FINANCIAL REPORTING AND ACCOUNTABILITY

Professional 2
December 2001

MARKING SCHEME

CIPFA

SECTION A (Answer one question)

Question 1 (Central Government)

Total part (a) 8 marks
Total part (b) 7 marks
Total part (c) 5 marks
Total part (d) 5 marks
Total 25 marks

(a) **Reconciliation of operating surplus to net cash flow from operating activities**

	£000	£000	
Surplus (10,458-7,840)		2,618	*½*
Add: Interest (w3)		395	*2*
Surplus on ordinary activities		3,013	
Non-cash items:			
Buildings depreciation (w1b)	1,920		*1*
Plant and equipment depreciation (w2b)	576		*1*
Profit on sale (note 3)	(320)		*½*
Loss on sale (note 3)	64	2,240	*½*
		5,253	
Working capital adjustments:			
Stock decrease	128		*½*
Debtors increase	(960)		*½*
Trade creditors decrease	(274)	(1,106)	*½*
Net cash inflow from operating activities		4,147	*1*

Total for part (a) - 8 marks

(b)

Jordanstown Stationery Office
Cash Flow Statement for the Year Ended 31 March 2001

	Working	£000	£000	
Net cash inflow from operating activities			4,147	
Returns on investment and servicing of finance				
Interest received	note 1	34		
Interest paid	note 1	(423)		
Net cash outflow from returns on investment and servicing of finance			(389)	
Capital expenditure and financial investment				
Payments to acquire buildings	W1a	(5,760)		*1*
Payments to acquire fixtures and fittings	W2a	(974)		*2*
Receipts from sales of buildings	W1c	2,240		*½*
Receipts from sale of fixtures and fittings	W2c	128		*½*
Net cash outflow from capital expenditure and financial investment			(4,366)	
Cash outflow before management of liquid resources and financing			(608)	
Management of liquid resources				
Acquisition of Short-term investments			(1,920)	½
Financing				
Loan raised			3,840	½
Increase in cash			1,312	

CF format and presentation 2 marks
Total for part (b) - 7 marks

(c) **Reconciliation of net cash flow to movement in net funds**
(can be shown on face of cash flow statement or as a note)

	£000	
Increase in cash in the period (1,952 – 960 + 320)	1,312	
Cash inflow from new long-term loan	(3,840)	
Cash used to purchase short-term investments	1,920	
Change in net funds	(608)	
Net funds at 1 April 2000 (960 - 320)	640	
Net funds at 31 March 2001 (1,920 + 1,952 – 3,840)	32	*2 ½*

Analysis of changes in net funds

	At 1/4/00 £000	Cash flows £000	At 31/3/01 £000	
Cash in hand and at bank	960	992	1,952	
Overdrafts	(320)	320	-	
	640	1,312	1,952	
Current asset investment	-	1,920	1,920	
Debt due > 1 year	-	(3,840)	(3,840)	
Total	640	(608)	32	*2 ½*

Total for part (c) – 5 marks

(d)

1. I have prepared the cash flow statement for the financial year. The main points of note in our performance are:
   a) an net inflow of cash from operating activities of £4,147k;
   b) a considerable outflow of cash in respect of capital acquisitions of £6,734k, which in turn was partly offset by capital receipts of £2,368k from the sale of surplus assets;
   c) raising of long term loan finance of £3,840k;
   d) acquisition of short term investments costing £1,920k
   e) a total increase in cash holdings of £1,312k over the year.

2. Cash inflows from operating activities would almost have been enough to match net capital expenditure but it was thought necessary to raise a loan to finance some of this. This may have been because acquisitions had to be made before either operating funds or capital receipts were available to finance them.

3. Some of the Agency's surplus cash has been invested in short term investments but we now need to review our cash requirements for the forthcoming year. One reason for this is that the long term loan is costing us approximately 12 per cent pa, whereas the short term investment is only earning 5 per cent. We also have cash holdings of £1,952k which will be included when we calculate our required 6 per cent return on capital.

4. I propose that unless we have an immediate need for the cash or the cash which could be realised by liquidating our short term investments (eg for additional capital expenditure in the next financial year) we should use these funds to pay off some or all of the long term loan. Note the terms of the loan may mean that this results in our having to pay penalty interest.

5. I also propose that in future, if we experience timing difficulties in our cash flow for financing capital expenditure, we use short term borrowings to add to our liquid resources until the operating cash flows are available. These are easier to raise and redeem and can be matched to our precise needs. However we should check that our legislative framework allows us to raise money in this way.

Up to 1 mark per point made to a maximum of 5
(25)

Workings:

		DR	CR	
1	*Buildings*			
(a)	At cost	£000	£000	
	Opening balance	6,592		
	Disposal		3,200	
	Closing balance		9,152	
	Additions in year (balance)	5,760		
		12,352	12,352	*1*
(b)	Accumulated depreciation			
	Opening balance		2,112	
	On disposal	1,280		
	Closing balance	2,752		
	Depreciation charge for year (balance)		1,920	
		4,032	4,032	*1*
(c)	Disposal account			
	Cost	3,200		
	Profit on sale	320		
	Accumulated depreciation		1,280	
	Cash received (to balance)		2,240	
		3,520	3,520	*1*
2	*Plant and equipment*			
(a)	At cost			
	Opening balance	3,648		
	Disposal		640	
	Closing balance		4,032	
	Additions (to balance)	1,024		
		4,672	4,672	*1*
				1

Total additions £1,024,000 less £50,000 unpaid = £974,000 paid during year.

(b)	Accumulated depreciation			
	Opening balance		1,984	
	On disposal	448		
	Closing balance	2,112		
	Depreciation (balance)		576	
		2,560	2,560	*1*
(c)	Disposal account			
	Cost	640		
	Loss on sale		64	
	Accumulated depreciation		448	
	Cash received (to balance)		128	
		640	640	*1*
	Opening balance		32	
	Paid and received	423	34	
	Closing balance	38		
	Income statement (to balance)		395	
		461	461	*2*

Question 2 (Further and Higher Education)

(a) **Reconciliation of operating surplus to net cash flow from operating activities**

	£000	
Surplus (Working 1)	2,452	*2*
Buildings depreciation (Working 2b)	2,020	*1 ½*
Plant and equipment depreciation (Working 2b)	578	*1*
Profit on sale (note 3)	(320)}	*½*
Loss on sale (note 3)	64 }	
Taxation (Working 3)	274	*1*
Decrease in stock (1,184 – 1,312)	128	*½*
Increase in debtors (1,888 – 928)	(960)	*½*
Decrease in creditors [(656 – 50) – 976]	(370)	*1*
	3,866	*(8)*

(b) **Cash flow statement for the year ended 31 July 2001**

	£000	£000	
Net cash inflow from operating activities (part (a) above)		3,866	
Returns on investment and servicing of finance			
Interest received (note 1)	346	}	*½*
Interest paid (note 1)	(474)	}	
Net cash outflow from returns on investment and servicing of finance		(128)	
Taxation			
Tax paid (note 1)		(178)	*½*
Capital expenditure and financial investment			
Payments to acquire buildings (Working 2a)	(5,460)		*1 ½*
Payments to acquire plant and equipment (Working 2a)	(974)		*1*
Receipts from sales of buildings (Working 2c)	2,140		*1*
Receipts from sale of plant and equipment (Working 2c)	126		*1*
Endowments received	1,280	}	*½*
Endowment investments made	(1,200)	}	
Net cash outflow from capital expenditure and financial investment		(4,088)	
Cash outflow before management of liquid resources and financing		(528)	
Management of liquid resources			
Short-term investments (1,920 – 1,000)		(920)	*½*
Financing			
Loan raised (3,840 – 1,000)		2,840	*½*
Net cash inflow (2,032) – (960 – 320)		1,392	*1*
Presentation			*1*
			(9)

(c) **Reconciliation of net cash flow to movement in net funds**

	£000	
Increase in cash (2,032) – (960 – 320)	1,392	
Long-term loans raised	(2,840)	
Endowment investment made	1,200	
Short-term investments made	920	
Change in net funds during year	672	
Net funds at 1 August 2000	640	
Net funds at 31 July 2001	1,312	*2*

Analysis of changes in net funds	**At 1/8/00 £000**	**Cash flows £000**	**At 31/7/01 £000**	
Cash in hand and at bank	960	1,072	2,032	
Overdrafts	(320)	320	-	
	640	1,392	2,032	
Endowment investment	-	1,200	1,200	
Current asset investment	1,000	920	1,920	
Debt due > 1 year	(1,000)	(2,840)	(3,840)	
Total	640	672	1,312	*2*

(d)

- The college generated a net cash inflow from its operations of £3,866k, largely through its surplus for the year and its depreciation retentions.
- The main utilisation of cash was the acquisition of net tangible fixed assts amounting to £4,168k (£5,460k + £974k – £2,140k - £126k).
- During the year the college's short term investments increased by £920k while it also increased long term loans by £2,840k.
- Overall the college has increased its cash balances during the year by almost £1.4m to over £2m. This raises two related fundamental questions about the cash management at the college – (i) why did it need to raise loans of almost £3m? and (ii) why did it not invest more of its cash resources?

One mark for each valid point made up to a maximum of 4 marks
(4)

25

Workings

1 Surplus/Deficit for year

	£000
Income & expenditure account 31.7.01	11,100
Income & expenditure account 31.7.00	(8,840)
Net interest payable (Working 4)	192
Operating surplus for year	2,452

2 Tangible fixed assets

		Buildings	Plant & equipment
		£000	£000
(a)	*Cost/valuation*		
	Balance 31.7.00	6,592	3,648
	Disposal (note 3)	(3,200)	(640)
	Revaluation (11,300 - 10,750 - 250 land (note 4)	300	
	Amount owing in respect of P&E (note 2)		50
	Additions paid for (balancing item)	5,460	974
	Balance 31.7.01	9,152	4,032
(b)	*Accumulated depreciation*		
	Balance 31.7.00	2,112	1,984
	On disposal (3,200 – 1,820; 640 – 190) (note 3)	(1,380)	(450)
	Depreciation charge for year (balance)	2,020	578
	Balance 31.7.01	2,752	2,112
(c)	*Sale proceeds* (note 3)		
	Book value on disposal	1,820	190
	Profit/(loss) on disposal	320	(64)
	Cash proceeds	2,140	126

3 Taxation

Balance 31.7.00	(176)
Payment (note 1)	178
Charge to I&E a/c (balancing item)	(274)
Balance 31.7.01	(272)

4 Interest payable

Balance 31.7.00	(32)
Payment (note 1)	474
Receipts (note 1)	(346)
Charge to I&E a/c (balancing item)	(192)
Balance 31.7.01	(96)

Question 3 (Health Service)

Total part (a) 6 marks
Total part (b) 9 marks
Total part (c) 4 marks
Total part (d) 6 marks
Total 25 marks

(a) **Calculation of operating surplus:**

	£000	
Retained surplus for year [3,400-840]	2,560	½
Public Dividend Capital dividends paid (note 6)	474	½
Interest received (note 6)	(346)	½
Profit on disposal of buildings (note 2)	(320)	½
Loss on disposal of plant and equipment (note 2)	64	½
Operating Surplus	2,432	

Note 1 Reconciliation of operating surplus to net cash flow from operating activities

	£000	
Total operating surplus	2,432	
Depreciation charge (??)	2,496	*2*
Decrease in stock [1,312-1,184]	128	½
Increase in debtors [928-1,188]	(960)	½
Decrease in creditors [924-1,134]	(210)	½
Net cash inflow from operating activities	3,886	

6

(b)

Jordanstown NHS Trust
Cash flow statement for the year ended 31 March 2001

	Working	£000	£000	
Net cash inflows from operating activities			3,886	
Returns on investments and servicing of finance				
Interest received		346		
Interest paid		0		
Net cash inflow from returns on investments and servicing of finance			346	
Capital expenditure				
Payments to acquire tangible fixed assets	1(b), 1(c)	(6,734)		*2½*
Receipts from sales of fixed assets	1 (d)	2,368		*1½*
Net cash outflow from capital expenditure			(4,366)	
Dividends paid			(474)	*½*
Net cash outflow before financing			(608)	
Financing				
New public dividend capital received	(21,852 – 18,960)	2,892		*1*
Net cash inflow from financing			2,892	
Increase in cash	[2,924 – (960 – 320)]		2,284	
Format and presentation				*2*
				(9)

(c)

Reconciliation of net cash flow to movement in net funds
(can be shown on face of cash flow statement or as a note)

	£000
Increase in cash in the period (2,924 - 960 + 320)	2,284
Change in net funds	2,284
Net funds at 1 April 2000 (960 - 320)	640
Net funds at 31 March 2001	2,924

2

Analysis of changes in net funds

	At 1.4.00 £000	Cash Flows £000	At 31.3.01 £000
Cash in hand and at bank	960	1,964	2,924
Overdrafts	(320)	320	0
	640	2,284	2,924

2

(d) The External Financing Limit (EFL) is a key financial target which NHS Trusts are required to meet, and it is linked very closely with the cash flow statement. A selection of the following points should be made to explain the EFL:

- The target is agreed prior to the start of the financial year (with the NHSE Regional Office)
- It represents the difference between internally generated cash (from depreciation, interest received, capital receipts etc) and the agreed capital programme for the forthcoming year.
- If internally generated cash is insufficient to fund the required capital expenditure for the year, a positive EFL will be set. Under these circumstances, the NHSE Regional Office will provide additional public dividend capital.
- If internally generated cash more than covers the capital programme, then cash will be paid back to the NHSE (repayment of public dividend capital). The Trust will be set a negative EFL under these circumstances.
- NHS Trusts are now required to have cash balances at the end of the year which are similar to the balances at the start of the year. This makes achievement of the EFL target more difficult than previously.
- The actual External Financing Requirement (EFR) for the year should be compared to the External Financing Limit (target) at the end of the year.
- The EFR can be identified on the cash flow statement as the net cash flow before financing and management of liquid resources.

1 mark per point to a maximum of 4

The performance of Jordanstown NHS Trust is as follows:

- EFR for the year was £608,000 (net cash outflow before financing and management of liquid resources)
- EFL target was £700,000
- The EFL has been undershot by £92,000, which means that either internally generated cash was higher than planned or the capital programme was lower than planned.

1 mark per point to a maximum of 2

6

Workings:

1. Capital

		£000
(a)	Land	
	Opening NBV	18,960
	Additions	-
	Disposals	-
	Closing NBV	18,960
(b)	Buildings Gross Current Cost	
	Opening GCC [23,440-18,960+2,112]	6,592
	Additions [balancing item]	5,760
	Disposals [note 2]	(3,200)
	Closing GCC [25,360-18,960+2,752]	9,152
	Buildings Accumulated Depreciation	
	Opening [note 4]	2,112
	Charge for year [balancing item]	1,920
	Disposal [3,200-1,920 (note 2)]	(1,280)
	Closing [note 4]	2,752
(c)	Equipment Gross Current Cost	
	Opening GCC [1,664+1,984]	3,648
	Additions [balancing item]	1,024
	Disposals [note 2]	(640)
	Closing GCC [3,200+2,112-1,280]	4,032
	Equipment Accumulated Depreciation	
	Opening [note 4]	1,984
	Charge for year [balancing item]	576
	Disposal [640-192 (note 2)]	(448)
	Closing [note 4]	2,112
(d)	Disposals	
	Buildings Net Book Value [note 2]	1,920
	Sales proceeds [balancing]	2,240
	Profit on disposal of buildings [note 2]	320
	Equipment Net Book Value [note 2]	192
	Sales proceeds [balancing]	128
	Loss on disposal of equipment [note 2]	(64)

Question 4 (Housing Associations)

(a) **Reconciliation of operating surplus to net cash flow from operating activities**

	£000	
Surplus (working 1)	2,282	*3*
Buildings depreciation (Working 2 (b))	520	*1*
Plant and equipment depreciation (Working 2 (b))	316	*1*
Profit on sale (notes 3 and 4 and working 2(c))	(370) }	*1*
Loss on sale (note 3)	64	
Increase in provisions	50	*1*
Decrease in stock (1,184 – 1,412)	228	*½*
Increase in debtors (1,888 – 1,388)	(500)	*½*
Decrease in creditors [(928 – 50) – 1,152]	(274)	*1*
	2,316	*(9)*

(b) **Cash flow statement for the year ended 31 July 2001**

	£000	£000	
Net cash inflow from operating activities (part (a) above)		2,316	
Returns on investment and servicing of finance			
Interest received (note 1)	346	}	*½*
Interest paid (note 1)	(874)	}	
Net cash outflow from returns on investment and servicing of finance		(528)	
Capital expenditure and financial investment			
Payments to acquire buildings (Working 2a)	(3,760)		*1*
Payments to acquire plant and equipment (Working 2a)	(674)		*1*
Receipts from sale of land (working 2(c))	300		
Receipts from sales of buildings (Working 2c)	1,140		*1*
Receipts from sale of plant and equipment (Working 2c)	88		*1*
Social housing grant received (Working 4)	1,930		*1*
Social housing grant repaid (note 3)	(270)		
Net cash outflow from capital expenditure and financial investment		(1,246)	
Cash inflow before management of liquid resources and financing		542	
Management of liquid resources			
Short-term investments (1,920 – 1,400)		(520)	*½*
Financing			
Loan raised (9,650 – 7,400)		2,250	*½*
Net cash inflow [1,952 – (320)]		2,272	*1*
Presentation			*1 ½*
			(9)

(c) **Reconciliation of net cash flow to movement in net funds**

	£000	
Increase in cash [1,952 – (320)]	2,272	
Long-term loans raised	(2,250)	
Short-term investments made	520	
Change in net funds during year	542	
Net funds at 1 August 2000	(6,320)	
Net funds at 31 July 2001	(5,778)	*1 ½*

Analysis of changes in net funds	**At 1/8/00 £000**	**Cash flows £000**	**At 31/7/01 £000**	
Cash in hand and at bank	-	1,952	1,952	
Overdrafts	(320)	320	-	
	(320)	2,272	1,952	
Current asset investment	1,400	520	1,920	
Debt due > 1 year	(7,400)	(2,250)	(9,650)	
Total	(6,320)	542	(5,778)	*1 ½*

(d)

- The Association generated a net cash inflow from its operations of £2,366k, largely through making a surplus for the year.
- The main utilisation of cash was the acquisition of net tangible fixed assts amounting to £2,956k (£3,510k + £674k – £1,140k - £88k), partly offset by net SHG received of £1,660k (£1,930k - £270k).
- During the year the Association's short term investments increased by £520k while it also increased long term loans by £2,250k.
- Overall the Association has increased its cash balances during the year by almost £2.3m, taking it from an overdraft of £320k to almost £2m in hand. This raises two related fundamental questions about the cash management at the Association – (i) why did it need to raise loans of almost £2.250k? and (ii) why did it not invest more of its cash resources?

One mark for each valid point made up to a maximum of 4 marks. 4

(25)

Workings

1 Surplus/Deficit for year

	£000
Revenue reserves 31.3.01	8,860
Revenue reserves 31.3.01	(7,740)
Transfer to designated reserves (720 - 580)	140
Transfer to restricted reserves (670 – 240)	430
Net interest payable (Working 3)	592
Surplus for year	2,282

2 Tangible fixed assets

		Buildings	Plant & equipment	Land
		£000	£000	£000
(a)	*Cost/valuation*			
	Balance 31.3.00	8,592	3,648	12,000
	Disposal (iii)	(1,200)	(340)	(250)
	Revaluation (3,950 - 3,100)			850
	Amount owing in respect of P&E (ii)		50	
	Additions paid for (balancing item)	3,760	674	
	Balance 31.3.01	11,152	4,032	12,600
(b)	*Accumulated depreciation*			
	Balance 31.3.00	2,612	1,984	
	On disposal (1,200 – 820; 340 – 152) (iii)	(380)	(188)	
	Depreciation charge for year (balance)	520	316	
	Balance 31.3.01	2,752	2,112	
(c)	*Sale proceeds* (iii)			
	Book value on disposal	820	152	250
	Profit/(loss) on disposal	320	(64)	50
	Cash proceeds	1,140	88	800

3 Interest payable

Balance 31.3.00	(32)
Payment (i)	874
Receipts (i)	(346)
Charge to I&E a/c (balancing item)	(592)
Balance 31.3.01	(96)

4 SHG

Balance 31.3.00	(3,170)
Payment (i)	270
Charge to I&E a/c (balancing item)	(1,930)
Balance 31.3.01	(4,830)

Question 5 (Local Government)

Reconciliation of net surplus to cash inflow

	£000	£000	
General fund surplus (1,139+130)		(1,269)	½
Add items not resulting in cash flow			
Depreciation	(190)		*1*
Additional MRP (152-190)	38		*2*
Direct revenue financing	(549)		*1*
		(701)	
Movements in working capital			
Less decrease in creditors (1,024-1,504)	480		½
Add decrease in debtors (888-928)	(40)		½
Add decrease in stock (1,184-1,312)	(128)		½
		312	
Add revenue costs of financing			
Net interest [324 (working 1) – 16 (note 1)]		(308)	*2*
Cash inflow from revenue		**(1,966)**	*(8)*

Working 1

AMRA Reconstruction

AMRA

	£000		£000
Depreciation	190	Asset rentals (190+456)	646
Actual interest (balance)	**324**		
AMRA adjustment	132		
	646		646

Cash flow statement for the year ended 31 March 2000

	£000	£000	
Revenue activities			
Cash outflows			
Cash paid to employees		4,836	½
Other operating cash payments		3,100	½
Cash inflows			
Precepts	(5,802)		½
Grants	(4,100)		½
		(9,902)	
Net cash inflow from revenue activities		**(1,966)**	
Returns on investments and servicing of finance			
Interest paid	324		*1*
Interest received	(16)		½
		308	
Capital activities			
Purchase of assets (working 2)	2,539		*2*
Sale of fixed assets (working 3)	(1,325)		*2*
		1,214	
Management of liquid resources			
Net increase/decrease in short term deposits		520	½
Financing			
Movement in loans		(168)	½
Net (increase)/decrease in cash		**(92)**	
Presentation			½
			(9)

Working 2

Fixed Assets

	£000		£000
Opening balance	6,144	Depreciation	190
		FARR (2,797 – 1,904)	893
Additions (balance)	**2,539**	Closing balance	7,600
	8,683		8,683

Working 3

Usable Capital Receipts

	£000		£000
Used capital receipts – cfr	1,600	Opening balance	434
Closing balance	159	**Cash received (balance)**	**1,325**
	1,759		1,759

(c) Reconciliation of net cash flow to movement in net funds

	£000
Increase in cash in the period	92
Cash inflow from new long-term loan	(168)
Cash used to purchase short-term investments	520
Change in net funds	444
Net funds at 1 April 2000	(2,712)
Net funds at 31 March 2001	(2,268)

2

Analysis of changes in net funds

	At 1/4/00 £000	Cash flows £000	At 31/3/01 £000
Cash in hand and at bank	960	92	1,052
Current asset investment	-	520	520
Debt due > 1 year	(3,672)	(168)	(3,840)
Total	(2,712)	444	(2,268)

2

(d)

- Council generated a net cash inflow from revenue activities of £1,966,000 largely due to cash received from grants and precepts.

- Management of working capital has impacted on this figure – the Council has less creditors at the year end resulting in a large cash outflow, offset slightly through a lower stock balance and less debtors at the year end.

- The main utilisation of cash was the acquisition of new fixed assets, which have been financed through a contribution of cash from the sales of fixed assets, revenue and long term loans.

- The authority invested surplus cash at the year-end in a short term investment.

1 mark per comment to a maximum of 4

SECTION B (Answer one question)

Question 6 (Central Government)

MEMORANDUM

To:	Finance Director
From:	Accountant
Date:	4 December 2001
Subject:	Outstanding accounting issues

As requested, I have outlined below explanations relating to the outstanding accounting adjustments.

Format & presentation 1

Issue 1:

FRS 3 *Reporting Financial Performance* requires a prior period adjustment in the financial statements for the year ended 31 March 2001 since the creditors relate to previous years and their omission has only now been discovered. Therefore it represents a fundamental error, ie if it had been discovered at the time, the financial statements would have been restated since they would no longer give a true and fair view.

Opening reserves are incorrect and will have to be adjusted, including comparatives. The prior period adjustment should also be recorded in statement of total recognised gains and losses.

DR	General Reserve	£150,000
CR	Creditors	£150,000

1 mark for explanation
1 mark for accounting entries

Issue 2:

FRS 5 *Reporting the substance of transactions* and the (ASB's Statement of Principles) define assets as 'rights or other access to future economic benefits controlled by an entity as a result of past transactions or events'. Assets should be recognised at the point when the organisation has access to economic benefits. In the case of Foyle Agency access to economic benefits occurred from 12 March 2001, so the equipment should be capitalised on the balance sheet as at that date:

DR	Fixed Assets	£250,000
CR	Suspense Account	£250,000

FRS 15 *Tangible Fixed Assets* deals with the initial measurement of fixed assets, their revaluation and depreciation. HM Treasury guidance also determines the treatment of fixed assets. Revaluation by indexation is compulsory where there is a material difference between the opening and closing values of tangible fixed assets. It is highly unlikely that there will be a material difference between 12 and 31 March. The asset should not be depreciated (in accordance with the Agency's policy).

2 marks for explanation
1 mark for accounting entries

Issue 3:

SSAP 21 *Accounting for Leases and Hire Purchase Contracts* deals with the definitions of leases and their accounting treatment.

In this case the job monitoring system should be capitalised on the balance sheet at its fair value, and the finance lease payment should be split between principal and interest. Finance leases should be depreciated over the shorter of the lease term or the useful economic life of the asset.

The repayment schedule over the life of the lease can be established by one of 3 ways:

- Assume straight line repayment of principal
- Use sum of digits method to provide a more realistic estimate of the principal repayment schedule
- Use the actuarial method to establish the exact principal repayment.

Students should pick one of the first two methods to calculate the first year principal repayment.

Straight line:

Fair value	£500,000
Term of lease	10 years
Principal per year	£50,000

Therefore, interest element is £20,000 (£70,000 - £50,000)

Sum of digits:

10+9+8+7+6+5+4+3+2+1 = 55 [or n(n+1)/2]

Interest for term of lease = £70,000x10 - £500,000 = £200,000

Year 1 Interest = 10/55 x £200,000 = £36,364 Principal = £33,636
Year 2 Interest = 9/55 x £200,000 = £32,727 Principal = £37,273

Required accounting entries

		Straight Line	Sum of Digits
Capitalise Asset		£	£
DR	Fixed Asset	500,000	500,000
CR	Creditors < 1year	50,000	33,636
CR	Creditors > 1year	450,000	466,364
Lease Payment			
DR	Interest payable	20,000	36,364
DR	Creditors < 1 year	50,000	33,636
CR	Cash / Bank	70,000	70,000

Next year's principal

DR	Creditors > 1yr	50,000	37,273
CR	Creditors < 1yr	50,000	37,273

Depreciation (lease term)

DR	Operating expenditure	50,000	50,000
CR	Accumulated Depreciation	50,000	50,000

2 marks for explanation
3 marks for accounting entries

Issue 4:

SSAP 2 *Disclosure of Accounting Policies* requires prudence when reporting income. In the two cases relating to bad or doubtful debts SSAP 2 requires adjustments to be made to the value of debtors in the balance sheet.

For the bankrupt debtor the correct accounting treatment is to write off the whole amount:

DR	Bad Debts	£80,000
CR	Debtors	£80,000

For the other doubtful debts, if the student takes a highly prudent approach they may suggest:

DR	Bad debt expense	£60,000
CR	Debtors	£60,000

Alternatively, students may choose to set up a bad debt provision:

DR	Bad debt expense	£60,000
CR	Provision for bad debts	£60,000

FRS 18 *Accounting Policies* may be quoted as the accounting standard which replaces and consolidates the requirements of SSAP 2. Full credit should be given for this.

2 marks for explanation
2 marks for accounting entries

For the negligence claim, FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* is relevant. FRS 12 suggests that a provision should be made when an entity has a present obligation as a result of a past event (the accident in this case), it is probable that the obligation will lead to a transfer of economic benefit (a payout is probable), and a reliable estimate of that obligation can be made (an expected value has been provided in the question).

Foyle Agency should therefore establish a provision and charge the expected value of the final settlement to the I&E.

DR	Expenditure	£350,000
CR	Provision	£350,000

1 mark for explanation
1 mark for accounting entries

Issue 5:

Accounting for assets funded through donations is determined by the resource accounting manual. The value of the assets transferred should be credited to a donation reserve. The accounting entries for this are:

DR	Fixed assets	£130,000
CR	Donation reserve	£130,000

Depreciation should be charged to the I&E account in accordance with the Agency's policy (see note 2) and matched with a release from the donation reserve to income.

Depreciation calculation £130,000 / 5 = £26,000 per year
£26,000 x 9/12 = £19,500 for this year

DR	I&E - depreciation	£19,500
CR	Accumulated depn.	£19,500
DR	Donation Reserve	£19,500
CR	Income – other	£19,500

1 mark for discussion
2 marks for accounting entries

(20)

Question 7 (Further and Higher Education)

MEMORANDUM

To:	Director of Finance
From:	Financial Accountant
Date:	4 December 2001
Subject:	Outstanding accounting issues

As requested, I have outlined below explanations relating to the outstanding accounting adjustments.

Format & presentation 1

Issue 1:

FRS 3 *Reporting Financial Performance* requires a prior period adjustment in the financial statements for the year ended 31 July 2001 since the creditors relate to previous years and they have only now been discovered. Therefore it represents a fundamental error, i.e. if the error had been discovered at the time, the financial statements would have been restated since they would no longer give a true and fair view.

Opening reserves are incorrect and will have to be adjusted, as will comparative figures. The prior period adjustment should also be recorded in statement of total recognised gains and losses.

DR	Accumulated general reserve (I&E reserve)	£150,000
CR	Creditors	£150,000

1 mark for explanation
1 mark for accounting entries

Issue 2:

FRS 5 *Reporting the substance of transactions* and the (ASB's Statement of Principles) define assets as 'rights or other access to future economic benefits controlled by an entity as a result of past transactions or events'. Assets should be recognised at the point when the organisation has access to economic benefits. In the case of Foyle University access to economic benefits occurred from 12 July 2001, so the equipment should be capitalised on the balance sheet as at that date:

DR	Fixed Assets	£250,000
CR	Suspense Account	£250,000

FRS 15 *Tangible Fixed Assets* deals with the initial measurement of fixed assets, their revaluation (not compulsory) and depreciation. The asset should be depreciated from the date of capitalisation. Depending on the university's accounting for depreciation policy (and assuming a 10 year asset life with no residual values) the depreciation charge could range from £25,000 if a full year's depreciation is charged to nil if it is argued that 19 days' ownership would result in an immaterial depreciation charge.

Taking the former assumption, the accounting entries would be:

DR	Income and expenditure account	£25,000
CR	Fixed Assets	£25,000

2 marks for explanation
2 marks for accounting entries

Issue 3:

SSAP 21 *Accounting for Leases and Hire Purchase Contracts* deals with the definitions of leases and their accounting treatment. In this case the computerised system should be capitalised on the balance sheet at its fair value, and the finance lease payment should be split between principal and interest. Finance leases should be depreciated over the shorter of the lease term or the useful economic life of the asset.

The repayment schedule over the life of the lease can be established by the sum of digits method to provide an estimate of the principal repayment schedule.

Students may use an alternative method to calculate the principal repayments and full credit should be allowed for its correct application.

Sum of digits = 10+9+8+7+6+5+4+3+2+1 = 55 [or n(n+1)/2]
Interest for term of lease = £70,000x10 - £500,000 (fair value) = £200,000
Year 1 Interest = 10/55 x £200,000 = £36,364; Principal = £70,000 - £36,364 = £33,636
Year 2 Interest = 9/55 x £200,000 = £32,727; Principal = £70,000 - £32,727 = £37,273

The required accounting entries are:

DR	Fixed Assets	£500,000
CR	Creditors > 1year	£466,364
CR	Creditors < 1yr	£33,636

Accounting for the capitalisation of the asset.

DR	Income and expenditure account	£36,364
DR	Creditors < 1year	£33,636
CR	Suspense	£70,000

Accounting for the amount due in respect of the lease payment.

DR	Creditors > 1year	£37,273
CR	Creditors < 1yr	£37,273

Accounting for next year's principal repayment.

DR	Income and expenditure account	£50,000
DR	Fixed asset	£50,000

Accounting for the annual depreciation charge

3 marks for explanation
3 marks for accounting entries

Issue 4:

SSAP 2 *Disclosure of Accounting Policies* requires prudence when reporting income. In the two cases relating to bad or doubtful debts the SSAP 2 requires the debt to be written off to the I&E Account.

DR	Income and expenditure account	£140,000
CR	Debtors	£140,000

FRS 18 *Accounting Policies* may be quoted as the accounting standard which replaces and consolidates the requirements of SSAP 2. Full credit should be given for this.

1 mark for explanation
1 mark for accounting entries

For the unfair dismissal claim, FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* is relevant. FRS 12 suggests that a provision should be made when an entity has a present obligation as a result of a past event (the dismissal in this case), it is probable that the obligation will lead to a transfer of economic benefit (a payout is probable), and a reliable estimate of that obligation can be made (an expected value has been provided in the question). Foyle University should establish a provision and charge the expected value of the final settlement to the I&E.

DR	Income and expenditure account	£350,000
CR	Provision	£350,000

1 mark for explanation
1 mark for accounting entries

Issue 5:

SSAP 4 *Accounting for Government Grants* deals specifically with assistance received from government sources. However, SSAP 4 is also indicative of best practice for accounting for assistance from other sources. Donated fixed assets should be included in the balance sheet at valuation with the corresponding credit to reserves (e.g. donation reserve). The accounting entries for this transaction are:

DR	Fixed assets	£130,000
CR	Donation reserve	£130,000

As the equipment has been in use for most of the financial year, it is prudent to charge a full year's depreciation to the I&E account, and this should be matched with a release from the donation reserve to income. The accounting entries are:

DR	Income and expenditure account	£26,000
CR	Fixed assets	£26,000
DR	Donation Reserve	£26,000
CR	Income and expenditure account	£26,000

1 mark for discussion
2 marks for accounting entries

(20)

Question 8 (Health Service)

MEMORANDUM

To:	Director of Finance
From:	Accountant
Date:	4 December 2001
Subject:	Outstanding accounting issues

As requested, I have outlined below explanations relating to the outstanding accounting adjustments.

Format & presentation 1

Issue 1:

FRS 3 *Reporting Financial Performance* requires a prior period adjustment in the financial statements for the year ended 31 March 2001 since the creditors relate to previous years and they have only now been discovered. Therefore it represents a fundamental error, ie if it had been discovered at the time, the financial statements would have been restated since they would no longer give a true and fair view.

Opening reserves are incorrect and will have to be adjusted, including comparatives. The prior period adjustment should also be recorded in statement of total recognised gains and losses.

DR	I&E Reserve	£150,000
CR	Creditors	£150,000

1 mark for discussion
1 mark for accounting entries

Issue 2:

FRS 5 *Reporting the substance of transactions* and the (ASB's Statement of Principles) define assets as 'rights or other access to future economic benefits controlled by an entity as a result of past transactions or events'. Assets should be recognised at the point when the organisation has access to economic benefits. In the case of Foyle NHS Trust access to economic benefits occurred from 12 March 20001, so the equipment should be capitalised on the balance sheet as at that date:

DR	Fixed Assets	£250,000
CR	Suspense Account	£250,000

FRS 15 *Tangible Fixed Assets* deals with the initial measurement of fixed assets, their revaluation (not compulsory) and depreciation. The asset should be depreciated from the date of capitalisation. However, the NHS Capital Accounting Manual and Manual for Accounts state that depreciation should not be charged in the quarter of acquisition. So, no depreciation is due for the theatre equipment for 2000/2001.

1 mark for discussion
2 marks for accounting entries

Issue 3:

SSAP 21 *Accounting for Leases and Hire Purchase Contracts* deals with the definitions of leases and their accounting treatment.

In this case the pathology system should be capitalised on the balance sheet at its fair value, and the finance lease payment should be split between principal and interest. Finance leases should be depreciated over the shorter of the lease term or the useful economic life of the asset.

The repayment schedule over the life of the lease can be established by one of 3 ways:

- Assume straight line repayment of principal
- Use sum of digits method to provide a more realistic estimate of the principal repayment schedule
- Use the actuarial method to establish the exact principal repayment.

Students should pick one of the first two methods to calculate the first year principal repayment.

Straight line:

Fair value	£500,000
Term of lease	10 years
Principal per year	£50,000

Therefore, interest element is £20,000 (£70,000 - £50,000)

Sum of digits:

10+9+8+7+6+5+4+3+2+1 = 55 [or n(n+1)/2]

Interest for term of lease = £70,000x10 - £500,000 = £200,000

Year 1 Interest = 10/55 x £200,000 = £36,364 Principal = £33,636
Year 2 Interest = 9/55 x £200,000 = £32,727 Principal = £37,273
Required accounting entries

		Straight Line	Sum of Digits
Capitalise Asset		£	£
DR	Fixed Asset	500,000	500,000
CR	Creditors < 1year	50,000	33,636
CR	Creditors > 1year	450,000	466,364
Lease Payment			
DR	Interest payable	20,000	36,364
DR	Creditors < 1 year	50,000	33,636
CR	Cash / Bank	70,000	70,000

Next year's principal

DR	Creditors > 1yr	50,000	37,273
CR	Creditors < 1yr	50,000	37,273

Depreciation (lease term)

DR	Operating expenditure	50,000	50,000
CR	Accumulated Depreciation	50,000	50,000

2 marks for explanation
3 marks for accounting entries

Issue 4:

SSAP 2 *Disclosure of Accounting Policies* requires prudence when reporting income. In the two cases relating to bad or doubtful debts the SSAP 2 requires the debt to be written off to the I&E Account.

For the Health Authority, the NHS does not recognise "inter-NHS bad debts", so the correct accounting treatment (per the NHS Manual for Accounts) is to issue a credit note:

DR	Income from activities	£80,000
CR	Debtors	£80,000

For the private patient income, the write off should be through bad debt expense on the I&E. If the student takes a highly prudent approach they may suggest:

DR	Bad debt expense	£60,000
CR	Debtors	£60,000

Alternatively, students may choose to set up a bad debt provision:

DR	Bad debt expense	£60,000
CR	Provision for bad debts	£60,000

FRS 18 *Accounting Policies* may be quoted as the accounting standard which replaces and consolidates the requirements of SSAP 2. Full credit should be given for this.

2 marks for explanation
2 marks for accounting entries

For the clinical negligence claim, FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* is relevant. FRS 12 suggests that a provision should be made when an entity has a present obligation as a result of a past event (the operation in this case), it is probable that the obligation will lead to a transfer of economic benefit (a payout is probable), and a reliable estimate of that obligation can be made (an expected value has been provided in the question).

Foyle NHS Trust should establish a provision and charge the expected value of the final settlement to the I&E.

DR	Expenditure	£350,000
CR	Provision	£350,000

1 mark for explanation
1 mark for accounting entries

Issue 5:

SSAP 4 *Accounting for Government Grants* deals specifically with assistance received from government sources. However, SSAP 4 is also indicative of best practice for accounting for assistance from other sources. In the case of NHS Trusts, accounting for assets funded through donations is determined by SSAP 4. The accounting entries for this transaction are:

DR	Fixed assets	£130,000
CR	Donation reserve	£130,000

As the equipment was in use in June 2000 (quarter 1), 3 quarters of depreciation should be charged to the I&E account, and this should be matched with a release from the donation reserve to income.

Depreciation £130,000 / 20 = £6,500 per quarter

DR	Expenditure	£19,500
CR	Accumulated depn.	£19,500
DR	Donation Reserve	£19,500
CR	Income – other	£19,500

1 mark for discussion
2 marks for accounting entries

(20)

Question 9 (Housing Associations)

MEMORANDUM

To:	Director of Finance
From:	Financial Accountant
Date:	4 December 2001
Subject:	Outstanding accounting issues

As requested, I have outlined below explanations relating to the outstanding accounting adjustments.

Format & presentation 1

Issue 1:

FRS 3 *Reporting Financial Performance* requires a prior period adjustment in the financial statements for the year ended 31 March 2001 since the creditors relate to previous years and they have only now been discovered. Therefore it represents a fundamental error, ie if the error had been discovered at the time, the financial statements would have been restated since they would no longer give a true and fair view.

Opening reserves are incorrect and will have to be adjusted, as will comparative figures. The prior period adjustment should also be recorded in statement of total recognised gains and losses.

DR	Income and expenditure reserve	£150,000
CR	Creditors	£150,000

1 mark for explanation
1 mark for accounting entries

Issue 2:

FRS 5 *Reporting the substance of transactions* and the (ASB's Statement of Principles) define assets as 'rights or other access to future economic benefits controlled by an entity as a result of past transactions or events'. Assets should be recognised at the point when the organisation has access to economic benefits. In the case of Foyle Housing Association access to economic benefits occurred from 12 March 2001, so the equipment should be capitalised on the balance sheet as at that date:

DR	Fixed Assets	£250,000
CR	Suspense Account	£250,000

FRS 15 *Tangible Fixed Assets* deals with the initial measurement of fixed assets, their revaluation (not compulsory) and depreciation. The asset should be depreciated from the date of capitalisation. Depending on the Association's accounting for depreciation policy (and assuming a 10 year asset life with no residual values) the depreciation charge could range from £25,000 if a full year's depreciation is charged to nil if it is argued that 19 days' ownership would result in an immaterial depreciation charge.

Taking the former assumption, the accounting entries would be:

DR	Income and expenditure account	£25,000
CR	Fixed Assets	£25,000

2 marks for explanation
2 marks for accounting entries

Issue 3:

SSAP 21 *Accounting for Leases and Hire Purchase Contracts* deals with the definitions of leases and their accounting treatment. In this case the computerised system should be capitalised on the balance sheet at its fair value, and the finance lease payment should be split between principal and interest. Finance leases should be depreciated over the shorter of the lease term or the useful economic life of the asset.

The repayment schedule over the life of the lease can be established by the sum of digits method to provide an estimate of the principal repayment schedule.

Students may use an alternative method to calculate the principal repayments and full credit should be allowed for its correct application.

Sum of digits = 10+9+8+7+6+5+4+3+2+1 = 55 [or n(n+1)/2]
Interest for term of lease = £70,000x10 - £500,000 (fair value) = £200,000
Year 1 Interest = 10/55 x £200,000 = £36,364; Principal = £70,000 - £36,364 = £33,636
Year 2 Interest = 9/55 x £200,000 = £32,727; Principal = £70,000 - £32,727 = £37,273

The required accounting entries are:

DR	Fixed Assets	£500,000
CR	Creditors > 1year	£466,364
CR	Creditors < 1yr	£33,636

Accounting for the capitalisation of the asset.

DR	Income and expenditure account	£36,364
DR	Creditors < 1year	£33,636
CR	Suspense	£70,000

Accounting for the amount due in respect of the lease payment.

DR	Creditors > 1year	£37,273
CR	Creditors < 1yr	£37,273

Accounting for next year's principal repayment.

DR	Income and expenditure account	£50,000
DR	Fixed asset	£50,000

Accounting for the annual depreciation charge

3 marks for explanation
3 marks for accounting entries

Issue 4:

SSAP 2 *Disclosure of Accounting Policies* requires prudence when reporting income. In the two cases relating to bad or doubtful debts the SSAP 2 requires the debt to be written off to the I&E Account.

DR	Income and expenditure account	£140,000
CR	Debtors	£140,000

FRS 18 *Accounting Policies* may be quoted as the accounting standard which replaces and consolidates the requirements of SSAP 2. Full credit should be given for this.

1 mark for explanation
1 mark for accounting entries

For the negligence claim, FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* is relevant. FRS 12 suggests that a provision should be made when an entity has a present obligation as a result of a past event (the operation in this case), it is probable that the obligation will lead to a transfer of economic benefit (a payout is probable), and a reliable estimate of that obligation can be made (an expected value has been provided in the question). Foyle Housing Association should establish a provision and charge the expected value of the final settlement to the I&E.

DR	Income and expenditure account	£350,000
CR	Provision	£350,000

1 mark for explanation
1 mark for accounting entries

Issue 5:

SSAP 4 *Accounting for Government Grants* deals specifically with assistance received from government sources. However, SSAP 4 is also indicative of best practice for accounting for assistance from other sources. These fixed assets should be included in the balance sheet at valuation with the corresponding credit to deferred income. The accounting entries for this transaction are:

DR	Fixed assets	£130,000
CR	Deferred income	£130,000

As the equipment has been in use for most of the financial year, it is prudent to charge a full year's depreciation to the I&E account, and this should be matched with a release from the deferred income to income. The accounting entries are:

DR	Income and expenditure account	£26,000
CR	Fixed assets	£26,000
DR	Deferred income	£26,000
CR	Income and expenditure account	£26,000

1 mark for discussion
2 marks for accounting entries

(20)

Question 10 (Local Government)

MEMORANDUM

To:	Director of Finance
From:	Financial Accountant
Date:	4 December 2001
Subject:	Outstanding accounting issues

As requested, I have outlined below explanations relating to the outstanding accounting adjustments.

Format & presentation 1

Issue 1:

FRS 3 *Reporting Financial Performance* requires a prior period adjustment in the financial statements for the year ended 31 March 2001 since the creditors relate to previous years and their suppression has only now been discovered. Therefore it represents a fundamental error, ie if it had been discovered at the time, the financial statements would have been restated since they would no longer present fairly.

However, the SORP requires prior year adjustments to be accounted for in the year. They are identified and disclosed within the notes to the accounts or, if necessary, on the face of the appropriation revenue account.

1 *mark for explanation*
1 mark for accounting entries

Issue 2:

FRS 5 *Reporting the substance of transactions* and the ASB's Statement of Principles define assets as 'rights or access to future economic benefits controlled by an entity as a result of past transactions or events'. Assets should be recognised when the organisation has access to economic benefits. In the case of Foyle District Council access to economic benefits occurred from 12 March 2001, so the equipment should be capitalised on the balance sheet as at that date:

Dr Fixed Assets	£250,000
Cr Suspense	£250,000

In addition in accordance with the Local Authority SORP 2000 the Council needs to account for the financing of this asset from usable capital receipts:

Dr Usable Capital Receipts	£250,000
Cr Capital Financing Reserve	£250,000

2 *marks for explanation*
2 marks for accounting entries

Issue 3:

SSAP 21 Accounting for Leases and Hire Purchase Contracts deals with the definitions of leases and their accounting treatment.

In this case the reprographics equipment should be capitalised on the balance sheet at its fair value, and the financing lease payment should be split between principle and interest. Finance leases should be depreciated over the shorter of the lease term or the useful economic life of the asset. This charge should go via the AMRA and asset rentals should be calculated and charged on this asset

Dr Fixed asset	£500,000
Cr Deferred liabilities	£500,000

Capitalise the asset

Dr AMRA	£50,000	(£500,000/10 years)
Cr Fixed asset	£50,000	

Depreciate the asset

Dr Service Revenue Accounts	£80,000
Cr AMRA	£80,000

Being the charge of asset rentals on the asset (assuming notional interest of 6% of opening NBV = £30,000 + £50,000 depreciation)

N.B Student should also be given full credit for calculating notional interest based on closing NBV (ie £450,000 x 6% = £27,000)

The total interest implicit in the lease should be charged to the AMRA over its life using the sum of digits method. The yearly payment can then be split between principle and interest elements.

Financing element = 500,000 – (70,000*10) = 200,000

Sum of digits:

10(10+1)/2 = 55

	Interest	Principal
Year 1 10/55*200,000	£36,364	£33,636

Dr AMRA	£36,364
Cr Suspense account	£36,364

Being the interest due on the lease in the first year.

Dr Deferred liabilities	£33,636
Cr Suspense account	£33,636

Being the principal repayment in year one.

N.B Students should also be given full credit for using any other appropriate method of identifying the annual interest element.

The interest payable under the lease arrangements should be funded from the Capital Financing Reserve.

Dr Capital Financing Reserve	£36,364
Cr CRA: Appropriations	£36,364

3 marks for explanation
3 marks for accounting entries

Issue 4:

FRS 12 Provisions, Contingent Liabilities and Contingent Assets applies to LA accounts. A provision is a liability of uncertain timing or amount and should therefore meet the rules of recognition for a liability ie present obligation and a requirement to transfer economic benefits. The case of the OAP meets these recognition rules and a provision should be created by:

Dr Service Revenue Account	£350,000
Cr Provision for liabilities and charges	£350,000

1 mark for explanation
1 mark for accounting entries

Issue 5:

In according with the Capital Accounting Guidance notes and the LA SORP when an asset is disposed of the net book value should be written off against the fixed asset restatement reserve and income from the disposal should be credited to the usable capital receipts reserve. Where applicable, the proportion reserved for the repayment of external loans should be credited to the capital financing reserve.

In this instance the asset should be written out at its NBV of £1m by:

Dr FARR	£1m
Cr Fixed asset	£1m

The proceeds of £15m should be taken to the UCR reserve and as the assets are housing 75% of this should then be set aside for the repayment of debt.

Dr Cash	£1,500,000
Cr UCR	£1,500,000
Dr UCR	£1,125,000
Cr CFR	£1,125,000

3 marks for explanation
2 marks for accounting entries
(20)

SECTION C (Compulsory)

Question 11

(a) Performance measures (PMs) and Performance indicators (PIs)

- Performance measures are used to mean instances where economy, efficiency and effectiveness can be measured precisely and unambiguously (rarely possible in public sector);
- Performance indicators cover the more usual circumstances where precise measurement is not possible. A factor which can be measured is taken as an indicator of economy, efficiency or effectiveness;
- It is customary to use a variety of different indicators to assess services or programmes since one indicator can rarely give a complete picture of performance;
- PM/PI can be used to improve management practice and accountablility by enabling regular monitoring of activity at various levels throughout the organisation;
- Internally they can be used to:
  - assist in the formulation and execution of policy
  - assist in the planning and budgeting of service provision
  - improve standards of service delivery
  - monitor the economic and effective use of resources
  - ensure fair distribution of and access to resources by service users
- Externally they can be used to:
  - assess performance by comparison against targets, previous years or other organisations
  - highlight areas of public importance or interest
  - develop benchmarks or targets for performance

up to 1 mark per point made to a maximum of 5

(b) PMs/PIs as complentary to traditional methods of demonstrating accountability

- Traditional methods of demonstrating financial accountability rest on annual financial statements and independent audit. Whilst there is still a need for this, it is no longer sufficient on its own.
- The wider network of accountabilities to many different stakeholders in the public sector and the greater variety of corporate models means that additional ways of demonstrating accountability are required.
- There is an ever increasing focus on managerial accountability and value for money which necessitates alternative reporting measures. It is no longer simply about what was spent but how it was spent that is of concern to stakeholders.
- Attention has also shifted towards the quality of services provided by the public sector, which is not well measured by traditional methods of accountability.
- These additional requirements in the public sector have led to the generation of both externally and internally set PIs and PMs to fill the gap between traditional methods and stakeholder expectations.

up to1 mark per point made to a maximum of 4

(c) Arrangements for setting, validation and reporting of PMs/PIs

Sector	***Setting***	***Validation***	***Reporting***
Central Government Departments	Citizens Charter/ Service First standards set by Cabinet Office; targets set by Departments	Internal validation subject to scrutiny by Cabinet Office	Annual departmental report to Parliament; Cabinet Office annual publication of results
Agencies	Key targets set by Secretary of State	Audited by IA or NAO	Annual report to Parliament
Local Government	LGA 1982 PIs set by Audit Commission Best Value PIs set by DETR	Audited by external auditors appointed by the Audit Commission	To SofS and Members as part of annual report and accounts. Publication of "league tables" of PIs.
Health Service	Patients Charter / Performance Assessment Framework	Data validation by NHS Executive	Annual returns by health bodies to NHSE; publication of results by NHSE
Further and Higher Education	Key measures and targets set by Funding Councils	Self validation and scrutiny by funding body	Annual returns to the relevant Funding Council; publication of PIs by HEFC/LSC
Housing	Key measures and targets set by regulators (Housing Corporation, Scottish Homes, Tai Cymru)	Self validation plus inspections and validations by regulator	Annual returns by HAs to the relevant regulator; publication of PIs by regulator
All Sectors	Internal measures and targets set by and for management	Validation by management with assistance of IA	Internal reporting lines

up to1 mark per point made to a maximum of 6
Total for question 11 – 15 marks

SECTION D (Compulsory)

Question 12

Consolidated Balance Sheet as at 30 June 2001

Fixed assets (book value)	**£m**	**£m**	**£m**	**Working**	
Intangible: goodwill			99	1	*5*
Tangible			1,385	2	*2*
			1,484		
Current assets					
Stock		696		3	*1*
Debtors		530		4a	
Bank & cash		103		5	*1*
		1,329			
Less: Creditors < 1 year					
Creditors	(322)			4b	
Proposed dividends	(111)			6	*1*
		(433)			
			896		
			2,380		
Capital and reserves					
Ordinary share capital (F plc only)			750		*½*
Profit & loss A/c			1,458	7	*4½*
			2,208		
Minority Interest			172	8	*3*
			2,380		*18*
Aggregation and cancellation					*1*
Presentation					*1*
					(20)

Working 1: Goodwill (Cost of control)	**R Ltd**	**A Ltd**	**Total**
	%	**%**	
A Proportion of equity owned by F plc (i) (ii)	75	100	
Proportion of equity owned by minority interest	25	0	
B Years as subsidiary (i) (ii)	5	1	
	£m	**£m**	**£m**
C Investment at cost	597	500	1,097
D Nominal value of ordinary share capital			
R Ltd: £300m @ 75% (i)	(225)		(225)
A Ltd: £200m @ 100% (ii)		(200)	(200)
Pre-acquisition profits			
E R Ltd: £240m @ 75%	(180)		(180)
E A Ltd (£270m @ 100%)		(270)	(270)
F Increased fair value of of tangible fixed assets (i)			
R Ltd: £64m @ 75%	(48)		(48)
G Goodwill [C - (D + E + F)]	144	30	174
H Annual amortisation (over 10 years) (v)	14.4	3	17.4
I Amortisation charges against group profits [B * H]	72	3	75
J *Total to CBS [G - I]*	72	27	99

Working 2: Tangible fixed assets	**F Ltd**	**R Ltd**	**A Ltd**	**Total**
	£m	**£m**	**£m**	**£m**
Balances	653	340	360	1,353
K Increase in fair value (i)				
Goodwill (Working 1) (group £64m @ 75%)		48		48
MI (£64m @ 25%)		16		16
Increased depreciation (addl 10 yrs: 5 elapsed)				
P&L a/c (group) (K/10*5 @ 75%)		(24)		(24)
MI (K/10*5 @ 25%)		(8)		(8)
Total to CBS	653	372	360	1,385

Working 3: Stock	**F Ltd**	**R Ltd**	**A Ltd**	**Total**
	£m	**£m**	**£m**	**£m**
Balances	290	230	180	700
Unrealised profit on stock (iii) (£20m @ 40% * 0.5)				0
P&L a/c (group 75%)	(3)			(3)
MI (25%)	(1)			(1)
Total to CBS	286	230	180	696

Working 4	**F Ltd**	**R Ltd**	**A Ltd**	**Total**
	£m	**£m**	**£m**	**£m**
a Debtors	140	200	190	530
b Creditors	(104)	(60)	(158)	(322)

Working 5: Bank & cash	**F Ltd**	**R Ltd**	**A Ltd**	**Total**
	£m	**£m**	**£m**	**£m**
Balances	80	10	10	100
Cash in transit (iv)	3			3
Total to CBS	83	10	10	103

Working 6: Proposed dividends	**F Ltd**	**R Ltd**	**A Ltd**	**Total**
	£m	**£m**	**£m**	**£m**
Balances				
Receivable (R=£60m@75% plus A=£80m@100%)	125			125
Payable	(96)	(60)	(80)	(236)
Total to CBS	29	(60)	(80)	(111)

Working 7: Profit & loss a/c	**F Ltd**	**R Ltd**	**A Ltd**	**Total**
	£m	**£m**	**£m**	**£m**
Balance	1,440	360	300	2,100
Pre-acquisition profits (see working 1)		(180)	(270)	(450)
Amortisation of goodwill (see working 1)		(72)	(3)	(75)
Unrealised profit on stock (iii) (£20m@40%*0.5*75%)	(3)			(3)
Increased depreciation (i) (working 2)		(24)		(24)
Attributable to minority interest				0
R Ltd (£360m @ 25%)		(90)		(90)
A Ltd (£300m @ 0%)			0	0
Total to CBS	1,437	(6)	27	1,458

Working 8: Minority interest	**R Ltd**		**Total**
	£m		**£m**
Nominal value of ordinary share capital			
R Ltd: £300m @ 25% (i)	75		75
Share of profits (working 7)	90		90
Increased fair value of of tangible fixed assets (i)			
R Ltd: £64m @ 25%	16		16
Increased depreciation (i) (working 2)	(8)		(8)
Unrealised profit on stock (iii) (£20m@40%*0.5*25%)	(1)		(1)
Total to CBS	172		172

N.B. Current accounts	**F Ltd**	**R Ltd**	**A Ltd**	**Total**
	£m	**£m**	**£m**	**£m**
Balances	5	0	(2)	3
Cash in transit (iv)	(3)			(3)
Total	2	0	(2)	0

SECTION E (Answer one question)

Question 13

The main changes introduced by FRS 15 *Tangible Fixed Assets* and the impact these are likely to have on public sector organisations.

Key changes	Likely impact
1. Revaluation policy: - must decide to revalue or not, and if not, then revert to historic cost or freeze existing current amount; - rules for how valuations obtained; - harder to justify non-depreciation on the basis of continuous programme of repair and maintenance.	- Public sector bodies use a combination of historic cost and revalued Fixed Assets. Where assets are not held at historic cost they are already revalued every 5 years and for some public sector bodies (eg NHS) indexation is also applied annually. - the only valid reasons for non-depreciation is now that the charge would be immaterial or that the asset has an infinite life, and when depreciation is not charged, an annual impairment review must be carried out. This is having a significant impact on certain public sector bodies eg LA's.
2. Capitalisation of finance costs: - tightened definition of costs that may be capitalised.	- may impact on items capitalised by public sector bodies.
3. Cyclical repairs: - can no longer match costs of repairs against income which is now consistent with FRS 12.	- No real impact on public sector bodies as not accounting practice.
4. Disclosures: 5. Replacement of SSAP 12:	- increased information regarding initial measurement, valuation and depreciation; - should enable users to more fully understand the impact of an organisation's policies. - no significant change, depreciation has always been charged on the revalued amount in the public sector.
6. Treatment of gains/losses on revaluation and disposal recognised on a consistent basis.	- revaluation gains/losses should be recognised in the STRGL this should have no change to existing practice in the public sector - fall in value due to wear and tear should be taken to the equivalent I&E account, other reasons for a decrease in asset values should be taken to the revaluation reserve when sufficient reserves available. This will have an impact on the public sector and its accounting.

1 mark for each key change mentioned up to a maximum of 4 marks,
and 1 mark for each impact mentioned up to a maximum of 4 marks

(b) *Open market value*

Value that could be obtained in an open market where there is reasonable time to market the asset, the buyer and seller are both willing and able to complete a cash purchase and both parties are acting freely with full knowledge.

Can be used for investment properties that some public sector organisations may have. *2*

Existing use value

This value reflects the current use of the property and assumes there will be no change in use. A version of this method is to be used to value council housing stock. *2*

Open market value for alternative use

This is the value that could be obtained if the property were sold and used for a different purpose. This value should not be used in the accounts unless the property is about to be sold.

This basis could be used for a closed school sites being sold for redevelopment into luxury flats. *2*

Depreciated replacement cost

This basis can be used for properties that have no ready market and therefore no apparent market value. The land value is estimated using existing use and buildings are valued using gross replacement cost adjusted for age and condition of the building.

This basis could be used for a school or town hall. *2*

Value to the business

The value to the business is the lower of net current replacement cost and recoverable amount. Where recoverable amount is the higher of net realisable value and the capitalised value attributable to the remaining use of the asset in the business.

This basis is commonly used for plant and machinery or vehicles outside the public sector, however in the public sector this type of asset is usually held at historic cost or indexed historic cost. *2*

(10)

(c) Overcome the idea that capital assets are 'free';

Establish the full cost of providing services, either as a basis for pricing in the market, setting charges for the public or for comparisons between organisations;

Assist in the setting and monitoring of financial targets. *(2)*

Question 14

Introduction:

- The Cadbury Report defined corporate governance as the system by which organisations are directed and controlled. It is concerned with systems, processes and controls at the highest level, and with the roles and responsibilities of top management.
- In particular it is concerned with the potential abuse of power and the need for openness, integrity and accountability. Consequently, corporate governance is relevant to both the private and public sectors;
- However, it is difficult to define the public sector since it is a series of diverse public services which have their own unique features, each governed by different statutory and managerial frameworks which range from organisations such as local authorities with elective regimes to Health Trusts with directors appointed by Government and executive directors appointed by the directors.

Setting the scene, including definition of corporate governance - up to 3

Similarities:

- Emphasis on "bottom line" in both sectors. Private sector aims to maximise income and minimise expenses; public sector under continuous pressure to cut costs and, with the advent of competitive tendering/Best Value, demonstrate value for money.
- Desire by management in both sectors not to disclose full information. Private sector do not wish to give information that is of a competitive nature. Public sector – "league tables" and performance indicators produce a growing tendency not to be as open in disclosure as in the past. The growing emphasis upon performance and market testing has led to a shift to greater secrecy, to less sharing of information. The culture of commercial secrecy is gradually being transferred into the public services;
- Both are dealing with other peoples money and therefore have an obligation to operate in the light of the basic principles of integrity, openness and accountability;
- Cadbury deliberately chose to establish a set of underlying principles rather than a single format for all companies to follow. This makes it a more flexible model which is capable of being applied to a variety of organisational types and crossing between the public and private sectors.
- These principles. as amplified and developed in later reports such as Turnbull, are not just about accountability but also about how their application can help improve business performance – something which both sectors should be concerned about.

1 mark for each similarity identified up to a maximum of 5

Differences:

- Private sector companies driven by the need to earn a profit and create wealth for the shareholders, while public sector organisations are driven by the need to serve and to use their financial resources in the most effective manner;
- Shareholders in the private sector can opt into and out of a company by buying and selling shares. A citizen does not have that luxury. The citizen has a wider public interest in public sector organisations;
- Similarly, a member elected by a citizen has a much wider responsibility to the citizens as stakeholders than the director appointed by shareholders of a company;
- One of the major considerations of Cadbury was to try and ensure that the balance of power between the chief executive and chairman was more equally split. In the public sector there are statutory requirements and checks and balances to mitigate against power being held in too few hands;
- In private sector companies the directors on behalf of the shareholders usually appoint auditors. Auditors are also allowed to carry out other services for the company. The potential for a conflict of interest is not so great with the public sector auditor.

CIPFA's discussion paper on Corporate Governance in the Public services identified a number of distinguishing public service characteristics that need to be taken into account:

- The role of political choice in the level and nature of services;
- Both the complexity of the objectives – political, economic and social – and the lack of precision or measurability of the objectives that are associated with many public services;
- The variety of existing forms of accountability to the stakeholders, the community and higher levels of government;
- The uncertainty in some corporate models about who actually are the proprietors and the stakeholders (e.g. NHS Trusts);
- The managerial structures and the processes of appointment to managerial positions, including sometimes great uncertainty as to who the managers actually are – e.g. is the chief executive the real chief executive or is it the majority party leader in a local authority or the chairman in a health trust?
- The public service has traditionally had an ethos of impartiality, openness and transparency in the application of public funds for public services.

1 mark for each difference identified up to a maximum of 10

Conclusion:

- The Cadbury Report uses the words integrity, openness and accountability. These are the fundamentals that both the private and public sector have to aspire.
- The Cadbury Report has stimulated the debate and if carefully applied, the basic principles can bring real benefit to the management of the public sector.

2

(20)