FINANCIAL AND PERFORMANCE REPORTING

June 2005
Diploma stage

MARKING SCHEME

Question 1

(a) Baudelaire NHS Trust:

Income and expenditure account for the year ending 31 March 2004

	Workings	**£000**	
Income from activities	(120,790 + 3,500 – 150)	124,140	½
Other operating income	TB	4,740	
		128,880	
Operating expenditure	(Working 1)	(126,675)	
Operating surplus		2,205	
Profit on sale of fixed asset	(Working 2)	5	
Surplus before interest		2,210	
Interest receivable	TB	15	
Surplus before dividends		2,225	
PDC Dividends	TB	(4,050)	
Deficit for the year		(1,825)	

Working 1: Operating expenditure

		£000	
Salaries	TB	85,900	
Supplies and services	TB	29,000	1
Premises	TB	6,590	
Establishment	TB	1,310	
Private patient debt write off		25	½
Depreciation	See working 3	3,850	½
		126,675	

Working 2: Profit on sale of fixed assets

		£000	
Cost at disposal date	Working 3	15	
Accumulated depreciation at disposal date	Working 3	(13)	
NBV		2	
Proceeds		7	
Profit on sale		5	1

Baudelaire NHS Trust: Balance Sheet as at 31 March 2004

		£000	£000	£000	
Fixed assets					
Land	(Working 3)			6,095	
Buildings	(Working 3)			62,248	
Plant and equipment	(Working 3)			13,380	
Vehicles	(Working 3)			106	
				81,829	
Current assets					
Stock		250			
Debtors	(7,930 – 150 – 25)	7,755			½
Cash	(275 + 7)	282			½
			8,287		
Creditors due within one year			(3,900)		
Net current assets	(TB)			4,387	
Total net assets				86,216	
Taxpayers' Equity					
Public dividend capital	(TB)			80,000	
Revaluation reserve	(Working 4)			7,286	
Income and expenditure reserve	(Working 5)			(1,070)	
				86,216	

Working 3: Fixed assets

	Workings	**£000**	
Land b/f		5,750	
Indexation	(5,750 x 6%)	345	½
c/f		6,095	
Buildings b/f		60,230	
Indexation	(60,230 x 6%)	3,614	½
		63,844	
Depreciation	(63,844 / 40)	(1,596)	½
c/f		62,248	
Plant and equipment – cost b/f		20,575	
Indexation	(20,575 x 2%)	412	½
c/f		20,987	
Plant and equipment – depreciation			
b/f		5,400	
Backlog	(5,400 x 2%)	108	½
Charge	(20,987 / 10)	2,099	½
c/f		7,607	
NBV Plant and equipment		13,380	
Vehicles – cost b/f		750	
Indexation	(750 x 3%)	23	½
		773	
Disposals	(15 x 1.03)	(15)	½
c/f		758	
Vehicles – depreciation			
b/f		495	
Backlog	(495 x 3%)	15	½
Charge	(773 / 5)	155	½
Disposals	(10 x 1.03 + (15 / 5)	(13)	½
c/f		652	
NBV Vehicles		106	

Total depreciation charge = 1,596 + 2,099 + 155 = 3,850

Working 4: Revaluation reserve

	Workings	**£000**	
b/f		3,720	
Indexation	(345+ 3,614 + 412 + 23)	4,394	½
Backlog depreciation	(108 + 15)	(123)	½
Historical cost depreciation adjustments:			
Buildings	(1,596 – 1,000)	(596)	
Plant and equipment	(2,099 – 2,000)	(99)	*1*
Vehicles	(155 -145)	(10)	
c/f		7,286	

Working 5: Income and expenditure reserve

	Workings	**£000**	
b/f		50	
Deficit for the year	(I&E Account)	(1,825)	½
Historical cost adjustment	(596 + 99 + 10)	705	½
c/f		(1,070)	

Presentation of statements *1*

(14)

(b) Performance against the break-even target

The in year deficit of £1,825,000 exceeds the 0.5% of turnover materiality threshold. The Trust has three years to recover the cumulative deficit of £1,070,000. *2*

(c) Accounting treatment for transferring services

FRS 3, Reporting financial performance requires that organisations report separately continuing and discontinuing operations. The NHS Manual for Accounts only requires disclosure of discontinuing operations if services discontinue at a national level. *1*

The transferring service will represent a post balance sheet event. SSAP 17 considers the accounting treatment for post balance sheet events. The transfer of services would be classed as a non-adjusting post balance sheet event. A narrative disclosure should be made in the notes to the financial statements stating that services are transferring from 1 April 2004 and the value of income, expenditure and net assets transferring. *3*

(20)

Question 2

(a) Sunny Unitary Authority: Cash flow statement for the year ending 31 March 2004

		£000	£000
Cash flows from revenue activities			
Payments to employees		355,750	
Payments to other suppliers		299,890	
			655,640
Council tax		(220,700)	
NNDR		(173,160)	
Grants		(10,510)	
Fees and charges		(4,670)	
Revenue support grant		(250,900)	
			(659,940)
Net cash inflow from revenue activities	(N1)		(4,300)
Returns on investment and servicing of finance			
Interest paid		4,300	
Interest received		(2,090)	2,210
Capital activities			
Payments to acquire fixed assets	(W2)	3,750	
Receipts from the sale of fixed assets	(W3)	(10,000)	(6,250)
Financing			
Loans raised	(W4)	(4,390)	
Loans repaid		3,000	(1,390)
Increase in cash			(9,730)

Note 1: Reconciliation of operating surplus to cash inflow

		£000	
Surplus for the year	(1,200 – 4,270)	(3,070)	½
Non cash flow and non operating items			
Depreciation	(W1)	(5,000)	
DRF		(750)	½
MRP	(4,380 – 5,000)	620	*1*
Interest paid		(4,300)	½
Interest received		2,090	
Movement in working capital			
Stock	(1,020 – 1,010)	(10)	½
Debtors	(4,000 – 6,500)	2,500	½
Creditors	(9,050 – 5,430)	3,620	½
Net cash inflow from revenue activities		(4,300)	

Presentation ½

Working 1: Calculation of depreciation

AMRA

	£000			£000	
Depreciation	$\boxed{5,000}$	*1*	Asset rentals	9,681	½
External interest	4,300	½	Deferred grants (3,500 – 3,150)	350	*1*
To CRA	731	½			
	10,031			10,031	

Working 2: Fixed asset additions

FARR

	£000			£000	
Disposals	$\boxed{5,000}$	*1*	b/f	8,530	
c/f	10,217		Revaluation	6,687	½
	15,217			15,217	

Fixed assets

	£000			£000	
b/f	133,740		Depreciation	5,000	½
Revaluations	6,687	½	Disposals	5,000	½
Additions	$\boxed{3,750}$	*1*	c/f	134,177	
	144,177			144,177	

Working 3: Cash received from sale of fixed assets

UCR

	£000			**£000**	
			B/f	2,890	
Used in year	1,250	½	Received in year	$\boxed{10,000}$	½
C/f	11,640				
	12,890			12,890	

Students do not need to prepare the CFR as well since note 4 identifies that no capital receipts are set aside for debt repayment

Working 4: Loans received

Long term borrowing

	£000			**£000**	
			B/f	109,500	
Repaid	3,000	½			
			Raised	$\boxed{4,390}$	½
C/f	110,890				
	113,890			113,890	

(b) Points that should be made in the notes for meeting:

Use of the capital receipt

Capital monies should not be used to subsidise revenue expenditure. The capital receipt cannot be used to subsidise council tax as this will lead to sub optimal financial management. The council will need to deal with a funding gap next year once the capital receipt has effectively been used up. *1*

The council could either:

- Invest the cash received and use the interest generated to reduce the net cost of operations and therefore reduce the amount which the local taxpayer needs to fund.
- Use the capital receipt to pay off long-term borrowing and thus reduce the interest charge and minimum revenue provision that the local taxpayer needs to fund. *2*

The decision to invest or pay off existing debts will depend on where the best financial return can be gained. *1*

Reduction of council tax

Reduction of council tax through use of the capital receipt could lead to claims of financial mismanagement. Local Authorities should not fund revenue expenditure from capital sources. The members will need to consider any proposed caps on council tax in light of the level of Central Government support received or will need to look to increase fees and charges raised. *2*

(6)

Other valid comments made should attract credit

(20)

Question 3

Note that the marking scheme for this question is intended to be illustrative. A student's answer to this question will depend on the public service organisations with which they have selected to illustrate their answer. Students should be awarded credit for relevant points made, even if these points are not explicitly referred to in this marking scheme.

(a) UK GAAP is the term given to the framework for financial reporting within the UK. It will include the Companies' Act, Stock Exchange reporting requirements, accounting standards in issue, UITFs and FREDs. *2*

(b) UK GAAP should in general apply as a framework for accounting within the public services so that accounts are prepared on a consistent basis to promote comparability across organisations (and across sectors).

ASB's Statement of Principles identifies that application of UK GAAP within the public services is a matter for Treasury/Government. Therefore accounting standards will be interpreted for different sectors through their SORPs/Manuals etc.

Specific legislative reporting requirements will overrule UK GAAP, eg LGHA 1989 requires specific accounting treatment such as the separation of the general fund and housing revenue account.

Financial reporting will be driven in the public services by the need to demonstrate financial stewardship. This may overrule UK GAAP or change the influence of UK GAAP's requirements.

Some parts of UK GAAP will not apply given the nature of the public services. Eg no shareholders therefore earnings per share disclosures are not needed, accounting standards/UITFs dealing with taxation will only apply where there are taxable activities therefore tend only to apply to public service group financial statements where group members have taxable activities. Similarly stock exchange reporting requirements will not apply since public service organisations are not listed on the stock exchange

1 mark per point made and explained to a maximum of 4. Other valid points to attract credit

(c) **Eg Local Government**

Legislative requirements eg LGHA 1989 establish the separation of the revenue account and HRA, overriding reporting requirements of Companies' Act and FRS 3. LGHA 1989 also identifies requirements for capital accounting which differ from UK GAAP (eg use of capital reserves, requirement for MRP etc).

SORP applies accounting standards. Differences from UK GAAP appear in terms of capital related accounting standards, eg FRS 11 and ability to charge temporary (market prices) impairments to the FARR in full, requirement to appropriate out of the CRA contributions from capital grants.

Accounts required to be adopted in a public meeting and made available to stakeholders/local electorate. This is similar to the need to hold an AGM to adopt the financial statements in a company. Reinforces the need for local authorities to demonstrate financial stewardship and be accountable to the local electorate.

Eg NHS

Gross principle widely adopted as per the Companies' Act as there is a need for NHS organisations to disclose income and expenditure streams clearly.

Dividends paid on public dividend capital (NHS Trusts only) mirror the idea of paying dividends to shareholders and are accounted for in the same way (eg as expense after surplus after interest).

NHS MFA defines accounting treatment/application of accounting standards. Generally companies' interpretations adhered to. Exceptions include treatment of revaluation reserve on impairment of assets (due to impact on financial targets), exemption from SSAP 9 in relation to valuation of long-term contracts for patient healthcare since Treasury determined impossible to value accurately and impact of excluding this year on year and across the NHS would be immaterial.

1 mark per point made, 1 mark for explanation to a maximum of 8
Students asked explicitly for 2 examples per sector

(d) Main driver for introduction of international accounting standards in the private sector is the increased need to be able to compare organisations operating in different national environments because of increased multi-national trading and increased international competition.

There are no plans at present to adopt international accounting standards in the UK Public Sector.

International accounting standards are of less relevance to the public sector since the public sector exists within national (even regional) boundaries. There is no direct comparator between international public sectors given the diversity of arrangements for providing public services across nations.

1 mark per point made to a maximum of 5
1 mark for argued conclusion as to whether international accounting standards should be applied in the public sector

(20)

Question 4

(a) Quagmire Agency: Revised operating cost statement for the year ending 31 March 2004

		£000	
Staff costs		(12,650)	
Other costs	Working 1	(5,847)	
		(18,497)	
Other income	(18,675 – 17,430)	1,245	½
Net operating cost for the year		(17,252)	

Quagmire Agency: Revised balance sheet as at 31 March 2004

		£000	
Fixed assets	(16,758 – 372)	16,386	½
Current assets			
Stock		35	
Debtors		4,580	
Cash		1,230	
		5,845	
Creditors due within 1 year		(3,500)	
Total net assets		18,731	
Taxpayers' equity			
General Fund	Working 3	16,683	
Revaluation reserve		2,048	
		18,731	

Presentation of statements ½

Depreciation calculation = 16,758 / 45 = 372

Working 1: Other costs

	£000	
Per original OCS	4,385	
Depreciation charge	372	½
Notional charges (working 2)	1,090	½
	5,847	

Working 2: Notional charges

		£000	£000	
Audit fee			75	*½*
Insurance				
Staff costs	(12,650 x 2%)	253		*½*
Fixed assets	(16,758 – 372 x 1%)	164		*½*
			417	
Notional interest:				
Opening relevant NA	(1,250 + 17,055 – 1,640)	16,665		*1 ½*
Closing relevant NA	(16,386 + 5,845 – 3,500 – 1,230)	17,501		*1*
Average	(16,665 + 17,501 / 2)	17,083		*½*
Cost of capital at 3.5%			598	*½*
Total notional charges			1,090	

Working 3: General Fund

	£000	
Opening general fund (as at 1 April 2003) (17,055 – 1,640)	15,415	
Notional charges	1,090	*½*
Parliamentary funding	17,430	*½*
Revised Net operating cost for the year	(17,252)	*½*
General fund as at 31 March 2004	16,683	

(b) Reasons for adjustments:

Depreciation needs to be charged to the operating cost statement to comply with FRS 15 and the RAM so that the cost of using fixed assets is recognised in the financial statements. *1*

Notional charges are included in the operating cost statement to ensure that the full cost of services is recorded and therefore promote benchmarking etc. *1*

Notional 3.5% interest is charged to represent the opportunity cost of tying up public money in net assets and thus encourage stewardship of assets. *1*

Parliamentary funding is accounted for through the general fund. It does not represent income earned but investment received during the year. *1*

(c) Financial performance measures could include:

- Remaining within the Agency's resource limit
- Remaining within a set cash limit

1 mark per measure

Other relevant measures to attract credit. Students should not be awarded credit for trading related targets that would not apply under the supply financed regime of Central Government.

(d) The general fund in Central Government represents the amount of continued investment made in a service by the taxpayer. This differs from the Local Government general fund which represents retained surpluses from activities available for future use. *1*

The general fund will be used to account for notional charges in Central Government and account for parliamentary funding received in year. Parliamentary funding cannot be recorded in the OCS since it is not income earned but investment received through funding allocations. Repayment of excess appropriations in aid to the consolidated fund are accounted for through the general fund (no equivalent in Local Government). *3*

The net operating cost for the year is written through the general fund. This is like bringing the surplus/ deficit for the year from the CRA into the general fund balance in Local Government to identify the retained surplus or deficit for the year. *1*

NB Students may answer this question with reference to the Council fund in Wales or the General Rate fund in Scotland. Credit should be awarded for using these terms.

(20)

Question 5

(a) Private sector organisations focus on profit generation or maximising shareholder wealth.

Financial performance focuses on profit objectives (eg: identification of gross v net profits), return on capital employed, earnings per share etc.

Primarily performance reporting focuses on how profit has been generated and planned investment in the business to increase profit/shareholder wealth. May report performance in non-financial areas (such as environmental/community projects), as part of any ethical objectives but this is secondary to reporting financial performance.

Within the public sector the focus is not on generating profit but is on using funds wisely to deliver good quality services.

Financial performance focuses on demonstrating stewardship for funding received. (eg CRA showing net cost of services, PCT OCS splitting income and expenditure by commissioning and providing functions).

Performance reporting focuses on whether service objectives have been met. May be demonstrated through performance indicators or measures. Examples could include BVPIs, assessment against star ratings, national targets etc.

Across the public services systems like CPA/star ratings look to bring together an assessment of both financial and non-financial performance.

1 mark per relevant point made to a maximum of 6

(b) **Further and higher education**
Financial performance is assessed through locally set targets. Areas likely to be assessed include:

- Attainment of break even or surplus for the year.
- Return on assets (measured through ROCE).
- Liquidity, gearing and interest cover, particularly if financed through significant loan capital.

Institutes with endowments may assess financial performance through looking at returns on endowment investment and the extent to which endowment income is used.

Where institutes have established separate trading organisations, assessing financial performance will need to consider both the financial performance of each entity and of the group as a whole. Stakeholders may find information on group/entity performance confusing unless it is clearly presented.

Non financial performance can be assessed through two main sources:

- Formal reviews (such as QCA assessments) that assess the quality of services provided.
- Locally developed VFM style indicators.

For any performance information to be useful for stakeholders benchmarking should be adopted, although this too has its weaknesses, especially in the FHE sector since two courses provided on the same subject can be very different in syllabi content and therefore not be directly comparable.

1 mark per relevant point to a maximum of 4

Housing Associations
Financial performance is assessed through local targets. Financial performance can be assessed in two main ways:

- Through review of financial ratios assessing performance at the organisational level as a whole eg attainment of break-even/ surplus, return on assets, gearing and liquidity.
- Through assessing financial effectiveness through more VFM style indicators, eg % of rent collected.

There is a clear link between financial and non financial performance assessed through VFM style indicators (eg level of rent charged will relate to attainment of break even).

Non financial performance is assessed through performance systems such as the Housing Corporation's Comprehensive Performance Assessment and through local VFM indicators. Although CPA provides a single assessment of the organisation's performance, stakeholders concerned with the performance of larger housing associations may find that this does not provide enough detailed information on individual services provided by the Association.

Benchmarking needs to be completed to understand financial and non financial performance and make it meaningful for stakeholders.

1 mark to a maximum of 4

(c) Changes in the financing of public sector organisations do not change their core objective of delivering services and using funds wisely. Public sector organisations will continue to have to demonstrate that money has been used wisely and that "value for money" has been achieved in providing services. There will continue to be a need for the public services to report on whether assets have been used wisely to deliver public services. This is particularly so in Local Government where the members are elected locally and therefore locally accountable for service delivery but is also necessary for the NHS.

Greater financial freedoms may require a change in focus of financial statements. Measures of performance such as gearing and interest cover will become more important as organisations have greater freedoms to borrow. The development of NHS Foundation Trusts will practice this. Disclosure of trading activities to ensure that fee generating services have not been cross subsidised by statutory services will continue and may become more important. This is already required in Government and will become more important as ALMOs are.

Increased joint working with the private sector may require the format of financial statements to change eg because financial consolidated statements are needed. This may require significant changes in some sectors (eg Local Government because of different capital accounting regime). The aim of these consolidated statements will still need to consider if funds have been used wisely to deliver services.

1 mark per point made and examples given to a maximum of 6

(20)

Question 6

(a) The NHS overall has financial targets as it is funded at a national level using public money. Non-executive members are not locally elected therefore are accountable at a distance to the public (unlike Local Government where elected members are directly accountable to the local population for service delivery). Local NHS organisations therefore remain accountable to the Department of Health for their performance. Set financial targets allow the Department of Health to monitor and assess performance of local organisations and the financial target regime promotes benchmarking across different parts of the NHS. *2*

(b) There are six targets in total that PCTs need to report:

1. Performance against the revenue resource limit. This assesses if the PCT has controlled revenue expenditure within a limit set by the Department of Health. It acts as a measure of break even and is assessed on an annual basis.
2. Performance against the capital resource limit. This assesses if the PCT has controlled capital expenditure within a limit set by the Department of Health. It helps to ensure that capital investment across the health sector as a whole is controlled.
3. Performance against the cash limit. The PCT needs to ensure that cash based expenditure does not exceed the target set by the Department of Health. This is to help manage the public sector cash requirement overall and acts in some ways as a gearing type measure.
4. Provider arm break even. This helps demonstrate the extent to which the PCT has subsidised its own services compared with what has been spent on commissioning from other parties.
5. Management costs will be disclosed in the accounts. This demonstrates the extent to which resources have been spent on front line services and therefore helps to demonstrate stewardship and accountability for the funding which the PCT has received.
6. Performance against the Public Sector Payment Policy *(also referred to as the Better Payment Practice Code. Students should be awarded credit for using either definition).* This assesses the extent to which the PCT has complied with the requirements of the Late Payment of Commercial Debts (Interest) Act 1998 by paying invoices within 30 days and whether any interest has been paid by the PCT for late payment, therefore linking to stewardship of resources.

½ mark for identification of target
Up to 1 mark per target for explanation of what the target assesses

(c) *Note that recommendations suggested here are indicative. Students making other appropriate recommendations should be awarded credit. Please note the marking summary below for part (c).*

Performance against the revenue resource limit:

	£	
Net operating costs for the year	212,730,000	
Less: Non cash limited payments to GPs	(3,500,000)	½
Less: Provider arm impairment (250,000 – 175,000)	(75,000)	½
Charge against the revenue resource limit	209,155,000	
Revenue resource limit	208,500,000	
Overshoot	655,000	

Note students can also approach calculating the target from the limit down (see below for workings). Both methods to be awarded credit.

	£	
Revenue resource limit	208,500,000	
Add: Non cash limited payments to GPs	3,500,000	½
Add: Provider arm impairment (250,000 – 175,000)	75,000	½
Adjusted resource limit	212,075,000	
Charge against the resource limit	212,730,000	
Overshoot	655,000	

The PCT has exceeded its revenue resource limit for 2003/04. ½

Recommendations for revenue resource limit target:

- Can payments to local provider trusts be reduced for 2003/04, thereby moving any deficits into Trust books as Trusts have three years to break even.
- The PCT should look to agree a recovery plan with the strategic health authority and local provider trusts to recover the deficit.
- The PCT should review its general cost control and income recovery to see if the deficit can be clawed back through efficiency savings/ additional income.

Performance against the capital resource limit

Charge against the CRL	£	
Gross book value of additions	230,000	
Less: Donated asset additions	(50,000)	½
Less: NBV disposals	(12,000)	½
Charge against the CRL	168,000	
CRL set	350,000	
Undershoot	182,000	

Note students can also approach calculating the target from the limit down (see below for workings). Both methods to be awarded credit.

	£	
Capital resource limit	350,000	
Add: Donated asset additions	50,000	*½*
Add: NBV disposals	12,000	*½*
Adjusted resource limit	412,000	
Charge against the resource limit	(230,000)	
Undershoot	182,000	

The PCT has undershot the CRL which is permitted *½*

Recommendations for capital resource limit

- Undershooting could be indicative of weak management of the capital programme. Has the rehabilitation wing project slipped? Does capital project management need to be improved to prevent this happening in the future? *1*
- The PCT should seek to agree a carry forward of the CRL for 2004/05 and either invest in additional capital programmes itself or pass any spare limit to local trusts *1*

Provider arm break even duty:

Net cost of provider arm activities	£4,500,000
Amount commissioned from own PCT	£4,500,000

Target has been met exactly. No recommendations needed *½*

Performance against the cash limit:

Cash limit set	£215,000,000	
Parliamentary funding drawn down	£210,870,000	
Undershoot	£4,130,000	*½*

The PCT has undershot the cash limit which is permitted but this represents that there is £4,130,000 that the PCT could use for the year but it has not used. *½*

Recommendations for cash limit

- The PCT cannot use the spare cash to incur additional expenditure since it has already exceeded its resource limit for the year.
- The PCT can therefore only make use of its spare cash resource through balance sheet items such as repaying creditors/ making prepayments and/ or offering cash brokerage to other parts of the NHS.
- Since the PCT's capital additions exceed its cash payment for capital activities paying creditors would seem wise, particularly as the cash limit may decrease as the capital programme is completed.

Marks to be awarded for calculation and basic comment (ie target met/ failed) as indicated above (total = 1 ½ + 1 ½ + ½ + ½ = 4)
Recommendations made: 1 mark per relevant recommendation made and explained to a maximum of 5

(20)