FINANCIAL AND PERFORMANCE REPORTING

Diploma stage examination
6 December 2005

From 2.00pm to 5.00pm
plus ten minutes reading time from 1.50pm to 2.00pm

Instructions to candidates

*Answer **five** questions in total: **Two** questions from **Section A**, and **three** questions from **Section B**. The marks available for each question are shown in italics in the right-hand margin.*

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.

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

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

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

The questions in this examination are based on the 2003/2004 financial year and should be answered as such. Candidates are being provided with the most recent version of all UK Accounting Standards – those extant as at 30 April 2004. Candidates should assume that these Accounting Standards are relevant to the 2003/2004 financial year for the purposes of this examination paper.

CIPFA

SECTION A (Compulsory)

1

The following balances have been extracted from the trial balance of Makine Unitary Authority as at 31 March 2004:

	£000	£000
Tangible fixed assets	190,985	
Long term investments	750	
Stock	250	
Debtors	24,560	
Cash	735	
Creditors (all due within 1 year)		13,970
Long term borrowing as at 31 March 2003		45,980
Deferred grants		100
Fixed asset restatement reserve		43,785
Capital financing reserve		79,500
Useable capital receipts		4,500
General fund as at 31 March 2003		6,500
Central services	2,350	
Environmental and planning	10,450	6,790
Education	243,530	123,905
Highways, roads and transport	25,000	11,215
Social services	138,750	70,590
Libraries and leisure	7,840	3,960
Interest payable	1,095	
Interest receivable		450
Precepts payable	1,650	
Revenue support grant		90,300
Council tax		108,000
National non domestic rates		25,540
Loan transactions	2,500	15,360
	650,445	650,445

Additional information

1. Makine Unitary Authority has embarked on a significant capital programme during 2003/04. £10,000,000 of fixed asset additions have been purchased in the year and have been financed as follows:

	£000
Capital receipts	3,000
Revenue contributions	2,000
Capital grants (relating to highways maintenance equipment with a useful economic life of 10 years)	100
Long term borrowing	4,900
	10,000

The only transactions recorded so far have been to recognise the loans received (included within the loans transactions line in the trial balance) and to record receipt of the capital grant. The grant has been received to support an asset with a useful economic life of ten years.

2. Land that was surplus to use was sold at a value of £1,300,000. This land is included in the trial balance at valuation of £750,000. No accounting entries have been made to record the sales proceeds or to account for the disposal. Makine Unitary Authority does not reserve capital receipts.

3. The capital accountant has calculated asset rental figures for 2003/04 to comprise depreciation of £8,040,000 and notional interest of £9,035,000. These are to be charged to services on the following bases:

	£000
Central services	755
Environmental and planning	1,510
Education	5,275
Highways, roads and transport	2,260
Social services	3,415
Libraries and leisure	3,860
	17,075

   The asset rental figures have already been adjusted for the fixed asset additions and disposals identified above.

4. The minimum revenue provision for 2003/04 has been calculated as £3,900,000.

5. During the year the education service recharged social services £55,000 for the use of educational psychologists in assessing child welfare cases. The amounts due to/from the services are included within the debtors and creditors balances as well as service income and expenditure.

- **Requirement for question 1**

(a) Prepare the consolidated revenue account and consolidated balance sheet for Makine Unitary Authority for the year ended 31 March 2004. *16*

(b) Explain how the capital grant should be accounted for. Your answer should make reference to appropriate accounting standards, legislation and regulation and explain why divergence from the UK GAAP exists. (Journal entries are not required.) *4*

(20)

2

The following balance sheets relate to Akhmatova Primary Care Trust

	31/03/2003 £000	**31/03/2004 £000**
Land	2,500	2,725
Buildings	12,670	13,293
All other fixed assets - cost	6,570	6,866
All other fixed assets - depreciation	(2,790)	(3,466)
	18,950	19,418
Stock	15	20
Debtors	7,050	8,670
Cash	185	320
	7,250	9,010
Creditors less than 1 year	(8,080)	(7,000)
	(830)	2,010
Creditors greater than 1 year	0	(100)
Provisions	(15)	(16)
	18,105	21,312
General fund	15,760	17,788
Revaluation reserve	2,345	3,474
Donation reserve	0	50
	18,105	21,312

Additional information

1. The donation reserve relates to assets received in February 2004.

2. The following indexation rates were applied to fixed assets for 2003/04:

Land	9%
Buildings	7%
All other fixed assets	2%

3. Depreciation charged on buildings for 2003/04 totalled £339,000. The charge relating to all other assets was £670,000.

4. The PCT's capital programme for the year included the purchase of medical equipment through a finance lease. The asset had a fair value of £150,000 and the lease term was five years. The PCT pays £40,000 per year for this equipment and a full year's payment was made in 2003/04. The principal for 2004/05 is held in creditors due within 1 year. Creditors greater than 1 year relates in full to the finance lease. As at 31 March 2004 a further £30,000 remained unpaid in respect of capital additions. No amounts for capital creditors were outstanding as at 31 March 2003.

5. The PCT disposed of other fixed assets with a net book value of £10,000. Sales proceeds totalled £7,000.

6. The PCT reported a net operating cost for the year after interest of £197,510,000.

7. The movement in provisions relates to the interest charge for unwinding the discount on provisions.

- **Requirement for question 2**

Prepare the cash flow statement and the reconciliation of operating costs to net cash outflow for Akhmatova Primary Care Trust for the year ending 31 March 2004. (Other notes to the cash flow statement are not required.) ***(20)***

SECTION B – (Answer three questions from this section)

3 You are the Financial Controller of the Pushkin Agency. The Pushkin Agency is a Central Government Trading Agency. It was awarded trading status from 1 April 2003, having previously operated as a supply financed agency.

The Agency's final accounts for the financial year 2003/04 have just been completed. The income and expenditure account and balance sheet are included below:

Pushkin Agency: Income and Expenditure Account for the year ended 31 March 2004

	£000
Income	24,150
Staff costs	(12,970)
Depreciation	(1,205)
Other operating costs	(9,060)
Operating surplus	915
Interest payable (all relating to loans)	(175)
Interest receivable	10
Surplus before dividends	750
Public dividend capital dividends	(742)
Surplus for the year	8
Surplus b/f	0
Retained surplus	8

Pushkin Agency: Balance sheet as at 31 March 2004

	£000
Fixed assets (at Net Book Value)	20,739
Stock	300
Debtors	2,760
Cash	1,293
	4,353
Creditors, due within 1 year	(2,800)
Total net assets	22,292
Financed by:	
Deferred grants	1,250
Public dividend capital	16,490
Long term loans	3,500
Revaluation reserve	1,045
Income and expenditure reserve	8
	22,293

Additional information

1. The Agency has two key financial targets:

   - To ensure that a surplus is generated over a three year period and used for investment.
   - To manage its cash position carefully and ensure that it remains solvent.

   Managing its cash position was also a target that the Agency had to meet as a supply financed organisation. The Agency's non-executive Board members are particularly keen to understand how the Agency has performed this year compared with how its performance would have been under its former supply financing regime.

   The Agency uses benchmarks of a current ratio of 2:1 and a quick ratio of 1:1 to assess its cash position.

2. The Agency's former department has provided a grant of £2,500,000 to cover transitional costs over a two year period. 50% of this grant was recognised within income during 2003/04. Costs associated with this income totalled £1,245,000 and were fully paid by the year end.

3. Other operating expenditure for 2003/04 included an audit fee of £100,000 and insurance of £75,000. Both items were paid in full during the year.

4. An analysis of creditors at year end has been completed and has identified the following amounts outstanding:

	£000
Trade creditors	850
Public dividend capital dividends payable	200
Capital creditors	1,750
	2,800

5. The public dividend capital dividends included in the income and expenditure account represent 3.5% of the Trading Agency's average relevant net assets. Under the initial agreement to move to trading fund status the Pushkin Agency agreed that it would provide a 5% return on relevant net assets each year to its originating department from 2004/05. It has been agreed that as a Trading Agency, the Pushkin Agency would make a cash payment of dividends to its host department each year.

- **Requirement for question 3**

Prepare a report for the Board of the Pushkin Agency in which you:

(a) Assess performance against the Agency's financial targets for 2003/04 and make appropriate recommendation for improvements. *11*

(b) Outline the main advantages of being a trading agency compared with the previous status as a supply financed agency. *2*

(c) Illustrate how the Agency would have performed against its cash management target if it had continued to operate as a supply financed agency and comment on the decision to convert to a trading fund. *(Assume that loans and public dividend capital have replaced supply financing but not provided additional financing in 2003/04.)* *7*

(20)

4

Harms Housing Association is a Registered Social Landlord providing low cost housing to a number of tenants in a rural area from a number of local offices. A new Finance Director has recently been appointed to the Association who has worked in a range of private sector organisations. The appointment of the new Finance Director has prompted review of how the finance function is managed and whether current arrangements offer value for money. At present each local office has finance staff based within it covering creditor payments, debtor collection and some financial management roles.

You are the financial accountant at the Association responsible for performance management. The following information has been collected as part of a benchmarking exercise completed with two other Housing Associations for the year ending 31 March 2004:

Performance data for the year ending 31 March 2004

	Harms HA	**HA 1 (Rival based)**	**HA 2 (City based)**
Cost of the creditors function *	£100,400	£85,000	£87,000
Number of staff in the creditors function **	10	6	6
Full time equivalent of staff in the creditors function **	3.2	4	4.5
Number of invoices processed	70,400	45,400	46,000
Average invoice value	£50.00	£120.00	£145.00
Number of invoices paid within 30 days	42,240	39,952	42,780
Error rates	2%	0.5%	0.5%

* Cost includes all direct costs and overheads
** Staff numbers include both direct staff and management time

The Finance Director has asked you to use the provided information to assess whether the current arrangements offer value for money. Consideration is being given to the centralisation of creditor payments. Similar information is currently being collected in relation to the Housing Association's debtors function and the Finance Director is keen to know your views as to whether centralisation of the debtors department should be considered as well.

- **Requirement for question 4**

  Draft a report for the Finance Director using the above information to assess if the creditors function offers value for money and examine the business case for centralising creditors and/or debtors. Your report should:

  - Briefly define value for money. *3*
  - Using the available information, assess the performance of the creditors function, making recommendations where appropriate. *12*
  - Recommend if the creditors and/or debtors functions should be centralised. *2*
  - Highlight any limitations of your analysis. *3*

(20)

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5 The Mandelstam Project has been established between Osip County Council, Blok Further Education College and Nadezhda Primary Care Trust to provide health and social care and education to young teenage parents. The Project has its own Board, Constitution and Terms of Reference and operates as a registered charity.

Votes on the Project's board are split equally across all three parties, although Osip County Council funds 50% of the costs with the remaining expenditure being split equally between the Primary Care Trust and the College. The Project was set up in September 2003 and uses 31 August as its reporting year end.

You are the financial accountant for the Mandelstam Project and have received the following memo from one of the members of the Project's Board:

"The Project Board started discussing preparing the final accounts for the 2003/04 financial year. I thought that this would be a fairly straightforward matter since we clearly defined at the start of the project how much each stakeholder would contribute and what the annual costs were expected to be. Jo Steel, the Council's representative, is saying that the Council will need to prepare group accounts for which we will need to produce some information to help prepare the accounts.

I know you're very busy at this time of the year and I am not sure what value we will add by consolidating our performance with that of the Council and no doubt our other partners. Our identity as a public service organisation in our own right has been essential in promoting our service. Surely the best way to demonstrate the successes we have achieved is through our own reporting, not to merge our performance with our funders.

Jo Steel began talking about the technical requirements that we will need to comply with for consolidating with the Council's accounts. It all went beyond me, but I do remember him saying that capital accounting would be an important area that would require significant adjustment and Jo says accounting policies need to be reviewed. I'd like to know more about the principles involved as this area is completely unfamiliar to me and since you have worked in a Local Authority before you must be in a perfect position to help.

Alex Silver"

- **Requirement for question 5**

Prepare a memo in response to Alex Silver which:

(a) Identifies when consolidated accounts are required and outlines in principle how the accounts should be consolidated. (You should refer to appropriate accounting standards in your answer.) *12*

(b) Explains the benefits to stakeholders of producing both organisational and consolidated accounts. *3*

(c) Explains the adjustments that will need to be considered in relation to fixed assets when group accounts are produced by Osip County Council. Assume that the Project completes accounts that are UK GAAP compliant as relevant for Charities. (Journal entries are not required.) *5*

(20)

6

The valuation of assets and recognition of impairment losses is as important in the public sector as in the private sector. As such, FRS 11 should be interpreted in both the public and the private sector in the same way.

- **Requirement for question 6**

(a) With reference to FRS 11, compare and contrast how Local Authorities and a Central Government Department would account for impairment losses. Your answer should refer to relevant legislation and regulation where departures from UK GAAP are made. *15*

(b) A Local Authority identifies that it has suffered impairment losses of £100,000 due to losses of economic benefit. Identify the accounting entries that are required to account for the impairment loss. *3*

(c) Explain the impact that the impairment in (b) above will have on the total net costs shown on the consolidated revenue account. *2*

(20)