

# TREASURY AND TAX MANAGEMENT

## **Professional 2 examination 11 June 1999**

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.*

**SECTION A (Answer two questions)****1**

You are the Treasury Manager in an NHS Trust. On the morning of Tuesday 1 June 1999 your cash balances are as follows:

Current account:	£35,000
Paymaster General Account	£2,250,000

The following information is available for the coming month:

**Payments**

Creditor runs take place on 3 and 17 of June. The average creditor run is £4 million and all payments are normally made to supplier's bank accounts via BACS.

The Payments Supervisor has given you details of the 3 June run for authorisation, the total value of payments is £4.6 million and includes the following:

- (i) ABC NHS Trust block contract payment, £850,000 due on 15 June 1999.
- (ii) Supplies invoice totalling £500,035 (50,000 items @ £10 each plus carriage of £35 invoice date 3 May 1999).
- (iii) XYZ Builders £1.5 million for work on new theatre block. Payment is due on 10 June 1999 in accordance with the contract.

Wages: £25,000 per week, paid on Friday via BACS.

Salaries: £6.5 million paid via BACS on 30 June 1999.

**Income**

Block contract income: £9 million due on 15 June 1999. (Assume 80% of payments are received on the due date, the other 20% evenly over the period 7-25 June.)

Other income: £100,000 per week.

Analysis of the debtors ledger shows the following:	0-30 days	£600,000
	31-60 days	£850,000
	61-90 days	£750,000
	90+ days	£75,000

**Investments**

Investments maturing in June:

£1.5m on 10 June 1999 (invested for 90 days @ 6%)

£2.5m on 30 June 1999 (invested for 60 days @  $5\frac{7}{8}\%$ )

- **Requirement for question 1**

- (a) Calculate the estimated cash forecast position at the end of each week in June and on 30 June 1999. 8
  - (b) Comment on the cash position and suggest ways in which the position can be improved. 5
  - (c) Calculate the Economic Order Quantity and the number of orders per year for the item on the NHS Supplies invoice. The Supplies Manager has told you total annual demand is 100,000 items, the cost of capital is 6% and the holding cost per item is 50p per annum. 5
  - (d) Explain the term “stockless”. Outline the financial and non-financial benefits of a stockless system and consider what risks are involved in an NHS Trust switching to such a system. 7
- (25)

# 2

The overall objective of debt management is to minimise the cost of borrowing to the organisation.

- **Requirement for question 2**

- (a) Describe factors which need to be taken into account, other than cost, when establishing a debt management policy. 5
- (b) Describe the factors to be monitored by the treasury officer before the decision of when, how much and for what period long-term borrowing should be made. 8
- (c) A number of organisations now outsource their debt portfolio to private sector organisations. Highlight the advantages and disadvantages of outsourcing such a function. 6
- (d) A number of performance measures can be used to indicate the effectiveness of debt management. Give four examples explaining how they would demonstrate effective debt management and comment on the underlying issues affecting the interpretation of such measures. 6

(25)

# 3

- **Requirement for question 3**

(a) Central Government continues to monitor and control public expenditure closely. In the light of this explain the role of the Treasury Manager in your organisation or one with which you are familiar. 10

(b) A public sector organisation has the following debt portfolio:

<b>Maturity</b>	<b>£M</b>	<b>Rate of Interest %</b>
1999/00	14	5.75
2000/01	4	6.25
2001/02	3	5.50
2002/03	4	4.75
2003/04	5	5.00
2004/05	1	4.50

Calculate the Weighted Average Cost of Capital. 5

(c) Comment on the usefulness of the figure you have just calculated. 5

(d) Suggest alternative ways of determining the cost of capital to the above and comment on their usefulness. 5

(25)

**SECTION B (Answer two questions)****4**

Monkmorning Ltd has traded successfully for many years preparing accounts annually to 31 March. The following information relates to the 18 month period of account ended 30 September 1998:

<b>MONKMORNING LTD</b>		
<b>PROFIT &amp; LOSS</b>		
<b>ACCOUNT</b>		
<b>PERIOD ENDED</b>		
<b>30 SEPTEMBER 1998</b>		
	£	£
Gross profit		100,000
Surplus from letting spare warehouse space	8,000	
Bank interest received	500	
Profit on sale of equipment	1,000	
		9,500
		109,500
<b>LESS</b>		
Salaries	75,000	
Heat light & Power	10,000	
Office expenses	5,000	
Travel expenses	15,000	
Depreciation	30,000	
Legal expenses	20,000	
Bad debts	5,000	
Other expenses	10,000	
Loan interest	10,000	
Lease payments	20,000	
		200,000
	<b>TRADING LOSS</b>	<b>(90,500)</b>

You are advised of the following information:

- (i) The salaries include £30,000 paid to the managing director who is the 98% shareholder, Mr Monk.
- (ii) The company operates from premises situated within a residential area of Scruton, a small provincial town. Incorporated in the premises is an apartment which is used by Steve Pegrum, the company secretary, for purely residential purposes. The

Inland Revenue do not consider the apartment to form part of any special security arrangement or feel that it aids the performance of his duties.

(iii) Travel expenses include £5,000 of petrol reimbursed to Monk and Pegrum for business and private motoring (20% private).

(iv) Legal expenses consist of:

Legal fees for the renewal of the premises lease until  
31 December 2014 £8,000

The lease commenced 1 January 1998.

Successful legal challenge to an Inland Revenue  
investigation in 1994 £7,000

Fine for a breach of health and safety regulations £5,000

(v) The bad debt account shows the following:

	£		£
Trade debts written off	3,000	Provision brought forward	1,000
Loan to Mr Monk	2,000	Debts now recovered	1,000
Provision carry forward	2,000	P & L	5,000

(vi) Other expenses consist of:

Entertaining UK customers £3,000

Entertaining Overseas customers £2,000

Company diaries for customers costing £5 each £1,000

Donation to a local charity which supports  
retired persons who worked within

Monk morning's industry £500

Trade association subscription £500

College fees for trainee accountant £1,000

Donation to Oxfam paid under the Gift Aid  
scheme on 30 September 1998 £2,000

(vii) Loan interest relates to debentures which were raised to support the trading activities of the company.

(viii) Lease payments relate to:

Premium on Lease £15,000

Lease rental £1,000

Car £4,000

The car which is provided to Mr Monk had a list cost, when new, of £20,000 in 1997.

- (ix) The surplus warehouse space was let for the period 1 April 1998 to 30 August 1998.
- (x) Capital Allowances have been calculated for the period to 31 March 1998 as £15,000. The pool carried forward to 1 April 1998 is £30,000.
- (xi) The company has agreed its taxation assessment for the year ended 31 March 1997 as:

Schedule D1	£30,000
Other income	£5,000
Non trade charges	£2,500
Profits chargeable to corporation tax	£32,500

- (xii) The company's accountants estimate that taxable profits to 30 September 1999 will be approximately £400,000.
- (xiii) Bank Interest was received on 1 January 1998.

- **Requirement for question 4**

- (a) Calculate the corporation tax for the 18 month period ended 30 September 1998. 18
- (b) Advise Mr Monk on the merits of alternative loss relief strategies. 7

(25)



# 5

As part of your training within Ensom City Council, you have been assigned to the financial policy and planning division. One of the roles of the division is to review operational policies of the organisation.

Last week, your Director of Finance received a questionnaire from the Inland Revenue investigations section as a prelude to a PAYE audit and, alarmed at finding no formal policies within the Council, she has instructed you to conduct an outline review of current practice.

Generally you are happy that the payroll procedures are effective and risk of tax infringement is low. However, remembering your CIPFA studies you identify some issues which you are uncertain about:

- (i) The current Director of Social Services, who has been in post for 18 months, has contracted his predecessor as a consultant. The consultant works 30 hours per week for the Council and 2 hours per week as a tutor at the local University. To date he has invoiced £35,000 since 6 April 1998.
- (ii) Mrs Bellwood has run a very successful childminding business for many years. Throughout this time, the Inland Revenue have treated her as a schedule D1 trader.

Since 6 April 1997 Mrs Bellwood has only received children from single parent families where Social Services believe both the parent and the child would benefit from a half day break from each other. Fearful that some parents would not arrange or pay for the childminding, the Council pay Mrs Bellwood direct.

- (iii) An accountant who works 1 day per week for the council advising them on VAT issues also teaches 3 hours a week on the Council's adult education courses. The other 4 days the accountant manages her own tax practice.

- **Requirement for question 5**

Prepare a detailed report on the general issues involved and explain the employment status for each of the scenarios outlined above. You are not expected to conclude in each case, as insufficient information is currently available to fully determine the status. However, you should supplement your report with the further questions you wish to ask in order to confirm the employment status.

(25)

**IF YOU CHOOSE TO ANSWER THIS QUESTION YOU MUST ATTEMPT BOTH PARTS 6A AND 6B**

# 6a

Two schools, one infant and one junior, share a joint site with shared services. There is, however, a complication. Although the infant school is operated by the Local Education Authority, the small junior school is classified as an independent special school which operates as a registered charity.

There is single electricity supply to the two schools with the cost apportioned on a 60:40 basis with the junior school incurring 60% of the expenditure. Currently the junior school pay the electricity invoices which are subject to 5% reduced standard rate VAT. The junior school is not registered for VAT even though it is anticipated that income from fees and grants will exceed the VAT registration limits soon.

The governors of the two schools agreed to the current arrangement for electricity payments because they were informed that VAT would be charged at 17.5% if paid by the infant school.

- **Requirement for question 6a**

- (i) The governors of both schools wish to be advised of the different VAT status of the schools. In particular, the junior school governors require advice on VAT registration.
- (ii) Evaluate the option of the infant school paying the electricity invoices and recharging the junior school; compare this with the existing arrangement. Illustrate your answer using the last combined electricity bill of £1,000 (excluding VAT).

7

8

(15)

• Requirement for question 6b

6b

Advise the following organisations as to the latest date they must register for VAT.

- (i) Tloyd social club began operation on 1 January 1999 and has the following results:

Month	Standard rate Supplies	Zero rate Supplies	Exempt Supplies
	£	£	£
January 1999	9,000	3,000	8,000
February 1999	10,000	2,000	8,000
March 1999*	8,000	4,000	5,000
April 1999*	18,000	1,000	1,000
May 1999*	10,000	5,000	3,000
June 1999*	12,000	5,000	2,000

Items marked \* relate to estimated figures.

The standard rate supplies in April 1999, include £8,000 for a computer system gifted to them by a sponsor in 1998, but the system proved to be inadequate and was replaced in March 1999 with a new system costing £20,000.

As a social club, all of their supplies are to non VAT registered persons.

6

- (ii) Guilletserve Ltd is planning to commence trading on 1 July 1999 and has an anticipated annual turnover of £300,000 which will accrue evenly throughout the year.

4

(10)

(25)

## TAXATION RATES

<b>Corporation Tax</b>	<b>Financial Year (FY)</b>	<b>FY</b>	<b>FY</b>	<b>FY</b>	<b>FY</b>	<b>FY</b>
	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
Full rate	33%	33%	33%	33%	31%	31%
Small companies	25%	25%	25%	24%	21%	21%
<i>Small companies profit levels:</i>						
Lower relevant amount	£250,000	£300,000	£300,000	£300,000	£300,000	£300,000
Higher relevant amount	£1,250,000	£1,500,000	£1,500,000	£1,500,000	£1,500,000	£1,500,000
<i>Small companies</i>						
Formula fraction	1/50	1/50	1/50	9/400	1/40	1/40
ACT fraction	22.5/77.5	20/80	20/80	20/80	20/80	20/80
ACT rate	22.5%	20%	20%	20%	20%	20%

Small companies marginal relief formula:  $(UL - P) \times (B/P) \times MRF$

where

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

**Fuel benefit tables**

	<b>1998/99</b>		<b>1997/98</b>	
	<b>Petrol</b>	<b>Diesel</b>	<b>Petrol</b>	<b>Diesel</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
0 - 1400 cc	1010	1280	800	740
1401 - 2000 cc	1280	1280	1010	740
2001 cc and above	1890	1890	1490	940
No cylinder capacity	1890		1490	

**Income Tax Rates****1998/1999**

Lower rate: £1-£4300	20%
Basic rate: £4301-£27,100	23%
Higher rate: £27,101 and above	40%

Personal allowance    £4,195

**1997/1998**

Lower rate: £1-£4100	20%
Basic rate: £4,101-£26,100	23%
Higher rate: £26,101 and above	40%

Personal allowance    £4,045