Interest paid *(Note 4)*	105	½
Profit on disposal of fixed assets *(Note 4)*	(60)	½
	9,790	

Reconciliation of operating surplus to net cash flow from operating activities	**£000**	
Operating surplus	9,790	
Depreciation charged for year (*W1)*	6,525	*2*
Decrease in stock	21	½
Decrease in debtors (operating) *(Note 5)*	1,680	½
Increase in creditors (operating) *(Note 5)*	1,065	½
Net cash inflow from operating activities	19,081	
		(6)

Working 1

	£000	
Balance 1/4/03	155,670	(see BS)
Additions	22,935	1 (Additions, Revaluation/indexation, disposal)
Revaluation/indexation	2,190	
disposal (NBV)	-513	
	180,282	
Balance 31/3/04	173,757	(see BS)
Depreciation for year - by difference	6,525	1

(ii)

Cash flow statement for the year ended 31 March 2004

	£000	**£000**	
Operating activities			
Net cash inflow from operating activities		19,081	
Returns on investment & servicing of finance			
Interest received (20+5-20) *(Notes 4 & 5)*	5		*1*
Interest paid (105-15) (*Notes 4 & 5)*	(90)	(85)	*½*
Capital Expenditure			
Payments to acquire fixed assets *(W2)*	(15,975)		*2*
Receipts from sale of fixed assets (513+60) *(Notes 3 & 4)*	573	(15,402)	*1*
Dividends paid		(7,980)	*½*
Net cash outflow before financing		(4,386)	
Financing			
New PDC (145,183 + 19.5 – 139,528)	5,675		*1*
PDC repaid *(Note 6)*	(19.5)		*½*
Principal element of finance lease *(W3)*	(840)		*1 ½*
Net cash inflow from financing		4,815	
Increase in cash		**429**	
			(8)

Working 2

	£000	
Additions to buildings (Note 2)	18,735	
Less Donated building (Note 2)	(1,350)	*1*
Opening Fixed asset creditor (Note 5)	4,245	*½*
Less Closing Fixed Asset creditor (Note 5)	(5,655)	*½*
	15,975	

Working 3

	£000	
Additions to equipment (Note 2)	4,200	*½*
Less Finance lease Long Term creditor (BS)	(2,520)	*½*
Less Finance lease creditor (Note 5)	(840)	*½*
	(840)	

(iii) Reconciliation of movement in net debt

	£000	
Increase in cash for period	429	*½*
Cash outflow from repayment of debt	840	*½*
Change in net debt	1,269	
Non cash changes	(4,200)	*½*
Changes in net debt	(2,931)	
Net funds b/f	356	*½*
Net funds c/f	(2,575)	
		(2)

Analysis of movement in net debt

	01/04	Cash flow	Non cash flow	31/03	
	£000	£000	£000	£000	
Cash	356	429	0	785	*1*
Finance lease	0	840	(4,200)	(3,360)	*1*
Net debt/funds	356	1,269	(4,200)	(2,575)	

General presentation 1
(3)

(b) NHS Trusts are required to earn a return (recently revised down from 6% to 3.5%) on their relevant net assets. The actual charge is in the form of PDC dividends which are payable every year. They are agreed in advance of the financial year and calculated as 3.5% of the predicted average relevant net assets of the Trust.

The actual absorption rate for the Trust is found by stating the PDC dividends as a proportion of its actual average net relevant assets for the year.

Donated assets are excluded as they may deter future donations. Assets in the course of construction are not yet operational and so are incapable of earning a return, but must be included as they represent a tying up of capital investment. Loans and overdrafts are added back to the calculation to avoid the understatement of total assets, but cash balance should be excluded.

Up to a maximum of 1 mark

Capital Cost Absorption Duty

Average relevant net assets		**2004**	**2003**	
Total capital & reserves		152,187	143,682	
Less;				
Donation reserve		(1,350)	0	½
Plus;				
Loans & overdrafts		0	0	
Less cash		(785)	(356)	½
		150,052	143,326	
PDC dividends	10,455			
CCAD	0.071	average	146,689	½

7% Has exceeded target ½

Comments up to 1 mark
(4)

(25)

Question 4

(a) Rosemonk City Council 31 March 2004

AMRA

	Debit		Credit	
	£000		**£000**	
Depreciation	13,204	Asset rentals	63,830	
External interest	29,322	grant deferred	107	*(note 5)*
Balance to CRA	21,411			
	63,937		63,937	

(4)

(b) Rosemonk City Council Consolidated Revenue Account for the year ended 31 March 2004

Statement of net expenditure

	gross exp	income	net exp		
(See working 1)	**£000**	**(£000)**	**£000**		
Education (note 4)	633,270	(57,156)	576,114		*1*
Social Services	128,176	(12,124)	116,052		*½*
Environment and planning (note 8)	80,987	(1,430)	79,557		*1*
Highways, roads and transport	39,263	(11,788)	27,475		*½*
Central Services	5,540		5,540		
Cultural and Leisure	42,386	(1,350)	41,036		*½*
Net cost of services				845,774	
Corporate Income & Expenditure					
Precepts			6,332		
Interest on investments			(730)		
AMRA			(21,411)		
				(15,809)	*1*
Appropriations					
MRP adjustment (working 2)			264		*1*
Direct revenue financing			1,320		*½*
Government grant deferred (note 5)			107		*1*
				1,691	
Sources of finance					
Revenue support grant			(270,694)		
Council tax			(456,900)		
NNDR			(128,798)		
				(856,392)	
Surplus for the year				(24,736)	
General fund balance b/f				(25,374)	
General fund balance c/f				(50,110)	

(7)

Workings for net expenditure.
For the net expenditure need calculations that show:
Service expenditure plus asset rentals (depreciation and notional interest) less income.

Note the adjustment for the amount outstanding for Education (note 4).
Note the adjustment for the Environmental and Planning (note 8).

Working 1

	Depreciation	Notional interest	Asset rent	Exp	Gross exp
	£000	£000	£000	£000	£000
Education	8,130	31,572	39,702	593,568	**633,270**
Social Services	1,850	6,074	7,924	120,252	**128,176**
Environment and planning	530	3,745	4,275	76,712	**80,987**
Highways, roads and transport	1,958	6,325	8,283	30,980	**39,263**
Central Services	85	325	410	5,130	**5,540**
Cultural and Leisure	651	2,585	3,236	39,150	**42,386**

Working 2

Depreciation (note 1)	13,204
MRP provision (note 2)	13,468
MRP adjustment	264

Rosemonk Consolidated Balance sheet
Adjustments as per working reference

(i) **Net tangible assets**

	£000
O/bal	800,006
Note 7	29,320
Note 6*	528
Note 3	(6,000)
Note 1 depreciation	(13,204)
	810,650

(ii) **Debtors**

	£000
O/bal	12,496
Note 4	2,400
Note 8	(60)
	14,836

(iii) **Long term borrowing**

	£000
O/bal	361,860
Loan transaction from	188,164
Trial balance	(156,816)
	393,208

(iv) **Government grants deferred**

	£000
O/bal	4,280
Note 5	(107)
	4,173

(v) **F.A.R.R**

	£000
O/bal	358,640
Note 6	528
Note 3	(6,000)
	353,168

(vi) **Capital Financing reserve**

	£000
O/bal	20,962
Note 5	107
Note 7	8,000
Note 7	1,320
MRP adjustment	264
	30,653

(vii) **UCR**

	£000
O/bal	15,444
Note 7	(8,000)
Sale of assets from trial balance	7,290
	14,734

Rosemonk City Council Consolidated Balance Sheet for the year ended 31 March 2004

Fixed Assets	**£000**	**£000**	**£000**	
Net tangible assets (i)			810,650	*2*
Long term investment			12,100	
Current assets				
Stock	11,084			
Debtors (ii)	14,836			*1*
short term investments	4,150			
Cash	312			
		30,382		
Current liabilities				
Creditors		(7,086)		
Total assets - current liabilities			846,046	
Long term borrowing (iii)			(393,208)	*2*
Government grant deferred (iv)			(4,173)	*1*
			(397,381)	
Total assets less liabilities			**448,665**	
Fixed asset restatement reserve (v)			353,168	*1*
Capital Financing reserve (vi)			30,653	*2*
Useable Capital Receipts Reserve (vii)			14,734	*1*
General Fund Balance			50,110	
			448,665	

(10)

(c) Functions of the AMRA and MRP adjustments.

The purpose of the AMRA is to bring together asset rental charges to ensure they are recharged to revenue services and to ensure that the amount raised from taxation is sufficient to cover external interest payments. If notional interest charged through the CRA via asset rentals is greater than the actual charge then there is a need to reduce the expenditure in the CRA. This is done by DR the AMRA and CR the Corporate Income and Expenditure in the CRA. If the notional interest charged to the CRA via asset rentals is less than the actual interest then the expenditure in the CRA to be met from taxpayers needs to be increased or the actual cost to the council will not be met. This is done by CR AMRA and DR the Corporate Income and Expenditure in the CRA.

The MRP adjustments are necessary in the appropriations section of the CRA. It DR or CR for the difference between statutory amounts set aside for the repayment of loan principal and the depreciation already charged to the accounts. The contra entry is found in the Capital Financing reserve of the Balance Sheet. *(4)*

(25)

Question 5

(a) Arba Housing Association

Income and expenditure account for the year ended 31 March 2004

	£000	
Turnover (i)	46,791	*1*
Operating costs (ii)	(31,767)	*1*
Operating surplus	15,024	
Interest payable (iii)	(5,995)	*2*
Interest receivable	420	
Surplus on Sale of asset (see working 1)	11	*2*
Surplus for the year	9,460	
Transfer to designated reserve (note h)	(211)	*1*
Revenue reserves b/f	49,465	
Revenue reserves c/f	**58,714**	
		(7)

Adjustments as per working reference

	Turnover	**£000**
(i)	O/bal	46,750
	Note (d)	41
		46,791

	Operating costs	**£000**
(ii)	O/bal	31,680
	Note (c)	27
	Note (e)	60
		31,767

	Interest payable	**£000**
(ii)	O/bal	5,780
	Note (b)	200
	Note (c)	15
		5,995

Working 1

Surplus/loss on sale of asset

	£000
Cost	12
Depreciation	9
NBV	3
Cash received	14
Profit	11

Arba Housing Association Balance Sheet as at 31 March 2004

	£000						£000	
Fixed assets								
HOUSING PROPERTIES								
Properties for letting	395,600						395,600	
Shared ownership	8,930	Note (a) & (c)		(450)	(15)		8,465	*2*
Properties in development	25,450	Note (c)	(27)				25,423	*1*
Less SHG	211,370	Note (a) & (g)		(380)	534		(211,524)	*1*
Other fixed assets (at NBV)								
Motor vehicles	295	Note (f)	(12)				283	*1*
Office at cost	4,370						4,370	
Office furniture	1,975						1,975	
Less depreciation	740	Note (f)	(9)				(731)	
							223,861	
Current assets								
Debtors	3,970	Note (a) & (d)		450	41		4,461	*2*
Cash	890	Note (b) & (f)	3,500		14		4,404	*2*
Less								
Creditors less than 1 year	4,120	Note (a) & (e)			380	60	(4,560)	*1*
Net current assets							**228,166**	
Creditors over 1 year								
Recycled capital grant fund	2,400	Note (g)	(534)				1,866	*1*
Loans	155,760	Note (b)		3,700			159,460	*1*
							161,326	
Provisions	480						480	
Capital and reserves								
Share capital	1						1	
Designated reserve	5,480	Note (h)	211				5,691	*1*
Restricted RSF								
Reserve	1,954						1,954	
Revenue reserve							58,714	
							228,166	
								(13)

(b) Property disposals

The surplus/deficit on the disposal of a fixed asset (including shared ownership) should be accounted for in the income and expenditure account for the period in which the disposal takes place. This will be the difference between the net sale proceeds and the net carrying value (historic cost or at valuation). The surplus or deficit should be shown as a separate item in the income and expenditure account, below operating surplus and above interest.

SHG implications for disposals
When any SHG to be repaid or recycled (England only) is less than the SHG relating to the disposal, the difference is treated as abated SHG. The abated SHG should be treated as a component of the surplus/deficit on disposal. Any SHG to be recycled should be credited to the Recycled Capital Grant Fund/Disposal Proceeds Fund within creditors need to include principle of repaying/recycling SHG. Any SHG which becomes repayable should be accounted for as soon as the liability arises and should be included in the creditors falling due within one year.

(5)

(25)

Question 6

(a) Key financial objective of private sector companies is to maximise shareholders' wealth. This is done by maximising profits and thereby maximising the return on capital employed and earnings per share. *1*

Main financial objective of 'not for profit organisations' is to demonstrate stewardship of public funds. *1*

Other key objectives

Private	**Public**
Calculate a profit	Check organisation is meeting legal & contractual requirements
Provide accountability for the stewardship of shareholders funds	Plan resources & monitor budgets
Assess the scope for expansion through re-investment of profit	Assess the performance & efficiency of Management
Measure investors' capital	Check that funds have been used for the purpose intended
Assess the performance of Directors	Provide information for statutory monitoring purposes
Measure the available profits to distribute to shareholders	Provide information to a variety of Interest groups

Up to 4 marks for discussion of the above, highlighting key differences

(b) **(i)** With reference to a sector of the student's choice;
Because the needs of users of public sector financial statements are so varied it is difficult to orientate financial statements to meet them all.

For many years much of the financial information in the public sector was geared towards monitoring expenditure against available resources, and the availability and format of the information was driven by its providers not its users. However, in more recent years this has begun to change. Financial information is becoming more user driven and there is an ever increasing demand for better information, particularly for performance evaluation purposes. This has enhanced the published financial statements of many organisations by making them more user friendly.

However, the demands for more information are ever changing making it difficult to continue to satisfy the needs of varied users with differing agendas.

Up to 2 marks for general discussion as above
1 mark each, up to a maximum of 2 further marks for illustrative examples from the students chosen sector
(4)

(ii) Students may raise a variety of points which should each be considered in relation to the sector chosen. These could include the following, but marks should be awarded for any valid point discussed;

Enhanced by:

- Standardisation - facilitates better comparison.
- Allows for a certain degree of flexibility within given framework.
- Forces forward looking approach – future liabilities etc.

Constrained by;

- Private sector focus of much accounting regulation – limited applicability?
- Profit rather than service orientated – limited value to main users.
- Multiple objectives reduce the focus on purely finance based measures.
- Legislation
  (eg LGHA ’89)

1 mark per point discussed up to a maximum of 5 marks

(15)

Question 7

(a) Definition of GAAP

A term used to cover all accounting regulations relating to companies.
Answer should include reference to Companies Act, FRSs and SSAPs with particular mention of those which are relevant to Central government accounting.

Possible SSAPs 4,5,9 and 17
Possible FRSs 1,3,5,11,12,15, although others could also be included where relevant students will be given appropriate credit.

Candidates should select from the above and give a brief description and explanation of the chosen 4 and how they are applied in Central government.

The following is a brief summary of possible description, candidates should illustrate with examples of reference to specific Central Government examples where possible to gain the full 2 marks for each chosen SSAP or FRS.

SSAP 4 Accounting for government grants

SSAP 4 deals with the accounting treatment and disclosure of government grants and other forms of government assistance, including grants, equity finance, subsidised loans and advisory assistance. It is also indicative of best practice for accounting for grants and assistance from other sources.
Government grants are made in order to persuade or assist enterprises to pursue courses of action that are deemed to be socially or economically desirable. The range of grants available is very wide and changes regularly, reflecting changes in government policy. More significantly, different grants tend to be given on different terms as to the eligibility, manner of determination, manner of payment and conditions to be fulfilled.

The general rule of SSAP 4 is that government grants should be recognised in the profit and loss account so as to match them with the expenditure towards which they are intended to contribute. To the extent, therefore, that grants are made as a contribution towards specific expenditure on fixed assets, they should be recognised over the useful economic lives of the related assets. In contrast, grants made to give immediate financial support or to reimburse costs already incurred should be recognised in the profit and loss account in the period in which they become receivable; those made to finance the general activities of an entity should be recognised in the profit and loss account in the period in which they are paid.

SSAP 5 Accounting for value added tax

SSAP 5 seeks to achieve uniformity of accounting treatment of value added tax (VAT) in financial statements.
In the UK and the Republic of Ireland, VAT is a tax on the supply of goods and services that is eventually borne by the final consumer but collected at each stage of the production and distribution chain. As a general principle, therefore, the treatment of VAT in the accounts of a trader should reflect his role as a collector of the tax and VAT should not be included in income or in expenditure whether of a capital or revenue nature. There will, however, be circumstances in which a trader will bear the VAT, and in such cases where the VAT is

irrecoverable, it should be included in the cost of the items reported in the financial statements.

SSAP 9 Stocks and long-term contracts
SSAP 9 gives guidance on the accounting treatment of both stocks (inventories) and long-term contracts.
The determination of profit for an accounting period involves the allocation of costs to reporting periods. As part of this process, the cost of unsold or unconsumed stocks is—to the extent that it is believed to be recoverable—carried forward until the period in which the stock is sold or consumed.
Separate consideration needs to be given to long-term contracts. Owing to the length of time taken to complete such contracts, to defer recording turnover and taking profit into account until completion may result in the profit and loss account (income statement) reflecting not so much a fair view of the results of the activity of the company during the period but rather the results relating to contracts that have been completed in the period. It is therefore appropriate to take credit for ascertainable turnover and profit while contracts are in progress in accordance with the guidance given in SSAP 9.

SSAP 17 Accounting for post balance sheet events
SSAP 17 gives guidance on the identification and treatment of two types of post balance sheet events: adjusting and non-adjusting. For the purposes of the standard, post balance sheet events are defined as those that occur between the balance sheet date and the date on which the financial statements are approved by the board of directors.
The standard distinguishes between two different types of post balance sheet events. Adjusting events are those post balance sheet events which provide additional evidence of conditions existing at the balance sheet date. Non-adjusting events are those post balance sheet events which concern conditions that did not exist at the balance sheet date.
Events arising after the balance sheet date need to be reflected in financial statements if they provide additional evidence of conditions that existed at the balance sheet date and materially affect the amounts to be included.
To prevent financial statements from being misleading, disclosure needs to be made by way of notes of other material events arising after the balance sheet date which provide evidence of conditions not existing at the balance sheet date. Disclosure is required where this information is necessary for a proper understanding of the financial position.

FRS1 Cash Flow Statements
FRS 1 (Revised 1996) requires reporting entities within its scope to prepare a cash flow statement in the manner set out in the FRS. Cash flows are increases or decreases in amounts of cash, and cash is cash in hand and deposits repayable on demand at any qualifying institution less overdrafts from any qualifying institution repayable on demand.
An entity's cash flow statement should list its cash flows for the period classified under the following standard headings:

Cash flow statements have increasingly come to be recognised as a useful addition to the balance sheet and profit and loss account in their portrayal of financial position, performance and financial adaptability (in particular in indicating the relationship between profitability and cash-generating ability) and thus of the quality of the profit earned. The concept of profit however, is not one that applies to Central Government apart from those Agencies which are deemed trading accounts.

FRS 3 Reporting Financial Performance
FRS 3 has changed the way in which performance is reported. Its objective is to require entities to highlight a range of important components of financial performance to aid users in understanding the performance achieved by the entity in a period and to assist them in forming a basis for their assessment of future results and cash flows.
The standard requires a layered format for the profit and loss account to highlight a number of important components of financial performance:

a. results of continuing operations (including acquisitions);
b. results of discontinued operations;
c. profits and losses on the sale or termination of an operation, costs of a fundamental reorganisation or restructuring and profits or losses on the disposal of fixed assets; and
d. extraordinary items.

The effect of the standard has been effectively to outlaw extraordinary items. If any were to arise, the standard requires them to be included in the earnings figure used to calculate earnings per share.
The standard also requires a statement of total recognised gains and losses to be shown. This is a primary financial statement that includes the profit or loss for the period together with all movements in reserves reflecting recognised gains and losses attributable to shareholders.

FRS 5 Reporting the Substance of Transactions
FRS 5 addresses the problem of what is commonly referred to as 'off balance sheet financing'. One of the main aims of such arrangements is to finance a company's assets and operations in such a way that the finance is not shown as a liability in the company's balance sheet. A further effect is that the assets being financed are excluded from the accounts, with the result that both the resources of the entity and its financing are understated.
FRS 5 requires that the substance of an entity's transactions is reported in its financial statements. This requires that the commercial effect of a transaction and any resulting assets, liabilities, gains and losses are shown and that the accounts do not merely report the legal form of a transaction.
To aid its application, FRS 5 contains seven application notes that show how its requirements apply to transactions with certain features. These are:

A. Consignment stock
B. Sale and repurchase agreements
C. Factoring of debts
D. Securitised assets
E. Loan transfers
F. Private Finance Initiative and similar contracts (September 1998)
G. Revenue recognition (November 2003)

However, FRS 5 has general application and is not limited to the transactions covered in the application notes.

FRS 11 Impairment of Fixed Assets and Goodwill
The objective of FRS 11 is to ensure that:

a. fixed assets and goodwill are recorded in the financial statements at no more than their recoverable amount;

b. any resulting impairment loss is measured an recognised on a consistent basis; and
c. sufficient information is disclosed in the financial statements to enable users to understand the impact of the impairment on the financial position and performance of the reporting entity.

FRS 11 sets out the principles and methodology for accounting for impairments of fixed assets and goodwill. It replaces the previous approach whereby diminutions in value were recognised only if they were regarded as permanent. Instead, the carrying amount of an asset is compared with its recoverable amount and, if the carrying amount is higher, the asset is written down.
Recoverable amount is defined as the higher of the amount that could be obtained by selling the asset (net realisable value) and the amount that could be obtained through using the asset (value in use). Value in use is calculated by forecasting the cash flows that the asset is expected to generate and discounting them to their present value. Where individual assets do not generate independent cash flows, a group of assets (an income-generating unit) is tested for impairment.
Impairment tests are only required when there has been some indication that an impairment has occurred.

FRS 12 Provisions, Contingent Liabilities and Contingent Assets
FRS 12's objective is to ensure that a provision (a liability that is of uncertain timing or amount) is recognised only when it actually exists at the balance sheet date. A provision should be recognised therefore only when:

a. an entity has a present obligation (legal or constructive) as a result of a past event;
b. it is probable that a transfer of economic benefits will be required to settle the obligation; and
c. a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.
Contingent liabilities and contingent assets are not recognised as liabilities or assets. However, a contingent liability should be disclosed if the possibility of an outflow of economic benefit to settle the obligation is more than remote. A contingent asset should be disclosed if an inflow of economic benefit is probable.
Provisions often have a substantial effect on an entity's financial position and performance. Earlier published guidance, however, had tended to concentrate on particular forms of provision rather than the general principles underlying all provisions. Furthermore the practice had grown up of aggregating present liabilities with expected liabilities of future years, including sometimes items related to ongoing operations, in one large provision, often reported as an exceptional item. The effect of such 'big bath' provisions was not only to report excessive liabilities at the outset but also to boost profitability during the subsequent years, when the liabilities were in fact being incurred.

FRS 15 Accounting for Tangible Fixed Assets

FRS15 sets out the principles of accounting for tangible fixed assets, with the exception of investment properties, which are dealt with in SSAP 19 'Accounting for investment properties'. The objective of the FRS is to ensure that tangible fixed assets are accounted for on a consistent basis.

Consistently with previous practice (as reflected, for example, in the Companies Act) the FRS permits a choice as to whether tangible fixed assets are stated at cost or at revalued amount. However, where an enterprise chooses to adopt a policy of revaluing some assets, all assets of the same class (that is, those with a similar nature, function or use) must be revalued. The FRS also contains requirements that ensure that the valuations are kept up to date.

2 marks to be awarded for each one, students must ensure that they make reference to the government aspect of the SSAPs and FRSs
8

Resource Accounting Manual RAM

Five Schedules
1. Summary of resource outcome
2. Operating cost statement and statement of recognised gains and losses OCS
3. Balance sheet
4. Cash flow statement
5. Resources by departmental aim and objective

A brief explanation of the content of these schedules and a comparison with the equivalent or otherwise to that found in company accounting.

Mention to be made of the not for profit and service orientated nature of the activity as well as the lack of profit indicator within Central government accounting. *2*

(10)

(b) The value of the assets transferred should be credited to a donation reserve.

The accounting entries for this are:

Journal entries

DR	Fixed Assets	£195,000
CR	Donation reserve	£195,000

Depreciation should be charged to the OCS in accordance with the Agency's policy and matched with a release from the donation reserve to income.

Depreciation calculation

£195,000/10 = £19,500 per year
£19,500 x 6/12 = £9,750 for this year

Journal entries

DR OCS – depreciation	£9,750
CR Accumulated deprn.	£9,750
DR Donation reserve	£9,750
CR OCS – other income	£9,750

5
(15)

Question 8

(a) Corporate Governance in the Private and the Public Sector

Need to provide a background to the development of the Corporate Governance requirements a per the various reports published.
In the late 1980s there were a number of high profile collapses of prominent UK companies, eg Maxwell Corporation, BCCI, Pollypeck International plc, etc. These failures were attributed to weak governance systems, poor oversight of the board and concentration of too much control in the hands of a single top executive.

At the same time, SSAPs and accounting regulations were seen as being too loose and ambiguous in places, consequently the quality of financial reporting was questioned. There was little guidance or requirement on directors to oversee controls in their business; the remuneration of some directors was seen as too high; and there was a perception that auditors did not provide the level of protection and safeguards that stakeholders had the right to expect.

Brief description of the CG Reports published during 1990's **CADBURY report 1992** focused on the issue of corporate governance in stock exchange listed companies. In particular, it looked at the potential abuse of power and the need for **openness, integrity and accountability** in the decision-making process of an organisation.

The Cadbury Committee produced the Code of Best Practice,
- the procedures adopted by the board to discharge its duties;
- the board's accountability to shareholders and other stakeholders;
- the manner in which the board controls the company;
- statement of responsibilities by directors;
- remuneration of directors;
- audit committees.

The Cadbury Report recommended that:
- the boards of all listed companies in the UK should comply with the code, this was reinforced by the London Stock Exchange.
- listed companies to state in their financial statements the extent of code compliance and disclose reasons for any non-compliance;
- the statement of compliance to be reviewed by auditors before publication.

In **1995, Greenbury** reported on the remuneration of directors, and recommended;

- the remuneration committee - composed of non-executive directors to review the remuneration of executive directors;
- disclosure and approval arrangements - the remuneration committee annual report to form part of the annual report;
- remuneration policy - pay rate for the job;
- service contracts and compensation – period of notice to less than one year.
- recommendations were included in the Stock Exchange Listing Rules from Oct. 1995.

Hampel report 1998

A successor body to Cadbury established to review progress that produced a code which combined the findings of Cadbury and Greenbury, known as the Combined Code and contained principles and provisions in two parts:

- principles of good governance;
- code of best practice.

The London Stock Exchange required compliance with the Combined Code from December 1998, listed companies are required to include a statement of compliance in their annual report to shareholders.

The **Turnbull report 1999**, took a broader view of the governance in term of the overall structure and management and looked in greater detail at internal control issues. The Turnbull Committee produced a report 'Internal Control: Guidance for Directors on the Combined Code' which the London Stock Exchange requires listed companies to comply with from 2000 onwards.

Higgs and Smith reports of 2002 and FRC Combined Code of Corporate Governance.
These reports and resulting combined code set our the specific role and responsibility of directors, auditors and audit committees for corporate governance. Currently this is the recognised and recommended practice requirements for sound corporate governance.

CORPORATE GOVERNANCE IN THE PUBLIC SECTOR
The CIPFA discussion paper 'Corporate Governance in the Public Services' concluded that the Cadbury principles 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.

These characteristics include:

- political dimension in the management and delivery of services;
- objectives are multi-various and difficult to quantify;
- loosely defined accountability to stakeholders;
- uncertainty regarding proprietors and stakeholders;
- role of chief executive officer is different;
- parallels for chairman and board are hard to identify;
- public service ethic and motivation in interests of public good are unique concepts;
- wider audit role;
- presence of regulators and ombudsman in some sectors;
- lack of one universally-accepted motivational objective;
- lack of a single regulatory environment - Companies Acts/Stock Exchange Rules.

The existence of these differences means that the corporate governance recommendations cannot be simply transferred to the public sector. However, the basic principles of openness, integrity and accountability can be underpinned and nurtured in a public service environment.

The main objective in the review and formalisation of corporate governance practices is to ensure that the processes of control and management within the organisation are properly regulated and this will involve ensuring that:

- there is a controlled balance of power;
- proper working procedures are specified and adhered to;
- the following of working procedures can be verified;
- there is a proper division of responsibility;
- due regard is paid to the wider public interest.

Examples of failures and scandals in the public sector can be used to illustrate that it was not simply the private sector that had governance problems. Specific examples relating to the students chosen sector can be included.
In 1994 the Code of Best Practice for Board Members of Public Bodies was published by HM Treasury in June 1994. The code made a number of recommendations on best practice covering such areas as:

- disclosure of financial interest;
- good stewardship of public funds;
- non-disclosure or use of insider information;
- key functions of board members;
- responsibilities of audit committee.

In response to the series of critical Public Accounts Committee reports, in October 1994 the government established the ***Committee on Standards in Public Life*** under the chairmanship of Lord Nolan. This was to be a long-life committee to examine key areas of public life and to make recommendations aimed at ensuring the highest standards were achieved and maintained.

The first report was concerned with Members of Parliament, ministers and civil servants, executive agencies, quangos and NHS bodies. It established ***seven guiding principles for public life:***

- selflessness -act purely in the public interest not for personal or associates gain;
- integrity - be free from any outside influences or obligations;
- objectivity - make choices and decisions on merit;
- accountability - be mindful of public accountability and stewardship;
- openness - be open about decisions and actions and give reasons ;
- honesty - declare any private interests and obey the law;
- leadership - promote these principles by example and leadership.

The report also recommended adequate training where necessary, establishment of internal systems, external scrutiny of activities and formulation of appropriate codes of conduct.

Other reports by Nolan and later by Lord Neill as chair of the committee covered aspects relating to;

- appointments process;
- openness in the activities of the governing body;
- codes of conduct and conflicts of interest
- formal whistle-blowing procedures
- ethics and propriety

- regulation of expense payments

Elective and non-elective bodies, depending on the chosen sector will have different comparison.
Public service bodies can be divided into two main categories and the corporate governance issues will be different for each category. The two categories are:

- elective regime where ultimate power lies with elected politicians;
- non-elective public sector body where power lies with a board appointed by a minister.

Some significant differences between both of these models and the private sector are:

- The board of a company has a direct responsibility to shareholders for the creation of wealth and the payment of dividends to shareholders and only a minimal responsibility to other stakeholders.
- In the public sector, there is a much wider responsibility to all stakeholders for the efficient and cost effective delivery of services in line with their aspirations.
- In the public sector the auditor has a wider and distinctive role to play. There are important regulatory and VFM aspects to public audit which are not explicitly part of the role of an auditor appointed by the shareholders of a company.
- A public sector auditor is appointed by a body established by Parliament with a significant public interest agenda to address.
- The Cadbury recommendation on audit committees has been hailed as a sensible one for all public sector bodies, although progress in implementation has been both slow and patchy. Reference to the reluctance of local government to accept these as the audit committee was deemed to be yet another committee to add the long list of existing committees

However, in the non-elective scenario members of the board are appointed by the Secretary of State and are not elected by the citizens or directly responsible and accountable to them. This lack of direct accountability to the public means that the demonstration of good governance needs to be more open and transparent. This need is heightened in some areas, for example in NHS trusts, where the board members appointed by the Secretary of State proceed to appoint and employ executive directors who join them on the board. Here, there could be real dangers of the division of roles and the balance of power not being maintained and it is particularly necessary in these areas that the public is protected and reassured by robust systems of corporate governance and internal control. It is no coincidence that the non-elective sector has been particularly energetic in its response to Cadbury from the outset. Examples of this would be the NHS and housing associations.

In the NHS, the concepts of good governance and corporate governance have been extended to place quality issues alongside financial considerations. A move away from a business-like approach and competition towards co-operation and collaboration in the delivery of healthcare. Health organisations now have a statutory duty for delivery of quality and a local corporate responsibility for clinical governance. From April 1999, it was the government's clear intention that the corporate governance of healthcare bodies would encompass quality as well as financial issues.

Clinical governance is defined in the 1998 White Paper 'The New NHS - Modern and Dependable' as a framework through which NHS organisations must continuously improve the quality of their services and safeguarding high standards of care by creating an environment in which excellence in clinical care will flourish.

8 marks will be awarded for the deomonstration of knowledge relating to the developments in CG in the private sector and the relevant reports.
7 marks will be awarded for the application of CG in the public sector

(15)