

FINANCIAL MANAGEMENT, SYSTEMS AND TECHNIQUES

Certificate stage examination
9 December 2004

From 2.00 pm to 5.00 pm
plus ten minutes reading time from 1.50 pm to 2.00 pm

Instructions to candidates

Answer **six** questions: You must answer the **two** compulsory questions contained in **Section A**, plus any **four** questions from **Section B**.

All workings must 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 examination room.

Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.



Section A (Answer both questions)**1**

Over the past thirty years business organisations have become increasingly reliant upon the use of computer networks as a basis for their information systems. During this time the technology used in computer networks has been the subject of significant development and change, particularly in relation to network architecture and the hardware and software components of the systems. Client/server architecture is now being replaced by networks based upon Internet protocol (IP) and application service providers (ASP).

- **Requirement for question 1**

- (a) Explain what a computer network is and define the terms local area network (LAN) and wide-area network (WAN). 3
 - (b) What are the main business benefits of networks? Provide examples of these benefits drawn from an organisation or a sector known to you. 8
 - (c) Explain what is meant by the terms client/server architecture, Internet protocol and application service provider. 6
 - (d) What advantages should accrue from the use of this newer technology? 3
- (20)**
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2

BCD Ltd is a medium sized manufacturer of specialised medical equipment whose customers are, largely, organisations within the NHS. The company is making a reasonable profit and a return on capital comparable to other firms in the sector. The management of the company has, however, become increasingly concerned over its liquidity position and believes that this may be due to poor working capital management practices and an over conservative approach to working capital management policy.

The following information has been extracted from the accounts for the year ended 31 December 2004.

	£
Sales	3,100,000
Cost of goods sold	2,450,000
Materials purchases	1,900,000
Creditors	260,000
Debtors	390,000
Cash	25,000
Inventory – work in progress	245,000
Inventory – finished goods	230,000
Inventory – raw materials	190,000

You are the management accountant for the firm. You have received an email from the Managing Director:

“I need your help urgently. At this morning’s management meeting we had a discussion about working capital but we didn’t get very far as Fred (the Finance Director) is still away and we probably need some guidance. I think we need to shorten our working capital cycle but I want to be sure of what we are doing, and I also need to know what the latest position is following our year end.

Can you draft me a note. Explain fully what the working capital cycle is – a diagram might help. How do we measure it? And what about liquidity – can you give me some figures on that too? While you’re on could you give me your best thoughts on what we might do to improve things. A couple of suggestions would be good.

Sorry to drop this on you. Later this pm would be great.”

• **Requirement for question 2**

Draft a note to the Managing Director providing a briefing which:

- | | |
|---|---|
| (a) Explains what is meant by the working capital cycle with the aid of a suitable diagram. | 6 |
| (b) Calculates appropriate ratios that will quantify the firm’s working capital cycle. | 6 |
| (c) Explains and calculates liquidity ratios. | 3 |
| (d) Comments upon the firm’s current position and makes two suggestions for improvement. | 5 |

(20)

Section B (Answer 4 questions only)

3 The cleaning services for the administrative headquarters of Westerdale Council have been contracted out for some years following compulsory competitive tendering. The existing contract has proven to be unsatisfactory and much of the blame has focused on the procedures used at the time of awarding the contract and, in particular, the poor quality of the contract specification.

The headquarters are based in one building built in the 1970s. It is four stories high with access through stairs and lifts. There is a mixture of office space, much of it open plan; committee rooms and the Council Chamber; and public open space around the two reception areas. The building has the usual amenities: toilets, kitchen areas where hot drinks may be made and a space set aside for smokers. There have been disputes with the current contractors over frequency and quality of cleaning, and a failure to clean some areas at all.

The Finance Department is represented on an officer group which has responsibility for the operation of contracts. Until recently the Council employed a contract manager to oversee all contracts but the post has been made redundant due to internal reorganisation.

The current cleaning contract has now lapsed although the contractors are continuing to provide a service on a temporary negotiated basis. The Council is anxious to let the contract as soon as possible. As Finance Department representative the officer committee is looking to you for guidance.

- **Requirement of question 3**

Present a brief report to go to the next meeting of the officer committee. It should include:

- (a) The main generic areas that should be covered in a contract specification. 5
- (b) Discussion of how the above should be applied to a cleaning contract and an indication of how the problems reported in the current contract may be avoided. 10

(15)

4

Southcastle Hospital is a large acute city centre hospital which provides a range of commercial services for the benefit of patients and visitors and in order to generate income for health service funds.

Until recently there was a banking facility on site but the Trust has decided to discontinue this service following a failure to negotiate suitable terms with the current bank. The suggestion has now been made that the Trust installs its own cash point (ATM) facilities. This would be subject to demonstrating a satisfactory financial return.

Some research has been carried out into this proposal, which is for two ATMs, and the following data is available:

1. The machines can be purchased at a cost of £4,495 per machine.
2. There will be a charge to customers of £0.75p per transaction.
3. The capacity of the machines is £10,000 and it is estimated that they will need to be restocked twice a week.
4. Securit Ltd has indicated that they would collect cash from the Trust's bank, restock the machines and account for unspent balances for a charge of £85 for each re - stocking.
5. Other costs including phone line rental, paper rolls and insurance should amount to £1,300 per year per machine.
6. The current bank has been unco-operative in providing activity data but market research and consultation with other Trusts suggest that it would be reasonable to expect there to be an average of 350 transactions per week.

Appraisal should be carried out using a discount rate of 4.0%.

- **Requirement for question 4**

Using the data provided:

- | | |
|--|---|
| (a) Calculate the Net Present Value over five years of the proposal to install two ATMs. | 6 |
| (b) Determine the Internal rate of return for the proposal. | 4 |
| (c) Comment upon the results of your calculations and suggest other factors which should be taken into account before reaching a decision. What are the relative merits of the NPV and IRR approaches? | 5 |

(15)

5

Treasury management has long been recognised as an important aspect of local authority financial management and more recently has become significant in other areas of the public sector, as a wider range of organisations have been given responsibility for their own cash management. CIPFA has been extremely proactive in promoting high standards of professional practice and CIPFA has published two documents, the *Standard of Professional Practice on Treasury Management* (1995), and the *Code of Practice* (2001).

- **Requirement for question 5**

- (a) Define treasury management and describe the four main activities that constitute it. 5
- (b) Why was it felt necessary by CIPFA to issue a revised Code of Practice in 2001? 2
- (c) A key recommendation of CIPFA is that public sector organisations should write four clauses into their standing orders, financial regulations or equivalent policy documents. What is the content of these four clauses? Explain how this recommendation has been or could be implemented in an organisation known to you. 8

(15)

6 Edmond District Council has received comments on its approach to risk management as part of the Annual Letter issued following the Audit and Inspection for 2004. The comments are as follows:

“The Council has corporate governance arrangements that include many good practice features. Your approach to managing risk is, however, largely informal. The absence of a strategy and formal approach to risk management hinders your ability to demonstrate all risks are being identified, managed and minimised by appropriate action.”

You have been asked to investigate the possibility of developing a risk management strategy and to produce an initial report to be submitted to the Council’s Senior Management Team (SMT).

• **Requirement for question 6**

Draft a report, for the consideration of the SMT, on risk management strategy. Your report should cover:

- (a) The main purposes of a risk management strategy. 5
- (b) An outline of the typical contents of a risk management strategy with an indication of what are likely to be the most difficult tasks involved in the development of the strategy. 10

(15)

7 Westshire County Council is responsible for winter maintenance of roads. The current annual budget is £3.75m which is based upon the council's assessment of the requirements of an "average" winter. This base has been unchanged for at least ten years, the only adjustment being due to inflation year on year. Any monies, which are unspent, may be carried forward as a reserve and this reserve is then used in those years when the winter weather conditions are poor and the budget becomes overspent.

The current reserve stands at £1.9m as a result of a steady increase over a period of time. This now represents over half the annual budget and there is some concern that this level is too high and also that the budget itself has been set too high which will result in the reserve increasing in size even further.

Information on the past ten years is contained in the table below:

Year	Budget £m	Out-turn £m	Variance £m	RPI	Average daily temperature °C
1994/95	2.99	3.30	-0.31	100	5.50
1995/96	3.06	2.55	+0.51	103	7.00
1996/97	3.14	2.76	+0.38	108	4.25
1997/98	3.22	3.04	+0.18	110	4.25
1998/99	3.30	3.70	-0.40	113	6.25
1999/00	3.38	3.19	+0.19	116	6.25
2000/01	3.47	3.27	+0.20	119	6.00
2001/02	3.56	3.50	+0.06	122	6.50
2002/03	3.66	3.45	+0.21	125	6.00
2003/04	3.75	3.15	+0.60	128	6.25

The Council has decided to review its budget provision and some analysis of the above figures is required to inform this process. There are initially two questions which they wish to have answered from this data analysis.

- What has been the actual cost of an "average" winter over this period and how does this compare with the present budget?
- Is there a relationship between temperature and actual out-turn expenditure?

• **Requirement for question 7**

In order to help to answer the above questions:

- (a) Using the RPI data, recalculate the out-turn figures to a 2003/04 price base and calculate the mean, mode and median values over the ten year period. What conclusion can you draw? 9
- (b) Determine the strength of the relationship between the average temperature and the adjusted out-turn figures. Calculate the correlation coefficient for the relationship and comment upon it. 6

(15)
