FINANCIAL REPORTING IN CENTRAL GOVERNMENT AND AGENCIES

Professional 2
8 June 1999

From 10.00 am to 1.00 pm,
plus ten minutes reading time from 9.50 am to 10.00 am

Instructions to candidates

Answer ***four*** *questions in total.* ***Both*** *questions from Section* ***A*** *and* ***two*** *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 examinations room.

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

SECTION A (Answer both questions)

1 The following information has been extracted from the accounts of the Scientific Research Agency for the 1998/99 financial year. The agency is a trading fund of the Department of Natural Resources, and undertakes commercial research work in addition to performing a number of statutory functions on behalf of the parent department.

The Scientific Research Agency

Trial Balance as at 31 March 1999

Category	**£000**
Fixed Assets (net book value)	83,700
Turnover	310,555
Stock at 31 March 1999	44,840
Research Funding Grants	18,412
Interest payable	2,900
Interest receivable	1,599
Retained profits at 31 March 1998	13,228
Loans from National Loans Fund	31,609
Cost of Sales Adjustment	350
Consumables	19,514
Other Operating Charges	150,800
Staff Costs	110,150
Debtors	52,900
Cash	5,330
Creditors	72,494
Revaluation Reserve	18,277
Insurance Provision	4,310

Additional Information

(i) Depreciation charged for the year amounted to £4,250,000. A full year's depreciation is charged in the year of acquisition. Assets are depreciated on a straight line basis over the following estimated useful lives:

Buildings	40 years
Scientific equipment	10 years
Vehicles	5 years

(ii) The agency purchased two landrovers, under three year hire purchase terms on 15 December 1998. An initial payment of £6,000 was made on the date of purchase, with further quarterly payments of £3,000 due in arrears, commencing on 15 March 1999. The cash price of the vehicles is £42,000. The vendor charges interest of 8% on outstanding balances. Interest is also charged on a quarterly basis.

(iii) On 24 March, the agency sold a gas chromatograph, which it had purchased some years before at a cost of £350,000, to the science department of the local university. The equipment had a written down value of £210,000, and sales proceeds amounted to £100,000.

(iv) In November 1998, the agency received a research grant of £8,584,000 from a multi-national research laboratory to undertake a commercial research programme. The grant funding relates to a three year research programme, which is scheduled to commence in June 1999, when a specialised research team will be established for the purpose.

(v) Land valued at £5,350,000 on 1 April 1998 has been revalued at £5,800,000 on 31 March 1999.

(vi) Backlog depreciation of £85,000 should be charged.

(vii) Opening stock at 1 April 1998 was £49,320,000.

- **Requirement for question 1**

Prepare the following from the above information:

(a) The income and expenditure account for the Scientific Research Agency for the year ended 31 March 1999. *12*

(b) The balance sheet for the Scientific Research Agency for the year ended 31 March 1999. *13*

NB. All calculations should be rounded to the nearest £000.

(25)

2

The following information has been extracted from the accounts of the Public Safety Agency for the year 1998/99:

The deficit shown in the operating account for the year amounted to £5,230,000. The operating account included the following transactions:

- depreciation of £500,000;
- cost of capital of £670,000;
- insurance of £200,000; and
- an increase in the bad debt provision of £50,000.

Capital expenditure for the year amounted to £350,000. Proceeds from the sale of fixed assets amounted to £20,000, and were recorded in the operating account as a loss of £5,000.

The Supply Grant voted by Parliament for the Public Safety Agency for 1998/99 was £15,150,000. Appropriations in aid of £8,500,000 were approved, with appropriations in aid collected amounting to £8,620,000. The surplus to be surrendered for the year amounted to £1,430,000.

The working capital balances at the beginning and the end of the year were as follows:

	1 April 1998	**31 March 1999**
	£000	**£000**
Stocks	3,220	3,660
Debtors	4,280	5,050
Creditors	2,740	3,250
Cash	2,450	2,715

- **Requirement for question 2**

Using the above information, prepare the following for the Public Safety Agency for the 1998/99 financial year:

(a) Notes to calculate the net cash outflow from activities and the movement in cash and equivalents. *6*

(b) Note to show the net Parliamentary grant received reconciled to the Appropriation Account for the Vote. *6*

(c) The cash flow statement for the year. *8*

(d) Explain the anticipated improvements in financial reporting to be achieved through the introduction of FRS1. *5*

(25)

SECTION B (Answer two questions)

3

The Department of Conservation and Heritage wishes to construct a multi-purpose visitors' centre at the Lakeland National Park. The development will include self-catering accommodation units, restaurant facilities, a multi-media education and information unit, and an outward-bound centre to be used by both school groups and business parties. Outline estimates have been undertaken which show that the capital cost of the development is likely to be in the region of £15 million, with ongoing revenue costs of approximately £3 million per annum.

The department has established a steering group to consider the different methods of funding the capital expenditure, and have asked the Director of Finance to provide the steering group with a report that considers the various methods of funding capital expenditure, and their financial and accounting implications.

The Director of Finance has requested that you, as a senior accountant, draft a report for the steering group. She is keen that the report not only considers the various methods of funding that are available to the department from internal and external sources, but also considers the implications of entering into a PFI deal.

- **Requirement for question 3**

(a) Identify the methods of capital funding which may be available to the department to fund this development; *4*

(b) Explain in detail the accounting implications of each of the funding methods identified. *21*

(25)

4

- **Requirement for question 4**

Briefly explain the following:

(a) The principal uses made of a set of public sector financial reports. *6*

(b) Who are the potential "users" of a set of public sector financial reports, and what information are they looking for? *6*

(c) The Chief Executive of your agency has received the following letter from a County Councillor. Draft a response from your Chief Executive, which addresses each of the queries raised. *13*

(25)

Joseph Bloggs
Pennyville County Council
Pennyville

Chief Executive
Highways (Roadways) Agency
Pennyville

30 May 1999

Dear Sir

1998/99 Annual Report and Accounts of the Highways (Roadways) Agency

As you are aware, Council has expressed some concern at the condition of the major roads around the Pennyville area following the severe winter frosts and the major subsidence incident in the early Spring. As a direct consequence, a number of Council Members have tabled an item for October's Council meeting to discuss the performance of the Highways (Roadways) Agency during 1998/99, and the level of expenditure on general roads maintenance programmes.

In preparation for the meeting, I have been closely studying the annual accounts of your agency for the 1998/99 financial year. Although I pride myself on having a practical head for business matters, I am not an accountant, and as a consequence, I am a little unclear concerning some of the detailed information contained in the accounts. I would be grateful if you could provide a "layman's" explanation of the following:

(i) The notes to the accounts advise that the major road network has been valued on an "infrastructure accounting basis". What is infrastructure accounting, and why do you attempt to place a value on a road?

(ii) The operating cost statement includes a figure for interest on capital, and the notes explain that this is a non-cash charge. How can you have a charge which is "non-cash", and what is "interest on capital"?

(iii) The balance sheet includes a figure for a "contingent liability", and the notes state that this relates to an industrial injury claim taken by a former employee against the agency. If this claim has not been settled, why do you include an amount in the balance sheet?

(iv) The accounting statements are preceded by "The Report of the Comptroller and Auditor General", who states that it is his opinion that "the financial statements give a true and fair view of the state of affairs" of the agency. On this basis, can I assure fellow Council Members that the expenditure figures quoted in the accounts are accurate?

(v) Note 16 of the accounts refers to a "post-balance sheet event". My understanding of a balance sheet is that it records the assets and liabilities of the agency as they were on 31 March. If I am correct, how can events occurring after 31 March be relevant to the accounts of 1998/99?

(vi) Knowing that I have an interest in finance matters, our Treasurer regularly passes me a copy of an accountancy magazine that he receives each week. Recent articles have focused on developments of a new method of accounting for Central Government, called Resource Accounting, which came into effect on 1 April 1999. I am assuming that Resource Accounting also applies to Central Government agencies, such as the Roadways Agency, so would be grateful if you would explain how the initiative will impact upon the style and content of your agency's accounts.

Yours sincerely,

Joe Bloggs

J. R. Bloggs

Pennyville County Council

5

You have recently taken up the position of Finance Manager in the Central Print Unit of the Department of Administration. The post has been vacant for several months following the early retirement of the previous incumbent on health grounds. Your predecessor had spent most of his career in the personnel division of the department, and had struggled with the financial responsibilities of the post, prompting the department to appoint a qualified accountant to undertake the Finance Manager role.

The unit provides printing and copying services to the department on a hard charging basis, with the financial objective of full cost recovery. The unit has a devolved budget for the 1998/99 financial year, which is based on an output level of 325 completed jobs each month.

	Volume	**Cost £**
Direct materials Paper, ink, binding, etc.	58,500 units	263,250
Direct labour Staff salaries		136,500
Variable overheads Heat, light, power, maintenance, transportation costs		117,000
Fixed Overheads Rent, rates, management and administrative salaries		150,000

Soon after taking up post, you are advised that the Unit is to be the subject of an audit review, which will commence with a review of financial management procedures and controls. In response to your request for the current budget outturn position, your staff advise that they merely receive payment and receipts schedules from the department's central accounts processing division, which they use to determine spend to date. It had been assumed that your predecessor dealt with any budget reports. You approach the accounts division for a copy of the most recent budget report, month 08. You are advised that budgetary outturn reports are not available until six to eight weeks after the month end.

You discover that the annual budget for the 1998/99 year had been prepared by the previous Finance Manager, who had uplifted the 1997/98 financial data on the basis of HM Treasury inflators. Output projections had been provided by the Operations Manager, who manages the Unit on a day-to-day basis. The Operations Manager monitors output performance, customer relations and Service Level Agreements (SLAs), but relies on the Finance Manager and his/her staff for the provision of financial data, and the management of financial performance.

SLAs have been agreed with all departmental users of the Central Print Unit for a three year period, from 1 April 1997 to 31 March 2000, at an agreed price of £175 per job. The SLAs have not been reviewed or updated following their finalisation in February 1997.

You discover that the supplier of materials used by the Print Unit has issued a revised price list effective from 1 April 1998, which increases the price of all products by 10%. (This was the first increase in the price of materials consumed since June 1996). Materials are purchased on a "just in time" basis, with minimal stocks held.

Major problems have been experienced with two of the Unit's printers throughout the year. The Operations Manager blames the equipment downtime experienced on the failure to adequately maintain equipment, due to what he calls a totally inadequate allocation of resources to the maintenance budget. Equipment failure resulted in the contracting out of a major job in Month 05 to an external print shop. As a consequence, materials consumed by Month 08 stood at 32,000 units.

Equipment repair costs have contributed to cumulative variable costs at Month 08 of £83,200.

The original budget had included the costs of the Unit's Finance staff, but had failed to include the salary of the Finance Manager. The gross salary cost for the Finance Manager is £30,000 per annum.

The Print Unit are actively addressing a high absenteeism rate which has impacted upon job turnaround times and output targets. The mechanistic and repetitive nature of the work of the Unit is perceived to offer poor job satisfaction, making recruitment of staff difficult. The Unit is currently carrying two vacancies at operator grade. These staff shortages, coupled with the problems experienced with printing and copying equipment throughout the year, have resulted in a total output of 2,250 jobs completed by the close of Month 08. The Unit has the capacity to undertake a maximum of 950 further jobs before the financial year end.

- **Requirement for question 5**

  In advance of the audit review, you discuss the problems that you have discovered in the Unit's staffing, reporting and management arrangements with the department's Director of Finance, and how these problems may have contributed to the Unit's failure to achieve its planned level of output each month. You agree that the auditors must be provided with an accurate assessment of the Unit's current financial position, and an analysis of how this situation arose. The Director asks you to:

(a) Prepare two budgetary control statements for the year to date as at Month 08, one based on the fixed budget for the year, and one based on a flexible budget for the actual level of output achieved. *13*

(b) Prepare a checklist of the key weaknesses in the Unit's system of budget setting and control, and the corrective action that you intend to initiate. *12*

(25)