

FINANCIAL REPORTING AND ACCOUNTABILITY

Professional 2 examination 10 June 2004

From 10.00 am to 1.00 pm
plus twenty minutes reading time from 9.40 am to 10.00 am.

Instructions to candidates

Answer **five** questions in total: the compulsory question from **Section A**, **one** question from **Section B**, **one** question from **Section C**, and **two** questions from **Section D**.

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

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



SECTION A (Compulsory)

1

The balance sheets for three individual companies as at 31 December 2003 are as follows:

	H Ltd £000	A Ltd £000	B Ltd £000
Fixed assets	7,270	3,170	1,800
Investment in A Ltd (2,000 50p shares)	1,800	-	-
Investment in B Ltd (800 £1 shares)	2,960	-	-
Net current assets	355	1,205	1,355
Less: proposed dividend	(125)	(75)	(75)
	12,260	4,300	3,080
Creditors due in > 1 year	(1,250)	(700)	(830)
Debentures	(800)	-	(600)
	10,210	3,600	1,650
Ordinary share capital	8,000	2,500	1,000
General reserve	500	-	-
Profit and loss account	1,710	1,100	650
	10,210	3,600	1,650

Additional information:

- (i) H acquired its shares in A Ltd at the beginning of this financial year. Ordinary share capital in A Ltd is unchanged.
- (ii) H acquired its shares in B Ltd on 1 January 2000. At this date the retained profits were £1,500,000. The fair value of B Ltd's fixed assets was deemed to be £200,000 above the book value on acquisition, with 10 years of useful life remaining.

The profit and loss accounts for the three companies for the year ended 31 December 2003 are as follows:

	H Ltd £000	A Ltd £000	B Ltd £000
Turnover	3,080	950	1,360
Cost of sales	(1,985)	(560)	(1,155)
Gross profit	1,095	390	205
Distribution	(330)	(90)	(40)
Administration	(270)	(60)	(25)
Operating profit	495	240	140
Dividends receivable	90	-	-
Profit before tax	585	240	140
Taxation	(150)	(65)	(40)
Profit after tax	435	175	100
Proposed dividend	(125)	(75)	(75)
Retained profit for the year	310	100	25

Additional information:

- (i) H Ltd anticipates receipt of proposed dividends.
- (ii) It is the policy of H Ltd to amortise goodwill over a 20 year period.
- (iii) During 2003 B Ltd made sales to H Ltd, amounting to £250,000 of which £50,000 remained unsold by H Ltd at 31 December 2003. B Ltd applied a profit margin of 20%.

- **Requirement for question 1**

- (a) Prepare the consolidated balance sheet for H Ltd as at 31 December 2003. 16
 - (b) Identify the entries that should appear on the consolidated profit and loss account of H Ltd for the year ended 31 December 2003, in respect of the profit of A Ltd. 4
- (20)**
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SECTION B (Answer one question)**2**

The consolidated balance sheet for Somewhere County Council at 31 March 2003 is as follows:

	1 April 2002 £000	31 March 2003 £000
Fixed assets:		
Operational assets	635,000	727,500
Long term investments	18,000	20,350
Total long term assets	653,000	747,850
Current assets:		
Stock	10,850	11,250
Debtors	13,500	18,750
Cash and bank	2,750	6,450
Current liabilities:		
Bank overdraft	(300)	0
Creditors	(20,750)	(24,500)
Total assets less current liabilities	659,050	759,800
Long term borrowing	(223,000)	(248,500)
Total assets less liabilities	436,050	511,300
Fixed asset restatement reserve	392,500	440,350
Capital financing reserve	16,750	24,350
Usable capital receipts	12,100	21,350
General fund balance	14,700	25,250
Total balances and reserves	436,050	511,300

- (i) The consolidated revenue account included asset rentals of £83,500,000, of which depreciation was £17,500,000. The minimum revenue provision for the year was £9 million, and the consolidated revenue account received a credit transfer from the asset management revenue account of £49,350,000.
- (ii) Cash inflows for 2002/03 were made up as follows:

	£000
Precept	203,985
Revenue support grant	175,000
National non-domestic rates	83,500
Grants (specific)	29,250
Fees and charges	8,750
Interest received	1,405

- (iii) Cash outflows relating to employees totalled £393,115,000, while other operating expenditure accounted for payments of £73,125,000.

- (iv) The policy of the County Council is to reserve 50% of all capital receipts. Capital expenditure was financed from a mixture of new borrowing, plus £1.35 million charged to revenue and £2.75 million taken from existing usable capital receipts.

• **Requirement for question 2**

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|---|-------------|
| (a) Prepare Note 1 to the cash flow statement for 2002/03. | 6 |
| (b) Prepare the cash flow statement for 2002/03 (further notes are not required). | 16 |
| (c) Show the ledger account for the capital financing reserve. | 3 |
| | (25) |
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3

The Countryside Protection Agency is a supply-financed (formally “on-vote”) agency of Central Government. The following information has been extracted from its balance sheet for 31 March 2003:

	1 April 2002 £000	31 March 2003 £000
Tangible fixed assets - NBV	2,750	2,925
Stock	810	750
Debtors	85	90
Creditors	(320)	(260)

Additional information:

- (i) Land was valued at £1,250,000 at 1 April 2002 and at £1,425,000 at 31 March 2003. There were no acquisitions or disposals of land during the year. Movements on all other tangible fixed assets, in addition to the annual depreciation charge, included:

	£000
NBV of disposals	200
Indexation of non-land fixed assets	170
Backlog depreciation	10
Acquisitions	105

- (ii) Disposal proceeds amounted to £225,000.
- (iii) The net supply grant voted by Parliament for the Countryside Protection Agency for 2002/03 was £9,850,000. The surplus of the vote over actual expenditure for the year was £1,270,000. Appropriations in aid collected for 2002/03 amounted to £11,250,000 compared to approved appropriations in aid of £11.5 million.
- (iv) The following rates should be applied in the calculation of notional charges:

	%
Interest on capital	6.0
Insurance: F.A (excl. land) @ NBV 31/3/03	1.0
Staff costs	0.1
Average stock	0.5

- (v) Staff costs for the year amounted to £8,950,000, and the audit fee was £45,000.
- (vi) The operating deficit for the year was £8,550,000.

- **Requirement for question 3**

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| (a) Calculate the notional charges borne by the Operating Account for 2002/03. | 7 |
| (b) Prepare Note 1 to the Cash Flow Statement for 2002/03. | 10 |
| (c) Prepare the Cash Flow Statement for the year ended 31 March 2003 (further notes are not required). | 8 |
| | <hr/> (25) |

SECTION C (Answer one question)**4**

The trial balance for the Gooding Registered Social Landlord for the year to 31 March 2003 is as follows:

	£000	£000
Turnover		42,500
Interest receivable		420
Operating costs	31,450	
Interest payable	7,250	
Land	100,000	
Housing Property: cost	228,400	
depreciation (1 April 2002)		2,820
Housing property under construction	31,865	
Office buildings: cost	4,800	
depreciation (1 April 2002)		1,200
Furniture/equipment: cost	1,750	
depreciation (1 April 2002)		700
Cash at bank	870	
Debtors	2,150	
Creditors due within one year		3,650
Provisions for liabilities and charges		300
Social Housing Grant: properties under construction		16,000
other housing properties		106,400
Loans		112,500
Designated reserves		14,920
Restricted reserves		42,600
Revenue reserves		58,880
Disposals account		5,930
Other suspense	285	
	408,820	408,820

Additional information:

- (i) Depreciation has not yet been charged for 2002/03. The policy of Gooding is to charge depreciation in the year of acquisition. None of the existing fixed assets are yet fully depreciated. Asset lives, used to calculate depreciation on a straight line basis, are as follows:

Housing property (on cost net of SHG)	50 years
Other property	20 years
Other assets	5 years

- (ii) On 1 April 2002 Gooding sold a small office building for £730,000. The building had cost £400,000 and had borne depreciation of £160,000 by 31 March 2002. A second disposal took place at the end of the 2002/03 financial year. Housing property was sold for £5.2million, having originally cost Gooding £3.3million. £300,000 of this cost related to the land on which the property stood. Depreciation on this property amounted to £440,000 at 31 March 2002. This sale will necessitate the repayment of £1.1million in Social Housing Grant, and it is the policy of the RSL to transfer the profit on all disposals to the designated

reserves. The only entries completed to date are to record the sales proceeds in the disposals account.

- (iii) The suspense account contains repairs and maintenance expenditure, £210,000 of which has enhanced the rental values of the associated properties, which are all currently being let. The remaining £75,000 involved only routine repairs.
- (iv) Outstanding housing benefits due from the local authority in respect of March 2003 have been discovered, amounting to £25,000.
- (v) On 1 April 2002 Gooding took up a finance lease, which will last for 5 years. The equipment leased had a fair value of £300,000. The only accounting entry so far made has been to include the first of the five annual lease payments of £75,000 in operating costs for 2002/03.

- **Requirement for question 4**

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|-----|---|-------------|
| (a) | Prepare the income and expenditure account for 2002/03. | 9 |
| (b) | Prepare the balance sheet as at 31 March 2003. | 16 |
| | | (25) |
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5

The following trial balance has been prepared for the Saint Sebastian NHS Trust for the year ended 31 March 2003:

	£000	£000
Income from activities		68,300
Private patient income		4,200
Salaries and wages	42,750	
Supplies and services	15,950	
Transport	485	
Premises	970	
Dividends paid	2,860	
Interest receivable		245
Land	7,925	
Buildings (NBV)	48,950	
Equipment – NHS	12,200	
Equipment – donated	1,700	
Accumulated depreciation – NHS		3,300
Accumulated depreciation – donated		200
Stock	240	
Debtors	1,550	
Cash	160	
Creditors		2,790
Provisions for liabilities and charges		300
Public dividend capital		49,080
Revaluation reserve		5,740
Donation reserve		1,500
Retained surplus on I & E account		260
Suspense account – capital expenditure	285	
Disposals		110
	136,025	136,025

Additional information:

- (i) Indexation has not yet been applied, and the following indices should be used:

	%
Land	0.5
Buildings	1.5
Equipment	1.0

- (ii) Depreciation has also yet to be charged for the year. Buildings have a remaining useful economic life of 40 years, while equipment depreciation is to be calculated using a standard life of 5 years.
- (iii) On 1 April 2002 land and buildings were independently re-valued. Buildings were found to have increased by £1,450,000, while land values had been impaired by £125,000. The latter was due to a general market trend in the area.

- (iv) Acquisitions financed by NHS funds in the year were limited to the purchase of equipment in February 2003. This has so far been recorded only in the suspense account. In addition, medical equipment valued at £85,000 was donated to the Trust in March 2003, and this has not been recorded in the trial balance at all.
- (v) Equipment with a gross current cost of £300,000 at 31 March 2002 was sold on 1 January 2003 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 1 February 2002.
- (vi) The depreciation charges on an historical cost basis for 2002/03 have been calculated as:

	£000
Buildings	1,160
NHS Equipment	2,120

- (vii) Additional private patient income in respect of 2002/03, which has yet to be invoiced, has been identified as £350,000.
- (viii) The provision in the trial balance was established in March 2002, for a liability expected to arise in 3 years time, and is hence discounted to 84% of its expected value. The liability is still anticipated to arise, now in 2 years time, requiring a discounting adjustment for 2002/03 to 89% of its expected value.

• **Requirement for question 5**

- (a) Prepare the income and expenditure account for 2002/03. 8
- (b) Prepare the balance sheet as at 31 March 2003. 17
- (25)**
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SECTION D (Answer two questions)**6****• Requirement for question 6**

- (a) Name two specific, main sources of finance in each of the five public sectors. 5
- (b) With reference to accounting standards, compare and contrast the accounting treatment of a government grant in the private sector with that of:
- local government, and
 - the higher and further education sector. 10
- (15)**

7

Define **specific** measures of financial performance, stating the method and purpose of each relevant measure, in:

• Requirement for question 7

- (a) The private sector. 5
- (b) Local government. 5
- (c) The National Health Service. 5
- (15)**

8

Identify, with reference to the degree of compliance with FRS 15, the treatment of appropriate categories of fixed assets on the balance sheet, including the approach taken to depreciation or capital charges, in each of the following sectors:

- **Requirement for question 8**

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|----------------------------------|-------------|
| (a) Central government. | 5 |
| (b) The National Health Service. | 5 |
| (c) Local Government. | 5 |
| | (15) |
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