FINANCIAL REPORTING AND ACCOUNTABILITY
REPUBLIC OF IRELAND

Professional 2
June 2004

MARKING SCHEME

Question 1

(a) Consolidated balance sheet as at 31 December 2003:

	€000	
Goodwill	640	*3*
Fixed assets	9,190	*2*
Investment in A Ltd	1,820	*1*
Net current assets	1,640	*1*
Less: Proposed dividends	(140)	*½*
	13,150	
Creditors due in > 1 year	(2,080)	
Debentures	(1,400)	*½*
	9,670	
Ordinary share capital	8,000	*½*
General reserve	500	
Profit and loss account	818	*5*
	9,318	
Minority interest	352	*1½*
	9,670	

1 mark for aggregation and cancellation

(16)

Working 1: Goodwill (Cost of Control)

A	Proportion of equity owned by H Ltd	80%
	Proportion of equity owned by minority interest	20%
B	Years as subsidiary	4
		€000
C	Investment at cost	2,960
D	Nominal value of share capital	(800)
E	Pre-acquisition profits (1,500 x 80%)	(1,200)
F	Fair value of assets	(160)
G	Goodwill [C - (D+E+F)]	800
H	Annual amortisation (over 20 years)	40
I	Amortisation charges against group profits [B x H]	160
J	Total [G - I]	640

Working 2: Tangible fixed assets

		H Ltd €000	B Ltd €000	Total €000
Balances		7,270	1,800	9,070
Revaluation to fair value	Group		160	160
	Minority Interest		40	40
Increase in depreciation	Group		(64)	(64)
	Minority Interest		(16)	(16)
Total		7,270	1,920	9,190

Working 3: Net current assets

	H Ltd €000	B Ltd €000	Total €000
Balances	355	1,355	1,710
Unrealised profit on goods in stock		(10)	(10)
Cancellation of intra-group dividend	(60)		(60)
Total	295	1,345	1,640

Working 4:

	H Ltd €000	B Ltd €000	Total €000
Creditors due in > 1 year	(1,250)	(830)	(2,080)

Working 5: Proposed Dividend

	H Ltd €000	B Ltd €000	Total €000
Balances	125	75	200
Cancellation of intra-group dividend		(60)	(60)
Total	125	15	140

Working 6: Profit and loss a/c

	H Ltd €000	B Ltd €000	Total €000
Balances	1,710	650	2,360
Pre-acquisition profits		(1,200)	(1,200)
Unrealised profit on goods in stock		(8)	(8)
Amortisation of goodwill		(160)	(160)
Increased depreciation on fair value of assets		(64)	(64)
Share of A Ltd's post acqn. profit (40% x 100)	40		40
Amortisation of goodwill in A Ltd	(20)		(20)
Attributable to minority interest		(130)	(130)
Total	1,730	(912)	818

Working 7: Minority interest

	B Ltd €000	Total €000
Nominal value of ordinary share capital	200	200
Share of profit and loss a/c	130	130
Increase in fair value of fixed assets	40	40
Increased depreciation on fair value of assets	(16)	(16)
Unrealised profit on goods in stock	(2)	(2)
Total	352	352

Treatment of A Ltd:

Shareholding of 40% (2,000 of the 5,000 50 pence shares), hence use equity method to incorporate into group balance sheet:

Working 1: Calculation of implicit goodwill

A	Proportion of equity owned by H Ltd	40%
B	Years as subsidiary	1
		€000
C	Investment at cost	1,800
D	Nominal value of share capital	(1,000)
E	Pre-acquisition profits [40% x (1,100 – 100)]	(400)
F	Implicit goodwill [C - (D+E)]	400
H	Annual amortisation (over 20 years)	20
I	Amortisation charges against group profits [B x H]	20

Working 2: Value of investment in A Ltd on group balance sheet

	Total €000
Investment at cost	1,800
Share of post-acquisition profit (40% x 100)	40
Amortisation of implicit goodwill	(20)
Total	1,820

(b) Included in the consolidated profit and loss account:

(A Ltd's post acquisition profit x 40%) – (goodwill amortised)

= 40 – 20 = 20.

Shown as net of two entries on the consolidated P&L A/c after operating profit:

Share of A Ltd's operating profit: (240 x 40%) – 20 = 76

Taxation to include: (A Ltd's taxation x 40%) = (65 x 40%) = 26

Plus:

Elimination of dividend receivable by H Ltd from A Ltd:
(75 x 40%) = 30 *(4)*

(20)

Question 2

(a) SCC Ltd.

Note 1: Reconciliation from operating activities.

	€000	€000	
General surplus (25,250 - 14,700)		10,550	*1*
Add: Depreciation	17,500		*½*
		17,500	*½*
		28,050	
Add/less: Movements in working capital			
Less: Increase in stock	(400)		*½*
Less: Increase in debtors	(5,250)		*½*
Add: Increase in creditors	3,750	(1,900)	*½*
		26,150	
Add:			
Add: External interest paid	16,650		*1*
Less: Investment income	(1,405)	15,245	*½*
		41,395	
Add: Loss on Sale of Asset		2,000	
		43,395	

1 mark for presentation
(6)

(b)

SCC Ltd.
Cash flow statement for the year ended 31 March 2003.

	€000	€000	
Revenue Activities: Net cash flow (a)		43,395	*1½*
Returns on investments and servicing of finance			
Interest paid	(16,650)		*2*
Interest received	1,405	(15,245)	*1½*
		28,150	
Capital activities:			
Purchase of fixed assets	(57,300)		*3*
Purchase of investments	(2,350)		*1½*
Sale of fixed assets	10,000	(49,650)	*2½*
Net cash flow before financing		(21,500)	
Financing:			
			1½
New loans raised		25,500	
Increase in cash		4,000	*1*

1 ½ mark for presentation
(16)

Reconciliation:

Position @ 1/4/02	2,450
Position @ 31/3/02	6,450
	4,000

Working:

Purchase of Fixed Assets

Increase in Revaluation		64,700
Fixed Assets	727,500 – 635,000 + 12,000 + 17,500 =	122,000
Purchases		**57,300**

(c) Cash flow statements identify the flows of cash/cash equivalents within the organisation for the preceding year.

Whereas operating statements consider accrued income and expenditure, the cash position, liquidity and indeed viability and long term survival can be analysed in this statement.

The prescribed headings and formats in FRS 1 identify revenue sources and uses of cash and capital flows which in a public service setting is important to demonstrate investment in physical infrastructure and service delivery initiatives.

The comparison with budget estimate and actual out-turns in accruals and cash terms is very instructive and supports operational and strategic decision making and the setting and review of financial objectives. *(3)*

Question 3

(a) The Department of Finance Guidelines on the appraisal and management of capital expenditure projects suggests that a national test discount rate of 5% be used for evaluation purposes. The Guidelines also include sections on cost benefit, cost effectiveness analysis and financial and non-financial appraisal.

However, the follow-through and accountancy rules for capital charges are underdeveloped. There is recognition of the need to include opportunity cost for capital investment in public services and to see this as a notional cost to include in cost of service provision.

The impact of such a charge would result in:

- notional computations of capital charges
- comparison and discussion of asset rental concept
- Increased cost for services provided
- Adjustments below the line for notional elements
- Creation of capital / sinking fund

There would be significant accounting and financial reporting consequences for Local Government, Health Services and Educational Bodies. However, the implementation of Water pricing directives from EU and the move to more and greater transparency in public service pricing and charging will force the adoption of principles in this area within the Local Government Sector at least. *(7)*

(b) **Note 1: Reconciliation of operating deficit to net cash outflow from operating activities**

	€000	€000	
Operating deficit		(8,550)	*1*
Add: Charges not involving cash movements:			
Depreciation	75		*3*
Less: Profit on disposal FA (225-200)	(25)	50	*1*
Less Interest Received		(50)	*1*
Add/less: Movements in working capital			
Add: Decrease in stock	60		*1*
Less: Increase in debtors	(5)		*1*
Less: Decrease in creditors	(60)	(5)	*1*
Net cash outflow from operating activities		(8,555)	

1 mark for presentation

(10)

Workings:

Derivation of depreciation charge for the year:

	Land €000	**Other €000**	**Total €000**
Bal b/f 1/4/02	1,250	1,500	2,750
Disposals	-	(200)	(200)
Revaluation	175	170	345
Depreciation for year	-	*(75)*	*(75)*
	-		
Acquisitions		105	105
	1,425	1,500	2,925

(c) Cash flow statement for the year ended 31 March 2003

	€000	
Net cash outflow from operating activities	(8,555)	*1*
Capital expenditure and financial investment	120	*2*
Financing	8,680	*3*
Interest	50	
Increase in cash	295	*1*

1 mark for presentation

(8)

Workings:

Capital expenditure and financial investment:

	€000
Purchase of fixed assets	105
Less: Receipt from sale of fixed assets	(225)
Net cash inflow from investing activities	**120**

Financing:

	€000
Net parliamentary grant voted / paid	8,580
Misc. Income	100
Financing	**8,680**

Interest Received	€50

(25)

Question 4

(a) Income and expenditure account for year ended 31 March 2004.

	€000	
Turnover (42,500 + 25)	42,525	½
Operating costs (31,450 + 75 + 3,014 – 50 – 25)	(34,464)	2
Operating surplus	8,061	
Profit on sale of fixed assets (490 + 2,340)	2,830	2
Interest receivable	420	
Interest payable (7,250 + 25)	(7,275)	1
Surplus for the year	4,036	
Transfers to the designated reserves	(2,830)	2
Surplus for the year after transfers to reserves	1,206	
Surplus	116,400	½
Revenue reserves C/F	117,606	

1 mark for presentation
(9)

Workings:

Depreciation calculation:

	Land €000	Housing Prop. €000	Offices €000	Furn./Equip. €000
Trial balance	100,000	228,400	4,800	1,750
Less: SHG		(106,400)		
Disposals	(300)	(3,000)	(400)	
Leased asset				300
Additions		210		
	100,000	119,210	4,400	2,050
Depn years	-	50 yrs	20 yrs	5 yrs
Depreciation	0	2,384	220	410

Total depreciation = 2,384+ 410 + 220 = 3,014

(b) Balance sheet as at 31 March 2004.

	€000	
Fixed assets:		
Land and housing property (100,000 + 228,400 – 2,820 + 31,865 + 210 – 2,384 – 3,300 + 440)	352,411	*4*
Less: Grants (106,400 + 16,000 – 1,100)	(121,300)	*1*
	231,111	
Other fixed assets (4,800 – 1,200 + 1,750 – 700 – 220 – 410 – 400 + 160 + 300)	4,080	*3½*
	235,191	
Current assets / liabilities:		
Debtors (2,150 + 25)	2,175	*1*
Cash	870	
Less: Creditors due in < 1 year (3,650 + 1,100 + 55)	(4,805)	*1*
Total assets less current liabilities	233,431	
Creditors due in > 1 year:		
Loans	112,500	
Finance lease (300 – 50 – 55)	195	*2½*
Provisions	300	
Capital and reserves		
Revenue reserves (117,606 + 2,830)	120,436	*1*
	233,431	*1*

1 mark for presentation
(16)

Workings:

Finance Lease:

	€000
Fair value of asset	300,000
Total lease payments	375,000
	75,000

Sum of digits = 1 + 2 + 3 + 4 + 5 = 15

Interest for 2003/04 = 75,000 x 5/15 = 25,000
Hence: Principal repayment for 2003/04 = 75k – 25k = 50,000

Interest for 2004/05 = 75,000 x 4/15 = 20,000
Hence: Principal repayment for 2004/05 = 75k – 20k = 55,000

Double entries:

	£000	£000
Dr furniture and equipment	300,000	
Cr creditors > 1 year: finance lease		300,000
Dr interest payable	25,000	
Cr operating costs		25,000
Dr creditors > 1 year: finance lease	50,000	
Cr operating costs		50,000
Dr creditors > 1 year: finance lease	55,000	
Cr creditors < 1 year		55,000

Calculation of profit on sale of fixed assets

Office building:	NBV = 400 – 160	= 240K
	Proceeds	= <u>730K</u>
	Profit on disposal	= 490K

Housing Property:

	NBV = 3,300 – 440	= 2,860K
	Proceeds	= <u>5,200K</u>
	Profit on disposal	= 2,340K

(25)

Grant policy

€ 1,1 m to be repaid from the disposal account

Workings

Disposal Account

Asset Acs	3,700	Balance (730 + 5200)	5,930
Transfer to Reserves	2,830	*Acc Depreciation*	*600*

Question 5

(a)

Registered Nursing Home
Income and expenditure account for year ended 31 March 2003.

	€000	
Income from activities (68,300 + 4,200 + 350)	72,850	
Admin Cost	(2,860)	*1*
Operating expenses (42,750+15,950+485+970+1,160+2,437+357)	(64,109)	*2*
Profit / loss on disposal of fixed assets	(130)	*2*
Surplus / deficit before interest	5751	
Interest receivable	245	*2*
Surplus / deficit for financial year	5996	
Retained surplus for the year	5996	

1 mark for presentation
(8)

(b)

Registered Nursing Home
Balance sheet as at 31 March 2003.

	€000	€000	
Fixed assets:			
Land		7,800	
Buildings		49,240	
Direct equipment		6,508	
Donated equipment		1,228	
		64,776	*7*
Current assets / liabilities:			
Stock	240		
Debtors (1,550 + 350)	1,900		*½*
Cash	160		
Creditors due in < I year	(2,790)	(490)	
Creditors due > 1 year:			
Provisions for charges and liabilities		(300)	*1*
Total assets employed		63,986	
Taxpayers' Equity:			
Capitalisation Account		49,080	
Rev. Res. (5,740-125+1,450)		7,065	*3½*
Donations reserve (1,500+85)		1,585	*2½*
Income and expenditure a/c (260+5,996)		6,256	*1½*
		63,986	

1 mark for presentation
(17)

Workings:

Calculation of depreciation and FA balance sheet entries:

Land and buildings:

	Land €000	**Buildings €000**
Opening balance	7,925	48,950
Revaluation	(125)	1,450
Depreciation	-	(1,160)
	7,800	49,240

Equipment:	**Direct €000**	**Donated €000**
Opening balance	12,200	1,700
Revaluation	-	-
Addition	285	85
Disposal	(300)	
	12,185	1,785

Accumulated Depreciation:

	Direct €000	**Donated €000**
Opening balance	3,300	200
Depreciation for year (20% SL)	2,437	357
Disposal	(60)	-
	5,677	557

Asset Disposal:

Cost (Feb 02)	300,000
Depreciation (20% SL)	60,000
NBV	240,000
Proceeds	110,000
Loss on Disposal	130,000

Equipment:

	Direct	**Donated**
Cost	12,185	1,785
Depreciation	(5,677)	(557)
NBV	6,508	1,228

(25)

Question 6

(a) Specific sources needed, examples of which might be as follows:

Central Government: Public sector borrowing, taxation, parliamentary vote on account, appropriations in aid.

Local Government: Rate support grant, levies and charges, commercial rates, housing rents, miscellaneous.

Health: Central funding, determinations, private patient income, investment income.

Education: Central grants, tuition fees, corporate sponsorship, research grants/contracts, other services eg: accommodation/catering/conference fees, HEA allocations

(½ mark per example, up to 1 mark per sector; maximum of 5 marks)

(b) Governed by SSAP 4 Accounting Treatment for Government Grant.

Private Sector: Revenue grants to P&L a/c when conditions of grant have been maintained – if over more than one year, the grant should be split and included as other Income in proportion to the element of qualifying expenditure that has been incurred in each year.

Capital grants are released to the P&L a/c over the useful life of the asset purchased / funded. Balance of grant is held on the balance sheet as Deferred Income. Effectively offsets depreciation within the P&L a/c.

Local Government: Revenue grants to I&E A/c when conditions of grant have been met.

Capital grants to capital fund account and transferred.

Education: Very similar to Local Govt. Revenue grants to I&E A/c when conditions of grant have been met.

(Up to 5 marks per sector)
(10)

(15)

Question 7

Specific measures of financial performance required, examples of which may include:

(a) Private sector:

1. Principally profit from P&L a/c – measures primary objective of private company.

2. Uni-variate ratio analysis, eg: ROCE, profit margin, EPS – measures ability to generate profit.

3. Investors ratios, eg: return on equity, earnings per share, price earnings ratio – ability to satisfy providers of finance, and hence generate capital for investment.

4. Multivariate ratio analysis eg: Altman's Z-score – combines measures of profitability, performance for investors etc. to give an overview of financial performance.

(b) Central and Local Government:

1. Limiting expenditure to budget – measures primary objective of stewardship of public funds.

2. Performance Indicators – under MIF or FM Reforms, comparing against similar organisations to demonstrate VFM in service delivery, benchmarking, service, indicators.

3. Minimising increases taxation charges – achieving local accountability in use of public money to deliver services.

(c) Health Service:

1. Service plan and indebtedness limits – maximum accounts that can spend on a cash basis. Set nationally for each service , Performance measured by comparison to the planned financing requirement.

2. Structure Business Case criteria for capital / NDP processes

3. Compliance with prompt payments requirements.

4. Break Even – Organisations must strive to break even taking one year with another within service plan and excess is a first charge on following year, per legislation.

(maximum of 5 marks per sector)

(15)

Question 8

(a) Central Government:

Accounting rules and principles set out in central finance circulars. Focus is on asset identification in first instance. It would be envisaged that tangible fixed assets at lower of replacement cost and recoverable amount be included in an overall asset register. Depreciation is not charged in accordance with FRS 15 on fixed assets, although appropriate depreciation methods are under review. *3*

(b) Local Government:

Asset Accounting is a relatively new concept. Detailed provisions in Accounting Code of Practice. Assets included in the Asset register according to a different bases of valuation:

Infrastructure held at historic cost, depreciated where appropriate.

Community assets, identified.

Operational assets held at lower of net replacement cost or net realisable value in existing use. The concept of Depreciation is only currently under review.

Non-operational assets, held at net replacement or realisable cost.

Only partial compliance with FRS 15 rules of depreciation (ie: except where land, fully maintained to infinite useful life or depreciation immaterial). It is envisaged that authorities determine method and period of depreciation appropriate to asset. *3*

(c) Report identifying benefits including:

Control of assets, information availability, value and usage of assets reflected in costing and pricing, assignment of responsibility and accountability, support decisions on lease, purchase and maintenance strategies, reflect stewardship and ownership of assets and support VFM initiatives relating to asset management and utilisation and identification of surplus requirements. *9*

(15)