TREASURY AND TAX MANAGEMENT

Professional 2
December 2000

MARKING SCHEME

Question 1

(a) Factors to include:

- Do you use invoice date or receipt date? – can be significant gap between the two dates although Audit Commission suggests only two days
- Disputed invoices
- Failure by suppliers to invoice correctly
- Slow certification procedures
- Invoicing for service in advance

1 mark for identification and 1 mark for description for relevant answers up to a maximum of 3 factors

(6)

(b) Reduction in credit period = 15 days

so 15/365 x 6% x 100,000 = £246.57

1 mark for reduction in credit period, 1 marks for extra interest payable

(2)

(c) Relevant factors include extra interest receivable on cash deposits made earlier (difficult to separate from cash you would have received without the discount) compared with interest cost of discount expressed as effective annual interest payable. *2*

(d) In the private sector you grant credit to the customer to the extent that credit is granted to you by suppliers otherwise you increase overdraft.
It also depends on competition for customers and the response to offers of credit.
You may use third party finance houses to pay you the cash price and take over the credit agreement with the customer.

up to a maximum of 3

In the public sector, credit offered to customers is governed by regulations, performance indicators and social considerations. The taking of credit is discussed in part (a).

up to a maximum of 4 marks, including relevant examples

(7)

(e) Average length of time outstanding =

(0.03 x 15) + (0.25 x 25) + (0.5 x 30) + (0.14 x 45) + (0.08 x 60) = 32.8 days *1*

Working capital required = 32.8/365 x £75 million = £6.74 million *1*

Total funding required = (£6.74 million x 0.06) + £1 million ba d debts = £1.4044 *1*

(3)

(f) Discussion of the content of Baumol and Miller-Orr models. *2*

Identification of the practical difficulties of ascertaining this content and applying it to public sector organisations. *3*

(5)

(25)

Question 2

(a) Ordinary shares

- generally referred to as equity
- shareholders are entitled to a share in the profits of the company via dividends
- shareholders have the right to vote at the AGM
- Shareholders not liable for debts of the company
- Greater risk = higher return than preference shares *2½*

Preference shares

- have a fixed % dividend
- priority payment over ordinary shareholders
- cannot vote at AGM
- part way between equity and debt
- lower risk = lower return *2½*

Issuing of shares

Offer for sale

- completely new or private shares
- done through a merchant bank
- merchant bank underwrites the sale for a commission

prospectus issue

- offers shares to the general public
- merchant bank may act as agent but not as underwriter
- tends to be issued by well known /established companies
- more risk then offer for sale

rights issue

- offer of new shares or other forms of capital to existing shareholders
- priced lower than existing market price
- may dilute the existing selling price

scrip issue/bonus issue

- shares issued free to existing shareholders
- used to reduced share price
- does not raise additional finance for the company
- conversion of equity reserves into issued share capital
- doesn't raise new funds
- reduces price of shares
- represents a dividend payment in the form of shares

1½ marks per method up to a maximum of 6
(11)

(b) sources available

- PWLB (local authorities only)
- commercial lenders
- use of brokers

movements in interest rates

- comparison between lenders
- view of future interest rate moves

fixed v variable

- depends on view of interest rates
- fixed when low rates / variable when high

actual cash flows

- borrow in advance to cover short term cash flows / reinvest funds
- defer decision if not required for cash flow

maturity profile

- selecting a loan period so don't have significant amount of debt maturing in any one year

assessment of borrowing requirement

- calculate funds required related to capital expenditure

½ mark for highlighting the factor and ½ mark for brief description
(6)

(c) debt restructuring

CAPITAL

- repaying loans early reducing capital debt to be repaid in future years
- used to smooth out peaks and troughs in a debt profile
- replace debt repaid with other loans/ cash balances *2*

REVENUE

- cashflow requirements to repay loans early/match to additional borrowing
- should reduce the annual interest repayments (reduced average interest rate) *2*

PREMIUM

- the additional payment required to be made by the organisation for early repayment of a high interest loan *2*

DISCOUNT

- amount paid by lender for organisation repaying a lower interest rate loan *2*

(8)

(25)

Question 3

(a) Cash flow forecasts are a vital planning and control tool, used to determine the expected surplus cash or anticipated deficit over a period of time (daily, weekly, monthly or annually). The cash flow forecast will inform treasury management decisions about investing surplus cash or borrowing to meet commitments. *3*

Cashflow forecasts are important in ensuring targets are met (for example external financing limits). *1*

Information required to compile cashflow forecast:

Current balances on all bank accounts
Receipts – detailed information on receipts collected and banked/awaiting banking or clearing
Receipts – information on anticipated receipts
Investments maturing
Payments due – by method
Debt repayment *1 mark per point to a maximum of 6*

(10)

(b)

Improvements: factors which can improve the quality of cashflow forecasts:

- Trend analysis of historical cashflow information;
- Preparation of forecasts more frequently;
- Communication internal
external
- Record keeping

4

Factors which can influence cashflow to and from the organisation –

- Treasury manager can advise on payment methods for receipts and payments
- Ensure banking is undertaken frequently.
- Advise on pricing and charging policies.
- Ensure debtors (making use of payment terms) and creditors (ensuring payments received) are properly managed.

4
(8)

(c)

Cash flow statement explains the movement in funds between balance sheet dates, organisations are required to follow FRS1 (revised) in compiling a cash flow statement. *2*

The cash flow statement highlights the changes in the composition of working capital and changes in the fixed asset position. The surplus or deficit net of tax is shown. *3*

The cash flow statement shows how funds are used and where the funds have been derived from or have been utilised. *2*

(7)

(25)

Question 4

(a) The answer requires an analysis of the established tests used to determine employment status.

• Control	who decides what and how
• Risk	who provides the capital and suffers loss
• Equipment	who provides tools of trade
• Performance and correction	who pays for mistake/use of subcontractors
• Holidays and sickness	payment of statutory amounts
• Exclusivity	single or multiple employers

The examples/illustrations may be different.

Up to 3 marks per item up to a maximum of 15

(b) This question requires explanation of the PAYE system.

The following may be included

- notification of coding H, L, D, V, B, R, K
- tax deduction tables / calculation
- P45 / P6 / P60 / P9D / P11 / P11D
- Payment of by 19th of month
- Joint collection of tax and NIC
- Use of NIC tables

1 mark for each valid point up to a maximum of 5

(c) Government advantages of implementing IR35

Some answers could conceivably be highly contentious but marks should still be awarded if candidate can demonstrate validity to the point. Key points expected:

- Collect more tax
- Collect tax sooner
- Employer is responsible for collection
- Lower Inland Revenue costs
- Employees have full NIC cover and are afforded greater social protection

Up to 1½ marks per point up to a maximum of 5

(25)

Question 5

(a)

Output tax

Std rate	411250 * 7/47	61,250	*2*
Zero rated	120000 * 0%	0	*1*
		61,250	

Input tax

Attributed to taxable supplies	94000 * 45%	42,300		*2*
Unattributed	94000 * 35%	32,900		*2*

$$\frac{350000\text{ (i)} + 120000}{350000\text{ (i)} + 120000 + 350000} = 57\% \qquad 3$$

32900 * 57%	18,753	*1*
	61,053	

VAT payable 61250 - 61053 = 197 *2*

Note (i) 411250-61250

(13)

(b)

Compare a UK plc with ONE public sector organisation

Plc	LG	NHS
Register when taxable supplies exceed 51000	Agree	Agree
Cash accounting available	No – but estimates accruals may be negotiated	No
Quarterly or monthly	Monthly	Agree
Recover all VAT suffered upon taxable outputs	*Recover all inputs even relating to exempt outputs on a) statutory services b) exempt trading activity if 5% limit not breached*	*Recover input tax on prescribed items only (capable of external provision)*
Subject to inspection and penalty	Agree	Agree
Required to keep full VAT records	Agree	Agree

Other comparisons may be made.

2 marks per comparison apart from item 4 above which is worth 4 marks, up to a maximum of 12
(25)

Question 6

Capital Allowance		Pool		
12 mth CAP				
Purchase		80,000		
FYA 40%		32,000	total 32,000	*2*
		48,000		
6 mth CAP				
WDA 25% / 2		6,000		*1*
Purchase	40,000		total 22,000	
FYA 40%	16,000	24,000		*1*
C'fwd		66,000		

Chargeable gain

Proceeds	7,500	
Cost	4,000	
UiG	3,500	
IA	500	
	3,000	*2*

Restricted to

5/3 (7500 – 6000) = 2500 *1*

Tax computation

	12 mth CAP	**6 mth CAP**		
TP	185,300	92,700	total 278,000	*1*
Cap All	32,000	22,000		
	153,300	70,700		
Rent	20,000	10,000		*1*
Bank Int	10,000	7,000		*2*
Gain		2,500		
	183,300	90,200		
Consort Relief 60,000 / 30,000	33,000	16,500		*2*
Taxable income	150,300	73,700		

Tax liability

Note students will not be aware of the FY2000 changes where profits are under £50000 which may be confusing if the 12 month CAP is split between financial years.
Tax tables instruct students to assume FY2000 rates are the same as FY1999.

12 mth CAP

Upper limit	750,000 (i.e. 2 associated companies)
Lower limit	150,000

156300 @ 30%	46,890	
(750000 – 156300) * 1/40	14,842	
tax due	32,048	*2*

6 mth CAP

76700 @ 30%	23,010	
(375000 – 76700) * 1/40	7,458	
	15,552	*1*

(16)

(b) (i) BUY 21%

Will create 75% group
Be able to pass 100% of loss to Muck
Transfer assets at No Gain No Loss
All Chargeable transfers through one company

up to a maximum of 5

(ii) SELL
Create chargeable transfer – potential increase in taxable profits
Loss of control / influence
Loss of consortium relief BUT
Loss of associated company status so Brass becomes a SMALL company on all of its profits.

up to a maximum of 4

(9)

(25)