TREASURY AND TAX MANAGEMENT

Professional 2 examination
8 June 2001

From 10.00 am to 1.00 pm,
plus 10 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 examination room.

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

SECTION A (Answer two questions)

1

- **Requirement for question 1**

(a) Inventory management and cash management techniques can have similar characteristics. Explain the similarities and differences between models that may be useful in cash and inventory management. *5*

(b) Identify the key characteristics of the Just in Time approach to inventory management and describe a public sector context in which this may apply. *7*

(c) The Miller-Orr model of cash management is seen by many to be superior to the Baumol model. Do you agree with this view? Give your reasons and comment on the possible problems of using cash management models as a tool in treasury management. *7*

(d) An organisation has a regular pattern of cash outflows of £2,650,000 per annum. It receives 5% interest on its deposits but faces a charge of £10 for every withdrawal. How frequently will a cash injection be necessary? *3*

(e) A maintenance department uses 10,000 door locks per annum. The administration of orders costs £20 each and the storage costs are £50,000 for the stores containing 15,000 linear metres of shelf space. There is an average stock of 50 locks occupying 1 linear metre. How frequently should an order be placed? *3*

(25)

2

For your local student society newsletter you have been asked to prepare an article that summarises the key issues surrounding PFI, taking account of the many debates that have taken place within the accounting press.

- **Requirement for question 2**

(a)	Explain the principles of PFI, and give examples of the types of projects throughout the public sector that are being funded by PFI.	*8*
(b)	Discuss the main advantages and disadvantages surrounding PFI and the arguments around them.	*10*
(c)	Explain the purpose of the Bates review of PFI which took place in 1997, and state the main recommendations arising from the review.	*7*
		(25)

3 The CIPFA SOPP on Treasury Management describes the objective of treasury management as "the management of an organisation's cash flow, its borrowings and its investments, in such a way as to control the associated risks, and to achieve a high level of performance or return, consistent with those risks".

- **Requirement for question 3**

(a) Explain how and why the Treasury Manager's attitude to risk will differ in a public service environment from that which may be found in the private sector. *6*

(b) Identify and describe four types of risk that should be considered when making investment decisions. *8*

(c) Taking two of the risks identified above, outline the steps that can be taken to evaluate and control the risks. *4*

(d) In addition to the SOPP on Treasury Management, CIPFA also produces a number of Codes of Practice on treasury management in various types of organisations. Outline the purpose of both the SOPP and Code of Practice and describe the obligations they place on CIPFA members working in the treasury management function. *7*

(25)

SECTION B (Answer two questions)

4

Assume that FY 99 tax rates apply for all chargeable accounting periods in this question.

Pyrogem Ltd commenced business on 1 January 2000. Pyrogem Ltd's first set of accounts for the period to 30 June 2000 is as follows:

The profit and loss account for the period produced a profit of £22,940.

Included in the results were the following items:

- Depreciation charge £4,960. This was calculated on the purchase of a luxury car for the managing director costing £32,000, a computer system costing £7,000 and other office equipment costing £5,800.

- The company entered into a five year lease of its premises, for which it paid a premium of £10,000.

- The profit and loss account includes:

Amortisation of lease premium	£1,000
Rent due for the period	£6,000
Redecoration of premises	£800
Repairs to roof after storm damage in the period between taking over the lease and occupying the premises	£1,112

- The agreed chargeable gain on the sale of investments is £1,550.

- Travel expenses incurred by the managing director to attend international trade fairs were £3,890.

- General entertaining expenses of overseas clients were £4,180.

- Legal and professional fees include:

5 year lease on new premises		£350
Managing director's contract		£100
Debt collection service	£300	
Audit service		£400

- The business pays a subscription of £195 to trade magazines and £900 for a gentleman's club in London which the managing director uses for overnight accommodation when on business in the capital.

- **Requirement for question 4**

(a) Compute Pyrogem Ltd's profits chargeable to corporation tax for the accounting period to 30 June 2000, and the corporation tax thereon. *19*

Marks will be awarded for explaining, in the form of bullet points, your reasons for your treatment ofeach of the above items,including those items not appearing in your computation.

(b)

(i) Pyrogem would have had to submit information to the Inland Revenue about its results for the period to 30 June 2000. What documentation and information must the company provide, and by what date? *2*

(ii) If the information in (i) is not submitted within the time limits, what penalties will be incurred? *2*

(iii) For the first accounting period ending after 30 June 1999, a system of payments on account of corporation tax liabilities has been introduced for large companies. Explain the implications for those companies affected. *2*

(25)

5

- **Requirement for question 5**

(a) AFPIC Ltd has asked you to explain when VAT registration will become compulsory for them. Currently they are making a profit of £5,000 per month, which is made up of standard rate supplies of £8,000 and exempt supplies of £2,000 minus costs of £5,000. Within your explanation it will be necessary to cover all aspects of registration and non-compliance with the rules. *15*

(b) The original case law for the definition of plant (applied in this case to a horse) is:

'whatever apparatus is used by a businessman for carrying on his business: not his stock in trade which he buys or makes for sale; but for all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in the business' (Yarmouth v France 1887).

Discuss this statement with the use of established examples. Show how the distinction between plant which has been used in the business as opposed to the setting in which the business is carried on has subsequently been defined. Your explanation should be concerned with the implications for a business with regard to capital allowances and industrial buildings allowances. *10*

(25)

6

- **Requirement for question 6**

(a) The Chancellor of the Exchequer attempts to encourage business by use of tax reliefs and incentives. Give examples of those reliefs available to a business or a group of businesses with regard to trading losses, capital gains, capital allowances and VAT, using the following scenarios to illustrate your points:

(i) X Plc is the holding company of a group of three companies. X owns 75% of Y Ltd and 70% of Z Ltd. X has taxable profits in the year to 31 December 1999 of £180,000 whilst Z has profits for the same period of £150,000. However, Y Ltd has a loss of £90,000. *10*

(ii) U Ltd is a 100% subsidiary of W plc and has recently disposed of a non-depreciating business asset resulting in a chargeable gain of £65,000. W plc plans to invest £250,000 in a new factory at some time in the next few years. Alternatively the money could be used to purchase new operating assets. *10*

(b) To what extent does the concept of 'a major change in the nature and conduct of a trade' limit the availability of tax relief? *5*

(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.