FINANCIAL REPORTING IN FURTHER AND HIGHER EDUCATION

Professional 2
December 2000

MARKING SCHEME

Question 1

Marlen College
Income and Expenditure Account for the Year Ended 31 July 2000

	Draft	Adjustments		Final
	£000	Working	£000	£000
Income:				
Educational contracts	22,700			22,700
Tuition fees and charges	19,750			19,750
Other operating income	7,065	(w7)	4	7,069
Investment income	85			85
Total income	49,600			49,604
Expenditure:				
Staff costs	26,995	(w6)	1,600	28,595
Other operating expenses	14,828	(w1d)	600	17,558
		(w1d)	1,000	
		(w4)	1,100	
		(w5)	30	
Depreciation	-	(w1a)	73	1,386.855
		(w1b)	760	
		(w1c)	553.855	
Interest payable	62	(w3)	1.713	63.713
Total expenditure	41,885			47,603.568
Surplus on continuing operations after depreciation of assets & before tax	7,715			2,000.432
Taxation	(315)			(315)
Surplus on continuing operations after depreciation of assets & tax	7,400			1,685.432

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Marlen College
Balance Sheet as at 31 July 2000

	Draft	Adjustments		Final
	£000	Workings	£000	£000
Fixed assets:				
Buildings	3,240	(w1a)	50	3,217
		(w1a)	(73)	
Plant and machinery	5,120	(w1b)	(1600)	2,760
			(760)	
		(w1c)	15.42	
Motor vehicles	1,560	(w1c)	(553.855)	1,021.565
	9,920			6,998.565
Current assets:				
Stocks	12,867	(w4)	(1,100)	11,767
Debtors	9,020	(w8)	100	9,120
Cash at bank & in hand	552			552
Creditors: amounts falling due within one year				
Bank overdraft	(120)			(120)
		(w7)	4	
		(w3)	(2.630)	
		(w5)	(30)	
Other creditors and accruals	(7,380)	(w6)	(1,600)	(9,008.63)
Taxation	(315)			(315)
Net current assets	14,632			11,455.37
Total assets - current liabilities	24,552			18,993.935
Creditors: amounts falling due after more than one year				
Finance lease	-	(w3)	(6.503)	(6.503)
Net assets	24,552			18,987.432
Represented by:				
Fixed asset reserve	-	(w2)	50	50
Income and expenditure account	24,552	(see w8)		18,937.432
(£17,152 + £7,400)	24,552			18,987.432

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WORKINGS:

1. Depreciation

		Cost £000	Depn £000	NBV £000	
(a)	Buildings	3,600	(360)	3,240	
	Net increase (w2)	50		50	
		3,650			
	depn @ 2%		(73)	(73)	
		3,650	(433)	3,217	*2*
(b)	Plant & machinery	10,000	(4,880)	5,120	
	Disposal (note 1)	(2,400)	800	(1,600)	
		7,600	(4,080)	3,520	
	depn @10%		(760)	(760)	
		7,600	(4,840)	2,760	*3*
(c)	Motor vehicles	2,200	(640)	1,560	
	Acquisition (w3)	15.42		15.42	
	depn @ 25%		(553.855)	(553.855)	
		2,215.42	(1,193.855)	1,021.565	*2*

(d)	Loss on disposal	- proceeds	1,000,000	
		- NBV	1,600,000	
		- Loss	600,000	*1*

Exceptional item per FRS 3 *Reporting Financial Performance*. It is necessary to revise original entry.

DR	Other operating expenses	1,000,000	
CR	Disposal account	1,000,000	*1*

2. Barter deal

College is acquiring asset with a value of £550,000. Therefore fixed assets should be increased by £50,000 (before depreciation).

DR	FA - buildings (car park)	£550,000	
CR	FA - buildings	£500,000	
CR	FA reserve	£50,000	*2*

3. Finance lease (SSAP 21)

The lease is for all of the minibus' life and the College is responsible for maintaining the asset. This suggests that the College has the benefit of the asset and also the responsibilities of ownership. Also there is an option to purchase the minibus at a notional sum, therefore if the minibus does have some residual value the College will benefit.

Consequently, the lease is a finance lease since the College is really borrowing cash to buy the asset (even though the College does not have legal title during the lease). The College pays a total of £20,000 for the asset with a cash price of £15,420. Therefore interest of £4,580 represents the finance cost to be allocated to the income and expenditure account over the term of the lease.

DR	FA - motor vehicles	£15,420
CR	Creditors	£15,420

Date	**O/bal.**	**Paid in adv.**	**Bal.**	**I & E a/c**	**Paid in arrears**	**C/bal.**
1 August 1999	15,420	(4,000)	11,420	1,713	(4,000)	9,133
1 August 2000	9,133	-	9,133	1,370	(4,000)	6,503
1 August 2001	6,503	-	6,503	975	(4,000)	3,478
1 August 2002	3,478	-	3,478	522	(4,000)	-

Depreciation = 15,420 / 4 = £3,855 pa

At 31 July 2000:	due < 1 year	(4,000 - 1,370)	= £2,630	
	due > 1 year	(9,133 - 2,630)	= £6,503	*5*

4. Stocks - SSAP 9 - lower of cost and NRV

	£
Cost	2.6m
NRV	1.5m
Stock write down	1.1m

i.e. additional evidence of conditions existing at the balance sheet date and therefore represents an adjusting event *1*

5. Claim - as probable will be paid, therefore provide for liability (FRS 12)

DR	Other operating expenses	£30,000	
CR	Creditors < 1 year	£30,000	*1*

6. Pay award

DR	Staff costs	£1,600,000

CR	Creditors < 1 year	£1,600,000	*1*

7. Purchase of cleaning and gardening materials from German supplier (SSAP 20)

Original entry:	DR	Other operating expenses	£100,000
	CR	Creditors < 1 year	£100,000
31 July 2000:	DR	Creditors < 1 year	£4,000
	CR	Other operating income (gain)	£4,000

- being restatement of creditor balance at 31 July 2000 using year end exchange rate (DM400,000 / 4.17) *2*

8. Debtor error at 31/7/99 - PYA required

	£	**£**	
Surplus for year	1,685.432		
Retained reserves b/f:			
- as previously reported	17,152		
- Prior year adjustment	100	17,252	
Retained reserves c/f		18,937.432	*2*

(25)

ie	DR Debtor	£400,000
	Income and expenditure account	£1,000,000

Question 2

(a)

Aberiver College
Cash Flow Statement for the Year Ended 31 July 2000

	£000	£000
Net cash inflow from operating activities (w1)		(1,270)
Returns on investments and servicing of finance:		
Interest received	70	
Interest paid	(58)	
Finance lease interest	(2)	10
Taxation:		
Tax paid (prior year)		(220)
Capital expenditure and financial investment:		
Proceeds from sale of plant and machinery		1,200
Cash outflow before use of liquid resources and financing		(280)
Management of liquid resources		-
Financing:		
Capital element of finance lease payments		(10)
Decrease in cash during the year (w2)		(290)

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other figures, excluding workings 6 x 1

(b)

The direct method of presenting operating cash flows shows receipts and payments under category headings (for example - staff). Consequently this method identifies sources of cash and the purposes to which cash has been applied. This approach is “encouraged” by FRS 1, but both private and public sector organisations tend to favour the indirect method. *3*

WORKINGS:

1. Reconciliation of Surplus to net cash flow from operations

	£000	£000
Surplus for year		1,850
+ Depreciation		1,400
- Investment income	(70)	
+ Loss on sale (w3)	300	
+ Interest payable	60	
+ Taxation	260	550
Increase in stocks	(3,800)	
Increase in debtors	(2,600)	
Increase in creditors (10,670 - 9,340)	1,330	(5,070)
		(1,270)

8

2. Analysis of changes in cash

	At 1 August 1999 £000	At 31 July 2000 £000	Movement £000
Cash at bank	810	600	(210)
Bank overdraft	(100)	(180)	(80)
	710	420	(290)

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3. Loss on disposal of plant and machinery

	£000
NBV	1,500
Proceeds	1,200
	300

(25)

Question 3

(a)

(i) SSAP2 (Disclosure of Accounting Policies) accruals concept states that goods received should be accounted for in the year they relate to. SSAP 9 (Stocks and Long-term Contracts) describes how unused stocks should be accounted for. An accrual of £5,000 should be raised for the stationery which have been used, and the stock valuation should be raised by £19,000 for the unused goods remaining in store.

DR	Operating Expenses	£5,000
DR	Stock	£19,000
CR	Creditors	£24,000

1 mark for discussion, 1 mark for accounting entries

(ii) UK GAAP recommends that income and expenditure should be reported and published gross, i.e. income and expenditure should not be netted off against each other. In order to show income and expenditure correctly in this case:

DR	Other operating Expenses	£8,000
CR	Other Operating Income	£8,000

1 mark for discussion, 1 mark for accounting entries

(iii) General endowments:
Income amounts to £550,000 (£750,000 - £200,000), and this should be credited to the income and expenditure account (Endowment income and interest receivable).

Specific endowments:
Although income of £200,000 was received, the amount to be transferred to the income and expenditure account is restricted to £130,000 (actual spend), and should be included under the heading "Endowment income and interest receivable". The balance of £70,000 should be included in endowment asset funds.

2 marks for discussion, 2 marks for accounting entries

(iv) The period of the lease agreement is for only half of the photocopier's life which suggests that it is an operating lease. It is reasonable to assume that the photocopier will still have a high residual value when it is returned, indeed there is no mention of any terms to suggest that it will not be returned to the lessor. Furthermore, the minimum lease payments represent 50% of the cash price (even before discounting).

Therefore £2,500 (6 mths) should be charged to the income and expenditure account for the year ended 31st July 2000, with £2,500 included as a prepayment.

1½ marks for discussion, 1½ marks for accounting entries

(v) The provision for the year ended 31 July 2000 is as follows:

	£
£1,000 x 17.61 x 3 =	52,830
£1,000 x 18.24 x 3 =	54,720
	107,550

Then in each of the subsequent years interest should be credited to the provision at 6% to the balance brought forward, and the actual cost of the enhancement to the pension payable for the year should be charged against the provision.

2 marks for discussion, 2 marks for accounting entries

(vii) FRS11 *Impairment of fixed assets and goodwill* is applicable in this case, and this accounting standard requires impairment reviews to be undertaken where there is an indication that the value of assets may be overstated in the balance sheet. Where the valuation is below the carrying amount in the balance sheet, the asset should be valued downwards, with the diminution charged to the income/expenditure account or revaluation reserve as appropriate.

Carrying value	=	£250,000
Value in use (VIU)	=	£240,570
Net realisable value (NRV)	=	£100,000

NRV appears impaired and therefore a review is required.

The recoverable amount is the higher of NRV and VIU.

= £100,000 v £240,570 (£90,000 x 2.673)
Therefore impairment loss is £250,000 - £240,570 = £9,430 to be charged to the income and expenditure account.

1½ marks for general discussion, 1½ marks for accounting entries
(18)

(b) FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* applies in this case, and requires that all provisions rather than those over 50% probable should be accounted for using the expected value concept and discounting if material.

In this case, the expected value of the provision is:

Forecast settlement	**Probability**	**Expected Value**	**Discount Factor**	**Discounted**
£50,000	40%	£20,000		
£8,000	60%	£4,800		
Total	100%	£24,800	0.8396	£20,822

The expected value should be discounted using the 6% public sector discount rate over 3 years.

The balance sheet provision needs to be increased and an equivalent charge made to the income and expenditure account.

DR	Other operating expenditure	£20,822	
	CR Provision		£20,822

Each year, the discount needs to be unwound. For next year, the discount on the provision will be unwound by 0.06 x £20,822 = £1,249

DR	Interest payable	£1,249
CR	Provision	£1,249

2 marks for calculating expected value, 1 mark for unwinding
2 marks for discussion of FRS 12
2 marks for accounting entries

(7)

(25)

Question 4

(a) **Cleaning contract**

	1999/2000	**Points**	**1998/99**	**Points**	**1997/98**	**Points**	**Total**	
Company A								
Current ratio	136:123=1.11	1	118:132=0.89	0	118:113=1.04	1	2	*1½*
Acid test	114:123=0.93	1	100:132=0.76	0	90:113=0.80	0	1	*1½*
Post tax profits	£105,000	1	£112,000	1	(£69,000)	0	2	*½*
Total							**5**	
Company B								
Current ratio	117:89=1.31	1	104:90=1.16	1	102:84=1.21	1	3	*1½*
Acid test	87:89=0.98	1	76:90=0.84	0	76:84=0.90	1	2	*1½*
Post tax profits	£52,000	1	£41,000	1	£38,000	1	3	*½*
Total							**8**	
Company C								
Current ratio	132:91=1.45	1	132:108=1.22	1	115:92=1.25	1	3	*1½*
Acid test	97:91=1.07	1	98:108=0.91	1	85:92=0.92	1	3	*1½*
Post tax profits	£72,000	1	£75,000	1	£69,000	1	3	*½*
Total							**9**	

Companies B & C can be invited to tender on financial criteria. *½*

(11)

(b) **Internal audit contract**

	X Ltd	**Points**	**Y Ltd**	**Points**	**Z Ltd**	**Points**	
Staff	6/30 =20%	5	10/59 =17%	5	21/99 =21%	10	*1½*
Contract		0		5		10	*½*
Price*		20.91		17.14		6.95	*4½*
Total		**25.91**		**27.14**		**26.95**	

Company Y should be offered the contract. *½*

(7)

Note: Students may interpret the last paragraph of the question in other ways, leading to a rounding of percentages, which may result in different points scores, the effect of which may be to change the recommendation to Company Z – full credit should also be given for recommending Company Z in these circumstances.

*** Price Notes:**	**£**
X Ltd	225,375
Y Ltd	241,095
Z Ltd	283,530
Total	750,000

Average Price = 250,000

225,375 = 9.85% less than the mean, hence points = 15+(9.85*(2%*30) = 20.91
241,095 = 3.56% less than the mean, hence points = 15+(3.56*(2%*30) = 17.14
283,530 = 13.41% greater than the mean, hence points = 15-(13.41*(2%*30) = 6.95

(c) **Client responsibilities**

OLM, Block 5, SU 20.

Responsibility	**Explanation**	
Drawing up the contact specification	Detailed description of the service/go ods/ works, e.g. tasks, times, frequencies, materials, etc. including minimum standards; Conditions, including client & contractor responsibilities; Provides a benchmark against which the tenders can be assessed.	*2*
Estimate of realistic cost	Based on the provision of the service/goods/ works detailed in the contract specification.	*1*
Publication of notice	To inform interested parties of the service to be tendered.	½
Send questionnaire and outline details	To obtain information to allow short-listing of contractors who will be invited to submit tenders.	*1*
Review questionnaire	To reject potential tenderers that do not meet minimum standards of financial standing or technical capacity.	½
Invitation to tender	Sending details to approved potential tenderers.	½
Tender evaluation	Review all tenders on the basis of cost and quality; Conclude with a preferred bidder.	½
Announcement of award	Notification to successful and unsuccessful tenderer.	*1*
		(7)
		(25)

Question 5

(a) **Role and responsibilities of Chief Financial Officer**

OLM, Block 1, SU 2

There are a number of appropriate structures which could be adopted. However the answer should cover the following key areas:

- provision of financial management advice;
- preparation of accounts and associated grant claims in accordance with relevant guidance;
- provision of internal audit function;
- provision of income collection and payment systems;
- budgetary control (capital and revenue budgets);
- cash flow management;
- financial planning;
- insurance and risk management;
- performance indicators / measures.

Also:

- HEFCE - Circular 5/96 - Model Financial Memorandum between the Higher Education Funding Council for England and Institutions;
- CIPFA - Corporate Governance in the Public Services;
- FEFC - Governance and Management of FE Colleges.

½ mark per point and 1 for explanation up to a maximum of 15

(b) **Devolved financial management**

OLM – Block 5, SU 21

The exact definition will vary but should refer to:

- the shifting of the decision making process away from the centre to front-line services;
- front line service managers being responsible for budgets and budget monitoring.

2

(c) **Advantages of Devolved Financial Management**

- Alignment of financial and managerial responsibility;
- Enables front line staff to respond more quickly to needs of clients;
- Fosters ownership of budgets;

- Clearer accountability;
- Any other appropriate points.

½ mark per point up to a maximum of 2

Disadvantages

- Costly to set up due to training requirements;
- Devolving financial responsibility to non-finance experts;
- More difficult for the centre to control and influence;
- Any other appropriate points.

½ mark per point up to a maximum of 2
(4)

(d) **Impact on the role of the Chief Financial Officer**

- Still maintains all statutory responsibilities;
- Quality assurance role e.g. are budgets being spent prudently;
- Co-ordination role re budgeting;
- Sets parameters e.g. cash limited budgets;
- Power to access documents and information becomes more important;
- Any other appropriate points.

1 mark per point up to a maximum of 4 marks

(25)