CIPFA

FINANCIAL AND PERFORMANCE REPORTING

Diploma stage examination

6 June 2006

MARKING SCHEME

AT THE HEART OF
YOUR CAREER

Question 1

(a) Yellow Unitary Authority: Revised balance sheet for the year ending 31 March 2004

(b)

	Workings	£000	£000	
Net fixed assets	W1		289,225	
Long term investments			4,500	
Total long term assets			293,725	
Stock		430		
Debtors		8,900		
Cash		6,690		
Creditors		(14,700)		
Net current assets			1,320	
Total assets less current liabilities			295,045	
Deferred government grants	(1,000 – 100) (N2)		(900)	½
Long term borrowing			(39,900)	
Total net assets			**254,245**	
Financed by:				
Fixed asset restatement reserve	(126,620 – 1,720)		124,900	*1*
Capital financing reserve	Working 2		93,060	
Useable capital receipts reserve			12,700	
General fund	Working 3		23,585	
			254,245	

Working 1: Fixed assets

	£000	
Balance from unaudited balance sheet	290,975	
Add back depreciation charged on disposal (policy in note 4 of Q)	220	½
Less disposal (£1,500K + £220K)	(1,720)	*1*
Less impairment	(250)	½
	289,225	

Working 2: Capital financing reserve

	£000	
Balance from unaudited balance sheet	103,400	
Add grant transfer from CRA	100	½
Less MRP adjustment (working 5)	(10,440)	½
	93,060	

Working 3: General fund

Note students need not adopt the format of the working as shown below.

		£000	
Balance from unaudited balance sheet		13,175	
Changes recognised through CRA – impact on services			
Impairment cost	(250)		½
Depreciation saved on cost of services	220		½
Notional interest saved on cost of services (working 4)	53		
		23	
Changes recognised through AMRA			
Impairment (250 – 250)	0		*1*
Asset rentals reduced (220 + 53)	(273)		*1*
Depreciation charges reduced	220		½
Grant transferred (1,000 / 10)	100		½
		47	
Changes recognised through appropriations			
MRP adjustment (working 5)	10,440		*1*
Grant transfer	(100)		½
		10,340	
		23,585	

Working 4: Changes in notional interest charges

	£000	£000	
Closing book value of disposal	1,500		
Notional interest @ 3.5%		53	½

Working 5: MRP adjustment

		£000	
MRP		1,715	
Less: Depreciation	(12,125 – 220)	(11,905)	*1*
Less: Impairment		(250)	½
		(10,440)	

(12)

(c) Yellow Unitary Authority: Reconciliation of revenue activities to net cash flow.

		£000	
Surplus for the year	(23,585 – 15,000)	(8,585)	*1*
Add Depreciation	(12,175 - 220)	(11,905)	*1*
Add impairment		(250)	½
MRP adjustment		10,440	*1*
DRF		(500)	½
Interest payable		(3,750)	½
Interest receivable		1,250	½
Movement in stock	(380 – 430)	50	½
Movement in debtors	(7,110 – [8,900 – 1,000])	790	*1*
Movement in creditors	(17,600 – 14,700)	2,900	½
Net cash flow from revenue activities		(9,560)	
Presentation of statements			*1*

(8)

(20)

Question 2

Red Primary Care Trust: Operating cost statement for the year ending 31 March 2004

		£000
Commissioning		
Gross costs	Working 1	(191,771)
Less miscellaneous income	Working 1	402
Commissioning net costs		(191,369)
Providing		
Gross costs	Working 1	(43,267)
Less miscellaneous income	Working 1	18,330
Providing net costs		(24,937)
PCT net costs for the year		(216,306)

Red Primary Care Trust: Balance sheet as at 31 March 2004

		£000	£000	
Fixed assets	(Working 2: 2,625 + 11,337 + 518 + 2,273)		6,753	
Current assets				
Stock		17		
Debtors	(6,900 – 125)	6,775		½
Cash		210		
		7,002		
Creditors		(6,280)		
Net current assets			722	
Total net assets			17,475	
Taxpayers' Equity				
General fund	Working 5		12,698	
Revaluation reserve	Working 6		4,259	
Donation reserve	Working 7		518	
			17,475	

Presentation of statements ½ mark

Working 1: Split of commissioner and provider costs and income

		Shared £000	Commissioner £000	Provider £000	
Depreciation	Working 2	1,160			½
Cost of capital	Working 3	578			½
Loss on sale of asset	Working 4	2			½
Maintenance expenditure	N2	50			½
Salaries	TB	25,790			
Premises costs	TB	5,800			½
Establishment	TB	3,590			
Other	TB	2,300			
		39,270	5,891	33,379	
Write off of private patient debts				25	½
Medical supplies				9,863	
Commissioning primary and secondary healthcare			185,880		½
			191,771	43,267	
Donation reserve transfer		12			½
Other income		2,670			
		2,682	402	2,280	
NHS write down of debts				(100)	½
Private patients				450	½
Income from other commissioners				15,700	
			402	18,330	

Working 2: Fixed assets

		£000	£000	
Land b/f			2,500	
Indexation	(2,500 x 5%)		125	½
c/f			2,625	
Buildings – purchased b/f			10,700	
Indexation	(10,700 x 6%)		642	½
			11,342	
Depreciation				
b/f assets	(11,342 / 45)	252		
Additions	(250 / 180 x 2)	3		
			(255)	1
Additions (Q2)			250	½
c/f			11,337	
Buildings – donated b/f			500	
Indexation	(500 x 6%)		30	½
			530	
Depreciation	(530 / 45)		(12)	½
c/f			518	

Other fixed assets – cost b/f		6,100	
Indexation	(6,100 x 2.5%)	153	½
		6,253	
Disposals	(40 x 1.025)	(41)	½
c/f		6,212	
Other fixed assets – depreciation			
b/f		3,000	
Indexation	(3,000 x 2.5%)	75	½
Depreciation	(6,253 / 7)	893	½
Disposals	(41 / 28 x 20)	(29)	*1*
c/f		3,939	
NBV	(6,212 – 3,939)	2,273	

Working 3: Cost of capital charge

		£000	
Opening relevant net assets			
Revaluation reserve		3,450	
General fund		12,890	
Less cash		(50)	
		16,290	½
Closing relevant net assets			
Total net assets		17,475	
Less Donation reserve		(518)	
Less cash		(210)	
		16,747	*1*
Average	(16,747 + 16,290 / 2)	16,519	
Cost of capital @ 3.5%		578	½

Working 4: Loss on sale of asset

		£000	
Sales proceeds		10	½
NBV	(working 2: 41 – 29)	12	½
Loss on sale		2	

Working 5: General fund

		£000	
b/f		12,890	
DoH Funding	TB	215,500	
Cost of capital charge	W3	578	½
Historic cost adjustment	W6	36	½
Net operating cost		(216,306)	½
		12,698	

Working 6: Revaluation reserve

		£000	
b/f		3,450	
Indexation	Working 2: (125 + 642 + 153)	920	*½*
Backlog	Working 2	(75)	*½*
Historic cost adjustment	(252 – 230 + 893 – 879)	(36)	*1*
c/f		4,259	

Working 7: Donation reserve

		£000	
b/f		500	
Indexation	Working 2	30	*½*
Depreciation transfer	Working 2	(12)	*½*
c/f		518	

(20)

Question 3

Answer to be written in a memo format ½

Item 1: Audit fee

This is a notional charge and needs to be included in the financial statements as even though it is not paid by the Agency it represents part of its cost of operations. (Required per the resource accounting manual.)

Dr Operating costs	£55,000
Cr General fund	£55,000

1 mark for explanation, 1 mark for journal (2)

Item 2: Insurance fund charges

This is also a notional charge required per the resource accounting manual and needs to be included in the financial statements.

Dr Operating costs	£150,000
Cr General fund	£150,000

1 mark for explanation, 1 mark for journal (2)

Item 3: Excess appropriations in aid

All income from appropriations in aid should be shown in the operating cost statement. The excess appropriations in aid will then be paid to the consolidated fund and be accounted for through the general fund.

Dr General fund	£60,000
Cr Operating cost statement: Other income	£60,000

1 mark for explanation, 1 mark for journal (2)

Item 4: Donated asset

Per FRS 15 Depreciation needs to be recognised on donated assets. The cost will be supported through a transfer from the donation reserve, per SSAP4.

Dr Operating costs	£20,000
Cr Accumulated depreciation	£20,000
Dr Donation reserve	£20,000
Cr Operating cost statement: other income	£20,000

1 mark for explanation, 2 marks for journal, ½ mark for calculation of depreciation (3 ½)

The donated asset should not have been included in the cost of capital charge. It is not a "relevant asset", per the resource accounting manual.

Dr Other creditors	£17,500
Cr Operating costs	£17,500

(Calculated as £1,000,000 / 2 x 3.5%)

1 mark for explanation, 1 mark for calculation, 1 mark for journal (3)

Cost of capital charge should have been included in the general fund not in other creditors as there is no liability arising from the notional charge.

Dr other creditors £617,500
Cr general fund £617,500

(Calculated as £635,000 – £17,500)

1 mark for explanation, 1 mark for journal (2)

Item 5: Building revaluation

Central Government revalues its assets every five years in accordance with FRS 15 and revaluation gains should be recognised through the revaluation reserve.

Dr Fixed assets – buildings £500,000
Cr Revaluation reserve £500,000

1 mark for explanation, 1 mark for journal (2)

Indexation also needs to be applied to the revalued amount of the building as Central Government operates a form of current cost accounting so that the taxpayer can determine the cost of replacing at today's value the assets of the organisation. *1*

Indexation required = £5,500,000 x 7% = £385,000. ½

This will also be recognised through the revaluation reserve:

Dr Fixed assets – buildings £385,000
Cr Revaluation reserve £385,000 ½

As the assets have increased in value this will affect the depreciation charge for the year and subsequently the value of the notional 3.5% cost of capital charge. *1*

(20)

Question 4

Answer to be written in a report format 1

(a) Analysis of financial performance

Performance against the two set targets

Net margin:

		2002/03		**2003/04**
Net margin	(250 / 9,400) x 100	3%	(-1,730 / 8,505) x 100	-20%

The target was met in 2002/03 but was missed significantly in 2003/03.

Income has decreased significantly and operating costs have increased significantly. (10% decrease in income, 11% increase in costs). Primarily grant income has drastically reduced.

1 mark for calculation of both year's ratios
Up to 1 ½ marks for comments on the performance

Return on capital

		2002/03		**2003/04**
Return on capital employed after capital financing.	(250 / 11,390 X 100)	2%	(-1,730 / 9,115 X 100)	-19%

The target was missed in both years. The low levels of surpluses generated have resulted in the targets being missed.

Adjusting for the capital additions incurred, net assets have rapidly decreased and would therefore result in an even worse return on capital. (-1,730 / 7,115 x 100 = -24%) but the high deficit returned indicates that the intended additional income has not arisen from this investment yet.

1 mark for calculation of both year's ratios
Up to 1 ½ marks for comments on the performance

Use of other ratios

In this section students may answer using other appropriate financial ratios. Marks to be awarded on the basis of 1 mark for calculation of a ratio for both years, 1 mark for comments. Maximum of 4 marks for looking at other ratios

Liquidity is a clear problem for the Leisure Trust and creditors in particular have caused a significant problem:

		2002/03		**2003/04**
Current ratio	(690 / 2,390)	0.29:1	(395 / 3,710)	0.11:1
Quick ratio	(620 / 2,390)	0.26:1	(330 / 3,710)	0.09:1
Creditor days	(440 / 8,080 x 365)	20	(3,110 / 8,955 x 365)	127
Debtor days	(70 / 6,000 x 365)	4	(75 / 5,000 x 365)	5
Stock turnover	(75 / 8,080 x 365)	3	(65 / 8,955 x 365)	3

Creditor days have significantly increased compared with last year because of the payment of capital creditors. Not enough income (cash) may have been generated from the new capital expenditure to have financed this investment.

(b) Recommendations

Can further steps to secure more grant income be taken? (Although be aware that this may lead to additional costs as well).

Either costs need to be saved or more income needs to be generated to help improve performance against the targets set and to generate more cash.

More work is needed to understand the extent to which income generation is successful – eg by separately identifying costs related to the catering income received.

Can we promote greater take up of annual passes to ensure that cash can be received in advance?

Can more loans be taken out as a temporary measure to pay off suppliers? (Although debt: equity ratios suggest that this may not be possible as there is already a high level of debt compared with equity. (56% for 2003/04, up from 50%.)

Other valid recommendations should attract credit. Recommendations to be marked on the basis of 1 mark per recommendation explained to a maximum of 5

(c) Recommendation for transferring cultural services.

Based on the financial standing of the Leisure Trust it would seem unwise to transfer cultural services. (Although note comments on limitations below).

Student recommendations should be base don their analysis. Recommendations that are based on their findings should be awarded credit as appropriate up to a maximum of 2

(d) Limitations of the review

We do not have complete financial statements for the Leisure Trust. Having a full cash flow statement or more detailed financial statements (ie a breakdown of costs would provide better information).

The review only considers financial performance and non financial performance such as service user perception of service improvement following the transfer of leisure services to the trust would need to be considered before reaching a final decision about whether the cultural services should also be transferred.

There is little information about the transferring of cultural services, for example could this result in income generating opportunities that would improve the financial position of the trust overall. Any transfer would need to be considered in light of such information.

We only have two year's data on which to assess financial performance. We may gain more information from considering the performance of the services before they transferred into the Leisure Trust.

Other appropriate comments to attract credit. 1 mark per point explained to a maximum of 3

(20)

Question 5

(a) Users of private and public sector financial statements

Users of private sector statements

The ASB sets out seven groups of users of private sector financial statements:

Users	Information they may be interested in
Investors'	Extent to which shareholder wealth has increased, earnings per share/ growth in profit attributable to shareholders
Lenders	The long term solvency and short term liquidity of the organisation in assessing if borrowings will be repaid
Suppliers	The short term liquidity of the organisation. Creditor days. Assessing if supplies made will be paid.
Customers	The viability / stability of the organisation determined through liquidity measures and profitability measures. Profit margins could be used to indicate the value / quality of a product.
The Public	Will depend on their relationship with the organisation as often the public fall into one of the other categories too.
Government and other agencies	Profitability and financial solvency may be used to assess the general health of the company as a way of assessing the general economy. May also use the financial statements in a regulatory role e.g. through assessing if profit figures relate to tax paid
Employees	Job security (assessed through profitability + going concern areas like liquidity) may also look to determine level of investment in staff eg via salary cost, training budget.

1 mark per user and information. Other relevant types of information identified should attract credit. Maximum of 1 point per user
7

Users of public sector financial statements

Users of public sector financial statements will follow the same broad categories of those in the private sector too except that investors' will be stakeholders, customers will be service users.

Typically public sector financial statements have a greater number of users interested in them. For example users could include partners, funders (ie for grants), the media and other public interest/ pressure groups and regulators.

In addition to the information that the users of private sector financial statements are interested in, the users of public sector financial statements will also be interested in whether public money has been spent wisely (i.e. can the organisation demonstrate accountability and stewardship for the funding it has received) and if value for money has been offered. Profit or notions of increasing shareholder wealth are not relevant.

Up to a maximum of 3 marks available for comparing and contrasting how information is used. Other valid comments should attract credit

(b) Housing v. central government dept. v companies

All three sectors need to produce the equivalent of an operating account, balance sheet, statement of (total) gains and losses and cash flow statement. *1*

Companies' financial statements focus reporting profit and increases to shareholder wealth. These objectives are not relevant to the public sector whereas demonstrating financial stewardship and value for money are relevant. *1*

Housing's financial statements are very similar to companies given they are funded through more commercial means – ie a large element of their income is rents which is similar in nature to receiving trading income. *1*

Housing discloses its housing stock on the balance sheet net of social housing grant received and thus shows the extent to which it has invested in housing stock through its own financial sources. *1*

Central Government departments also produce two further "schedules" showing their performance against their resource outturn (equivalent of break even) and departmental aims and objectives and the resources spent on these. This is due to their need to demonstrate how taxpayer's funding has been applied. *1*

A Central Government department produces an operating cost statement rather than an income and expenditure account or profit and loss account as it operates under resource accounting. *½*

This identifies the net cost of the department's admin function and its net cost of specific programmes that it operates. This therefore demonstrates back to the users of the financial statements how money has been spent on meeting key programme objectives and is thus part of the way in which the department demonstrates stewardship. *1*

The cash flow statement in central government is much shorter as many of the headings normally required under FRS 1 (revised) are not required. *½*

Notes to the cash flow statement in central government are different in structure and content. *½*

Note 1 will include adjustments for items specific to central government ie notional charges *½*

There is no notion of debt in a central government department since the organisation is backed by the consolidated fund. Therefore no notes are required for showing cash and its impact on net debt. *1*

The notes to the cash flow statement in central government department serve to meet the requirements of FRS 1 (revised) by providing the detail of cash in and out flows and provide evidence for the department's stewardship of cash by looking at the cash drawn down and the cash requirement for the year. *1*

Both central government departments and housing associations may complement their financial statements with information on non financial performance to demonstrate, for example, the extent to which value for money has been achieved. *1*

A maximum of 10 marks to be awarded for this section.
Other valid comments to attract credit.

(20)

Question 6

(a) Accounting for a capital grant in a Local Authority

Note: students are only required to show how the grant is accounted for, not any related asset as well

Capital grants are held on a Local Authority's balance sheet and released over the life of the asset to which they relate. This follows the basic principles of SSAP 4. *½*

Dr Cash/ Debtors
Cr Deferred Government Grants *1*

The grant is transferred from the balance sheet to AMRA to help off set the depreciation charges borne by AMRA. *1*

The grant is transferred over the asset's life. *½*

The matching of the grant through AMRA in this way is consistent with the treatment outlined in UK GAAP. *1*

Dr Deferred government grants
Cr AMRA *1*

Following this the amount transferred into the consolidated revenue account through AMRA is then transferred into the capital financing reserve. *½*

Dr CRA: Appropriations
Cr Capital Financing reserve *1*

This treatment is additional to the requirements of SSAP 4. *½*

This transfer is needed to:

- Remove capital financing from the revenue account so that the total net cost "to be met by government grants and taxpayers" only reflects the net revenue cost for the year. *1*
- Ensure that charges for capital assets included in the CRA meet the requirements of the LGHA 1989, ie that there is a charge for the minimum revenue provision and actual interest charges from capital borrowings only. *1*

(9)

(b) Disclosure of revenue grants in the CRA

Disclosure will depend on whether the grant is received to support a specific service/project or is received for general purposes. *1*

Specific grants will be disclosed in part 1 (cost of services) of the CRA. This is to show the net cost of providing specific services to the users of the accounts. *1*

General grants (eg revenue support) will be shown in part 4 (financing) of the CRA. This shows the users of the accounts how general funding and taxation sources have been applied to finance the total net costs of operations. *2*

Other valid comments to attract credit.

(4)

(c) Housing

The housing stock would be capitalised on the balance sheet as a fixed asset.

Dr Housing stock £1,000,000
Cr Cash/ Creditors £1,000,000 *1*

Costs can be capitalised in line with FRS 15. ½

The social housing grant of £250,000 will be shown netted off against the cost of the housing stock. This treatment shows the users of the accounts the net amount that the housing association has invested in its housing stock ½

Dr Cash/ Debtors £250,000
Cr Social Housing Grant £250,000 *1*

The social housing grant will not be matched over the life of the asset. Instead a net depreciation amount will be calculated using the net worth of housing stock of £750,000. ½

£750,000 / 40 = £18,750 ½

Dr Depreciation expense £18,750
Cr Accumulated depreciation £18,750 *1*

The depreciation charged over the asset's life will thus not fully match the benefit of the asset with a depreciation expense and so does not fully meet the requirements of FRS 15. It does, however, ensure that the housing association charges a depreciation expense that relates to its costs of acquiring the asset. *1*

The social housing grant will remain on the balance sheet until the housing stock is disposed of. At this point the housing grant needs to be either repaid or recycled. *1*

(7)

(20)