FINANCIAL REPORTING IN CENTRAL GOVERNMENT AND AGENCIES

Professional 2 examination
7 December 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

The following information has been extracted from the accounts of the Specialised Construction Agency for the 1998/99 financial year. The agency is a trading fund of the Department of Administration, and provides accommodation and related services to a number of Central Government departments and Non Departmental Public Bodies on a commercial hard charging basis.

The Specialised Construction Agency

Trial Balance as at 31 March 1999

Category	**£000**
Fixed Assets (net book value)	38,098
Turnover	244,287
Stock at 31 March 1998	29,823
Interest payable	2,134
Interest receivable	737
Retained profits at 31 March 1998	10,553
Depreciation charge for year	1,887
Loans from National Loans Fund	26,678
Cost of Sales Adjustment	138
Consumables	24,783
Other Operating Charges	179,014
Staff Costs	33,816
Debtors	40,638
Cash	1,866
Creditors	49,013
Revaluation Reserve	16,375
Insurance Provision	4,554

Additional Information

1. Assets are depreciated on a straight line basis across the following estimated useful lives. A full year's depreciation is charged in the year of acquisition.

Buildings	40 years
Furniture & fittings	10 years
Vehicles	5 years

2. The agency purchased five vehicles at a cost of £12,000 per vehicle on 19 March 1999. All vehicles were delivered and in use before 31 March 1999. This information was overlooked in the preparation of the Trial Balance.

3. The agency provides office accommodation with related premises management and maintenance services to Euro Advisory Services (EAS), an NDPB of the Department of Financial Affairs. The contract with EAS has been negotiated on a calendar year basis, with annual contract charges of £24,000 paid in advance. Payment of £24,000 was received for the 1999 year from EAS on 6 January 1999.

4. The Departmental Solicitor has advised the Chief Executive of the agency that a compensation claim taken by a former employee against the agency following an accident at work is likely to be settled in the employee's favour. The case is scheduled to be heard in January 2000, and the Solicitor has placed an estimated settlement cost of £74,000 on the case.

5. Backlog depreciation of £76,000 should be charged.

6. Stocks at 31 March 1999 were valued at £27,216,000.

- **Requirement for question 1**

Prepare the following from the above information:

(a) The income and expenditure account for the Specialised Construction Agency for the year ended 31 March 1999; *15*

(b) The balance sheet for the Specialised Construction Agency for the year ended 31 March 1999. *10*

(25)

2

The following information has been extracted from the accounts of the Urban Regeneration Agency for the year 1998/99:

The deficit shown in the operating account for the year amounted to £7,976,000. The operating account included the following transactions:

- depreciation of £2,070,000
- cost of capital of £2,898,000
- insurance of £172,000
- a decrease in the bad debt provision of £48,000

Capital expenditure for the year amounted to £1,863,000. Proceeds from the sale of fixed assets amounted to £345,000, and were recorded in the operating account as a gain of £186,000. Assets were revalued at the end of the year resulting in an increase in revalued historic cost of £690,000. Backlog depreciation amounted to £172,000.

The Supply Grant voted by Parliament for the Urban Regeneration Agency for 1998/99 was £7,590,000. Appropriations in aid of £43,470,000 were approved. Outturn resulted in a surplus to be surrendered for the year amounting to £1,070,000. Appropriations in Aid collected amounted to £42,435,000.

The working capital balances at the beginning and the end of the year were as follows:

	1 April 1998	**1 April 1999**
	£000	**£000**
Stocks	3,795	3,588
Debtors	5,658	6,831
Creditors	4,554	2,898
Cash	2,745	3,120

- **Requirement for question 2**

Using the above information, prepare the following for the Urban Regeneration Agency for the 1998/99 financial year:

(a) Notes to calculate the net cash outflow from activities and the movement in cash and equivalents; *5*

(b) Note to show the net Parliamentary grant received reconciled to the Appropriation Account for the Vote; *5*

(c) The Cash Flow Statement for the year; *5*

(d) An explanation of the importance of the Cash Flow Statement to an organisation. *10*

(25)

SECTION B (Answer two questions)

3

The Vehicle Records Agency provides vehicle registration and licensing services. The agency is organised on a geographical structure with three divisions, North, South and Central. The agency operates a rigorous system of target setting and performance measurement, with the relative performance of each division closely monitored.

You are the Management Accountant in Central Division, and have just received a copy of the performance indicators for the 1998/99 financial year (next page). The Director of Central Division has asked you to provide him with an analysis of the performance indicators, in advance of a meeting of the agency's Top Management Group.

- **Requirement for question 3**

Prepare a report for your Director which:

(a) Analyses the performance of the three divisions during 1998/99, paying particular emphasis to the performance of Central Division; and *15*

(b) The agenda for the Top Management Group Meeting includes "the discussion of targets for inclusion in the Output and Performance Analysis (OPA)". Your Director has asked you to explain what the OPA is and its relationship to the agency's performance indicator report. *10*

(25)

VEHICLE RECORDS AGENCY

Performance Indicator Report by Division for Year Ended 31 March 1999

	Performance Indicator	Central Division	North Division	South Division
A	**Labour**			
A.1	Hours worked	23,660 hrs	16,900 hrs	20,280 hrs
A.2	Number of staff processing applications	15	10	12
A.3	Staff costs	£135,200	£84,500	£109,850
A.4	Average hourly wage rate	£5.71	£5.00	£5.41
A.5	Absenteeism	5%	1%	3%
B	**Other Costs**			
B.6	Running costs	£3,880	£4,850	£4,980
B.7	Total annual cost	£139,080	£89,350	£114,830
C	**Output**			
C.1	Number of licenses issued	7,436	6,760	8,788
C.2	Number of licenses issued/number of staff	496	676	732
C.3	Number of vehicles registered	3,887	3,380	3,650
C.4	Number of vehicles registered/number of staff	259	338	304
D	**Income**			
D.1	Income from issues of licences, unit cost £12	£89,232	£81,120	£105,456
D.2	Income from registration of vehicles, unit cost £155	£602,485	£523,900	£565,750
D.3	Total income generated	£691,717	£605,020	£671,206
D.4	Operating surplus/ (deficit)	£552,637	£515,670	£556,376
D.5	Operating surplus in relation to gross income	80%	85%	83%
D.6	License income generated per member of staff	£180	£120	£144
D.7	Vehicle registration income generated per member of staff	£2,326	£1,550	£1,861
E	**Unit costs**			
E.1	Total cost attributed to licenses (60%)	£83,448	£53,610	£68,898
E.2	Total costs attributed to vehicles (40%)	£55,632	£35,740	£45,932
E.3	Cost per licenses processed	£11.22	£7.93	£7.84
E.4	Cost per vehicle registered	£14.31	£10.57	£12.58
F	**Administration**			
F.1	Percentage of invoices paid within 30 days	88%	89%	82%
F.2	Percentage of replies to written complaints within 10 working days	77%	97%	83%
F.3	Average days elapsed between receipt of application and issue of license or vehicle registration	3	8	3
F.4	Number of errors per 1000 applications processed	142	21	72
F.5	Staff turnover	40%	0%	25%
F.6	Average years in post of staff	3	7	5
F.7	Average training days per member of staff	10	7	10

F.8	Computer system down time	30%	35%	29%

4

The Chief Executive of your agency has received the following letter from the newly appointed President of the local Chamber of Commerce.

Benjamin Bottomline Esq.
Middletown Chamber of Commerce
Middletown

Chief Executive
Economic Development Agency
Metropolis

30 November 1999

Dear Sir

1998/99 Annual Report and Accounts of the Economic Development Agency

As you may be aware, I have recently taken up the office of President of the Middletown Chamber of Commerce. I am a businessman by profession, having spent my entire career in various management roles in a number of private sector companies. While not a qualified accountant, I am very familiar with a wide range of accountancy and financial concepts and terms through experience and practice gained throughout my private sector career.

It is on this basis that I have been somewhat perplexed in my initial dealings with your officials in my capacity as President of the Chamber of Commerce. It appears that we have a fundamental communication problem, both understanding different things when using similar terms. I will provide you with a number of examples of issues that have arisen in discussion, and I would be grateful if you would explain why these accountancy terms and their application differ within a Central Government context.

When discussing business cases for new ventures in receipt of grant aid from your agency, your officials place great emphasis on the inclusion of capital charges. From my perspective, the only relevant capital charge is the depreciation charge to take account of the diminution of the fixed asset being financed. However your officials also refer to the cost of capital. Please explain.

On a related issue, your officials have very fixed views in terms of the rates of return to be earned. Within a private sector context, the level of risk determines the rate of return and equity funding invested by the shareholders. Please describe what is understood by rate of return within a public sector context.

Accountability and stewardship are obviously relevant issues for both private and public sector organisations. How do these concepts differ between the two sectors, and how does the public sector demonstrate accountability and the stewardship of public funds?

Many in the private sector argue that the public sector is inherently inefficient, as the profitability requirement does not exist. Linked to your provision of funding to private sector enterprises, your officials demand assurances regarding the viability, efficiency and effectiveness of the projects seeking funding. What equivalent drivers for similar efficiencies and measures of effectiveness exist for public sector organisations, in the absence of the profitability requirement?

In fact, I have heard that the practice of funding Government departments and agencies on an annual basis leads to a short-term attitude to the use of public money. In contrast to the requirements placed by Government on private sector organisations in receipt of funding from agencies such as yours, Government does not manage its funds and resources on a strategic basis. Perhaps you would like to comment?

The accountancy profession in the private sector is governed by a series of accounting standards and guidelines that ensure comparability and consistency in the reporting of performance. How can Government defend its method of accounting, particularly in a more competitive environment where it is required to compete with the private sector in the delivery of services.

Yours sincerely,

Benjamin Bottomline

B. BOTTOMLINE
Middletown Chamber Of Commerce

- **Requirement for question 4**

Draft a response from your Chief Executive, which addresses each of the queries raised. *(25)*

5

- **Requirement for question 5**

(a) Describe the key features and objectives of FRS15, Tangible Fixed Assets. *14*

(b) One of the key objectives of the introduction of Resource Accounting and Budgeting is the improvement in the treatment of capital. Explain. *5*

(c) What is the role of the Departmental Investment Strategy in the management of capital in Central Government? *6*

(25)