FINANCIAL REPORTING IN CENTRAL GOVERNMENT AND AGENCIES

Professional 2 examination
5 December 2000

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.

CIPFA

SECTION A (Answer both questions)

1 The Administrative Affairs Agency is a single department, on-vote executive agency. Its role is to oversee the reform and restructuring of administration and administrative systems within central government. The Agency does not charge other departments for its work; its only income is derived from sales of good practice guides produced by the Agency.

The following information is available for the 1999/2000 financial year:

(i) Appropriation Account – Department of Administrative Affairs (Executive Agency)

Service	Grant £000	Expenditure £000	Less than granted £000	More than granted £000
A1 Running costs	10,677	10,647	30	
A2 Other current costs	902	815	87	
A3 Capital expenditure	200	262		62
Gross total	11,779	11,724	117	62
	Estimated	**Applied**		
AZ Appropriations in aid	(3,172)	(3,172)	-	-
Net total	8,607	8,552	117	62
			Surplus 55	

Actual surplus for surrender to the consolidated fund £54,742.77

	Estimated £000	Realised £000
Receipts of classes authorised to be used as appropriations in aid	3,172	3,750
Amount authorised to be used as appropriations in aid		3,172
Surplus appropriations in aid		578

Amount payable separately to the consolidated fund £578,100.12

(ii) The following information relates to the Agency's fixed assets:

	Land £000	Buildings £000	Vehicles £000	Computers £000
Gross book value b/f (at valuation) as 1 April 1999	1,565	835	72	270
Acquisitions	0	242	20	0
Depreciation b/f				
Balance at 1 April 1999	0	150	46	81

A building with a revalued gross book value and associated accumulated depreciation of £150,000 and £30,000 respectively was transferred to the Department of Appointments on 1 April 1999. There were no other asset disposals during the financial year.

(iii) Assets are to be depreciated on a straight line basis by applying the following asset lives to the gross closing value of the asset as at 31 March 2000:

	Life years
Buildings	50
Vehicles	10
Computers	5

A full year's depreciation is charged in the year of acquisition of the asset.

(iv) Land, buildings, vehicles and computers all require upward revaluation to 31 March 2000 as follows:

	Rate (%)
Land	0.5
Buildings	4
Vehicles	0
Computers	(2)

(v) The revaluation reserve had a balance of £645,000 at 1 April 1999, all of which related to previous revaluations of land, buildings and vehicles. The general fund balance at that date was £2,721,000.

(vi) The following information relates to the calculation of notional expenditure for the year.

Interest on capital	6.0%
Insurance:	
Fixed assets (excluding land) at closing NBV	1.0%
A1 running costs expenditure	0.25%
Average stock	0.5%
Audit fee	£35,000

(vii) Running costs (A1) consist of staff costs (£9,063,000) and agency administration costs (£1,584,000). Other current costs (A2) consist of costs of publishing the guides which the Agency sells. Working capital balances are as follows:

	1 April 1999	**31 March 2000**
	£000	**£000**
Stock	1,075	1,118
Debtors	175	166
Creditors	349	481

There are no cash balances. All creditors relate to subhead A2.

(viii) The Secretary of State has announced that the Administration Agency is to be converted into an off-vote trading fund from 1 April 2001.

- **Requirement for question 1**

(a) Prepare the operating account for year ended 31 March 2000. *9*

(b) Prepare the statement of general fund for year ended 31 March 2000. *5*

(c) Prepare the balance sheet as at 31 March 2000. *7*

(d) Prepare a note for the Chief Executive briefly setting out the main changes that conversion to Trading Fund status would have on the Agency's financial statements. *4*

(All calculations should be made to the nearest £000)

(25)

2 On 22 January 2000, the manager of the Printing and Publishing Centre of the Department of Tourism received his budgetary control printout for month 9 of 1999/2000, which is reproduced below:

Printing and Publishing Centre monthly budget report
Spending to December 1999 (month 9)

	Annual budget £	Spending to date £	Variance £
Staff costs			
Salaries	105,000	75,000	30,000
Wages	195,000	144,000	51,000
Casual staff	30,000	33,500	(3,500)
Sub-total	**330,000**	**252,500**	**77,500**
Accommodation costs			
Electricity	33,000	15,300	17,700
Rent	28,400	21,300	7,100
Repairs	12,000	15,000	(3,000)
Contribution in lieu of rates	13,800	10,350	3,450
Sub-total	**87,200**	**61,950**	**25,250**
Supplies and services			
Printing materials	42,500	50,150	(7,650)
Stationery and packing	27,800	21,330	6,470
Equipment maintenance	33,500	24,300	9,200
Sub-total	**103,800**	**95,780**	**8,020**
Central recharges (non-cash)			
Departmental administration	152,300	152,300	0
Central services	33,000	33,000	0
Capital charges & depreciation	25,700	25,700	0
Sub-total	**211,000**	**211,000**	**0**
Total operating expenditure	**732,000**	**621,230**	**110,770**
Less: operating income	**(120,000)**	**(72,000)**	**(48,000)**
Net operating expenditure	**612,000**	**549,230**	**62,770**
Capital expenditure	**50,000**	**5,000**	**45,000**

The manager is concerned because he calculates that at the present level of expenditure of £69,025 per month his operating budget will run out before the end of the year leaving him with an overspend of nearly £96,000. He has written to you (as his accountant) to ask whether he ought to cancel the remainder of the capital expenditure programme, which was to take place in February, in order to fund part of the projected overspend. He has also asked you if you have any other ideas on where he can find extra savings of £51,000 between now and the year end.

The following additional information is available:

(i) All expenditure is generally incurred evenly throughout the year, apart from the following:

Casual staff – Casuals are only employed from July to November inclusive. Expenditure occurs evenly through these months.

Electricity – bills are paid quarterly, costs are expected to be: April 25% of the budget, July 10%, October 25% and January 40%.

Rents and contribution in lieu of rates – these are paid quarterly in equal instalments.

Departmental administration, central service charges and capital charges – these are all allocated to cost centres by central finance at the end of December.

(ii) Salary budget consists of the Centre Manager (£60,000 p.a.) and his deputy (£45,000 p.a.). The deputy resigned at the end of November and will not be replaced before the year-end.

(iii) Wages – staff numbers and rates of pay are expected to remain stable for the rest of the year but unanticipated back payment of allowances totalling £5,000 are due in February.

(iv) A total of £10,000 was left out of the Centre's repairs budget when it was being compiled. It has been agreed that this should be added back to the budget.

(v) The manager has noted that during August invoices for printing materials totalling £20,150 relating to other cost centres in the Department have been coded in error to the Centre.

- **Requirement for question 2**

Draft a note to the Centre Manager

(a) Demonstrating the financial consequences of the budget revisions and advising on whether or not the capital programmed should be cancelled. *15*

(b) Outlining the attributes of good budgetary control information, and making recommendations for improving budgetary control at the Centre under the attributes you have identified. *10*

(25)

SECTION B (Answer two questions)

3

You are assisting in the preparation of the 1999/2000 final accounts for the Inward Investment Agency, an on-vote executive agency of the Department of Business. A trainee is assisting you and has sought your advice on the following issues.

(i) She is unclear on how the Financial Reporting Standards (FRSs) and Statements of Standard Accounting Practice (SSAPs) apply to the Agency.

(ii) She is also unsure about whether on-vote agencies are required to provide a 'true and fair view' in the same way as companies are required to by the Companies Act.

In addition, the following items are outstanding and the trainee is unsure how to treat them in the accounts:

(iii) Goods valued at £24,000 were received by the Agency on 27 March 2000. £5,000 worth of these goods were used immediately, and the remaining goods were placed in stores. The invoice has not yet been received.

(iv) The Agency charges £5 for an information pack on the services it provides to prospective inward investors. A total of £8,000 has been raised in this way for the financial year and this has been netted off against the Agency's general printing and stationery costs.

(v) Investigation of disputed debtor invoices has identified a total of £27,000 which it is highly likely will not be paid.

(vi) A grant has been received from the parent Department to fund capital expenditure on new computers of £800,000. The life of the computers is estimated to be 10 years.

(vii) The vehicles belonging to the Agency have yet to be revalued owing to a delay in production of the relevant index. The following information is now available

- The gross replacement cost of the vehicles at 31 March 1999 was £260,000. Accumulated depreciation at the same time was £105,000.
- The Agency charges depreciation on a straight-line basis and the estimated life of vehicles is 5 years. As at 31 March 1999 vehicles with a total gross replacement cost of £50,000 had been fully depreciated. There were no acquisitions or disposals of vehicles during the year.
- The applicable index at 31 March 1999 was 108 and at 31 March 2000 it was 111.

(viii) Impairment reviews were carried out on a number of assets prior to the year-end. The following impairments were identified:

- Equipment valued at £120,000 was revalued at £95,000 owing to its unexpectedly high usage. There is no balance on the revaluation reserve relating to this asset.

- A building was revalued to £180,000 following changes in the general price levels of property in the area. The net book value of the building was £230,000 prior to the revaluation, with an associated credit on the revaluation reserve of £70,000.

(Ignore the effects on depreciation of these items)

(ix) A claim is being made against the Agency in respect of an accident in the car park at its headquarters building. The final outcome of the claim is unknown but the Agency's legal advisers predict that the Agency is likely to be found at fault. An average level of settlement for cases of this type is about £200,000.

- **Requirement for question 3**

(a) Respond to items (i) and (ii), explaining how FRSs and SSAPs and the 'true and fair view' requirement are applied to on-vote agencies. *5*

(b) For items (iii) to (ix):

- Explain how the items should be treated and show journal entries for any adjustments which would be required in the accounts.

- Justify your treatment with reference to any relevant accounting standards. *20*

(25)

4 The Department of Specialised Construction are currently involved in the process of tendering two services, cleaning and internal audit. The cleaning contract is in the early stages of the tendering process and the interested parties must now be financially vetted. Bids have already been received for the internal audit service and now need to be evaluated.

Three companies have expressed an interest in the cleaning contract. They must meet the requirements for admission to the Department's approved contractors' list, although they need not be on the list currently. To achieve this the contractor must supply three years' audited accounts to demonstrate:

- reasonable liquidity over the three years;
- that they have made a profit in each of the last three years.

Reasonable liquidity for the industry has been independently assessed as a current ratio of 1:1 or better, and a quick (or acid test) ratio of 0.9:1 or better. For the purposes of financial vetting each company is awarded points for the number of these requirements that it is able to satisfy. A company is awarded one point for each requirement it meets and there are nine points available – one for each liquidity ratio for each of the last three years, and one for earning post-tax profits for each of the last three years. To be accepted the contractor must achieve at least two thirds of the available points. Extracts from the accounts of the three companies are attached.

Three tenders have been submitted for the internal audit contract. Each tender is to be evaluated on both financial and non-financial criteria. There are two non-financial factors:

(i) The ratio of qualified to unqualified staff. It is considered that at least 20% of the audit staff should be qualified. The following have been submitted as the numbers of staff and their qualifications:

	X & Co	**Y & Co**	**Z & Co**
Unqualified staff	24	49	78
Qualified staff	6	10	21

Weightings are to be attributed and marked as follows:

0 points if <15% of the audit staff are qualified
5 points if 15-20% of the audit staff are qualified
10 points if >20% of the audit staff are qualified

(ii) The number of other contracts they are currently operating. This is considered important as an indicator of not only experience and ability but also capacity. The following have been submitted as the number of contracts they operate:

	X & Co	**Y & Co**	**Z & Co**
No of internal audit contracts	2	15	10

Weightings are to be attributed and marked as follows:

0 points if 0-2 contracts
5 points if 3-6 contracts
10 points if 7-10 contracts
5 points if >10 contracts

The prices submitted by the companies are as follows:

	X & Co	**Y & Co**	**Z & Co**
Price	£225,375	£241,095	£283,530

For price they are to be scored out of a total of 30 points. Half of the available points are achieved at the mean price. For prices below the mean, add 2% of the total points for each percent below the mean price, and for prices above the mean, deduct 2% of the total points for each percent above the mean price.

- **Requirement for question 4**

(a) For the cleaning contract, evaluate the three companies financially and recommend which should be invited to tender. *11*

(b) For the internal audit contract, evaluate the bids and recommend who should be awarded the contract. *7*

(c) Detail the client responsibilities in relation to the tendering process. *7*

(25)

Extracts from the accounts of the three companies for the cleaning contract:

	1999/2000 £000	1998/99 £000	1997/98 £000
Company A:			
Turnover	1,090	1,135	1,024
Profit after tax	105	112	(69)
Stock	22	18	28
Debtors	65	68	73
Cash & bank	49	32	17
Current liabilities	123	132	113
Company B:			
Turnover	1,350	1,302	1,180
Profit after tax	52	41	38
Stock	30	28	26
Debtors	59	52	48
Cash & bank	28	24	28
Current liabilities	89	90	84
Company C:			
Turnover	2,580	2,700	2,100
Profit after tax	72	75	69
Stock	35	34	30
Debtors	68	74	61
Cash & bank	29	24	24
Current liabilities	91	108	92

5

- **Requirement for question 5**

(a) Explain the main role and responsibilities of the Accounting Officer in both government departments and executive agencies. *15*

(b) What is meant by devolved financial management? *2*

(c) What are the advantages and disadvantages of devolved financial management? *4*

(d) Consider the impact of devolved financial management on the role of the Accounting Officer. *4*

(25)