FINANCIAL REPORTING AND ACCOUNTABILITY

Professional 2 examination
8 December 2004

From 10.00 am to 1.00 pm
plus twenty minutes reading time from 9.40 am to 10.00 am.

Instructions to candidates

*Answer **five** questions in total. The compulsory question from Section **A**, **one** question from Section **B, one** question from Section **C,** and **two** questions from Section **D.***

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 examination room.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

Candidates may use the proforma sheets provided in the separate booklet and submit them as part of their answer.

CIPFA

SECTION A (Compulsory)

1

The following balance sheets relate to the Homer group of companies as at 30 November 2004.

	Homer Ltd	Socrates Ltd	Plato Ltd
	£000	£000	£000
Fixed assets (net book value)	15,800	7,500	3,600
Investments	10,045	-	-
Stocks	3,700	1,200	980
Debtors	2,000	690	420
Intra-group debtors			
- Homer Ltd	-	60	
- Plato Ltd	90	15	-
Bank	670	90	(120)
Creditors	(1,850)	(900)	(495)
Intra-group creditors			
- Homer Ltd	-	-	(90)
- Socrates Ltd	(50)	-	(10)
Taxation	(750)	(60)	(20)
Proposed dividends	(600)	(100)	(85)
Long-term loan	-	-	(70)
	29,055	8,495	4,110
Ordinary share capital (£1)	18,000	6,000	1,500
5% Preference share capital (£1)	-	-	1,500
Share premium account	4,000	-	400
Profit and loss account	7,055	2,495	710
	29,055	8,495	4,110

You have been provided with the following additional information:

(i) The investments in Homer Ltd's balance sheet comprise:

	£000
4.5 million ordinary shares in Socrates Ltd	6,000
1 million preference shares in Plato Ltd	1,000
1.2 million ordinary shares in Plato Ltd	3,000
Loan to Plato Ltd	45
	10,045

(ii) The investment by Homer Ltd in Socrates Ltd took place on 1 December 1999 when the balance on Socrates Ltd's profit and loss account stood at £680,000.

The investment by Homer Ltd in Plato Ltd took place on 1 December 2003 when the balance on Plato Ltd's profit and loss account stood at £500,000. In addition, the fixed assets of Plato Ltd include land at its historic cost valuation of £900,000. The fair value of this land was £1,700,000 at the date of acquisition.

(iii) The share premium in Homer Ltd and Plato Ltd arose when their respective ordinary shares were first issued.

(iv) Homer Ltd has accounted for the proposed dividends receivable from Socrates Ltd and Plato Ltd. No company paid any interim dividends during the year.

(v) On 28 November 2004 Plato Ltd posted a cheque for £5,000 to Socrates Ltd which was received by Socrates Ltd on 3 December 2004.

(vi) On 29 November 2004 Socrates Ltd despatched goods with a selling price of £10,000 to Homer Ltd who did not receive those goods until 4 December 2004.

(vii) Included in Homer Ltd's stock figure at 30 November 2004 are goods costing £150,000, which it had purchased from Socrates Ltd.

(viii) Socrates Ltd’s selling price is based on a mark up of 25% on the cost of its goods.

(ix) Goodwill arising on consolidation is to be amortised over 10 years.

- **Requirement for question 1**

Prepare the consolidated balance sheet for Homer Ltd and its subsidiary companies as at 30 November 2004. ***(20)***

SECTION B (Answer one question)

2

Williamstown College prepares its financial statements to 31 July each year. The following balance sheets have been extracted from the accounts for the years ended 31 July 2003 and 2004.

Williamstown College
Balance sheet as at 31 July

	2004		2003	
	£000	£000	£000	£000
Tangible fixed assets				
Land		3,250		2,925
Buildings - cost	22,425		19,500	
Buildings - accumulated depreciation	(7,345)	15,080	(5,850)	13,650
Plant & equipment - cost	13,650		11,700	
Plant & equipment - accumulated depreciation	(7,020)	6,630	(6,825)	4,875
Endowment assets		4,500		3,000
		29,460		24,450
Current assets				
Stock & WIP	500		510	
Debtors (trade)	3,500		2,350	
Investments	3,900		4,095	
Cash			130	
	7,900		7,085	
Creditors - falling due within one year				
Trade creditors	(1,105)		(780)	
Tax	(325)		(195)	
Overdraft	(650)		0	
	(2,080)	5,820	(975)	6,110
Creditors - amounts falling due after more than one year				
Long Term Loan		(29,900)		(24,700)
		5,380		5,860
Financed by;				
Endowments (specific & general)		4,500		3,000
Revaluation reserve		1,820		1,820
Income & Expenditure account		(940)		1,040
		5,380		5,860

Additional Information

1 Surplus land owned by the college was disposed of during the year for £1.040 million. The land sold was valued in the accounts at the time of sale at £845,000.

2 During the year, buildings which had cost £8.775 million (accumulated depreciation £2.925 million) were sold for £6.760 million. Surplus equipment was also sold during the year for £260,000. This had originally cost £1.950 million (accumulated depreciation £1.170 million).

3 Investment income due for the year of £390,000 had all been received by the 31 July 2004.

4 Investments of £1.170 million were realised during the year at cost.

5 Analysis of the creditors figures revealed that interest payable at 31 July 2003 was £260,000, and £325,000 on 31 July 2004. The total interest charge for the year was £1.495 million.

6 The tax charge for the year is included in the financial statements as £390,000.

7 Loans of £3.9 million were repaid during the year.

8 The movement in endowment assets has been entirely due to appreciation.

- **Requirement for question 2**

(a) Prepare the following for the year ended 31 July 2004:

(i) Reconciliation of operating surplus/deficit to net cash flow from operating activities.

(ii) Cash flow statement. *16*

(b) Historically, Further & Higher education institutions have acquired fixed assets financed primarily by specific government grants or donations. However, successive governments have adopted policies to reduce capital funding. As a result leasing is becoming increasingly popular as a way of financing capital expenditure.

Outline briefly the types of lease available and the accounting treatment of each alternative. *9*

(25)

3

Williamstown NHS Trust prepares its financial statements to 31 March each year. The following balance sheets have been extracted from the accounts for the years ended 31 March 2003 and 2004.

Williamstown NHS Trust
Balance sheet as at 31 March

	2004		2003	
	£000	**£000**	**£000**	**£000**
Tangible fixed assets				
Land		38,730		38,025
Buildings		114,210		94,905
Plant & equipment		20,817		22,740
		173,757		155,670
Current assets				
Stock & WIP	125		146	
Debtors	1,910		3,575	
Cash	785		356	
	2,820		4,077	
Creditors- falling due within one year	(21,870)		(16,065)	
Net current assets		(19,050)		(11,988)
Creditors - amounts falling due after more than one year				
Finance Lease		(2,520)		0
		152,187		143,682
Taxpayers' Equity				
Public Dividend Capital (PDC)		145,183		139,528
Revaluation reserve		5,783		3,593
Income & Expenditure account		(129)		561
Donation Reserve		1,350		0
		152,187		143,682

Additional Information

1 Revaluation and indexation of fixed assets for 2003/04 were as follows;

Revaluation/Indexation	**£000**
Land	705
Buildings	1,425
Equipment	165
Equipment depreciation	(105)
	2,190

2 During the year additions to buildings of £18,735,000 were made, which included £1,350,000 for a building donated to the trust as a legacy. Additions to equipment of £4,200,000 were also made, these being financed via a finance lease.

3 Equipment disposed of during the year was recorded in the asset register at gross replacement cost of £2,565,000 with associated accumulated depreciation of £2,052,000.

4 An analysis of the Income & Expenditure account for the year to 31 March 2004 revealed the following:

	£000
Profit on disposal of equipment	60
Interest receivable	20
Interest payable	105
PDC dividends payable	10,455

5 An analysis of debtors & creditors revealed the following:

	2004 £000	**2003 £000**
Debtors		
NHS (operating)	1,890	3,570
Interest	20	5
	1,910	3,575
Creditors		
PDC dividends payable	10,455	7,980
Fixed Assets	5,655	4,245
Trade creditors	4,905	3,840
Finance lease	840	0
Interest	15	0
	21,870	16,065

6 PDC of £19,500 was paid back at the end of the year.

- **Requirement for question 3**

(a) Prepare the following for the year ended 31 March 2004:

(i) Reconciliation of operating surplus/deficit to net cash flow from operating activities.

(ii) Cash Flow Statement.

(iii) Reconciliation of net cash flow to movement in net debt and analysis in the movement of net debt. *21*

(b) Explain the meaning of the term 'Capital Cost Absorption Duty', and outline clearly how the relevant net assets figure is arrived at. Calculate the Trust's performance against its target for 2003/4 and comment briefly on your findings. *4*

(25)

SECTION C (Answer one question)

4

Rosemonk City Council is in the process of closing down its accounts for the year ending 31 March 2004. The following balances have been extracted from the financial ledgers prior to the preparation of the Consolidated Revenue Account and Balance Sheet.

	£000	£000
Education	593,568	54,756
Social services	120,252	12,124
Environment and planning	76,712	1,490
Highways, roads and transport	30,980	11,788
Central services	5,130	
Cultural and leisure	39,150	1,350
Precepts to other authorities	6,332	
Net tangible fixed assets	800,006	
Interest paid	29,322	
Interest received		730
Sale of assets		7,290
Loan transactions	156,816	188,164
Capital expenditure	29,320	
Long term borrowing		361,860
Government grant deferred		4,280
Long term investments	12,100	
General fund balance		25,374
Council Tax		456,900
NNDR		128,798
Revenue support grant		270,694
Stock	11,084	
Debtors	12,496	
Short term investments	4,150	
Cash	312	
Creditors		7,086
Fixed asset restatement reserve		358,640
Capital financing reserve		20,962
Usable capital receipts		15,444
	1,927,730	1,927,730

The following information is also available:

1 Capital charges have been calculated as follows but have not yet been charged to the service departments:

	Depreciation £000	Notional interest £000
Education	8,130	31,572
Social services	1,850	6,074
Environment and planning	530	3,745
Highways, roads and transport	1,958	6,325
Central services	85	325
Cultural and leisure	651	2,585
	13,204	50,626

2 The minimum revenue provision for 2003/4 is estimated to be £13,468,000.

3 Assets with a book value of £6,000,000 have been sold during the year. The proceeds of the sale have been recorded as “sale of assets” in the ledger. The assets have not been written out of the accounts.

4 A European Union special grant for special needs supervision in primary schools is outstanding. The amount of the grant, £2,400,000 has yet to be entered on the Education committee ledgers.

5 During 2003/2004 a government grant was awarded for a city bypass and link road; it is to be amortised over 40 years.

6 For March 2004, a notification regarding a revaluation was received from the valuer, as part of the revaluation rolling programme. When assets are revalued during a month, any necessary revaluations only affect rentals from the start of the following month.

The multi storey car park on Westside originally valued at £1,500,000, has been revalued to £2,028,000.
The Balance Sheet has not been updated for the revaluation.

7 Capital expenditure on two sheltered accommodation units during the year was financed through direct revenue financing, loan and capital receipts.

	£000
Loan	20,000
Use of Capital receipts	8,000
Direct revenue financing	1,320

The loan transactions have been included in the ledger balances above, but adjustments are required for the other two methods of financing and the fixed asset ledger.

8 Debtors totalling £60,000 in respect of consultancy work undertaken by the Toxic Waste Material section within the Environment and Planning service have been deemed uncollectable and must be written off.

- **Requirement for question 4**

(a) Prepare the Asset Management Revenue Account for the year. *4*

(b) Prepare the consolidated revenue account for Rosemonk City Council for the year ended 31 March 2004 together with the Balance Sheet as at that date. Show all relevant workings. *17*

(c) Briefly explain the function of the Asset Management Revenue Account (AMRA) and why there has been adjustment made within the Consolidated Revenue Account for the Minimum Revenue Provision (MRP). *4*

(25)

5

The following items are the balances included in the trial balance of Arba Housing Association as at 31 March 2004:

	£000	£000
Turnover		46,750
Operating costs	31,680	
Cash at bank	890	
Interest payable	5,780	
Properties held for letting purposes at cost	395,600	
SHG & other grants		211,370
Interest receivable		420
Other designated reserves		5,480
Rent Surplus Fund reserve		1,954
Shared ownership property held for letting at cost	8,930	
Motor vehicles at cost	295	
Properties in development at cost	25,450	
Loans		155,760
Office at cost	4,370	
Office furniture at cost	1,975	
Debtors	3,970	
Share capital		1
Creditors due within one year		4,120
Provisions for liabilities and charges		480
Recycled Capital grant fund		2,400
Depreciation of other assets		740
Revenue reserves		49,465
	478,940	478,940

The following need to be taken into account prior to the completion of the year end financial statements for 2003/2004.

(a) During March 2004 property recorded at cost of £450,000 was transferred at cost to a Church Board under an arrangement relating to the provision of a training facility for young offenders. The property had a SHG of £380,000 when originally acquired. The SHG will be repaid on receipt of the cash.

(b) In order to acquire some land previously owned by the local authority and used as allotments the Association has taken out a Building Society loan of £3,500,000. The enhanced rate of interest attached to this loan has been calculated as 5.7%.

(c) The auditors disagreed with two expenditure items which had been capitalised that should have been included within the revenue expenditure figures. The first relates to the capitalisation of interest on a plot of land purchased under a shared ownership agreement in 2002 and amounts to £15,000. The second is a fee to solicitors that is within the properties under construction that relates to a fire damage dispute with the insurers for £27,000.

(d) The local authority is currently experiencing difficulties in recruiting suitably qualified staff to deal with the Housing Benefits enquiries. As a result an amount of £41,000 is still outstanding at the year end in respect of Housing Benefit payments from the local authority.

(e) Serious flooding due to freak weather conditions caused considerable damage to a number of riverside properties owned by the Association. This has resulted in the need to undertake short term remedial work prior to a complete repair programme. Due to the demands placed on the Association's own maintenance team an external contractor was employed, who has submitted an interim invoice for £60,000, which has yet to be paid.

(f) A change in policy for the replacement of property maintenance vans resulted in three vehicles being sold during March. The three vehicles were originally purchased three years ago at a cost of £12,000 each. Depreciation is on a straight line method and to date £9,000 depreciation per vehicle has been charged to the asset ledger. A local builder purchased all three vehicles for cash totalling of £14,000. No accounting entries have been made yet for this transaction.

(g) The SHG in respect of a major repairs programme in converting a nursing home into one person flats has been awarded at 60% of the total cost of £890,000. The SHG has yet to be accounted for but the Housing Association has had confirmation that it can recycle SHG from its existing fund. The cost of converting the home has been included in the trial balance.

(h) The Association has a policy of transferring any profit made on the sale of other assets to a designated reserve (asset replacement fund).

(i) The Association's Board agreed at the meeting held in January that providing sufficient funds were available at the year end, an amount of £200,000 would be transferred to a designated reserve (planned maintenance fund).

- **Requirement for question 5**

(a) Prepare the income and expenditure account of the Arba Housing Association in respect of the financial year ended 31 March 2004, together with the Balance Sheet as at that date. *20*

(b) Explain the treatment of any surplus or deficit on the disposal of property and the implications for SHG on disposal. *5*

(25)

SECTION D (Answer two questions)

6

- **Requirement for question 6**

(a) Briefly outline the main financial objectives of 'not for profit organisations' and explain how these are likely to differ from those of private sector companies. *6*

(b) With reference to a public service sector of your choice, discuss the extent to which the production of published financial statements is enhanced or constrained by:

(i) The needs of users. *4*

(ii) Accounting regulation, guidance and legislation. *5*

(15)

7 Resource accounting was introduced into all central government departments in the 1999/2000 financial year. Under resource accounting the financial statements have to be prepared in accordance with the *Resource Accounting Manual* (RAM) issued by HM Treasury. This applies generally accepted accounting practice in the United Kingdom (UK GAAP) to central government departments.

- **Requirement for question 7(a)**

  Explain what you understand by UK GAAP and identify the accounting standards (SSAPs and FRSs) that specifically apply to central government. Provide a brief description and explanation of 4 of the standards identified.

  Describe the five schedules that will have to be produced under the RAM and briefly explain the objective and make up of each schedule and compare with those produced by a private sector organisation. *8*

  Explain the rules which apply to the different types of government Agencies in terms of the schedules that they must produce. *2*

When a Supply Financed Agency receives a donation, the accounting for assets funded through donations is set out in the resource accounting manual.

Given the following scenario apply the appropriate accounting requirements.

A Supply Financed Agency acquired a piece of technical equipment valued at £195,000 which was donated to the Agency by a scientific research foundation when the chief research assistant collaborated on one of its major research projects. The donation was made on the 1 October and the equipment was put into operation immediately. It is anticipated that the equipment has a remaining expected life of 10 years with no residual value. No accounting entries have yet been made.

- **Requirement for question 7(b)**

  Calculate the depreciation charge and prepare all the relevant accounting entries involved with the receipt and depreciation calculation. *5*

(15)

8

During the last 15 years numerous reports have been published on corporate governance. The developments and changes as a result of these reports have in the main impacted on the private sector. Governance arrangements within public sector organisations have not, however, escaped the expected requirements of sound corporate governance.

- **Requirement for question 8**

Identify and discuss the developments in corporate governance in the private sector and compare these to the governance arrangements within a public sector of your choice. ***(15)***