FINANCIAL REPORTING IN FURTHER AND HIGHER EDUCATION

Professional 2 examination
December 1999

MARKING SCHEME

CIPFA

Question 1

(a)

Income & Expenditure Account	**£000**	**£000**	
Income			
Grants and Fees	61,250		*½*
Other (14,000k £962.5k)	14,962.5	76212.5	*1*
Expenditure			
Staff costs	43,750		
Other operating costs	29,750		
Depreciation	1,750	75250.0	*½*
Surplus (before Interest and Taxation)		962.5	
Exceptional item – profit on sale of asset		2625.0	*1*
Interest Payable		(875.0)	
Retained Surplus for year		2712.5	
			(3)

Balance Sheet	**£000**	**£000**	
Fixed Assets		18,550.0	*1*
- Land (19250-2275+1575)			
- Building	32.900		
Less			
Depreciation	(12,250)	20650.0	*1*
- Equipment			
Less	15,750		
Depreciation	(8,750)	7,000.0	*1*
		46,200.0	
Current Assets			
Stock	7,000		
Debtors (14000+962.5-815+3500)	17,587.5		
Cash	175	24,762.5	*2*
Current Liabilities			
Creditors less than 1 year			*½*
(20125+910+1400)		(22,435.0)	
		2,327.5	
Less			
Creditors more than 1 year (5,250 + 8,750)		(14,000.0)	
Deferred Creditors (4375-910)		(3,465.0)	*½*
Provisions		(1,750.0)	*1*
		29312.5	*½*

Financed By:	**£000**	
Revaluation Reserve (2100-1400+1575)	2.275.0	*1*
I & E Reserve (24325 + 2712.5 – 2625)	24,412.5	*1*
Capital Reserve	2,625.0	*½*
	29,312.5	

Finance Lease

- Lease payments 1,400,000 x 4 = £5,600.000 *½*
- Principal element = £4,375,000 *½*
- Interest element = £1,225.000 *½*
- Digits 4 + 3 + 2 + 1 = 10 *½*
- First years interest = 1.225.000 ÷ 10 x 4 =£490.000

(15)

(b)

(i) Recognise sale – write back unrealised gain on sale to Revaluation Reserve *2*

(ii) Oversight – not Post Balance Sheet Event
Revaluation can still be made – note to accounts *2*

(iii) Accrue income SSAP 2 *1*

(iv) Capital expenditure is to be included in Balance Sheet for finance lease.
Capitalise asset – create deferred liability – written off as principal paid. *4*

SSAP 21 SSAP 2 FRS 5 SSAP 21

(v) Capital expenditure incurred – accrue SSAP21 *1*

(10)

(25)

Question 2

(a) Reconciliation of operating to net cash flow.

	£000	
Surplus	2,749.5	
Add		
Depreciation	2,334.0	*½*
Provisions made in year	1,025.25	*1*
Less		
Deferred capital grants	(1,500.0)	*1*
Investment income	(5,695.5)	*½*
Add		
Interest payable	216.75	*½*
Adjust for working capital changes		
Increase in Stock	(23.25)	*½*
Increase in Debtors	(3,648.75)	*½*
Increase in Creditors	4039.5	*½*
	(502.5)	
		(5)

Cash Flow Statement

			£000	
1	**Net cash inflow/(outflow) from operations**		(502.5)	
2	**Returns on investment and servicing of finance**			
	Investment income (5695.5 + 258.75)	5,954.25		*2*
	Interest payable	(216.75)		*½*
	Taxation	(37.5)	5,700.0	*½*
3	**Capital Expenditure and Investment**			
	Acquisition of fixed assets (7896 +342)	(8,338)		*1*
	Acquisition of endowment assets	(4,050)		*½*
	Receipts from sale of endowments	3150.0		
	Capital Grants	562.5		*½*
	Endowments received	900	(7,675.5)	*½*
4	**Financing**			
	Loans Raised	5925		*½*
	Loans Repaid	(1,687.5)	4,237.5	*½*

Total Net Cash Outflow	(1,759.5)	
		(7)

Analysis of changes of net funds

	Opening	**Cashflow**	**Closing**	
Endowment assets	-	+ 258.75	258,75	*1*
Other	19,418.25	+ 1,527.0	20,945.25	*1*
Overdraft	(426.75)	(26.25)	(453.0)	*1*
	18,991.5	1,759.5	20,751	
				3

Explanatory Notes

1	- I & E account on accruals basis	
	- Adjusted to cash basis through	*1*
	- Non-cash items eg Depreciation/Provisions	*1*
	AND	
	- Working capital movements	*1*
2	Investment income and financing shown separately to identify impact separately to identify impact separately to operational finance changes	*½*
3	Capital changes shown separately to revenue	*½*
4	Financing sources identified	*1*
		(5)

Comments on Cash Flow

- Net cash outflow from operating activities (£502.5k) compared to operating surplus £2,4749.5k
- Significant changes in working capital particularly Debtors and Creditors
- Capital expenditure funded in main by loans and sale of endowments
- Future cost of loans need to be recognised
- Pressure on Revenue accounts by capital developments-revenue consequences of capital schemes

1 mark for each relevant point, including the above, to a maximum of 5 marks
(25)

Question 3

(a)

Draft a report on the importance of performance measurement in your organisation.

Performance Measurement (PM) arises from concept of VFM, applicable to all public sector organisations - Economy, Efficiency , Effectiveness.

PM underpins concept of accountability – which demands hard information about various aspects of performance - types of accountability = Financial, Managerial, Political.

Performance measures used Internally AND Externally

Internally – uses include Policy planning/ Control processes/ Resource Allocation/ Monitoring

Externally – used by stakeholders to judge performance, Audit Commission, Government, public etc

Potential conflict between internal and external roles.

PM useful in comparing public v private sector organisations/ public sector organisations against each other/ comparing one organisation over periods of time and possibly most important comparison against target.

How Performance Measured

Performance Indicators – types - Workload/productivity ratios
Time targets
Utilisation rates
Unit cost indicators

Benchmarking - ideal standard to measure organisation against

Summary

PM can provide considerable stimulus to improved performance

Pitfalls – do not tell full picture/ need many to tell full story/

Political problems in PM and PIs becoming be all and end all

Students may present answers in a variety of ways. However the central components of the answer are included in the above. Examiners therefore need to exercise some latitude. *(15)*

(b) The following indicators could have been calculated

(i) Performance against target £1.30 per meal

	Uptown Campus £	Midtown Campus £	Downtown Campus £
Food	242,640	35,000	647,600
Stock adjust	+100	+540	-8,800
Less income from swill	-6,768	-308	-1,996
Net food cost	235,972	35,232	636,804
Meal numbers	193,004	26,068	477,190
Food cost per meal	1.22	1.35	1.33
Target	1.30	1.30	1.30
Variance per meal	-.08	+.05	+.03
Total variance	(-) £15,440.0	(+) £1,303.40	(+) £14,315.70

(2)

(ii) **Comparative Unit Costs**

	Uptown Campus £	Midtown Campus £	Downtown Campus £
Food	242,640	35,000	647,6000
Wages	195,600	45,000	405,200
Management	36,000	15,400	45,600
Crockery	9,360	2,802	20,634
Swill income	(6,768)	(308)	(1,996)
Stock adjustment	+100	+540	-8,800
Net cost	476,932	98,434	1,108,238
Overheads apportioned on basis net cost	12,748	2,630	29,622
Total Cost	489,680	101,064	1,137,680
Total Meals	193,004	26,068	477,190
Cost per meal	2.54	3.88	2.38

(3)

Economic use of resources: Stock as % of food used

	Uptown Campus £	Midtown Campus £	Downtown Campus £	
Food – purchases less addition to stock	242,540	35,540	638,800	
Average stock	7,770	2,230	38,880	
Stock % Food	3.2%	6.3%	6.1%	*1*

Amount of waste as % food costs

Food Used	242,540	35,540	638,800	
Income from swill	6,768	308	1,996	
Swill as % of food	2.8%	0.9%	0.3%	*1*

Conclusions

1 Uptown appears more economical on food costs and maintain less stock.
2 Downtown closest to food target and lowest unit cost.
3 Midtown has highest unit costs
4 Income information would present full picture
5 Consumer satisfaction
6 Past performance

(½ mark for each relevant point to max of 3 marks)
(25)

Question 4

FEFC

Capital Grants

- New guidance on policy regarding treatment of capital grants;
- Projects over £100,000 normally loan finance support form FEFC;
- College should fund from reserves if available and no requirement to borrow;
- Grant is based on a 15 year annuity based on notional interest rates;
- Grant is both revenue (released to I & E) and capital (deferred SSAP 4);
- Grants spent for capital purposes but asset not capitalised (eg below de-min level) then credit directly to I & E;
- 1995/96 onwards capital allocations can be used to meet all of finance lease rentals (ie including interest) but not operating lease rentals or provisions for future rentals;
- Lease payments should be separated as per SSAP 21 (interest I & E, principal; Deferred liability);
- One-off grants (eg competitiveness fund) are rare but if given (SSAP 4) should be treated as Deferred Income and Released to I & E over life of asset. *10*

Provision and contingencies

- FRED 14 attempt to make measurement and disclosure consistent;
- Key issues nature, timing and amount of provisions and level of uncertainty of contingency;
- Provision is where uncertainty of timing or amount of liability but there is a legal or constructive obligation;
- No provision for future operating losses;
- Provide for net loss on onerous contract (SSAP 9);
- Reorganisation provision if college is obviously committed to the reorganisation;
- Environmental contamination does not of itself create an obligation;
- Ongoing refurbishment should be provided when work done and amount is due;
- Disclosure requirements include description, amount and movements. *8*

Treasurers Report

- FE colleges directive has extended the minimum requirement for the Treasurers (or Members) report;
- New items are Student Numbers, Student Achievements, Curriculum Developments, Governance and Management Taxation, Performance Indicators and a statement on Internal Financial Control;
- Influences include the funding regime and corporate governance (Cadbury);
- Exception is special initiatives or earmarked grants especially if paid in advance of activity. *5*

European Funds

- Receipts basis may be adopted for European funds because of the uncertain timing of payment of these funds. *2*

(25)

HEFCE

Issue

Capital grants

- SSAP 4 says defer grant and release over life of asset;
- Up to 1995/96 separate capital allocation received therefore defer grant;
- In 1996/97 could vire capital to recurrent therefore some of grant would be credited directly to I & E;
- 1997/98 onwards the block grant includes capital therefore all should be credited to I & E and no deferral;
- Exception is special initiatives or earmarked grants especially if paid advance of activity. *8*

Corporate governance

- A statement in accounts is best practice;
- CUC guidance more general and should go in annual report;
- Treasurers report should refer to Cadbury and stress financial aspects including financial controls. *6*

Inherited liabilities

- Current basis of accounting for these is correct;
- Interest recouped should be credited to I & E (FRS 3);
- Principal recouped should be credited to revaluation reserve as it is a capital injection (FRS 4);
- Principal will appear in the movement in reserves not in statement of recognised gains and losses. *7*

Loans to third parties

- HEIs do have powers to guarantee loans to third parties and if follow disclosure requirements of SSAP 18 (contingencies – evaluate probability of loss and provide if likely, disclose otherwise) then that is sufficient. *4*

(25)

Question 5

(a) Aid the planning of actual operations;

By forcing managers to consider how conditions might change and what steps should be taken now

By encouraging managers to consider problems before they arise *2*

(b) To communicate plans to the various levels of management and staff

All should have a clear understanding of the part they have to play in the achieving the annual budget

Appropriate individuals are made accountable for their share of the budget *2*

(c) To motivate managers to achieve budget goals

Through participation
Providing a challenging target / goal *2*

(i) To control activities

By comparison with budget
Having a mechanism for responding to divergences from budget *2*

(ii) To coordinate the activities of the institution

Compelling managers to examine relationships between their operations and those of other elements of the institution *2*

(10)

(iii) Bottom up v Top Down

No single approach. A stable organisation may develop budgets for a bottom up approach where the budget can be developed from the component parts of the institute.

For an organisation requiring significant change in performance it may be necessary for senior management to specify in advance the performance they will accept and not rely on the collating approach of the bottom up method.

In reality both approaches are used in most organisations to achieve senior managers expectations while not diminishing individual managers roles.

Most public sector organisations adopt the top down approach as changes in the main are planned and known in advance.

(2 marks for each point made to a maximum of 10)

(iv) Budgets are meant to reflect actual to be the most meaningful and effective.

Much expenditure incurred is not in an even pattern eg fuel , rates ,budgets should be profiled to reflect these patterns of expenditure to avoid presenting managers with unreal under / overspends.

Managers should be able to rely on the budgetary information to make meaningful decisions.

Profiling of expenditure / income allows accurate financial information to be constructed and prevents wasted time of finance staff investigating false variances.

Good quality budgetary information enhances the standing of the finance department.

Determining the profiles of expenditure can contribute to the creation of closer working relationships between the finance department and other departments.

The determination of expenditure and income profiles increases the knowledge and involvement of user departments in the budgetary control process.

1 mark for each point to a maximum of 5

(25)