FINANCIAL REPORTING IN FURTHER AND HIGHER EDUCATION

Professional 2 examination
5 December 2000

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 This is your first day as the newly appointed Financial Accountant for Marlen College, and you have just been told that the Director of Finance is off on sick leave for the foreseeable future. The College's financial statements for the year ended 31 July 2000 have not yet been prepared. You discover the following draft trial balance and additional information, relating to the financial statements for the year ended 31 July 2000, lying on the Director of Finance's desk, and you settle down to prepare the financial statements.

Marlen College
Draft trial balance as at 31 July 2000

	£000	**£000**
Higher education income		22,700
Full-time student fees		10,500
Part-time student fees		9,250
Catering income		3,725
Bookshop income		3,340
Bank interest		85
Staff - academic	14,850	
Staff - administrative	6,420	
Staff - services	5,725	
Teaching support services	4,200	
Administration and central services	1,830	
Heat, light, water and power	1,310	
General buildings and grounds maintenance	763	
Computer maintenance contract	800	
Catering foodstuffs and supplies	3,095	
Books for resale	2,830	
Bank interest	62	
Taxation	315	
Buildings - at cost	3,600	
Buildings - accumulated depreciation at 1 August 1999		360
Plant and machinery - at cost	10,000	
Plant and machinery - accumulated depreciation at 1 August 1999		4,880
Motor vehicles - at cost	2,200	
Motor vehicles - accumulated depreciation at 1 August 1999		640
Stocks - catering	4,800	
Stocks - bookshop	8,067	
Debtors and prepayments	9,020	
Cash at bank	552	
Bank overdraft		120
Other creditors and accruals		7,380
Taxation		315
Income and expenditure account		17,152
Suspense account (see note (iii) overleaf)	8	

Additional information:

(i) Depreciation has not yet been provided for in respect of the year ended 31 July 2000. It should be provided on a straight line basis as follows:

Buildings, including car parks	- 2% per annum
Plant and machinery	- 10% per annum
Motor vehicles	- 25% per annum

During the year ended 31 July 2000, Marlen College disposed of certain items of plant and machinery for £1,000,000 cash. This plant and machinery originally cost £2,400,000 and had a net book value of £1,600,000. The only entry made in the books and records in respect of this disposal was to debit the bank account and credit teaching support services with the disposal proceeds on the basis that this was the function to which the plant and machinery related. It is College policy to charge a full year's depreciation in the year of acquisition and none in the year of disposal.

(ii) Due to the increase in the number of students travelling to the College by car, Marlen College entered into a barter deal with a private company situated beside the College on 1 August 1999. Under the terms of the agreement, the College exchanged a building which had a net book value in the College's balance sheet at 1 August 1999 of £500,000 for a car park valued at £550,000 on the same date. No entries have been made in the College's books in respect of this transaction.

(iii) On 1 August 1999 Marlen College entered into a lease agreement with Swift Ltd in respect of a minibus. The cash price of the minibus was £15,420 and the College paid a deposit of £4,000 on 1 August 1999. Four further payments of £4,000 each are due on each subsequent 31 July. The payment due on 31 July 2000 was made in accordance with the agreement. Under the terms of the lease, the College is responsible for maintaining the minibus and has the option to buy the minibus for £1 at the end of the lease. The lease contains no break clause. The minibus has an expected life of four years at which time it will have no residual value. The interest rate implicit in the lease is 15%. The only entries that have been made in the College's books have been to record the two instalments in the bank and suspense accounts.

(iv) Bookshop stock at 31 July 2000 includes text books valued at their original cost of £2,600,000. New editions of these texts were published in August 2000 and their market value based upon sales in August and September 2000 was £1,500,000.

(v) In August 2000 Marlen College received a claim from a former employee for £30,000, alleging harassment at work and unfair dismissal. The employee had been dismissed in February 2000, and while the College refutes the claim, its legal advisors believe it will be upheld by the courts. As the claim was received after 31 July 2000, it is not reflected in the draft trial balance shown above.

(vi) On 31 July 2000 negotiations with trade union officials were successfully concluded, with the pay award being backdated to 1 August 1999. The cost to Marlen College for the year ended 31 July 2000 is £1,600,000. No entries have been made in the College's books and records in respect of this.

(vii) On 14 June 2000 Marlen College purchased cleaning and gardening materials form a German supplier for 400,000 Deutschmarks (DM) when the exchange rate was £1:4 DM. The account was settled on 3 September 2000 when the exchange rate was £1:4.25 DM. At 31 July 2000, the exchange rate was £1:4.17 DM. Apart from recording the original transaction on 14 June 2000, no other entry has been made in the College's books and records.

(viii) In April 2000, ie after financial statements for the year ended 31 July 1999 had been approved, it was discovered that there had been an error which had resulted in the understatement of debtors in respect of student fees by £100,000. No adjustment has been made in respect of this, and the error does not give rise to any tax effect.

- **Requirement for question 1**

Prepare the income and expenditure account of Marlen College account for the year ended 31 July 2000 and the balance sheet as at that date.

(25)

(Notes to the financial statements and comparative figures are NOT required.)

2 You are the Financial Accountant for Aberiver College and have just completed the College's income and expenditure account for the year ended 31 July 2000 and balance sheet as at that date. These are presented below, together with additional information relating to the College's fixed assets.

Aberiver College
Income and expenditure account for the year ended 31 July

	2000	1999
	£000	£000
Income:		
Educational contracts	24,100	23,500
Tuition fees	18,500	18,200
Other operating income	4,200	4,000
Investment income	70	50
	46,870	45,750
Expenditure:		
Staff costs	26,500	25,900
Other operating expenses	18,200	17,755
Interest	60	45
	44,760	43,700
Surplus before tax	2,110	2,050
Taxation	(260)	(220)
Surplus after tax	1,850	1,830

Aberiver College
Balance sheet as at 31 July

	2000		1999	
	£000	**£000**	**£000**	**£000**
Fixed assets:				
Buildings		3,420		3,500
Plant and machinery		2,900		5,200
Motor vehicles		1,100		1,600
		7,420		10,300
Current assets:				
Stocks	9,200		5,400	
Debtors	11,100		8,500	
Cash at bank & in hand	600		810	
	20,900		14,710	
Creditors: amounts falling due within one year				
Bank overdraft	(180)		(100)	
Other creditors and accruals	(10,670)		(9,340)	
Finance lease	(5)		-	
Taxation	(260)		(220)	
Net current assets		9,785		5,050
Total assets - current liabilities		17,205		15,350
Creditors: amounts falling due after more than one year				
Finance lease		(5)		-
Net assets		17,200		15,350
Represented by:				
Income and expenditure account		17,200		15,350

Additional information:

(i) Fixed assets

	Buildings	Plant and machinery	Motor vehicles
	£000	**£000**	**£000**
NBV at 1 August 1999	3,500	5,200	1,600
Acquisitions	20	-	-
Disposals	-	(1,500)	-
Depreciation	(100)	(800)	(500)
NBV at 31 July 2000	3,420	2,900	1,100

(ii) During the year ended 31 July 2000 Aberiver College entered into a lease agreement with Kabin Ltd in respect of new changing facilities for the College's football pitches. The cash price of the new changing facilities was £20,000 and this is included under building acquisitions shown above. The capital element of the finance lease payments made during the year amounted to £10,000. Finance lease interest paid during the year amounted to £2,000 and is included within interest expenditure in the income and expenditure account.

(iii) Aberiver College also disposed of certain items of plant and machinery during the year for £1,200,000 cash.

- **Requirement for question 2**

(a) Prepare a cash flow statement for Aberiver College in accordance with FRS 1 (Revised) *Cash Flow Statements* for the year ended 31 July 2000 together with the appropriate supporting statements. *22*

(b) Briefly explain the direct method of presenting operating cash flows. *3*

(25)

SECTION B (Answer two questions)

3 You are assisting in the preparation of the financial statements of Highpoint University for the year ended 31 July 2000. However, a number of outstanding items have been brought to your attention and your opinion on how to treat them is now being sought. The items are as follows:

(i) Stationery valued at £24,000 was received by Highpoint University on 27 July 2000. £5,000 worth of this stationery was used immediately to print examination papers and course booklets, and the remaining stationery was placed in stores. The invoice has not yet been received.

(ii) Highpoint University charges final year students £10 for a graduation photograph. £8,000 of income in total has been raised in this way for the financial year ended 31 July 2000, and this has been netted off against the University's administration expenses.

(iii) Information extracted from the financial statements of Highpoint University indicates that the balance of the endowment asset funds at 1 August 1999 was:

	£000
General endowments	5,000
Specific endowments	3,000
	8,000

There were no new endowments received during the year ended 31 July 2000. However, income received from endowment asset investments amounted to £750,000, of which £200,000 related to specific endowments. Expenditure on specific endowment activities during the year amounted to £130,000 and the value of endowment asset investments is:

	Market value 1 August 1999 £000	**Market value 31 July 2000 £000**
General endowments	5,000	5,800
Specific endowments	3,000	3,350
	8,000	9,150

(iv) On 1 February 2000 Highpoint University agreed to lease a photocopier from EZ Print Ltd. Under the terms of the lease the University has to make an immediate payment of £5,000, and subsequently three payments of £5,000 on the anniversary of the lease agreement. The lease contains no break clause, and the photocopier has an expected useful economic life of eight years. The cash price of the photocopier is £40,000.

(v) Three married male members of academic staff and three married female members of academic staff, all aged 55, retired from Highpoint University during the year ended 31 July 2000. Each received an enhancement to their pension of £1,000 per annum. Highpoint University estimate that average interest rates will be 6% and inflation will be 2½% over the next 25 years. *(Extracts from Factor Tables are included at the end of this question.)*

(vi) The Reprographics Department of Highpoint University undertakes both in-house and commercial printing and publishing work. However, certain items of printing machinery appear to have suffered a fall in value. The historical cost carrying value of these machines at 31 July 2000 is £250,000 and their net realisable value is estimated to be £100,000 at the same date. The estimated net cash inflows from the machines over the next three years is £90,000 per annum. *(A discount rate of 6% per annum is to be used in any present value calculations.)*

(vii) Legal advice has been received concerning an unfair dismissal case which arose at the start of the year ended 31 July 2000. The likely outcomes and associated probabilities are as follows:

Outcome	**Probability**
University liable, settlement £50,000	40%
University not liable, costs incurred £8,000	60%

The University wishes to make a provision in the financial statements for the year ended 31 July 2000 and expects the case to take a total of three years to resolve.

- **Requirement for question 3**

(a) For each of the outstanding items identified in (i) to (vi) above, explain, with reference to the relevant accounting standards where appropriate, the required accounting treatment and the appropriate action (if any) to take in the financial statements for the year ended 31 July 2000. *18*

(b) In respect of the unfair dismissal case, explain how the provision should be accounted for in the financial statements for the year ended 31 July 2000, calculating the discounted provision and showing how the provision is unwound over the following years. *7*

(25)

Factor Table (extract) - net interest rate of 3%

Age	Married men	Single men	Married women	Single women
55	18.68	16.03	19.37	18.62

Factor Table (extract) - net interest rate of 3½%

Age	Married men	Single men	Married women	Single women

55	17.61	15.22	18.24	17.56

4 Hogwish University is currently involved in the process of tendering two services: cleaning and internal audit. The cleaning contract is in the early stages of the tendering process and the interested parties have still to be financially vetted, whereas bids have already been received for the internal audit service and these now need to be evaluated.

Three companies have expressed an interest in the cleaning contract and in order to be considered each company must first meet the requirements for accreditation as a University approved contractor. Based upon their last three years' audited accounts, each company must demonstrate reasonable liquidity over the three year period and that it has made a profit in each of the last three years.

Reasonable liquidity for the industry has been independently assessed as a current ratio of 1:1 or better, and a quick (or acid test) ratio of 0.9:1 or better. For the purposes of financial vetting each company is awarded points based upon the number of these requirements it is able to satisfy. A company is awarded one point for each requirement it meets and there are nine points available – one for each liquidity ratio for each of the last three years, and one for earning post-tax profits for each of the last three years. To be accredited the company must obtain at least two thirds of the available points. Extracts from the accounts of the three companies expressing an interest in the cleaning contract are presented below:

	1999/2000 £000	**1998/99 £000**	**1997/98 £000**
Company A:			
Turnover	1,090	1,135	1,024
Profit/(loss) after tax	105	112	(69)
Stock	22	18	28
Debtors	65	68	73
Cash and bank	49	32	17
Current liabilities	123	132	113
Company B:			
Turnover	1,350	1,302	1,180
Profit after tax	52	41	38
Stock	30	28	26
Debtors	59	52	48
Cash and bank	28	24	28
Current liabilities	89	90	84
Company C:			
Turnover	2,580	2,700	2,100
Profit after tax	72	75	69
Stock	35	34	30
Debtors	68	74	61
Cash and bank	29	24	24
Current liabilities	91	108	92

Three tenders have been submitted for the internal audit contract, and each tender is to be evaluated on both financial and non-financial criteria. There are two non-financial factors:

(i) The ratio of qualified to unqualified staff - it is considered that at least 20% of the audit staff should be qualified, and the following details have been submitted as the numbers of staff and their qualifications:

	X Ltd	**Y Ltd**	**Z Ltd**
Unqualified staff	24	49	78
Qualified staff	6	10	21

Weightings are to be attributed and marked as follows:

0 points if <15% of the audit staff are qualified;
5 points if 15-20% of the audit staff are qualified;
10 points if >20% of the audit staff are qualified.

(ii) The number of other internal audit contracts currently handling. This is considered an important indicator of not only experience and ability but also capacity, and the following details have been submitted:

	X Ltd	**Y Ltd**	**Z Ltd**
Number of internal audit contracts	2	15	10

Weightings are to be attributed and marked as follows:

0 points if 0-2 contracts;

5 points if 3-6 contracts;

10 points if 7-10 contracts;

5 points if >10 contracts.

The prices submitted by the companies are as follows:

	X Ltd	**Y Ltd**	**Z Ltd**
Price	£225,375	£241,095	£283,530

With respect to price, each company is to be scored out of a total of 30 points. Half of the available points are achieved at the mean price. For prices below the mean, add 2% of the total points for each percent below the mean price, and for prices above the mean, deduct 2% of the total points for each percent above the mean price.

- **Requirement for question 4**

(a) For the cleaning contract, evaluate each of the three companies financially and recommend which should be invited to tender. *11*

(b) For the internal audit contract, evaluate each of the bids and recommend which company should be awarded the contract. *7*

(c) Outline client responsibilities in relation to the tendering process. *7*

(25)

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- **Requirement for question 5**

(a) Explain the main role and responsibilities of the Director of Finance within a college or university. *15*

(b) What is meant by devolv ed financial management? *2*

(c) What are the advantages and disadvantages of devolved financial management? *4*

(d) Consider the impact of devolved financial management on the role of the Director of Finance. *4*

(25)