FINANCIAL REPORTING IN FURTHER AND HIGHER EDUCATION

Professional 2 examination
June 2000

MARKING SCHEME

CIPFA

Question 1

(a)

Income and expenditure account for the year ended 31 July 1999

Income	**£**	**£**	**£**		
Funding council grants			26,020		
Deferred credit			1,000		*1*
Academic fees		16,609			
		113	16,722		*1*
Research grants			15,297		
Other income:					
Miscellaneous		1,506			
Residences		4,193			
Services provided		3,549			
Subsidiary co.		750	9,998		*1*
Endowment income and interest					
Endowment income		2,903			
Interest		894	3,797		*1*
Total income			72,834		
Expenditure					
Staff costs					
Academic		22,775		)	
Premises		2,097		)	
Other		1,765		)	
Administration		2,321		)	*1*
General		348		)	
Pensions		869		)	
Research		7,625		)	
Residences		1,505		)	
Services provided		1,397		)	
Student services		550		)	
Wage award		600			*1*
Subsidiary company		272	42,124		*1*
Depreciation			1,556		*1*
Other expenses					
Academic		3,465			
Premises		5,953			
Other		1,164			
Administration		1,009			
General		1,146			*½*

Miscellaneous		593		
Research		5,623		
Residences		2,959		
Services provided Student services		1,685 817		
Equipment costs		2,348		
Provision		100		*½*
Subsidiary company		314	27,176	*1*
Interest payable			145	
Total expenditure			71,001	
Surplus for year			1,833	

(10)

(b) **Balance sheet as at 31 July 1999**

	£	£	
Fixed assets			
Land	10,000		
Building Equipment	40,390 10,000		
Less Depreciation			
Equipment	-2,000		
Buildings Endowment assets	-10,411	47,979	*1*
Investments	16,313		
Cash	173	16,486	*1*
Current assets Stocks	 330		
Debtors	12,537		
Cash	13,963		*1*
	26,830		
Current liabilities			
Creditors falling due within one year	(15,517)		*2*
Net current assets		11,313	
Total assets liabilities		75,778	
Creditor falling due after more than one year		(2,712)	*1*
Provisions for liabilities and charges		(2,623)	*1*
Total assets - total liabilities			
Deferred credit		(28,616)	*1*
		41,827	

Represented by					
			£000	**£000**	
Endowments					
Specific				12,112	
General				4,374	½
Reserves					
Revaluation				8,000	
I&E				17,341	½
				41,827	

9

Explanatory Notes:

1 Wage award: increase I & E £600k, increase by creditors by £600k

2 Fees not invoiced: increased Income by £113k, increase debtors by £113k

3 Adjust for activities of subsidiary

4 Staff and other cost added to university staff and other costs because surplus of £164k included in other income entry should be reversed and sales income of £600k incl.

5 Mortgage repayment of £88,000 due within 12 months – reduce loan and increase creditors more than 1 year.

6 Endowment income retained of £173k deducted from general cash and shown under endowment asset investments

7 Creditors falling due within 1 year

	£k
Trial balance	14,527
Overdraft	302
Mortgage repayments	88
Wage award arrears	600
Total	15,517

(c)

(i) SSAP 12 – Accounting for Depreciation – applies to all fixed assets, except

- Investment properties SSAP 19
- Goodwill SSAP 22
- Depreciation costs SSAP 13

Depreciation is the measure of wearing out, consumption or other reduction in the useful economic life of a fixed asset, whether arising from use, effluxion of time or obsoleance.

A non-cash charge. Charged on values in balance sheet and must be changed against Income and Expenditure Account (Profit and Loss Account). *2*

(ii) Methods

– Straight line – even charge over economic life of asset
– Reducing Balance – Set % reduction eg 25%/50% reduction. *2*

(iii) Straight line – even income flows and calculation costs
Reducing Balance - greatest loss in earliest years. *2*

(6)

Question 2

Introduction

Purpose of report and content – outline financial performance and comment on results using financial and non-financial indicators *2*

Performance Indicators

Main focus is on financial health, but uses non – financial indicators to develop theme

Main indicators could the cover following broad areas

Cost per student fte
Liquidity
Employee costs *2*

Expected issues to be identified

1 Overall Financial Performance

Overall finance performance 1998/99 deficit £1,558k (1.7%) – a worsening of performance compared to previous years surplus of £354 k (0.4%)

Total income increased by 4.8 % from £87,500k to £91,700k

Linked to student increase of 6% from 14,658 to 15,538

Income per student 1998/9 £91,700k/ 15,538 = £5,902

1997/8 £87,500k/14,658 = £5,969 *3*

BUT

Expenditure increase 10% from £80,000k to £88,000k

Costs therefore have risen at a faster rate than income and student numbers

General Funds have fallen by 78% £2,390k to £532k, largely due to the deficit in year.

General funds can only support 2 days worth of expenditure compared to 10 days in previous year. *3*

2 Costs Per Fte

	1998/99	**1997/98**	
Students enrolled	15,538	14,658	
Total Expenditure- (£000) (ex depreciation)	£88,000	£80,000	
Cost per FTE	£5,664	£5,458	*2*

A rise of 3.8 % - broadly in line with inflation

3 Liquidity

	1998/99	**1997/98**
Liquid assets; current liabilities	1.47	1.17
Current assets: current liabilities	2.64	2.54
Debtor Days	118.7days	98.6days

Comment

Liquidity remains fairly steady. Debtor days are increasing with the danger of increased bad debt. *3*

4 Employee Costs

Payroll cost increased from 42% to 44 % - possible because of increased student numbers. If on permanent contracts could be problems of fixed costs. *2*

Summary

College facing a worsening financial position
Debtor management problems emerging
Staff cost increasing as % of total costs *3*
Possible Action

Establish Team to review financial position and make recommendations to balance position

Implement Debtor collection procedures
Cost Reduction exercise implemented immediately
All expansion developments reviewed before implementation *3*

Non Financial Measures

Student retention rates moving from 89 % 1997/8 to 90% - Thus despite increased numbers slight improvement.

Students qualifying 33% - 33 % Again numbers constant despite increased numbers *2*

(25)

NB. Marks should be allocated where other appropriate valid points are made in place of those included in the marking scheme.

Question 3

Sources of funding

- Donations – Resources received as a gift from donors. Where received for a specific capital development it should clearly be managed to achieve the wishes of the donor(s)

- Capital grants – still made by the different funding bodies. Accounted for in line with SSAP 4. Most capital grants are distributed by formula and details of specific grants for major projects are detailed in circulars from the funding councils

- Cash generated - from operational activity. The use of I&E reserves to fund capital expenditure. Occasionally used to fund minor capital schemes, but by its nature not likely to fund any significant capital expenditure

- Borrowing – Higher and Further education institutions can borrow from external sources subject to the consent of their funding bodies. Rules for borrowing are laid down in the financial memorandum. Institutions with loans need also to manage the cost of these loans and will therefore need to recognise the financial implications i.e. revenue consequences of capital schemes and plan to meet these consequences at the capital development stage.

* Leasing

  Many Fixed assets can be financed from leases. There are two types of leases

  - Finance Lease – SSAP 21 defines a Finance lease as a 'lease that transfers substantially all the risks and rewards of ownership to the lessee'

  - Operating lease – any lease other than a finance lease

* Private Finance Initiative

Public and private sector partnership in which in the main the private sector builds and operates capital assets for the public sector to use. The idea behind the PFI is that substantial risk is transferred to the private sector. Payments regarding PFI schemes are often similar to operating leases. The recent implementation of the PFI has to-date resulted in long lead-in times and costly start-up costs. However these are likely to reduce as PFI becomes a more common form of funding of capital schemes.

- Capital Receipts

Institutions may sell parts of their estate to finance the construction of new buildings . These transactions are governed by their financial memoranda. In some circumstances institutions are required to hand over some of these receipts to the funding council, though these situations are infrequent.

- <u>European grants</u>

Some institutions have obtained such funds from the European Regional Development Fund

- <u>Lottery funds and other sources</u>

Some institutions have received funds from Lottery, Sports Council, National Heritage Fund. These funds are often 'matched funds' i.e. the institutions have to match the funds obtained with equal sums from their own resources.

½ mark for identifying each source of funding and up to 1½ mark for an appropriate comment, or brief explanation about the nature of the source of funding up to a maximum of 12

(ii)

The accounting treatment for a variety of capital funding are listed below;

(a) Capital grants including European RDF grants etc-

as per SSAP4 *1*

Receipt of Grant
Dr Cash
Cr Capital Grants – deferred a/c *1*

As asset is depreciated
Dr Capital grants – deferred a/c
Cr Income and Expenditure account *1*

Matching grant to depreciation on asset

(b) Financing by capital receipt
Dr Bank
Cr Capital Receipts *1*

Purchase of Asset
Dr Fixed Assets
Cr Bank *1*

(c) Financing from revenue
Dr Fixed Asset
Cr Bank *1*
Dr Income and Expenditure Reserve
Cr Capital Financing Reserve *1*

(d) Leasing

As per SSAP 21 *1*

Operating Leases is in effect renting the equipment as the assets are not owned by the institution. The only implication for the accounts is that the lease rental is charged to the income and expenditure account. There are no other liabilities. *1*

A finance lease means that the institution has an outstanding liability. The ownership lies with the institution and there are future payments to be made.

It is necessary to identify the principal and interest elements of the lease payments. The principal element is equal to the value of the capital and should be shown as a liability to be paid.

Eg if equipment valued at £4 million is under a finance lease and the total value of the lease is £5 million

Dr Fixed Assets £4 million

Cr Deferred Liabilities £4 million

Capitalisation of expenditure and recognition of liabilities *2*

During the life of equipment principal repaid and interest charged to the income and expenditure

Principal repayment

Dr Deferred liabilities
Cr Cash *1*

Interest payment

Dr Income and |Expenditure a/c
Cr Cash *1*

(25)

Question 4

Introduction

Brief explanation of the substance of Corporate Governance –

Management of the organisation as a whole.

Management in the interest of the stakeholders.

Board has to protect stakeholders interests.

Board acts as a check on management.

Board must ensure organisation accountable to stakeholders and gives equitable treatment to all.

Board ensures organisation must act transparently

1 mark for each relevant point to a maximum of 6

(Applicable to both Further and Higher Education)

Higher Education

June 1998 produced 'Effective Financial Management in Higher Education'

Not mandatory – but organisations expected to use as self–assessment manual and act on outcomes.

10 principles identified – a number with specific finance department involvement.

including

- **Development of strategic planning** – Finance function to develop strategic financial planning techniques to ensure strategic plans

  Robust
  Feasible
  Within resource expectations
  Financial control framework capable of managing or developing to match strategic plans.

1 marks for each relevant point to maximum of 5

- **Financial information** to governors, Chief Officers and senior managers should be
  - Relevant
  - Timely
  - Reliable

  The organisation has to be assured by the finance information it receives and acts upon. Thus Finance function needs to satisfy itself and the organisation it has effective

  Competencies
  Finance department architecture
  Finance human resources
  Financial self assessment procedures e.g. benchmarks, unit costs

  Finance function thus needs to put above in place and systems to ensure these are efficient and effective.

1 marks for each relevant point to a maximum of 5

Organisational structures, processes and systems are in place.

The finance function needs to support the organisations organisational structures etc
And ensures the finance function adds value throughout the range of finance
functions including:

Payroll –
Debtors and creditors
Budgetary control system
Treasury management
Etc.

The effective contribution by these and other finance functions to the organisations procedures should support the management process to achieving its aims in a sufficiently transparent way

1 mark for each relevant point to maximum of 5

- **implementation of Audit Code of Practice**

  - Audit Committee - not members of but servicing
  - Internal audit service
  - External auditors

1 mark for each relevant point to maximum of 3
1 mark presentation
(25)

Further Education

Casterbridge College Financial Statements -

- FE finance departments are recommended to ensure that the following are in place

- **Comprehensive budgetary system** in place with an efficient and effective annual budget process that involves the organisation throughout and is

  timely
  accurate
  economic
  understandable
  etc

  The budgetary system is to be a major element of the medium and long term planning process. The budgetary control system should support and underpin this planning process

1 mark for each point to a maximum of 4

- **Regular reviews** by the organisation of periodic and annual financial reports which indicates financial performance against targets.

  A regular assessment of the full range of financial reports and statements to ensure that:

  The financial control/budgets system is accurate;

  The targets are realistic and attainable;

  The budgetary and other financial calculation process and assumptions are valid and relevant;

  Systems and processes are in place to revise financial targets where appropriate.

1 mark per relevant topic to a maximum of 4

- **Setting targets to measure financial and other performance**

  - establishing a control framework to measure financial and non-financial performance
  - benchmarks against both internal and external standards
  - unit costs across all areas
  - activity targets reasonable and achievable and linked to financial outcomes
  - manpower targets relate to financial budgets

1 mark per relevant point to a maximum of 4

- Clearly defined capital investment controls
- Formal project management disciplines where appropriate.
- Written, understood and available financial regulations

1 mark per relevant point to a maximum of 3

- **Audit Committee**

- Pivotal in ensuring that an appropriate control framework is in place
- Working relationship with internal and external audit
- No executive members or members of Finance Committee

1 mark per relevant point to a maximum of 3

1 mark for presentation

(25)

Question 5

(a)

(i)

- Ensuring detailed and systemic planning takes place
- Identify and resolve conflicts and prevent dysfunctional activities
- Communicate plans to all parts of the organisation
- Motivate managers
- Control activities by measuring activity against targets
- Evaluating performance

Providing delegation of responsibility

AND

Requirement of HEFC and FEFC for further planning purposes

Statutory requirement to balance income and expenditure
(HEFCE Financial Memoranda 1996 para 21/FEFC 1993 para 39)

Audit Requirements –Audit Code of Practise requires monitoring of results against targets.

1 mark for each relevant point made to a maximum of 10

(ii)

WHO

- Board/Council – ensure statutory obligations met-strategic direction being followed and internal objectives being met. Require ‘ bottom-line’ summarised statements

- Senior Management – to ensure financial stability within the organisation and targets being met- Summaries required with exception reports-Capital budgets

- Middle Management – Detailed reports to ensure overall operational performance being met – Capital budgets

- Operational Managers (Budget Holders) Detailed Localised budget reports department specific –concentrated on operational issues

1 mark for each relevant point to a maximum of 4 marks and 1 mark overall for presentation

(b)

— Staffing budgets underspending
— Significant overspending – Provisions approximately 15%
— Significant overspending – Income approximately 10%

Improvements

— Included staffing/manpower budgets
— Analyse staff budgets over grades
— Expand provision budgets to give greater analysis
— Ensure budget profiling is:
  - in place
  - accurate
— Detailed breakdown of staff costs, possibly through supplementary information
— Inclusion of some activity details eg meals served/ drinks purchased
— Comparison of income and menu cycles

1 mark per relevant point to a maximum of 10 marks
Award marks if point not included in above but relevant

(10)