TREASURY AND TAX MANAGEMENT

Professional 2 examination
8 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. **Two** 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.

CIPFA

SECTION A (Answer two questions)

1

- **Requirement for question 1**

(a) The Treasury has stipulated a credit period of 30 days for the public sector. Identify and briefly describe three factors that cause problems for organisations seeking to comply with this requirement. *6*

(b) Your organisation has settled its accounts with its suppliers after 45 days on average. Identify the extra cost of meeting the Treasury requirement for an average balance of £100,000. The cost of capital is 6%. *2*

(c) Cash discounts have been identified as a method of encouraging early settlement of debts, but the cost to the organisation must be established. Identify the relevant factors in calculating the cost to the organisation. *2*

(d) Discuss the relationship between debtor and creditor policy in working capital management for a private sector organisation, and how this differs from a public sector organisation. *7*

(e) The annual total for rents payable to your organisation is £75 million. The aged debtor profile is as follows:

% of total debtor payments (by value)	**Average collection period (days)**
3	15
25	25
50	30
14	45
8	60

Bad debts are currently £1 million per annum.

Calculate the total current funding cost. The cost of capital is 6%. *3*

(f) Discuss the usefulness of cash management models in the determination of liquid balances to be maintained by a public sector organisation of you choice. *5*

(25)

2

- **Requirement for que stion 2**

(a) One of the two main sources of long term financing available to the private sector is shares. Describe the different types of shares available and explain four different ways in which the shares are generally issued. *11*

(b) Debt financing is the main source of long term financing in the public sector. Debt management is therefore an important element of the overall treasury management function. Describe the six main factors to be taken into account by the treasury management officer when making decisions on long term borrowing. *6*

(c) Often decisions taken in the past need to be reviewed at various intervals, particularly where circumstances internal or external to the organisation change. This is known as debt restructuring. Describe both the capital and revenue effects of restructuring, including an explanation of 'premiums' and 'discounts'. *8*

(25)

3

- **Requirement for question 3**

(a) Cashflow management is an important element of treasury management. Describe the purpose of cashflow forecasting, and describe the information required to build up a forecast. *10*

(b) In order to be useful, the cashflow forecast should be reliable. Describe how the treasury manager can improve cashflow forecasting and influence cashflows to and from the organisation. *8*

(c) The Cashflow Statement is one of the primary statements required in an organisation's annual accounts. Describe the purpose of the information presented to users in the Cashflow Statement and the importance of the Cashflow Statement in the accounts. *7*

(25)

SECTION B (Answer two questions)

4

April 2000 has seen the introduction of, arguably, the most contentious change to tax legislation since the Poll Tax. This legislation, explained in IR35, looks beyond the veil of incorporation and deems that owners of personal service companies should be treated as employees of their clients.

Your Chief Executive would like background information to assist her understanding of the changes and you are asked to produce a briefing note dealing with the following relevant issues:

- **Requirement for question 4**

Prepare the briefing note covering:

(a) Criteria for determining the existence of an employment relationship if a contract of service does not exist. *15*

(b) The means by which tax is collected from employees. *5*

(c) The advantages to Government of implementing IR35. *5*

(25)

5

(a)

During the VAT quarter to 30 September 2000, the Hudderspool Council social club made the following transactions:

Standard rate supplies (including VAT)	£411,250
Zero rated supplies	£120,000
Exempt supplies	£350,000

Input tax amounts to £94,000 and, from the accounting records, you are advised that 45% relates to taxable supplies and 20% relates to exempt supplies. The remainder cannot be allocated.

- **Requirement for question 5(a)**

You are required to calculate the VAT payable/reclaimable for the quarter ending 30 September 2000. *13*

(b)

You have been invited to speak at your local CIPFA regional group meeting on the subject of VAT. Members have expressed an interest on hearing how public sector VAT differs from that of the private sector.

- **Requirement for question 5(b)**

You are required to draft your talk, in tabular format, showing the similarities in and differences between the treatment of VAT in a UK plc and in a public sector organisation or voluntary sector organisation of your choice (for example local government, health service, central government, further education, higher education, charity, housing associations). *12*

(25)

6 Liverfield Unitary Authority, in their role as a waste management agency, registered Muck Ltd as a limited company on 1 May 1999. The company is responsible for the management of the local waste disposal sites.

The company is producing its first set of accounts for the period ending 31 October 2000 and you have extracted the following data from the ledger and taxation file:

		£
(1)	Tax adjusted trading profits before capital allowances	280,000
(2)	Rental received from surplus land	30,000
(3)	Plant and machinery purchased 1 May 1999	80,000
	Plant and machinery purchased 1April 2000	40,000
(4)	Included in the figure of trading profit (before adjustment for tax purposes) is a surplus on the sale of a painting from the Boardroom disposed of on 1 June 2000.	2,000

The painting had cost £4,000 and was sold for £7,500. Indexation amounted to £500.

(5) Bank deposit interest:

Received	1 August 1999	£3,000
Received	1 January 2000	£3,000
Received	1 May 2000	£8,000

In addition to the interest received, the company estimated that £4,000 was accruable as at 31 March 2000 and a further £3,000 should be accrued in the final accounts to 31 October 2000.

(6) To deal with elements of re-cycling waste, Muck Ltd owns a 55% share of Brass Ltd. A privately owned company PotsOgold Ltd owns the remaining 45%. Both Muck and PotsOgold have held their shares since 1 May 1999. Brass Ltd has incurred a trading loss for the period 1 May 1999 to 31 October 2000 of £90,000, allocated £60,000 to the year ended 30 April 2000 and £30,000 to 31 October 2000.

- **Requirement for question 6**

(a) You are required to calculate the taxation liabilities for Muck Ltd for the period 1 May 1999 to 31 October 2000, utilising all possible reliefs. *16*

(b) Advise the managers of Muck Ltd on the potential implications of the following:

(i) Purchase of 21% of Brass shares from PotsOgold; and

(ii) Sale of all Brass shares to PotsOgold. *9*

(25)

TAXATION RATES

Corporation Tax	**Financial Year (FY)**	**FY 1997**	**FY 1998**	**FY 1999**
Full rate		31%	31%	30%
Small companies		21%	21%	20%
Small companies profit levels:				
Lower relevant amount		£300,000	£300,000	£300,000
Higher relevant amount		£1,500,000	£1,500,000	£1,500,000
Small companies				
Marginal relief fraction		1/40	1/40	1/40

Assume FY 2000 rates are as FY 1999 – candidates are not expected to know or apply the provisions of Finance Act 2000

Small companies marginal relief formula: (UL-P) x (B/P) x MRF

where UL = Higher relevant amount
P = Profits chargeable to corporation tax plus FII
B = Basic profits
MRF = Marginal relief fraction.