FINANCIAL REPORTING IN HOUSING ASSOCIATIONS

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.

SECTION A (Answer both questions)

1

The trial balance relates to the Noname Housing Association as at 31 March 2000:

	£000
Turnover	12,005
Operating costs	8,892
Interest receivable	87
Interest payable	1,980
Properties held for letting (at cost)	125,700
Social housing grant (SHG) and other capital grants	102,786
Designated reserves	1,387
Restricted rent surplus fund (RSF) reserve	1,209
Properties in development (at cost)	10,784
Shared ownership property held for letting (at cost)	4,367
Cash (dr)	1,301
Loans	28,901
Offices (at cost)	2,130
Office furniture (at cost)	506
Debtors	1,753
Share capital	1
Creditors due within one year	2,546
Provisions	350
Recycled capital grant fund (RCGF)	43
Depreciation of other fixed assets (at 31 March 2000)	208
Revenue reserves	7,998
Motor vehicles (at cost)	108

The following information needs to be taken into account in producing the financial statements for the year:

(i) £20,000 of the RCGF was used to finance eligible capital expenditure during the year.

(ii) £9,000 of the surplus generated in the financial year arose from a contract with a health authority to provide nursing home accommodation. This amount is to be refunded to the health authority in 2000/01.

(iii) Following the implementation of the new SORP in 1999/2000, £100,000 of central overheads, which had been capitalised during the year, can no longer be so treated. (The total of such overheads capitalised to date is £240,000 but you have agreed with the external auditors that a prior year adjustment is not required.)

(iv) The Association participated in a consortium bond issue which took place towards the end of the year. As a result of this bond issue the association raised £1,000,000 of loans at a premium of £40,000. The issue costs attributable to the Association amounted to £20,000. The bond is to be repaid in full in 20 years. None of these transactions have been included in the trial balance.

(v) You have agreed with the external auditors that the provision for bad debts in respect of current tenants arrears will be increased from £60,000 to £85,000 for 1999/2000.

(vi) The Chief Executive of the Association signed an agreement in March 2000 to transfer a property to another registered social landlord at its net book value of £10,000. The property originally cost £50,000 and the consideration was received in April 2000.

(vii) During the year a vehicle was scrapped; the vehicle had cost £6,000 and depreciation of £5,000 has been charged to date.

(viii) The transfer to the rent surplus fund for the year was calculated to be £100,000.

- **Requirement for question 1**

Prepare the income and expenditure account of the Noname Housing Association in respect of the financial year ended 31 March 2000 together with the balance sheet as at that date.

(25)

2

The following information relates to the Cashisking Housing Association:

Balance sheet as at 31 March

	2000	1999
	£000	**£000**
Fixed assets		
Housing properties	128,500	119,000
Social housing grant	(92,600)	(87,300)
Non housing fixed assets	2,250	1,220
	38,150	32,920
Net current assets	(500)	1,100
	37,650	34,020
Creditors: amounts falling due after more than one year	(27,860)	(25,580)
Provisions for liabilities and charges	(270)	(320)
Net assets	**9,520**	**8,120**
Capital and reserves		
Called up share capital	0	0
Designated reserves	960	640
Restricted reserves	1,140	980
Revenue reserves	7,420	6,500
	9,520	**8,120**

The following information has also been provided:

(i) **Fixed assets comprise:**

	31 March 2000	31 March 1999
	£000	**£000**
Housing property held for letting	120,000	111,000
Housing property depreciation	(500)	0
Housing property under construction	9,000	8,000
Offices at cost	1,950	900
Office fixtures and fittings	500	480
Fixtures and fittings depreciation	(300)	(240)
Motor vehicles at cost	250	200
Vehicle depreciation	(150)	(120)

(ii) The increase in housing property held for letting was due to

1 schemes under construction reaching completion and transferred from the housing property under construction account (£8,000,000);
2 capitalised interest incurred as a result of financing properties under development (£400,000); and
3 expenditure on major repairs (the remainder).

(iii) During the year ended 31 March 2000 the Association disposed of properties, which had previously been held for letting, for £750,000. These properties appeared in the accounts at £500,000, of which £260,000 had been funded from social housing grant. No depreciation had been charged on these properties.

(iv) **Net current assets comprise:**

	31 March 2000	**31 March 1999**
	£000	**£000**
Debtors	1,900	1,660
Investments	2,100	2,600
Cash	(1,060)	190
Repayments of loan principal	(1,000)	(1,000)
Other creditors	(2,440)	(2,350)

(v) **Creditors: amounts falling due after more than one year comprise:**

	31 March 2000	**31 March 1999**
	£000	**£000**
Long term loans	28,000	26,000
Deferred financing costs	(400)	(420)
Recycled capital grant fund	260	0

(vi) Non-amortising loans amounting to £3,000,000 were raised on 31 July 1999. All other loans are amortising and repayments of principal in respect of these loans took place on the due date (30 September 1999).

(vii) The weighted average interest rate on amortising loans was 8%; the rate of interest on the non-amortising loans raised on 31 July 1999 was 7%. Overdraft interest of £1,000 was paid during 1999/2000. The rate of interest on the average investment balance was 6%.

(viii) Five motor vehicles had been disposed of during 1999/2000 for £1,000 each. The vehicles, which had cost £50,000, had a book value of £10,000.

- **Requirement for question 2**

Prepare the cash flow statement for the Cashisking Housing Association for the year ended 31 March 2000, together with the supporting notes. *(25)*

SECTION B (Answer two questions)

3 You are the Financial Controller of Quicklet Housing Association. The Finance Director has asked you for a briefing note on the accounting treatment of various items in advance of a meeting of the external auditors, arranged to discuss the preparation of the statutory accounts for the financial year ended 31 March 2000. The auditors had not been satisfied with the way some items had been dealt with in the previous year's audit and had referred to this in their management letter to the Board. The Finance Director is concerned that this should not happen again and also wishes to understand fully the implications that the 1999 SORP will have on the Association's accounts. The specific items are as follows:

(i) The Association has a small estate developed 15 years ago with a net book value in its balance sheet of £2.25m, which is now proving difficult to let. As a result voids are averaging 40% and the net annual income from the properties has fallen in the last few years from £350,000 to £200,000. The estate is managed as a separate income-generating unit and there is no prospect of the ease of letting properties on the estate improving in the foreseeable future. You have consulted a firm of surveyors who have advised that the existing use value of the properties is ten times the net rental income.

(ii) The Association entered into a contract with a health trust two years ago for the provision of nurses' accommodation. During 1999/2000 the Association has made a surplus of £100,000 from this activity, which under the terms of the contract has to be shared equally between the Association and the Trust. The Trust's share can be offset against future repairs to the properties.

(iii) The Association has 20 properties let under shared ownership terms, the leases of which enable service costs to be fully recovered from service charges. At 31 March 2000 there had been an under-recovery of costs of £5,000.

(iv) The Association's development department undertook some preliminary work on a major scheme and incurred £20,000 of professional fees that were capitalised. The Association was unable to secure social housing grant funding and has, therefore, decided not to proceed any further with the scheme.

(v) Up until now the Association has made a bad debt provision for 50% of all rental debtors in respect of former tenants. You have now agreed with the auditors that the likelihood of non-recovery from former tenants is such that provision should be made for all of these debts. The former tenant arrears at the end of the financial year were £100,000.

(vi) The Association has incurred legal and other fees of £12,500 in arranging a new 25 year private finance loan facility. These fees have been charged to operating costs and the facility agreement was signed on 30 September 1999.

- **Requirement for question 3**

Prepare the briefing note requested by the Finance Director using the following brief:

(a) For each of the items in (i) to (vi) above:

- explain the required accounting treatment by reference to the relevant accounting standard; and
- show the appropriate accounting entries. *13*

(b) Outline four of the main changes between the SORPs produced in 1994 and 1999, explaining their possible financial implications for the Association.

12

(25)

4

Easyrent Housing Association is 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 Housing Association'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 Ltd	**Y Ltd**	**Z Ltd**
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 Ltd	Y Ltd	Z Ltd
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 Ltd	Y Ltd	Z Ltd
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

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- **Requirement for question 5**

(a) Explain the main role and responsibilities of the Director of Finance within housing associations. *14*

(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 Director of Finance. *5*

(25)