FINANCIAL REPORTING IN LOCAL GOVERNMENT

Professional 2 examination
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

Downdale District Council currently own a stock of council houses which, in accordance with legislation, are operated through a ring fenced Housing Revenue Account. The following transactions relate to the year ended 31 March 1999:

	£000
Income	
Rent from dwellings	9,140
Proceeds of sale	307
Service charges	525
Interest from mortgages	15
Expenditure	
Area housing office expenses	240
Repairs and maintenance of dwellings	3,027
Supervision and management	1,450
Rent Rebate	2,050

The following additional information is available which has not been taken into account:

(i) Outstanding advances to the Housing Committee, at 1 April 1998, were £31,870,000. Opening reserved capital receipts were £3,147,000 and the provision for credit liabilities amounted to £7,042,000.

(ii) The consolidated interest rate for the authority for 1998/99 was 7%.

(iii) The HRA raised £120,000 of new loans and repaid principal of £1,000,000 during 1998/99.

(iv) £25,000 of the " Proceeds of sale" relates to land, the remainder to dwellings.

(v) The Area Housing Office is shared with a "one stop shop" for council services. The "one stop shop" accounts for 200m^2 of the total 3000m^2 floor area.

(vi) Rent arrears are as follows:

	1 April 1998	**31 March 1999**
	£000	**£000**
Rent from dwellings	42	57
Mortgage interest	2	3

(vii) Housing subsidy for the year was zero.

(viii) The brought forward surplus balance as at 1 April 1998 was £25,000.

- **Requirement for question 1**

(a) Prepare the Housing Revenue Account for the year ended 31 March 1999. *15*

(b) Draft the following report:

The council is considering a proposal to sell its entire housing stock to a local Housing Association. The Housing Committee have requested a report outlining the potential advantages and disadvantages of such a sale to both the council and its tenants. They also wish to be informed of the likely main stages of the sale process. *10*

(25)

2

The following balances have been extracted from the ledgers of Shipton County Council as at 31 March 1999:

	£000
Revenue Support Grant	50,700
National Non Domestic Rate	24,080
Council Tax	32,040
Net Expenditure:	
Education	37,500
Leisure services	11,000
Highways & Transportation	17,700
Social Services	24,510
Planning	3,000
Environmental protection	9,750
DSO Surplus	127
Net fixed assets	247,000
Investments	11,500
Stock	2,470
Debtors	5,310
Creditors	3,470
Cash and bank	2,150
Useable Capital Receipts Reserves	7,427
Capital Financing Reserve	14,568
Fixed Asset Restatement Reserve	79,217
Interest on investments	800
Interest payable on borrowing	2,147
Long term loan	150,000

The following information is also available:

(i) The General fund balance at 1 April 1998 was £1,500,000.

(ii) Asset rentals are calculated at an amount equal to straight line depreciation, plus notional interest (being calculated at a rate of 6% on current value assets and 8% for historic cost ones). Asset rentals amounting to £10,108,000 have been calculated and are included in the committee net expenditure in the above table, **apart from those relating to notes (iii) and (iv) below**. Depreciation charged in the year amounted to £4,250,000. Asset rentals are fully charged in the year of purchase, but are not charged in the year of sale.

(iii) Shipton's Highways Committee purchased vehicles at a cost of £280,000, financed by capital receipts. The vehicles have an expected life of 5 years with a residual value of £30,000. The invoice has not yet been paid and the transaction has not been entered into the accounts.

(iv) On 30 March 1999, Leisure Services sold land with a book value of £2,000,000 during the year to a housing developer. The sale price was £6,000,000 and a cheque is expected from the developer on 4 April 1999.

(v) The Minimum Revenue Provision for 1998/99 has been calculated at £6,000,000.

(vi) Three years ago, the Education Department purchased a stock of "Healthy Living" books which were valued at £2,000. None have been sold in the past 18 months and so the entire amount is to be written-off.

- **Requirement for question 2**

(a) Prepare a working note for the the Chief Accountant, explaining in detail the adjustments you propose to the figures given in the above table. Include relevant journal entries where required. *15*

(b) Prepare a Consolidated Revenue Account and Balance Sheet for the year ended 31 March 1999. *10*

(25)

SECTION B (Answer two questions)

3

Capital Metropolitan Borough Council wish to build and open a new arts centre to serve a new housing estate that has recently been completed. Outline estimates of costs have been undertaken by the council which show that the total capital costs of the arts centre are likely to be in the region of £15 million, and the on going net revenue costs approximately £3 million.

The Council's Finance Committee are due to consider the different methods of funding the capital expenditure and, accordingly, have requested that the Director of Finance provide the Committee with a report considering the various methods of financing capital expenditure and their financial and accounting implications.

The Director of Finance has requested that you draft a report for the Committee. She is keen that the report not only considers the various methods of funding that are available to the Council from internal sources, but also considers the implications of entering into a Private Finance Initiative deal.

- **Requirement for question 3**

Write a report for the Finance Committee which:

(a) Identifies the methods of capital finance which may be available to the council. *5*

(b) Explains, in detail, the financial issues surrounding the funding methods identified. (Note you are not required to show any journal entries.) *20*

(25)

4

Memorandum

To: Director of Finance

From: Director of Leisure Services

Subject: Budgetary Control Information

I have just received my year end budgetary control printout from my accountant and I notice that Leisure Services have overspent their allocated budget by some £500,000, or 7% of the budget.

As a new Chief Officer with a background in the private sector leisure industry, I am seeking your advice on a number of issues.

Firstly, I have a suspicion that the budget on which this comparison is based, has not been calculated to reflect the actual services and expenditure patterns of the department. I am keen to hear your views on how this can be changed for next year's budget.

Secondly, I have been told by others in local government that an overspend like this is viewed with more concern than it is in the private sector. Could you please advise me on accountability issues that may arise when Councillors and the public get to hear of the overspend.

Thirdly, do I have to worry about the external auditors? I understand that they have more power than the private sector auditors I am used to.

Finally, and on a wider issue, my previous employers had an Audit Committee which dealt with audit and accountability issues which seemed to work very well. We do not seem to have one at the Council. Is this something that we could introduce or are there other corporate governance mechanisms here in local government?

Sorry to burden you with so many questions, but I am keen to learn!

- **Requirement for question 4**

Write a memorandum to the Director of Leisure Services in reply to the above. Your memorandum should consider the following areas:

(a) The principles of good budgetary control and any techniques that may assist in ensuring the accuracy of the budget. *6*

(b) An explanation of the term "financial accountability" and its relevance to local government. *6*

(c) The role and statutory powers of local government external auditors, highlighting the differences from the private sector. *6*

(d) An explanation of what controls should be in place regarding corporate governance in local government and a comparison with private sector arrangements. *7*

(25)

5

- **Requirement for question 5**

(a) Who are the users of local authority published accounts, and what are each user's information needs? *12*

(b) You are a Senior Financial Accountant and you have been asked to draft a response to the following list of queries from a CIPFA trainee who is covering for a senior capital accountant who is on extended leave.

(i) I understand that the authority is to receive, on 1 April 2000, two grants from central government, both of which are material to our finances. I refer to the £56,000 grant for sports centre equipment (expected asset life 8 years), and the £88,000 grant for the purchase of a plot of land for a playground and day nursery.

Please detail for me the accounting entries you would expect to make for these transactions in 2000 /2001, and briefly explain why they will be made.

(ii) Members are considering exchanging a plot of land for an office building and adjoining gardens. We can use the gardens as a park. The value of our piece of land is put at £400,000. The building is valued at £150,000 and the gardens at £300,000.

Ignoring the impact on asset rentals, how will this deal be recorded in the accounts?

(iii) The Environmental Health Department is considering entering a lease agreement for some new testing equipment. The lease will be over 5 years (the equipment's expected life), will start on 1 April 2000, and will be non-cancellable. The payments will be £650 a quarter. At the end of the lease we can keep the equipment. Apparently, we simply don't have the resources to buy the equipment now - it would cost about £10,000 cash. An accounting technician has worked out that the finance charge element of the first year's lease payments would be £1,037 and an interest element of £1,563. Also the implicit interest rate is 2.75% per quarter, and the total financial element over 5 years is £3,000.

In your view, from this information does this deal sound like it is a finance lease or an operating lease? Please explain how you came to your view.

If it is a finance lease, how will this transaction be recorded in our 2000/2001 accounts?

(iv) How is the housing revenue account set aside calculated - what figures go into it?

13
(25)