FINANCIAL REPORTING IN HOUSING ASSOCIATIONS

Professional 2
December 2000

MARKING SCHEME

CIPFA

Question 1

Noname Housing Association

Income and expenditure account for the year ended 31 March 2000

		£000	
Turnover		12,005	
Operating costs	8,892 +9(ii) +100(iii) +25(v)	(9,026)	*3*
Operating surplus		2,979	
Interest receivable		87	
Interest payable	1,980 - 2(iv) +1(iv)	(1,979)	*2*
Loss on disposal of fixed assets	1(vii)	(1)	*1*
Surplus for the year		1,086	
Less: transfers to designated and restricted reserves	100 (viii)	(100)	*1*
Surplus for the year after transfers to designated and restricted reserves		986	
Revenue reserves brought forward		7,998	
Revenue reserves carried forward		8,984	

Balance sheet as at 31 March 2000

		£000	£000	
Fixed assets				
Housing property	125,700 + 10,784 + 4,367 - 100 (iii) – 50 (vi)		140,701	*2*
Less: SHG and other capital grants	102,786 + 20 (i) – 40 (vi)		(102,766)	*2*
			37,935	
Non housing fixed assets	2,130 + 506 + 108 – 6 (vii) – [208 - 5 (vii)]		2,535	*1*
			40,470	
Current assets				
Debtors	1,753 – 25 (v) + 10 (vi)	1,738		*2*
Cash at bank and in hand	1,301 + 1,000 (vi) + 40 (vi) - 20 (vi)	2,321		*3*
		4,059		
Creditors: amounts falling due within one year	2,546 + 9 (ii)	(2,555)		*1*
Net current assets			1,504	
Total assets less current liabilities			41,974	
Creditors: amounts falling due after more than one year				
Recycled capital grant fund	43 – 20 (i)	(23)		*1*
Loans	28,901 + 1,000 (iv) + 40 (iv) - 20 (iv) – 2 (iv) + 1 (iv)	(29,920)		*4*
			(29,943)	
Provisions			(350)	
			11,681	
Capital and reserves				
Share capital			1	
Designated reserves			1,387	
Restricted reserves	1,209 +100(viii)		1,309	*1*
Revenue reserves			8,984	
			11,681	
Presentation of I&E account and balance sheet				*1*
				(25)

Question 2

Cashisking Housing Association

Cash Flow Statement for the year ended 31 March 2000

	£000	£000		
Net cash inflow from operating activities (Note 1)		3,325	*13*	(note 1)
Returns on investments and servicing of finance				
Interest received (working 2)	141		*1*	
Interest paid (working 3)	(1,861)		*1*	
		(1,720)		
Capital Expenditure and financial investment				
Acquisition and construction of housing properties (working 4)	(10,500)		*1*	
Housing association grants received (working 5)	5,560		*1*	
Purchase of other fixed assets (working 6)	(1,170)		*1*	
Sale of housing properties	750		*1*	
Sale of other fixed assets	5		*1*	
		(5,355)		
Net cash outflow before management of liquid resources and financing		(3,750)		
Management of liquid resources				
Investments realised		500		
Financing				
Housing loans received	3,000		*1*	
Housing loans repaid	(1,000)		*1*	
Net cash flows from financing		2,000		
Decrease in cash and cash equivalents		(1,250)	*(22)*	

Note 1

Reconciliation of operating surplus to net cash flow from operating activities

	£000	
Operating surplus (see working 1 overleaf)	3,120	*5*
Depreciation of housing properties (working 4)	500	*1*
Depreciation of other fixed assets (working 7)	130	*1*
Decrease in provisions	(50)	*1*
Increase in debtors	(240)	*1*
Increase in creditors	90	*1*
Deferred financing costs	20	*1*
Surplus on sale of properties (working 8)	(250)	*1*
Loss on disposal of vehicles (working 9)	5	*1*
Net cash flow from operating activities	3,325	*(13)*

Note 2

Reconciliation of net cash flow to movement in net debt *3*

	£000
Decrease in cash	(1,250)
Decrease in short term investments	(500)
Loans received	(3,000)
Loans repaid	1,000
Change in net debt	(3,750)

Analysis of the movement in net debt

		Movements		
	1 April 1999 £000	**Cash £000**	**Other £000**	**31 March 2000 £000**
Loans repayable after more than 1 year	(26,000)	(3,000)	1,000	(28,000)
Loans repayable within 1 year	(1,000)	1,000	(1,000)	(1,000)
Cash at bank/overdraft	190	(1,250)		(1,060)
Short term investments	2,600	(500)		2,100
Net debt	(24,210)	(3,750)	0	(27,960)

(25)

Workings

(1) Operating surplus

		£000
Increase in revenue surplus	7,420 – 6,500	920
Increase in restricted reserves	1,140 – 980	160
Increase in designated reserves	960 - 640	320
Interest payable	Working (2)	1,861
Interest receivable	Working (3)	(141)
Operating surplus at 31 March 2000		**3,120**

(2) Interest payable

		£000
Amortising loans at 1 April	26,000 + 1,000	27,000
Repayment of principal on 30 September		(1,000)
Amortising loans at 31 March		26,000
Average debt		26,500
Interest at 8%		2,120
Non-amortising loans raised	3,000 for 8 months at 7%	140
Total interest		2,260
less capitalised		(400)
Overdraft interest		1
Net interest payable		**1,861**

(3) Interest receivable

Average investments	(2,100 + 2,600)/2	2,350
Interest rate	@ 6%	
Interest receivable		**141**

(4) Housing assets

	Properties held for letting	Properties under construction	Total
	£000	**£000**	**£000**
BV at 1 April 1999	111,000	8,000	119,000
Cash (capitalised interest per (2) above)	400		**400**
Cash (expenditure for year) (balance)	1,100	9,000	**10,100**
Completions	8,000	(8,000)	0
Disposals (BV)	(500)		(500)
Depreciation charge	(500)	0	**(500)**
BV at 31 March 2000	119,500	9,000	128,500

(5) Capital grants

	£000
At 1 April 1999	87,300
Transfer to CGRF	(260)
Cash additions (balance)	**5,560**
At 31 March	92,600

(6) Non housing fixed assets	**Offices**	**Office F&F**	**Vehicles**	**Total**
	£000	**£000**	**£000**	**£000**
Cost at 1 April 1999	900	480	200	1,580
Cash additions (balance)	1,050	20	100	**1,170**
Disposals	0	0	(50)	(50)
Cost at 31 March 2000	1,950	500	250	2,700

(7) Depreciation of other fixed assets charge

At 1 April 1999	0	240	120	360
Written out on disposal	0	0	(40)	(40)
Charge for year (balance)	0	60	70	**130**
At 31 March 2000	0	300	150	450
Net other fixed assets				
At 1 April 1999	900	240	80	1,220
At 31 March 2000	1,950	200	100	2,250

(8) Profit on sale of housing properties

	£000
Sales proceeds	750
Cost	(500)
Profit	**250**

(9) Loss on disposal of motor vehicles

Cost	50
Less depreciation	(40)
Book value	10
Sales proceeds 5 * 1k	(5)
Loss	**(5)**

Question 3

Briefing note format should be used. *1*

(a) Specific points should be addressed as follows:

(i) FRS 11 (Impairment of fixed assets and goodwill) states that fixed assets should not be held at a figure greater than their recoverable amount. Impairment tests should be carried out on income generating units, based on the way properties are managed in practice. Impairment, if indicated should be the difference between the carrying (net book) value and the value in use. Given the problems in letting the properties they should be written down to their existing use value of £2m.

Dr Operating expenses (housing property impairment)	£250,000
Cr Fixed assets (housing property impairment)	£250,000

1 mark for discussion, I mark for accounting entries

(ii) FRS 12 (Provisions and contingencies) allows provisions to be made only to meet an obligation that derives from a contract, and the 1999 SORP emphasises that provisions should be restricted to such situations.

Dr Operating expenses	£50,000
Cr Provisions	£50,000

1 mark for discussion, I mark for accounting entries

(iii) SSAP2 (Disclosure of accounting policies) states that revenue should be matched with the associated costs unless this is inconsistent with the concept of prudence. Given that the terms of the shared ownership leases enable service costs to be fully recovered it is acceptable to accrue for the income charges in the year the costs were incurred.

Dr Current assets (service charge debtors)	£5,000	
Cr Turnover (service charge income)		£5,000

1 mark for discussion, I mark for accounting entries

(iv) FRS 15 (Tangible fixed assets) allows only costs that are directly attributable to bringing an asset into working condition to be capitalised. Since the £20,000 of capitalised fees were not incurred in relation to an asset in the ownership of the association they should be written off as abortive cots.

Dr Operating expenses (abortive development costs)	£20,000

Cr Fixed assets (housing property cost)	£20,000

1 mark for discussion, I mark for accounting entries

(v) SSAP 2 (Disclosure of accounting policies) requires prudence when reporting income. It will be necessary to reduce rental debtors by £50,000 to take account of the increase in the rate of provision.

Dr Operating expense (bad debts)	£50,000
Cr Rental debtors (provision)	£50,000

1 mark for discussion, I mark for accounting entries

(vi) FRS 4 (Capital instruments) requires that finance costs should be accounted for over the life of the instrument at a constant rate on the carrying amount. The arrangement fees can therefore be debited to the loan account and written off over 25 years. Of the full amount six months (£250) would be charged to 1999/2000 operating costs and £500 to 2000/01 (i.e. creditors: amounts falling due within one year). The remainder would be included as creditors falling due after more than one year.

Dr Creditors: amounts falling due after more than 1 year	£12,500	
Cr Operating costs		£12,500

Dr Operating costs	£250
Dr Creditors: amounts falling due within one year	£500
Cr Liabilities arising after more than 1 year	£750

1 mark for discussion, I mark for accounting entries
(13)

(b) SORP changes

Impairment

The SORP sets out the requirements of FRS 11 in respect of impairment reviews. The purpose of such reviews is to ensure that fixed assets are not carried at a figure greater than their recoverable amount. In the case of Housing Associations this will normally be its value in existing use calculated by discounting the cash flows from the assets income stream after deducting management, maintenance and future repairs costs. The test should be carried out if there is some evidence of potential impairment due to adverse social or environmental change. In addition, an annual impairment test should be carried out where an association does not depreciate housing properties on the grounds of immateriality or has estimated the remaining useful life of a property to be over 50 years. Impairment tests should be carried out on groups of income generating units. If a group of assets failed the test the write down of the asset and the consequent charge to the revenue account could be significant in any one year.

Restricted reserves

The 1999 SORP makes a distinction between reserves such as the Rent Surplus Fund, which are subject to external restrictions governing their use, and general or designated reserves. In some cases an external body may require such reserves to be held in a separate fund and cash backed. As in the previous SORP all transfers to and from reserves should appear in the Income and Expenditure Account.

Capitalisation of major repairs

FRS 15 permits the capitalisation of repairs costs where:

- The economic benefits of the property are enhanced
- Expenditure is on the replacement of an asset which has already been fully depreciated

The SORP defines enhancement of economic benefit as occurring when there is an increase in the net rental stream over the life of the property. This could occur if there was an increase in rental income, a reduction in future maintenance costs or a significant extension of the life of a property.

The above definitions are stricter than those in the 1994 SORP and are therefore likely to result in a higher proportion of repairs costs being written off to revenue in the year in which they are incurred

Depreciation

The 1999 SORP does not accept that depreciation is not necessary if properties are well maintained through repairs programmes, which has previously been used by Housing Associations as a reason not to depreciate. All properties have a finite life and require replacement at some time in the future. They should therefore be depreciated over their useful economic lives, whether or not they have been revalued. If an economic life is over 50 years or if depreciation has not been charged because of materiality, an annual impairment test must also be carried out.

Land does not have to be depreciated and the depreciable amount is the cost (or value) less land and any residual value. If properties are shown at cost, SHG and any other capital grant is also deducted. If the cost of the land is not known for a particular property it can be estimated from tables published by the NHF and SFHA. Properties should be grouped according to use (e.g. general needs new build, special needs) for depreciation purposes.

Whether or not a depreciation charge is put through the accounts depends on materiality, but most developing RSLs will have had to make a charge in their 1999/2000 accounts due to the lower level of SHG in recent years.

Accounting for development costs

The 1999 SORP brought about 2 changes in respect of capitalising development costs, which are more restrictive than the previous one:

Only costs attributable to bringing properties into working condition for their intended use can be capitalised. In particular central overheads should not normally be capitalised, nor should the costs incurred on schemes, which do not proceed to completion. For most developing associations, this change will mean that a higher proportion of costs will be written of to revenue, although it is possible to some extent to offset this by bringing an element of SHG into revenue in accordance with procedures that have been issued by the Housing Corporation. There has been some debate over whether this change requires an adjustment to prior year figures.

Interest can be capitalised while a development is in progress. The interest must represent a fair proportion of interest on the overall borrowings of an RSL or arise from borrowings specifically financing the development. In practice this means that interest cannot be capitalised after practical completion, nor if there is a significant break in the development of a scheme, say between land acquisition and contract start on site. These changes are likely to give rise to some increase in the proportion of interest charged to revenue for most developing RSLs.

Investments

The 1999 SORP recommends that all non-property investments should be shown at valuation and that changes in value should be reported in the Statement of total recognised surpluses and deficits. Investment should be valued on a market value basis and a revaluation reserve should be included on the face of the balance sheet. An adjustment will be required to prior year figures.

Mergers and acquisitions

The SORP sets out the criteria that have to be met to justify treatment as a merger under FRS6, as follows:

- No party dominating because of size
- No consideration paid
- Mutual benefit to the tenants of both social landlords

If these criteria are not fulfilled, then the combination should be regarded as an acquisition and dealt with accordingly. Under merger accounting, the carrying values of the combining social landlord are not required to be adjusted to fair value on consolidation. Fair value must always be based on Existing Use Value for Social Housing. The results and cashflows should be accounted for from the period in which the merger took place and prior year figures adjusted accordingly. If the combination is treated as an acquisition, the assets and liabilities of the social landlord acquired should be brought into the accounts from the date of acquisition with no adjustment for previous periods.

Up to 3 marks for each example to a maximum of 12

(25)

Question 4

(a)

	1999/2000	Points	1998/1999	Points	1997/98	Points	Total	
Company A								
Current ratio	136:123=1.11	1	118:132=0.89	0	118:113=1.04	1	2	*1½*
Acid test	114:123=0.93	1	100:132=0.76	0	90:113=0.80	0	1	*1½*
Post tax profits		1		1		0	2	*½*
Total							**5**	
Company B								
Current ratio	117:89=1.31	1	104:90=1.16	1	102:84=1.21	1	3	*1½*
Acid test	87:89=0.98	1	76:90=0.84	0	76:84=0.90	1	2	*1½*
Post tax profits		1		1		1	3	*½*
Total							**8**	
Company C								
Current ratio	132:91=1.45	1	132:108=1.22	1	115:92=1.25	1	3	*1½*
Acid test	97:91=1.07	1	98:108=0.91	1	85:92=0.92	1	3	*1½*
Post tax profits		1		1		1	3	*½*
Total							**9**	

Companies B & C can be invited to tender on financial criteria. *½*

(11)

(b)

	X Ltd	Points	Y Ltd	Points	Z Ltd	Points	
Staff	6/30=20%	5	10/59=17%	5	21/99=21%	10	*1½*
Contract		0		5		10	*½*
Price*		20.91		17.14		6.95	*4½*
Total		**25.91**		**27.14**		**26.95**	

Company Y should be offered the contract. *½*

(7)

Note: Students may interpret the last paragraph of the question in other ways, leading to a rounding of percentages, which may result in different points scores, the effect of which may be to change the recommendation to Company Z – full credit should also be given for recommending Company Z in these circumstances.

* Price Notes:

X Ltd	225,375
Y Ltd	241,095
Z Ltd	283,530
Total	750,000

Average Price = 250,000

225,375 = 9.85% less than the mean, hence points = 15+(9.85*(2%*30) = 20.91
241,095 = 3.56% less than the mean, hence points = 15+(3.56*(2%*30)=17.14
283,530 = 13.41% greater than the mean, hence points = 15-(13.41*(2%*30)=6.95

(c)

Responsibility	Explanation	
Drawing up the contact specification	Detailed description of the service/goods/ works, e.g. tasks, times, frequencies, materials, etc including minimum standards Conditions, including client & contractor responsibilities Provides a benchmark against which the tenders can be assessed.	*2*
Estimate of realistic cost	Based on the provision of the service/goods/ works detailed in the contract specification	*1*
Publication of notice	To inform interested parties of the service to be tendered	*½*
Send questionnaire and outline details	To obtain information to allow short-listing of contractors who will be invited to submit tenders	*1*
Review questionnaire	To reject potential tenderers that do not meet minimum standards of financial standing or technical capacity	*½*
Invitation to tender	Sending details to approved potential tenderers	*½*
Tender evaluation	Review all tenders on the basis of cost and quality and conclude with a preferred bidder	*½*
Announcement of award	Notification to successful and unsuccessful tenderer	*1*
		(7)

(25)

Question 5

(a) Role and responsibilities of Director of Finance

OLM Reference – Block 1, Study Unit 2

There are a number of appropriate structures which could be adopted. However the answer should cover the following key areas:

- provision of financial management advice
- preparation of statutory accounts and returns in accordance with the SORP and regulatory requirements
- provision/supervision of internal audit function
- provision of income collection and payment systems
- budgetary control (capital and revenue budgets)
- cash flow and treasury management
- financial and business planning
- insurance and risk management
- performance indicators/measures

1 mark per point and 1 mark for explanation up to a maximum of 14

(b) Devolved financial management

The exact definition will vary but should refer to:

- The shifting of the decision making process away from the centre to front-line services
- Front line service managers being responsible for budgets and budget monitoring

2

(c) Advantages of Devolved Financial Management

- Alignment of financial and managerial responsibility
- Enables front line staff to respond more quickly to needs of clients
- Fosters ownership of budgets
- Clearer accountability
- Any other appropriate points

½ mark per point up to a maximum of 2

Disadvantages

- Costly to set up due to training requirements
- Devolving financial responsibility to non-finance experts
- More difficult for the centre to control and influence
- Any other appropriate points

½ mark per point up to a maximum of 2

(4)

(d) Impact on the role of the Chief Financial Officer

- Still maintains all statutory responsibilities
- Quality assurance role e.g. are budgets being spent prudently
- Coordination role re budgeting
- Sets parameters e.g. cash limited budgets
- Power to access documents and information becomes more important
- Any other appropriate points

1 mark per point up to a maximum of 5

(25)