FINANCIAL REPORTING IN CENTRAL GOVERNMENT AND AGENCIES

Professional 2 examination
June 1999

MARKING SCHEME

Question 1

(a) **Income and Expenditure Account**

Working 1 - Hire Purchase Agreement (Note 2)

Vehicles Account

		£			**£**
15 Dec	Vendor	42,000			

Vendors Account

		£			**£**
15 Dec	Bank	6,000	15 Dec	Vehicles	42,000
15 Mar	Bank	3,000	15 Mar	HP Interest	2,880 *(1)*
31 Mar	Bal c/d	35,880 *(1)*			
		44,880			**44,880**
			1 Apr	Bal b/d	35,880

2

Provision for Depreciation

£			**£**
	31 Mar	Balance Sheet	8,400 *(1)*

1

Working 2 - Sale of Equipment (Note 3)

(i)	Written Down Value of Equipment	£210,000	
	Sales Proceeds	£100,000	
	Loss on Sale	£110,000	½
(ii)	Purchase Cost of Equipment	£350,000	
	Written Down Value	£210,000	
	Depreciation Charged	£140,000	½

Working 3 - Revaluation of Land (Note 5)

Value at 31 March 1999	£5,800,000	
Value at 1 April 1998	£5,350,000	
Revaluation	£450,000	
Dr Fixed Assets	£450,000	
Cr Revaluation Reserve	£450,000	*1*

Working 4 - Depreciation

4,250 + 8 –(140) = 4,118 *½*

Trial Balance	landrovers - purchased	equipment sold

Income and Expenditure Account for the Scientific Research Agency for year ended 31 March 1999

	£000	**£000**	
Turnover	310,555		
Changes in stocks (£44,840-£49,320 - *1 mark*)	(4,480)		
Grants	18,412		
		324,487	*1*
Consumables (£19,514+£350 - *1 mark*)	(19,864)		
Staff Costs	(110,150)		
Depreciation (W4)	(4,118)		
Other Charges	(150,800)		
Loss on Disposal of Asset (W2)	(110)	(285,042)	*1*
Operating Profit		39,445	
Interest Receivable		1,599	
Interest Payable (£2,900 + £3(W1))		(2,903)	*½*
Profit for Year		38,141	*1*
Retained Profit B/f		13,228	
Retained Profit C/f		51,369	*1*

2 marks for presentation
(12)

(b)

Balance Sheet of the Scientific Research Agency as at 31 March 1999

	£000	£000	
Fixed Assets		83,974	
(£83,700+£42(W1)+£450(W3))-			
(£210(W2)-£8(W1))-			*1*
Current Assets			
Stock	44,840		
Debtors	52,900		
Cash	5,330		
	103,070		*1*
Current Liabilities			
Creditors (amounts falling due within one year)	(72,494)		*1*
Net Current Assets		30,576	*1*
		114,550	*1*
Financed By:			
Provision for Liabilities and Charges			
Insurance Provision		4,310	
Deferred Income (Note 4)		8,584	*2*
HP on Vehicles (W1 – *1 mark*)		36	
Long Term Loan		31,609	
Revaluation (W3 – *1 mark*) 18,277+450-85		18,642	
Income & Expenditure Account		51,369	*1*
		114,550	*1*

2 marks for presentation

(13)

Question 2

(a)

Calculation of the net cash outflow from activities

	£000	
Operating deficit	(5,230)	½
plus		
Charges not involving cash movements		
depreciation	500	½
notional charges (670+200)870		½
increase in bad debt provision	50	½
loss on disposal of assets	5	½
plus/less		
Movements in revenue accruals adjustments		
increase in stock (3,660-3,220)	(440)	½
increase in debtors (5,050-4,280)	(770)	½
increase in creditors (3,250-2,740)	510	½
Net cash outflow from revenue activities	(4,505)	½

Movement in cash and equivalents

	1 April 1998	**31 March 1999**	**Movement**	
	£000	**£000**	**£000**	
Cash	2,450	2,715	265	½

1 mark for presentation

(6)

(b)

Parliamentary grant received reconciled to the Appropriation Account for the Vote

Reconciliation	**£000**	**£000**	
Gross Parliamentary grant		15,150	
Appropriations in aid		(8,500)	
Net Parliamentary grant voted		6,650	*1*
Excess of Parliamentary grant over actual expenditure	(1,430)		*1*
Excess of Appropriations in aid	(120)		*1*
		(1,550)	
Net Parliamentary grant received		5,100	*1*
The grant was utilised to finance			
- net cash outflow from operating activities		4,505	*½*
- net capital expenditure (350-20)		330	*1*
Increase in cash		265	*½*
			(6)

(c)

Public Safety Agency Cash Flow Statement for the Year Ending 31 March 1999

Cash Flows	**£000**	**£000**	
Net cash outflow from operating activities		(4,505)	*1*
Investing activities			
Purchase of fixed assets	(350)		*1*
less			
receipts from sale of fixed assets	20		*1*
Net cash outflow from investing activities		(330)	*1*
Net cash outflow before financing		(4,835)	*1*
Financing			
Net vote expenditure appropriated in the year		5,100	*1*
Increase in cash and equivalents		265	*1*

I mark for presentation
(8)

(d)

- the classification of cash flow in accordance with the substance of the transaction or event giving rise to it, provides consistent treatment across all the primary statements; *1*
- distinguishes cash flows for investing to maintain the business from cash flows for investing to expand the business; *1*
- allows users to understand the effect on cash flows of items shown as exceptional or extraordinary in the profit and loss account; *1*
- provides information that assists in the assessment of liquidity, solvency and financial adaptability; *1*
- greater visibility in the analysis of the reporting entity's inflows and outflows of cash; *½*
- facilitates comparison of the cash flow performances of different businesses. *½*

(5)

Question 3

(a)

(i)	cash from voted supply;	*2*
(ii)	Private Finance Initiative.	*2*
		(4)

(b)

The candidate must demonstrate awareness of the impact of both the introduction of Resource Accounting and Budgeting, and HM Treasury's acceptance of FRS5 (Revised) on the accounting treatment to be applied to capital transactions;

cash voted from supply:

appropriation accounts:

- annual capital spend subject to capital limit for department; *½*
- spend on construction of development charged in cash in year of expenditure; *½*
- capital spend identified separately in appropriation account, but the asset is not depreciated; *½*
- no interest charge; *½*
- revenue costs charged in full each year. *½*

(2½)

resource accounts:

- annual capital spend subject to capital limit for department; *½*
- spend on construction of development charged to balance sheet on commissioning of component elements of the development; *½*
- asset is written off over its estimated useful or remaining life, with depreciation charged to operating cost statement; *½*
- notional interest charged to operating cost statement; *½*
- asset subject to regular (minimum five-yearly) professional revaluations; *½*
- expenditure on "annual revenue costs" related to the ongoing operating costs of the development, which do not enhance the estimated life or value of the asset, are charged to operating cost statement as services are consumed; *½*
- expenditure on "annual revenue costs" which relate to the enhancement of the estimated life or value of the asset are capitalised, charged to the balance sheet, and written off over the remaining useful life of the asset. *½*

(3½)

implications

- decisions to fund the development are subject to affordability under the department's capital limits, and must be considered in light of competing capital bids and spending plans; *1*
- under resource accounting, the development will incur ongoing depreciation and interest charges, in addition to annual revenue costs. *1*

(2)

Private Finance Initiative

appropriation accounts (pre-FRS5):

- the financing of the development is provided by the private sector, and as such, is not subject the capital limit of the department; ½
- the private finance contractor operates the asset, and the relevant contract payments are charged in cash to the appropriation account; ½
- no depreciation or interest is charged; ½
- revenue costs charged in full each year. ½

(2)

FRS5

- where the construction of a substantial asset underpins a PFI contract, the ownership of the asset must be determined by looking at the associated risks and rewards of ownership – the successful transfer of risk to the private sector operator is a key issue; ½
- the asset must be recognised on the balance sheet of the party deemed to be the owner of the asset; ½
- HM Treasury accepted the application of FRS5 (Revised) in 1998. ½

(1½)

appropriation accounts (post-FRS5)

- should the development be classified on-balance sheet, capital spend is subject the capital limit of the department. ½

(½)

resource accounts
off-balance sheet

- the funding of the development is provided by the private sector, and as such, is not subject the capital limit of the department; ½
- the private finance contractor operates the asset, and the relevant contract payments are charged to the operating cost statement as services are consumed; ½
- no depreciation or interest is charged; ½
- annual revenue costs will be met by the private sector operator, and built into contract payments made by the department. ½

(2)

on-balance sheet

- capital value of on-balance sheet deal subject to capital limit for department; ½
- capital value of development charged to balance sheet on commissioning of component elements of the development; ½
- asset matched by liability in the form of a finance lease; ½
- notional interest charged to operating cost statement; ½
- the private finance contractor operates the asset, and the relevant contract payments are charged to the operating cost statement as services are consumed; ½
- annual revenue costs will be met by the private sector operator, and built into contract payments made by the department. ½

(3)

implications

- the capital funding of this development will be subject to the accounting requirements of FRS5 (Revised); *1*
- the transfer of risk will be a key determinant in the ownership of the asset, and subsequent accounting treatment; *1*
- all PFI deals are subject to the key criteria of both value for money and affordability – ongoing contract payment costs over a long-term PFI deal may lead to affordability issues at some future point; *1*
- should the PFI deal result in an on-balance sheet asset, affordability must also be considered in light of the department's capital limits and other competing capital bids and spending plans. *1*

  (4)

(21)

(25)

Question 4

(a)

Uses of accounts

(i) compliance with statutory and mandatory requirements;
stewardship; *1*

(ii) accountability;
performance evaluation;
bench marking;
achievement of objectives; *1*

(iii) planning future policy and activities;
supporting information for the authorisation of future funding; *1*

(iv) viability;
value for money; *1*

(v) public relations; *1*

(vi) source of facts and figures. *1*

(6)

(b)

Users of accounts

(i) elected members
- assess policy
- evaluate efficiency and effectiveness
- assurance that spend is within budget and on approved activities
- monitor activities *1*

(ii) the public
- information on how taxes have been spent
- evaluate performance, VFM of both the organisation and Government
- ensure consumer interests are met
- assurance that spend is within budget and on approved activities *1*

(iii) customers
- performance and value for money

- effectiveness in meeting customer's requirements
- charging policies
- plans *1*

(iv) management
- performance
- planning
- budget outturn and budget setting *1*

(v) suppliers/lenders/sponsors
- viability
- performance
- plans *1*

(vi) employees
- security of employment
- performance
- plans *1*

(6)

Source: "Public Sector Accounting and Financial Control" Henley, Holtman, Likierman, & Perrin, Van Nostrand Reinhold (International), 1989

(c)

Response to J Bloggs

1 mark to be awarded for presentation, and the ability to coherently relate the response to the queries to the circumstances/context referred to.

(i) **Infrastructure accounting**
- applies to a single network of integrated assets e.g., roads;
- assumes assets will be maintained at a steady state;
- assets are not depreciated, but a normalised maintenance charge is made to the operating cost statement;
- failure to achieve the planned level of maintenance spend is shown as backlog depreciation in the balance sheet.

Why value a road
- contributes to the achievement of the strategic objectives of the agency;

- significant investment of resources in a structure with an estimated useful life greater than one year.

2

(ii) **Non-cash charges**

- also referred to as notional charges, and may include items such as insurance, and internal recharges;
- shows full cost of operations;
- facilitates comparison with other organisations, including private sector.

Interest on capital

- charged at Treasury rate of return of 6% (8% for trading operations);
- recognises opportunity cost of investing capital in assets;
- recognises true cost of borrowing, removing concept of “free good” capital within Government;
- illustrates full cost of operations;
- facilitates comparison with other bodies, including the private sector.

2

(iii) **Contingent liabilities**

- requirements of SSAP 18;
- complies with prudence concept;
- condition which exists at balance sheet date, where the outcome will be confirmed only on the occurrence or non-occurrence of future events;
- should be accrued when it can be predicted with reasonable accuracy.

2

(iv) **True and Fair View**

- requirement of the Companies Act (and UK GAAP);
- alternative opinion is “presents fairly”;
- expresses an audit opinion of the overall group of statements comprising the accounts;
- does not imply that the accounts do not contain inaccuracies.

2

(v) **Post-balance sheet events**

- events occurring after the balance sheet date which provide evidence of the value of assets or the amount of liabilities at the balance sheet date;
- requirements of SSAP 17;
- adjusting events require changes to the amounts to be included in the financial statements;
- non-adjusting events arise after the balance sheet date and concern conditions that did not exist at that time, but are of such materiality that they require disclosure in the notes to ensure that the financial statements are not

misleading. They do not require changes to the amounts in the financial statements.

2

(vi) **Resource accounting**

- applies to Central Government departments, agencies and non-executive NDPBs;
- introduces accruals accounting and capital accounting concepts, which agencies currently operate;
- changes to agency accounts will include the renaming of accounting statements as Schedules 1 to 5, and specifically the production of:
  - Schedule 1, *Summary of Resource Outturn;*
  - Schedule 5, *Statement of Resources by departmental aims and objectives;*
  - *Output and Performance Analysis.*
- agency accounts will be consolidated with the accounts of their sponsor department to produce a set of Departmental Resource Accounts;
- the reporting emphasis is now on resources consumed, outputs produced, and the achievement of objectives.

2

(13)

(25)

Question 5

(a) **Fixed Budget as at Month 08 based upon an output of 325 jobs per month (2,600 jobs)**

1 mark for presentation

Expense		**Budget 2,600 jobs**	**Actual**	**Variance**	
		£	**£**	**£**	
Receipts					
Receipts from departmental users		**455,000**	**393,750**	**61,250**	
Budget: (325 jobs @ £175) x 8 = £455,000					
Actual: (2,250@ £175) = £393,750	*1*				
Total Budget v Actual Receipts		**455,000**	**393,750**	**61,250**	
Direct Materials		175,500	158,400	17,100	
Budget: (£263,250/12) x 8 = £175,500					
Actual: ((£263,250/58,500) x 1.1) x 32,000 = £158,400	*1*				
Direct Labour		91,000	91,000	0	
Budget & actual: (£136,500/12) x 8 = £91,000	*1*				
Variable Overheads		78,000	83,200	(5,200)	
Budget: (£117,000/12) x 8 = £78,000	*1*				
Fixed Overheads		100,000	120,000	(20,000)	
Budget: (£150,000/12) x 8 = £100,000					
Actual: ((£150,000 + £30,000)/12) x 8 = £120,000	*1*				
Total Budget v Actual Expenses		**444,500**	**452,600**	**(8,100)**	
Budget v Actual Surplus/(Deficit) on Operations		**10,500**	**(58,850)**	**(69,350)**	*1*

(7)

Flexed Budget as at Month 08 based upon an actual output of 2,250 jobs

I mark for presentation

Expense		Flexed Budget 2,250 jobs £	Actual £	Variance Favourable/ (Adverse) £
Receipts				
Receipts from departmental users		**393,750**	**393,750**	**0**
(2,250@ £175) = £393,750	*1*			
Total Budget v Actual Receipts		**393,750**	**393,750**	**0**
Direct Materials		151,875	158,400	(6,525)
Budget: (£263,250/3,900) x 2,250 = £151,875	*1*			
Direct Labour		91,000	91,000	0
All costs are fixed, regardless of output, as no overtime costs or performance related pay is included.	*1*			
Variable Overheads		67,500	83,200	(15,700)
Budget: (£117,000/3,900) x 2,250 = £67,500	*1*			
Fixed Overheads	*1*	100,000	120,000	(20,000)
Total Budget v Actual		**410,375**	**452,600**	**(42,225)**
Budget v Actual Surplus/(Deficit) on Operations		**(16,625)**	**(58,850)**	**(75,475)**

(6)

(b)

Budgetary Control Weaknesses and Required Corrective Action

(i) Budget reports are produced six to eight weeks after month close down:

- budget reports should be timely and available shortly after month close down, and should prepared by the finance team of the Central Print Unit. *1½*

(ii) budgets are uplifted by HMT inflators:

- budgets should be prepared on an outturn prices basis, using anticipated pay and price levels for the year;
- budgets should be profiled across the year to reflect actual expenditure patterns.

1½

(iii) Print Unit is managed by the Operations Manager, but the budget is managed by the Finance Manager:

- financial responsibility should be aligned with management responsibility. While the budget should be prepared by the finance team in consultation with the Operations Manager, budgetary responsibility should rest with the Operations Manager. *1½*

(iv) Three year SLAs have not been reviewed or up dated:

- SLAs should be subject to regular in-year, and annual reviews;
- SLA period should be reconsidered;
- output targets and budget forecasts should be continually revised in light of actual performance. *1½*

(v) Salary cost of Finance Manager overlooked:

- budget should reflect all costs;
- budget should be regularly reviewed, and variances investigated.

1½

(vi) Maintenance budget inadequate:

- Operations Manager should be involved in setting of budget;
- budget should be realistic and achievable;
- annual budget should be linked to long-term business plan.

1½

(vii) Absenteeism and staffing shortages:

- output targets should be realistic, and determined by Operations Manager;
- budget forecasts should be continually revised in light of actual performance.

1½

(viii) Target output cannot be achieved for the year:

- urgent action required to address budget shortfall;
- SLAs should be revised to reflect actual outputs achievable;
- user charges should be revised to ensure full cost recovery in future years, including recovery of 98/9 deficit;
- regular system of variance analysis should be developed;
- exception report should be developed.

1½

(12)

(25)