

**CIPFA FINAL TEST OF PROFESSIONAL COMPETENCE
FINANCE AND MANAGEMENT CASE STUDY EXAMINATION**

November 2006

THE COUNTESS OF FIRTH'S CHARITABLE TRUST

TUTORIAL GUIDE

1. General Comments

- (a) It is essential that candidates answer all the questions as set.
- (b) Where illustrative figures or information are asked for in a question or their use is implied in the data, then they must be shown in the candidate's answer.
- (c) Evasion of the terms of the question on the grounds that the situation depicted in the Case Study is unlikely to have arisen or occurred, or is improbable in concept, should be penalised.
- (d) Working papers submitted with answers should be scrutinised and used to test the candidate's line of argument in unfinished work and as a guide to the method by which the candidates have utilised their acquired knowledge to deal with the various aspects of the Case Study.
- (e) Detailed calculations are set out in the appropriate attached appendices. It must be emphasised that these are not 'model answer' figures but are based upon what are judged to be the 'best' assumptions made in answering the question. Candidates should not therefore be judged on whether they got the figures 'right', but on how they reached their figures and how reasonable are their assumptions and arguments.

2. Synopsis of case

The Countess of Firth's Charitable Trust (CFCT) provides services for disadvantaged children and their families in the Firth region of Endowland. The Trust is funded from a mixture of sources including charges for services, legacies and donations from the public, fundraising and income from a number of shops selling donated second-hand goods. The Trust also receives some income from the local social care authorities in respect of services provided to their clients. CFCT is a non-profit making limited company and a registered charity.

The Trust was founded over 90 years ago and has built a reputation as an effective provider of services to those in need. The Trust is generally well thought of by residents of the region who are generous in donating money and time to help the Trust.

The Trust is overseen by a board of Trustees, who have overall responsibility and make all strategic and policy decisions. Reporting to the board is the Chief Executive, who is responsible for the day-to-day running of the Trust. The Chief Executive heads a management team, which also includes

Directors of Operations and Appeals. The Chief Executive is responsible for administration, property matters, finance, and shops.

The candidate, Kim Cardine, has recently been appointed as Finance Manager to the Trust and is responsible directly to the Chief Executive. A Financial Services Officer, Dan Fermline, assists the candidate. The Chair of Trustees, Karen Larich, and the Chief Executive, Iain Verary, have also been newly appointed. Mr Verary has some concerns about the way that CFCT has been run in the past, including the management of its financial affairs, and wishes to see improvements made.

Question 1 (20%)

Lady Bank, a prominent supporter of the Trust (and currently its Patron), has written to the Chairman to make a number of complaints and accusations about the Tay shop. Some of these complaints relate to financial matters, in particular, lax record keeping, and others to the way in which the shop manager, Mrs Anne Struther, (a paid employee) operates the shop and treats the volunteers.

Lady Bank is particularly aggrieved to have seen an expensive and unusual designer handbag for sale in a second hand shop in another town. She believes that this was a bag that she had donated to the Trust at the Tay shop, and that Mrs Struther, recognising its high value, has sold it on and kept the proceeds. Lady Bank suggests calling in the police immediately.

A few days earlier, Dan Fermline visited the Tay shop to conduct an internal audit. Mr Fermline has reported that not all procedures are followed, particularly in relation to petty cash, the recording of income and donations and the treatment of donated goods. He has also advised that the volunteers seemed demoralised and unhappy with the way in which the shop was being run. Mrs. Struther expressed ignorance of the procedures laid down by the Trust for shop managers to adhere to and, in addition, complained about Mr Fermline's visit and about audit visits in general.

During the morning of 29 November, the Chair has faxed Lady Bank's letter to the Chief Executive, and she (the Chair) and the Chief Executive are due to meet at 1.15 pm.

The candidate is asked to draft a briefing note for the Chief Executive, covering the following issues:

- Tay Shop

Compare the performance of the Tay shop, against the average for the Trust's shops as a whole, and against the Clyde shop in particular. Look at the level of volunteer input and also the financial results. For the financial comparison, use the 2005/06 outturn data, taking out the costs of, and income from, the collector. Focus especially on sales and profit and use rent as a proxy for size of shop.

- Handbag and related performance issues in relation to Mrs Struther
Whilst Lady Bank is eager for the matter to be passed to the police, the Chief Executive asks for consideration of a range of options:
 - Reference to the police
 - Dismissal
 - Disciplinary action
 - No action – on the grounds that there are plenty of other issues to tackle if the Tay shop problems can be shown to be immaterial.

The candidate is asked to give views on the specific “handbag” allegation; any wider concerns about Mrs Struther’s performance from both a financial and management perspective; their view on each of the options identified above; and their recommendation as to the course of action the Trust should take in respect of Mrs Struther.

- Shop management
To help the Chair and Chief Executive, the candidate is asked to provide some notes explaining –
 - Any improvements the Trust can make to the general management and audit arrangements for the shops to prevent a recurrence of this type of situation
 - The advantages and disadvantages of appointing an accounting firm to provide an independent internal audit function for the Trust as a whole.

Question 2 (30%)

The Chief Executive is particularly concerned about the performance of the shops and suspects that some shops are not profitable enough to justify keeping them open.

Mr Verary has obtained a summary of results from the “National Charity Shops Benchmarking Survey” (which CFCT does not take part in). This survey produces benchmarking information on forecast income and expenditure for the coming financial year.

The candidate gains access to additional information from the National Benchmarking Survey, which enables a comparison to be made with sales and profits of other charity shops in the Firth Region by use of a Student’s t test.

The Chief Executive instructs the candidate to prepare a report for the trustees covering the following aspects:

- Brief background to the shops, the concerns about their performance, and the availability of benchmarking information.
- An income and expenditure forecast for each shop and in total for the year ending 31 March 2008.

- A critical evaluation of the results in the light of his concerns about profitability.
- A detailed comparison of the forecast average performance of the Trust's shops against the forecast performance of the shops in the National Charity Shops Benchmarking Survey. This comparison is to take into account all of the information (except about Christmas cards) that the candidate is able to gather regarding the National Benchmarking Survey and is to include:
 - A critical evaluation of the results of the comparison;
 - A calculation of the total profit that the Trust's shops would be expected to earn in 2007/8 if their profit as a percentage of sales was at the same level as for the shops in the National Charity Shops Benchmarking Survey;
 - An appropriate statistical analysis (Student's t test) of comparative sales and profit forecasts;
 - A brief explanation of any limitations applicable to the statistical analysis.
- Conclusions and recommendations as to a) whether any of the shops should be closed immediately and b) the longer term strategy for dealing with the less profitable shops.

Question 3 (28%)

CFCT operates the Lorne holiday home for disadvantaged families, providing holidays for families that would otherwise be unable to afford one. The home is an important part of the services offered by the Trust, but the building itself is dilapidated and does not meet modern safety and access standards. New legislation in both of these areas means that the Trust must replace the building by 1st April 2010 or cease to provide this service.

The Trust commissioned a feasibility study looking at options for either rebuilding the existing home or building a completely new home. The study concluded that it would not be economic to rebuild the existing home and that the preferred option for the Trust should be to build a completely new home on a nearby site. The estimated cost of the preferred option is £2.45m. The Trust has not yet formally agreed to go ahead with the replacement. If it does so, the capital payments would fall in 2007/08 and 2008/09, and the new home should be completed by 31st December 2008.

Funding for the new home is still being sought. Some sources of funding have already been agreed, subject to conditions, and other potential sources have been identified. One source of funding is the already committed sale of the site of the existing home, which is situated on the coast in a popular holiday area. The Trust is due to receive £1m (net) from this sale. The Trust hopes to receive external funding for the balance of the capital cost. However, the trustees have indicated that they will be willing, if necessary, to use the Trust's reserves to fund any shortfall and to cover differences in the timing of payments and receipts in respect of the project.

The Chief Executive would like reassurance about the implications of the project for the Trust and asks the candidate to look at the funding and cashflow and the relevant risks.

A particular concern is whether the use of the Trust's reserves for this project might cause it to breach the Charities Board's Code of Practice on reserves, and its own policy. The Code of Practice recommends that charities providing care services should normally maintain reserves of at least 40% of annual revenue expenditure. The Code is not statutory, but charities that do not comply may find that public sector funding is called into question and that they are restricted in the activities that they can undertake. The Trust's own target is to achieve a minimum reserve of 45% of annual revenue expenditure to provide a margin of safety.

The Chief Executive is also concerned to know whether the Trust will need an overdraft facility during the construction period.

The candidate is asked to prepare a report to the trustees including the following items:

- Brief background on the current situation, including the consequences of not replacing the existing home.
- An outline of the proposed replacement, including costs and funding, together with an explanation for Trustees of the differences between cash flow forecasts and income and expenditure forecasts.
- A cash flow forecast for the proposed replacement home, showing both capital payments and receipts, on a quarterly basis for 2007/08 and 2008/09.
- A budget forecast for the Trust for the years 2006 - 07 through to 2010 - 11, taking into account the amounts that would be required from reserves to fund the proposed replacement home.
- Preparation of a quarterly cash flow forecast for the Trust as a whole for 2007-08 and 2008-09, incorporating the cash flow of the holiday home project.
- A critical evaluation of all the results, including:
 - Analysis of the main risks and their potential impact and acceptability;
 - The candidate's assessment as to whether or not the Trust should arrange an overdraft facility during construction of the replacement home.
- The candidate's conclusions and a recommendation as to whether the Trust should go ahead with the home replacement project together with recommendations for any further action that may be appropriate.

Good candidates may note that the Director of Operations and her staff are completely ignored in all communications regarding the holiday home replacement.

Question 4 (22%)

The Director of Appeals has queried the recharge of central costs to his department, arguing that he has no control over these costs and that part of his department's costs should themselves be recharged to shops as his department's activities contribute to generating income for the shops.

The Director of Appeals has also suggested to the Chief Executive that CFCT should sell Christmas cards in its shops. The Trust already sells Christmas cards using a catalogue, but does not sell cards in its shops. The Director of Appeals believes that the Trust is missing out on a lucrative source of income by not selling cards in this way and has put forward a proposal to obtain cards from Posh Cards Ltd, a firm that is already well known to him.

The candidate receives an instruction from the Chief Executive, to reply to the Director (with copy to the Chief Executive) covering the following points:

Recharges:

- A note of the recharges to the Appeals function, the basis for these recharges, and an explanation of the reasons for making them;
- The candidate's comments on the suggestion by the Director of Appeals, that a proportion of the costs of the Appeals Department should be recharged to shops.

Christmas Cards:

- A validity check on the figures provided by the Director of Appeals, using his sales forecasts;
- For comparison purposes using information from the National Charity Shops Benchmarking Survey:
 - An estimate of the potential income and profit from sales of cards purchased from Posh Cards;
 - A calculation of the profit if 10% of the cards purchased were unsold;
- An evaluation of the proposals made by the Director of Appeals in the light of the candidate's results and setting out any other issues relevant to selling Christmas cards in this way;
- The candidate's recommendation as to whether or not the Trust should place an order with Posh Cards Ltd. for cards to be sold in the period before Christmas 2007.

Given that the candidate will need to reject many of the Director's proposals, and advise him that his figures on the Christmas cards proposal are incorrect, exceptional tact and diplomacy will need to be shown in framing the reply.

3. Question 1 (20%)

Aims

- (a) To test candidates' understanding of the issues raised in the confidential memoranda of 29 November from the Chief Executive, with attached copy of Lady Bank's letter to the Chair, Karen Larich.
- (b) To test candidates' ability under severe time pressure to recognise and analyse the facts and figures relevant to the issues raised;
- (c) To test candidates' skill in presenting this information in a clear, concise, relevant and tactful briefing note format for the Chief Executive.

Assessment

(a) Tay Shop

Compare the performance of the Tay shop, against the average for our shops as a whole, and against the Clyde shop in particular. Look at the level of volunteer input and also the financial results. For the financial comparison, use the 2005/06 outturn data, taking out the costs of, and income from, the collector. Focus especially on sales and profit and use rent as a proxy for size of shop.

(4): C – 3, A - 1

- The Tay shop had the lowest level of gross sales for any of the shops at £35,212. It was recorded as making a loss (£762), representing 2.2% of sales value;
- Two other shops also recorded a loss. However, one of them (Clyde) shows a profit of £6,369 (14.9% of sales), once the collector has been charged with his share of the premises costs at Clyde;
- The average level of sales for the seven other shops is £51,990, and their average level of profit is £14,254 (27.4% of sales);
- However, the loss at Tay was calculated after charging central costs of £5,000;
- The shop therefore made a contribution of £4,238 to the Trust's fixed costs i.e. central costs;
- Thus, if the Tay shop had been closed the Trust's overall surplus would have been reduced by £4,238 unless subsequent reductions in central costs were achieved;
- Using rent as a proxy, figures showing sales per £1 rent and profit per £1 rent can be calculated as shown in Appendix A. These comparisons are again unfavourable to Tay;
- However, candidates should not jump to the conclusion that these poor figures are necessarily the consequence of poor performance by Mrs Struther. Factors such as the location of the shop and the retail sales climate in Tay could have equal or greater importance;

P8

App A

- A comparison of volunteer input at the shops shows that the Tay shop attracts 28% fewer volunteer hours than the average for all shops. This provides strong support to the comments made by Dan Fermline and Lady Bank, but there could again be other factors apart from Mrs Struther that are affecting volunteer recruitment at Tay.

App A

Note For suggested calculations see Appendix A, but note comments in 1(e) above.

(b) Handbag and related performance issues – Mrs Struther

Whilst Lady Bank is eager for the matter to be passed to the police, the options are clearly broader than this for example:

- Reference to the police
- Dismissal
- Disciplinary action
- No action – we have plenty of other issues to tackle if the Tay shop problems can be shown to be immaterial.

Please let me have your views on the specific “handbag” allegation; any wider concerns about Mrs Struther’s performance from both a financial and management perspective; your view on each of the options I have identified above; and your recommendation as to the course of action we should take in respect of Mrs Struther.

(b 1) Possible theft of Handbag

(2): A – 2

- Lady Bank has seen an expensive handbag, donated to the Tay shop in a second-hand shop and has suggested that the shop manager (Mrs Struther) has been selling donated goods for her own profit;
- A note that Lady Bank has no proof that the handbag that she saw was the same one. Unusual is not the same as unique;
- As no records are kept of individual items received, it is not possible to check independently of Mrs Struther what happened to Lady Bank’s handbag;
- A volunteer has told Dan Fermline that Mrs. Struther sometimes sells donated goods to second-hand shops if she does not expect to be able to sell them in the shop;
- The income from such sales appears to be paid into petty cash;
- Mrs. Struther has confirmed that income is received from selling goods in these circumstances, but has said that it is not recorded as income and no record is kept of the goods that are disposed of in this way;
- This is not in accordance with the Trust’s procedures;
- Dan Fermline has found that petty cash records are inadequate and that the petty cash account does not balance, there being a surplus of £90;

P32

- A note that goods that are not appropriate for sale at a shop should be transferred to the collector for sale on the internet or sale to rag collectors;
- In the circumstances there is no evidence to substantiate this allegation made by Lady Bank;
- However, procedures in respect of the treatment of donated goods and petty cash are not followed. This leaves the shop manager open to accusations of impropriety and leaves the Trust vulnerable to accusations that it fails to account properly for donations from the public.

P6

(b2) Treatment of Volunteers

(2): A – 2

- Lady Bank has further suggested that Mrs. Struther bullies the volunteers;
- Dan Fermline has noted that volunteers appear to be demoralised and unhappy;
- Dan Fermline has reported that no new volunteers have come forward for over a year. Those that stay appear to do so in spite of Mrs. Struther, apparently out of loyalty to the Trust. This supports the comments made by Lady Bank;
- Dan Fermline has noted that Mrs. Struther is formal and distant, insisting that volunteers call her “Mrs. Struther”;
- Dan Fermline has reported that Mrs. Struther is frequently critical of suggestions made by the volunteers, particularly in respect of arranging displays of goods on sale, and that she seems to be unaware of Trust procedures;
- A note that only one other shop has fewer volunteer hours per week;
- Therefore, there does appear to be some substance to Lady Bank’s accusation about Mrs. Struther’s treatment of volunteers.

P32

(b3) Running of the shop and financial records

(2): A – 2

- Lady Bank has also suggested that Mrs. Struther ignores Trust guidelines about the arrangement of stock in shops;
- Dan Fermline has confirmed that the guidelines issued by the Administration Manager do not appear to be being followed;
- Some customers appear to have difficulty in finding what they are looking for;
- A note that the guidelines are designed to maximise sales. Mrs. Struther’s failure to follow the guidelines could have contributed to the Tay shop’s poor sales record;
- Lady Bank suggests that Mrs. Struther does not keep proper financial records;

P32

- Dan Fermline has reported that petty cash and stock records are not properly kept and indeed that Mrs. Struther seemed completely unaware of the existence of the Trust's procedure manual;
- Mrs. Struther appears to have a hostile attitude to what she sees as unnecessary red tape;
- Mrs. Struther demonstrates a similar attitude to internal audit;
- Lady Bank's allegation appears to have some justification.

P32

(b4) Options for action:**(2): A – 2***Reporting to the Police*

- There is no evidence of any criminal activity on the part of Mrs. Struther and it would not be appropriate to report the matter to the Police.

Dismissing Mrs. Struther

- There is evidence that Mrs. Struther is not keeping adequate records, that she is not following guidelines and procedures and that her management skills are poor. However, these are not grounds for dismissal.

Initiate disciplinary action

- In the absence of evidence of misconduct, the Trust cannot initiate disciplinary procedures without attempting to resolve any problems through other measures first.

Do nothing

- The problems at the shop cannot be resolved by doing nothing. The Trust must take positive action to deal with these problems.

(b5) Recommended course of action**(3): R - 3**

- There is no evidence to support the allegation of theft – there is evidence of poor management practices on the part of Mrs. Struther which may have damaged the shop's performance;
- Most of the problems at the shop can be resolved by ensuring that procedures are implemented properly and that the volunteers are managed in an appropriate way;
- A note that the Trust has a system of appraisal for employees including shop managers, but there is no evidence to show that anyone has previously expressed concern about the way in which Mrs. Struther runs the Tay shop;
- Accordingly, the first course of action should be to arrange a meeting between Mrs. Struther and the Administration Manager to allow him to raise these issues with her;
- No reference should be made to the specific allegations made by Lady Bank, but the Administration Manager should make it clear that he is unhappy with aspects of the way in which the shop is run;

P7

- In raising these issues, the Administration Manager should be specific about the issues and about how they can be resolved;
- This is a management issue, not a disciplinary one, so there is no need for Mrs. Struther to be invited to bring a representative from her trade union to the meeting;
- The Financial Services Officer should monitor the records supplied by the shop and there should be an internal audit visit within a specified period of time following the meeting;
- The Administration Manager should develop a training programme with Mrs. Struther to ensure that she is fully conversant with the Trust's requirements;
- The Administration Manager should ensure that there is a regular appraisal process to monitor Mrs Struther's progress and that of the shop. Mrs Struther should be given details of this process;
- The Administration Manager should assure Mrs. Struther that the Trust is prepared to offer her appropriate and reasonable support in resolving these issues;
- The Administration Officer should not raise the subject of disciplinary action at the initial meeting. Should she ask what would happen if these issues were not resolved, she should be advised that a capability or disciplinary hearing could become appropriate at a later stage;
- A note of the potential public relations problems if the Trust fails to resolve these problems in an appropriate way.

(c) Shop management

To help the Trust's Chair and me, some notes explaining:

- Any improvements we can make to the general management and audit arrangements for the shops to prevent a recurrence of this type of situation;
- The advantages and disadvantages of appointing an accounting firm to provide an independent internal audit function for the Trust as a whole.

(3): A – 3

Management and audit improvements

- Review Trust procedures and guidelines incorporating the publication of a supplementary handbook specifically designed to meet the needs of the shop managers;
- Review the Trust's risk management procedures and facilitate a full programme of audit visits;

P32

- Promote staff and volunteer development by:
 - Regular staff appraisals;
 - Training programmes;
 - Regular consultation;
 - Greater communication to spread best practice;
- Prepare and maintain monthly performance statements for the shops including:
 - Performance against budget;
 - Volunteer hours;
 - Any complaints received and their source;
- Take part in the National Charity Shops Benchmarking Survey;
- Investigate the time required for the Administration Manager to effectively manage the shops.

P14

P18

Advantages/disadvantages of appointing an outside firm to conduct internal audits

- Advantages:
 - Appointing an external firm should provide independence and objectivity. Using internal accountancy staff could lead to conflicts of interest i.e. self review;
 - Making such an appointment would ensure that internal audits were undertaken regularly and not missed because of pressure of work;
 - Outside auditors could bring to bear wider experience to the benefit of the Trust.
- Disadvantages:
 - Additional cost;
 - Auditors may take time to appreciate the detail of the Trust's operations;
 - Will the Trust's staff feel that they are not trusted? Therefore careful explanation will be necessary.

(d) Conclusions & recommendations, presentation, format, tact and general readability. **(2): P – 2**

4. Question 2 (30%)

Aims

- (a) To test the candidates' ability to locate, analyse and process financial and related data in the context of a report revising forecasts of income and expenditure for Trust shops and comparing financial performance with shops run by other charities, to analyse the results and make recommendations based on the analysis;
- (b) To test candidates' competence in drafting a report to the trustees of the charity.

Assessment

- (a) Brief background to the shops, the concerns about their performance, and the availability of benchmarking information.

(2): A – 2

- The purpose of the report is to address the concerns of the Chief Executive about the performance of the Trust's shops. This will involve producing the forecasts of income and expenditure for the year ending 31 March 2008 and comparing the resulting forecasts with information on forecasts made by other charities; P13
& 14
- A note of the number of shops; that they are all leased, with varying periods remaining until rent reviews, break options and the end of lease agreements; and that they are each staffed by a paid manager assisted by volunteers; P5
& 24
- A note that a collector is employed with a van for house-to-house collections, and disposing of any items not suitable for sale in the shops either to rag collectors or (in the case of valuable items) via the internet; P5
& 6
- When preparing the forecast, a recharge is necessary to the collector for a proportion (45%) of the premises costs of the Clyde shop, where the collector is based. The net costs of the collector (including the Clyde recharge) are then to be recharged to shops pro rata to sales as the collector is providing a service to them; P13
&19
- A note of the existence of the annual national survey of charity shops and the potential to use this information for performance comparisons (benchmarking); P13,
14
& 15
- CFCT does not currently participate in the survey, but intends to do so from the following year;
- Limited information has been obtained from the National Benchmarking Survey of forecasts for the year ending 31 March 2008, which can be used to make some comparisons with CFCT shops; P13,
14
& 15
- In addition, the survey co-ordinator has made available statistical information relating to other charity shops in the Firth Region, which can be used as the basis for further comparative analysis of sales and profit. P30

- The full results of the survey, only available to participating charities would allow better comparisons to be made, using charities that most closely resemble CFCT.

(b) An income and expenditure forecast for each shop and in total for the year ending 31 March 2008. **(5): C – 5**

- The forecast for gross sales is £428,000, plus cash donations of £12,690;
- The forecast for gross expenditure is £332,050 (£308,050 plus £24,000 for central costs);
- The forecast profit (including donations) is £108,640;
- The forecast profit (excluding donations) is £95,950, which is 22.42% of sales excluding donations.

App B1

Note For suggested calculations see Appendix B1, but note comments in 1(e) above.

(c) A critical evaluation of the results in the light of the Chief Executive's concerns about the profitability of the shops. **(3): C – 1, A – 2**

- Seven of the eight shops are forecast to make a profit. The Forth shop is the only one anticipated to make a loss, but it should still make a contribution to central costs;
- The Clyde shop is forecast to be profitable now that the collector's premises costs are properly recharged;
- On the basis of the forecast all shops make a contribution to central costs, therefore in the short term all shops should remain open;
- Four shops, Cromarty, Moray, Pentland and Solway provide 84% of the profit earned by the shops.

App B1

Note For suggested calculations see Appendix B1, but note comments in 1(e) above.

(d) A detailed comparison of the forecast average performance of the Trust's shops against the forecast performance of the shops in the National Charity Shops Benchmarking Survey. This comparison is to take into account all of the information (except about Christmas cards) that you are able to gather regarding the National Charity Shops Benchmarking Survey and should include:

- A critical evaluation of the results of the comparison;
- A calculation of the total profit that the Trust's shops would be expected to earn in 2007/8 if their profit as a percentage of sales

was at the same level as for the shops in the National Charity Shops Benchmarking Survey;

- If sufficient information becomes available, an appropriate statistical analysis (Student's t test) of comparative sales and profit forecasts;
- A brief explanation of any limitations applicable to the statistical analysis.

(13): C – 8;A - 5

- A note of the comparable figures and comments thereon as set out in Appendix B2.
- The calculation of the total profit that the Trust's shops would be expected to earn in 2007/8, if their profit as a percentage of sales was at the same level as for the shops in the National Benchmarking Survey, shows that the forecast profit would be £124,120. This is £28,170 greater than the profit of £95,950 resulting from the forecast based on the Trust's own figures;
- Credit should be given for candidates who adopt an alternative approach – i.e. $£308 \times 51 \text{ weeks} \times 8 \text{ shops} = £125,664$;
- A note of the results of the Student's t analysis, as set out in Appendix B3. Candidates should demonstrate from the information provided that there is no significant difference in the levels of sales between the Trust's shops and the other shops in the region, but (based on their own calculations) that the profits from the trust's shops are significantly lower;
- Comparison with the benchmarking information suggests that the Trust's shops cost significantly more to run than the shops of the charities in the benchmarking survey;
- The difference is more than accounted for by the higher than average salaries that the Trust pays to its shop managers and the higher than average rents that it pays for its shops;
- Sales and rents are dependent upon local market conditions, size condition and location;
- A note that the benchmarking information does not provide information about the size of shops and so it is not clear if the Trust is paying more per square metre or is leasing shops that are larger than the average shop included in the survey. The Trust could be paying more per square metre because rents are higher in the Firth Region than elsewhere in Endowland. If the Trust is leasing larger shops, it could see sales fall if it tries to move to smaller premises;
- Other areas where significant costs are incurred are premises costs other than rent, other running costs, central support costs and the costs of collecting donated goods. The survey information supplied did not

App B2
&
App B3

App B2

P5
& 24

allow any comparison in these areas, but this may be possible next year when the Trust will be participating in the survey;

- There is no information about shop opening hours. The shops in the National Benchmarking Survey may have significantly different opening hours;
- A comment that comparison with the benchmarking information suggests that sales in Trust's shops are not far behind those in the survey but that costs are significantly higher and profitability correspondingly lower, so there is room for improvement;
- Additional reasoned comparisons should be given credit;
- Limitations of Student's t distribution might include
 - Small samples therefore estimate of population standard deviation made which results in greater uncertainty
 - The smaller the sample the less like the normal distribution it becomes resulting in a wider interval than the normal distribution
 - Only gives 95% confidence - i.e. not 100% certain
 - Samples must be unbiased

Note For suggested calculations see Appendix B1, B2 and B3 but note comments in 1(e) above.

- (e) Conclusions and recommendations as to a) whether any of the shops should be closed immediately and b) the longer term strategy for dealing with the less profitable shops.

(4) A- 2, R -2

Immediate closure

- Only one of the shops (Forth) is forecast to make a loss, whilst another (Tay) could prove to be only marginally profitable, but they are all expected to make a contribution to central costs; App B1
- There may be performance issues similar to those apparent at the Tay shop. Tackling these problems could improve profitability;
- The National Benchmarking Survey comparison shows that on average the Trust's shops generate smaller profits from similar levels of income. This suggests that the average costs of the Trust's shops are higher than those of other charities; App B2
- All of these shops are leased and if the shops were closed the Trust would still have to pay rent until the end of the leases or the next break clause unless the lease could be assigned. It would only be appropriate to close a shop if it was making a loss greater than its rent. P5
& 24

This is not the case for any Trust shops and closing any of them before the end of the lease of the next break clause would not be appropriate;

- Therefore there is no case for the immediate closure of any of the shops.

Longer term

- It would be appropriate to review the future of each shop as it approaches the end of its lease, or a break clause, with a view to considering whether it should be closed or kept open. The contribution that the shop makes to central costs would also be relevant;
- A note that the Tay shop is the only poorly performing shop with a high probability of being sub-let if no longer needed by the Trust;
- In making its assessment the Trust should consider the likely long-term profitability of the shop (e.g. if it is in an area that is in decline) and the sensitivity of these forecasts;
- For the purposes of this exercise, the Trust should also assess the extent to which the rechargeable costs (collection and central costs) are fixed or variable. If a significant proportion of these costs are fixed, it may wish to consider keeping a shop open that is only marginally profitable because of the contribution that it makes to offsetting the fixed costs associated with the Trust's shops;
- The Trust might have to make shop managers redundant, and incur redundancy costs, if their shop closes, and this should be taken into account in making a decision;
- In determining the future of individual shops, the Trust should also consider whether there are any alternative premises available that might be more profitable. This should be something considered whenever opportunities arise, and the Trust might consider leasing premises in advance of when they are needed if this is seen as desirable in the long term;
- Closing shops might cause ill feeling among volunteers and poor publicity for the Trust. In the event that the Trust decides to close a shop, it will need to manage the closure sensitively. Failure to do so could damage the Trust's image;
- A recommendation that the future of each shop should be reviewed whenever alternative premises are identified and towards the end of their lease or in advance of their next break clause.

P24

(f) Presentation, format, tact and general readability.

(3): P – 3.

Question 3 (28%)

Aims

- (a) To test the candidates' ability to locate, analyse and process financial and related data in the context of a report to trustees on the implications of a major capital project for the Trust's reserves and cashflow, including a cashflow forecast for the project, a budget forecast for the Trust for the next four years, a cashflow forecast for the Trust and comments on the results;
- (b) To test candidates' competence in drafting a report to the trustees of the charity.

Assessment

- (a) Brief background of the current situation, including the consequences of not replacing the existing home.

(2): A – 2,

- A description of the purpose of the report and its contents;
- A summary of the situation in respect of the current home and of the need to cease to use the building by 1st April 2010;
- A note of the consequences for services and clients of not replacing the home;
 - Need to plan service provision if the home is no longer in use;
- A note of the restrictions on the use of the income from the sale of the land used by the existing home;
- Sale of land already committed - net proceeds should be £1.0 m;
- If the home is not replaced, the sale proceeds must be given back to original land provider or her heirs;
- A note of the need to make a decision before the end of 2006;
- Project must avoid disruption during the busiest holiday period;
- Must have any replacement operational by April 2010;
- A note of the feasibility study, including its funding, and the preferred option identified by the study;
- The only option under consideration is to replace the home. If there is no replacement, the Trust would have to close the home and return the land proceeds to the original provider or his heirs.

P6 & P12

P6 & P16

P6 & 12

P12 & 26

P6 & 12

- (b) An outline of the proposed replacement, including costs and funding, together with an explanation for Trustees of the differences between cash flow forecasts and income and expenditure forecasts.

(3) A - 3

- A note of the estimated cost and the anticipated sources of funding that have already been agreed;
- There is a gap between the cost and the anticipated funding, and some of the anticipated funding is not yet certain;
- A note that the Trust is continuing to seek additional sources of funding;
- A note that the Trust would have to use some of its reserves to meet the gap between the cost and external funding;
- A note of the level of reserves required by the Charities Board's Code of Practice on charity reserves and the reasons for this requirement;
- A reminder of the Trust's own policy on reserves and reason for this policy;
- A note that the Trust does not currently comply with its own policy;
 - Budgeted expenditure £2,398,000 – Reserves £1,016,000 which is 42.37%;
- A note that the Trust will also have to use its reserves to provide working capital for the project as the profiles of income and expenditure are different;
- Advice to the trustees that:
 - Cash flow forecasts show expected receipts and payments over a period of time (both capital and revenue), so that future cash balances and borrowing requirements can be projected.
 - Income and expenditure forecasts take account of all revenue income and expenditure relating to the period under review, whether or not the relevant receipts or payments occur within that period. They exclude capital items but include non-cash items such as depreciation, thus enabling an estimate to be provided of the anticipated surplus or deficit that the organisation can expect for the period.

P6, 16,
20, 26,
28, 31,
App C1

P6 &
16

P4

P9

P17

- (c) A cash flow forecast for the proposed replacement, showing both receipts and payments, on a quarterly basis for 2007/08 and 2008/09.

(3): C – 3

- The forecast is shown at Appendix C1

App C1

Note For suggested calculations see Appendix C1, but note comments in 1(e) above.

- (d) A budget forecast for the Trust for the years 2006-07 through to 2010 - 11, taking into account the amounts that would be required from reserves to fund the proposed replacement holiday home.

(4): C – 4

App C2

- The forecast is shown at Appendix C2

Note For suggested calculations see Appendix C2, but note comments in 1(e) above.

- (e) Preparation of a quarterly cash flow forecast for the Trust as a whole for 2007-08 and 2008-09, including the cash flow of the holiday home project.

(4): C – 4

- The cash flow forecast uses typical profiles for expenditure and income for the Trust, derived from an analysis of previous years' expenditure and income patterns;
- The cashflows need to exclude depreciation as a non-cash item and include the other items of capital expenditure as well as the net cashflow on the holiday home project;
- The profiles take account of the fact that some of the Trust's expenditure is paid in arrears and this means that some of the expenditure accounted for in a year is not actually paid until the future year. As a result, the Trust's cash balance at the start of the year is greater than its reserves;

App C3

Note For suggested calculations see Appendix C3, but note comments in 1(e) above.

- (f) A critical evaluation of all of the results, including:
- Analysis of the main risks and their potential impact and acceptability;
 - The candidate's assessment as to whether or not the Trust should arrange an overdraft facility during construction of the proposed replacement home.

(8): C – 2; A – 5; R – 1

- The estimates indicate that, allowing for all of the expected capital receipts, the replacement home project will require the use of £212,000 of the Trust's reserves in total, but with £577,000 needed in 2007/8;
- The budget projection shows the reserves ratio falling to 22.14% for 2007/08 because of the need to use reserves to fund the replacement home project, well below the normal 40% requirement set out in the Charities Board's Code of Practice;

App C1
&
App C2

- The reserves ratio would recover to 39.62% for 2008/09 (still below the Code of Practice threshold) and then to 42.71% for 2009/10 and 45.73% for 2010/11.
- The Trust would thus fail to achieve the 40% level of reserves recommended in the Code of Practice in 2007-08 and 2008-09, but should exceed this level by 2009-10;
- The Trust is allowed to reduce reserves below the 40% level in order to provide short-term funding for capital projects, and it could show that this would only be a short-term reduction and that following completion of the project, it should be able to comply with the Code
- The Trust could also see its own policy target for reserves (45% of revenue expenditure) being met by 2010/11.
- Appendix C3 indicates that the Trust's cash balances would fall to very low levels in 2008/09 (below £100,000 at two points), which would give a very small margin of solvency in the event of any of the assumptions proving too optimistic.

P4,
App C2
&
App C3

Risks:

- Construction programme - the construction programme for the new home could be delayed leading to difficulty in maintaining a continuous service. However, the intended programme should provide a margin of over one year between the intended completion date of the new home (end of 2008) and the date by which the Trust must cease to use the current home (31st March 2010).
- Capital expenditure – the cost estimates for the new home could prove inaccurate with additional costs being incurred – however a 10% contingency margin has been built in to the construction estimates in accordance with the architect's advice.
- Capital receipts
 - The additional capital contributions for the new home might not materialise or could be delayed. The amount of the Firth Social Care contribution is linked to the total of the other contributions, so any shortfall in those contributions could also reduce the Firth grant.
 - As a significant proportion of the intended funding is affected by the above considerations, this risk must be regarded as serious.
 - Appendix C4 shows the figures as recast in the event that only the currently assured elements of funding were received. **Candidates are not expected to present this information in the detail shown in Appendix C4, but they should provide at least a summary of the position in which the Trust would find itself, should this risk materialise.**
 - The assured elements of funding shown in Appendix C4 would amount to £352,000 less than the total funding projected in

P16
&
P31

P26

P20

App C4

Appendix C1 (i.e. £300,000 less in voluntary grants and £52,000 less in the contribution from Firth Social Care).

- If the additional elements were not secured, use of reserves would increase to £564,000.
 - The Trust would not then be able to comply with the Code of Practice on reserves (or with its own policy on reserves) during the period under review, thus leaving itself open to the consequences of non-compliance.
 - The Trust would also find itself requiring a substantial overdraft (in excess of £200,000) for most of 2008/09.
- Legacy income - this is stated to be irregular and variable. Legacies may therefore not meet expectations – this source of income represents £0.5 million over the two years when the capital expenditure will be incurred. Although this risk is one faced by the Trust in each financial year, it will become more serious at a time when the replacement home project has put the Trust's finances under greater pressure.
 - Interest - the interest calculation assumes a reasonably constant level of reserves. This is no longer the case. The interest calculation methodology is therefore suspect and the amount of income from this source is overstated for 2008-09. However, the amounts involved do not add significantly to other risks.
 - Compliance - any significant adverse variance from the anticipated outcome could lead to failure to comply with the Code of Practice. Non-compliance with the Code could result in public sector funding being put in question (e.g. in the case of the Trust, Firth Region social care contributions) and restrictions being placed on the activities an organisation can undertake. In addition there could be adverse publicity and damage to the Trust's reputation.

App
C4

P25

P25
&
App
C2

P4
&
P9

Overdraft facility:

- The forecast at Appendix C3 indicates that the Trust will not necessarily need an overdraft facility during the construction of the new holiday home. However, the Trust's cash balances will fall significantly in 2008-09. In view of the potential for variation in the estimated cash flows it would be prudent for the Trust to set up an overdraft facility to be drawn upon should this be necessary in 2008-09;
- The Trust should therefore negotiate an overdraft facility.

App
C3
&
App
C4

Note For suggested calculations see Appendix C4, but note comments in 1(e) above.

- (g) Conclusions and recommendation as to whether the Trust should go ahead with the home replacement project, together with recommendations for any further action that may be appropriate.

(2): R – 2.

- On the basis of the forecast, the Trust can afford to replace the home;
- It can do so whilst complying with the Charities Board Code of Practice and its own policy on reserves in the longer term;
- However, there are significant risks attaching to the project and the margin of safety is small;
- Appeals and fundraising efforts need to be intensified to reduce the risk of funding shortfall;
- Candidates may wish to question (tactfully) whether it is in fact too late for any other options to be considered given that the current home could be retained in use until March 2010, e.g. purchasing another existing building for conversion, or reducing the size and cost of the proposed replacement home.
- Whether the risks are deemed to be acceptable is a matter of judgement for candidates and either determination is acceptable providing it is well argued.

- (h) Presentation, format, tact and general readability.

(2): P – 2

6. Question 4 (22%)

Aims

- (a) To test candidates' understanding of the issues raised in the Chief Executive's memorandum of 29th November 2006 reflecting the requests made by the Director of Appeals in his memoranda of 23rd and 24th November;

Assessment

Recharges:

- (a) A note of the recharges to the Appeals function, the basis for these recharges, and an explanation of the reasons for making them;

(3) C -1, A - 2

- Recharges are not made to the Appeals Department but to the Appeals function; P3
- A note that the recharges to the Appeals function total £52,850 in 2006/07 as part of total central costs of £254,500; P21
- The recharges to the Appeals function represent 31.6% of the total costs of that function; App D1
- Therefore the recharges do not form the bulk of the cost of the function despite the comment made by the Director of Appeals; P27
- The recharges are made from the Chief Executive's Department and represent the costs incurred by that department because of specific activities of the other functions including the shops; P21
- The Trust is required to recharge costs in this way under the provisions of the Statement of Required Practice for Charities; P3
- The recharges allow the true costs of activities to be identified and reported; P3
- The recharges are all based on records of staff time, using information taken from staff time-sheets; P22
- This allows the Chief Executive and the trustees to assess the contribution that each function makes to the work of the Trust;
- Whilst it is true that the majority of funding for Trust activities is generated by the Appeals function, generating these funds is the main purpose of the Appeals function and so the costs should remain a charge to that function.

Note For suggested calculations see Appendix D1, but note comments in 1(e) above.

(b) Your comments on the suggestion, in the Director of Appeals' memorandum of 23rd November, that a proportion of the costs of the Appeals Department should be recharged to shops. **(3) C -1, A-2**

- the view expressed by the Administration Manager is that there is no evidence that shops benefit significantly from the public awareness generated by the Appeals Department. In some cases the Appeals Department has apparently refused to mention shops in publicity material for appeals; P18
- Shops are recognised as already playing an important role in raising awareness of the Trust and its activities; P5
- Shop managers and volunteers actually spend around 7.5% of their time running fund-raising activities organised by the Appeals Department; P18
- This equates to around 4,229 hours per year of work for which no recharge is made; App D1
- The cost of the time of shop managers in undertaking fund-raising activities is around £9,000 a year;
- A conclusion that recharging a proportion of the costs of the Appeals Department to shops is inappropriate and should not be done.

Note For suggested calculations see Appendix D1, but note comments in 1(e) above.

Christmas Cards:

(c) A validity check on the figures provided by the Director of Appeals in his memorandum of 24th November, using his sales forecasts; **(3) C - 3**

- The Director of Appeals' profit figure of £8,560 is based on his forecast of the total amount of income (£40,000); P28
&
App D2
- The Director's calculation of profit is flawed, because he has misunderstood the pricing schedule and ignored interest costs (and possible surcharge for payment on delivery); P18&
29
- Interest costs would be incurred by paying with the order by 31 March even if every card were sold by Christmas and should be calculated using the mid point of 1st December for sales; P29 &
App
D2
- Accepting the 1.5% surcharge for payment on delivery reduces the overall cost, but interest costs would still be incurred during the period from delivery to sale; App D2
- If the Director had used the correct pricing schedule – his profit would be £3,238 after surcharge and interest costs.

Note For suggested calculations see Appendix D2, but note comments in 1(e) above.

(d) For comparison purposes using information from the National Charity Shops Benchmarking Survey and a sale price of £1.25 per pack:

- An estimate of the potential income and profit from sales of Christmas cards purchased from Posh Cards;
- A calculation of the profit if 10% of the cards purchased were unsold.

(4): C - 4

- The sales projection calculated based on the National Benchmarking Survey information is £31,725, which is £8,275 less than the Director of Appeals estimate;
- The profit calculated on this basis is £1,953 after interest and surcharge costs (as compared to the Director's original and corrected figures shown in (c) above);
- It should be noted that there will also be some loss of income from card sales by catalogue – the evidence that this may prove to be a minor factor is anecdotal only;
- As cards are paid for when ordered or when delivered, the costs would not be reduced if sales were 10% less than expected;
- If sales were 10% less than estimated the Trust would actually make a loss of £1,219 after interest and surcharge costs;
- Cards unsold at Christmas would probably have to be written off.

App D3

P18

P29

App D3

P18

Note For suggested calculations see Appendix D3, but note comments in 1(e) above.

(e) An evaluation of the proposals made by the Director of Appeals in the light of the candidate's results and setting out any other issues relevant to selling Christmas cards in this way.

(5) A - 5

- The Director of Appeals' estimates are incorrect;
- Interest costs are incurred by purchasing cards in advance, with a surcharge being payable if payment on delivery is chosen;
- Once the correct figures are taken into account (including interest and surcharge costs) the profitability becomes marginal;
- There is a clear risk of loss if sales fall by only 10% below the sales level derived from the national benchmarking comparison;
- There is considerable uncertainty about the level of sales that the Trust might achieve, and even if it did achieve the estimated level of sales the profits would be relatively small;
- There are no restrictions to stop the Trust selling cards through its shops in addition to selling through catalogues;
- Evidence from other charities suggests that careful planning is needed to maximise sales of cards, and that without this sales may fail to reach the benchmarking figure;

P18

- The risk of failing to meet the estimated level of sales is greater for the Trust because it has no previous experience on which to base its plans for card sales; P18
 - The card company's pricing structure requires high turnover levels to be profitable – which is more suited to national charities; P28
 - The Director of Appeals' experience was with a national charity and may therefore not be directly comparable; P18
 - Experience from other charities, and consultation with administration staff and shop managers suggests that there would be considerable work involved in managing sales of cards, principally due to stock control issues and the need to arrange displays of cards in shops; P18
 - One key issue highlighted by other charities is the need to choose the designs used on cards carefully to ensure that they are attractive to customers; P18
 - Other charities have experience of choosing the correct designs – there is a high risk that the Trust might not choose the right designs – leaving it with excess cards; P18
 - Designs need to be changed annually (sales fall sharply if the same design is chosen for the following year). Consequently, left over stock is unlikely to sell in the following year and usually has to be written-off; P1 & 28
 - A note that quotations should be sought from other card companies. This is likely to be required in order to comply with the Trust's procedure manual. (Candidates may think it best not to refer to the Director's personal relationship with the MD of Posh Cards in this memo). P1 & 28
- (f)** Your recommendation as to whether or not the Trust should place an order with Posh Cards Ltd for cards to be sold in the period before Christmas 2007. **(1) R - 1**
- Recommendations: P29
 - That the Trust does not order cards from Posh Cards at present, as a decision does not have to be made before 31 March.
 - That alternative sources of cards be investigated that might be more geared to the potential level of sales.
- (g)** Presentation, format, tact and general readability. **(3): P –3.**
- The candidate is replying to a senior member of the Trust's staff rejecting his proposals and indicating that his figures are incorrect. This response therefore requires particular tact.
 - Candidates should also take into account that Kirk Caldys' comments on page 18 of the case may themselves not be 100% reliable.