



TPE 2023 – Case Study Part 1

Skene

History

TPE examination, May 2015. Pass rate 89%. 2½ hrs in the morning and 3 hrs in the afternoon.

Technical Content

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BACKGROUND NOTES

It is 12 May Yr26 (2021).

You are Fred and you work for Alba Bank ('Alba'). Alba is a small, regional, full-service bank with 12 branches located in central Scotland, but with customers throughout Great Britain. You have recently qualified in practice after a previous career working in management consultancy.

Alba has found trading difficult since Yr19 and is looking for additional ways to earn fees. It is a trusted adviser to many Small and Medium Sized Enterprise ('SME') clients and wants to use that relationship to sell additional services for fees. You have been recruited to provide consultancy and tax advice. You are currently working in the credit services department assessing loan applications whilst the business builds up.

You see an early morning email waiting for you from your line manager, Tessa Major ('Tessa'), the Senior Manager in your department. The email asks you to give her a call.

Tessa greets you, "Morning, Fred, I hope you had a good weekend. We have received a request which has been instigated by Robert Alloway ('Robert'), the Branch Manager in Ayr, on behalf of Skene Park Country Club ('Skene'), an existing customer which is looking to extend its overdraft facility. An annual review of Skene's facilities is due in August. This is an opportunity for us to offer some wider business expertise, in addition to considering the request for borrowing."

Before Tessa goes on to outline the proposal, she considers it important to give you some background on the wider scenario in which the bank finds itself in relation to lending.

"You will have seen from press coverage that the political rhetoric is that banks such as Alba should be lending more to businesses such as Skene. Against this, however, we are coming under increasing pressure from our regulators to ensure that we are holding appropriate levels of capital against any lending which we undertake. So, we will have to look at this funding request carefully."

"We are not going to bow to political pressure, are we?" you ask. "Stick to basic principles of banking," replies Tessa, "look at the borrower, not the asset. Focus on the fundamentals of the business more than any short-term difficulties they're experiencing." Very sound advice, you think to yourself.

Tessa continues, "Skene is a relatively new customer of the bank. For many years they had been customers of another bank in Ayr which, through mergers and acquisitions, is now part of a global banking alliance. Latterly, their relationship manager was based in London and was rarely able to journey north to discuss the account with the management team of Skene. Our contact at Skene is the general manager, Peppyr Lawson ('Pep')."

"The club is struggling. Even before the COVID-19 outbreak it had been losing members and having difficulty with cash flow. Although its term facilities with the bank are being repaid on time, the bank overdraft is increasing and Pep has approached us, looking for a temporary increase in the overdraft facility. Pep is trying to be pro-active with solutions as he recognises that Skene has some challenges currently."

Tessa hands you a file, “Section 1 contains notes on Skene prepared by Robert, the Branch Manager. There is an extract from the latest letter of comment to management from the auditors in Section 2 which you will need to take into consideration. Section 3 contains extracts from the accounts for the nine months to 31 March. A cash flow projection prepared by Pep is included at Section 4. As a modern bank, we need to be thinking about ways in which we can help our customers, and this is a good opportunity for us to demonstrate that we can consider the customer’s whole business and not just its borrowing and deposits.”

“What do you need me to do?”, you ask.

“We need to prepare a report for Pep setting out our view of Skene’s business as it is at present and, also, what improvements Skene should consider. Look at all relevant points you think appropriate including:

- the accounts information;
- the people and structure of the club;
- risks the business faces; and
- suggested business improvements.”

“Also consider what we at Alba would be looking for if we were to support the business further. As we already have normal covenants in place for this client, what additional terms and conditions might we propose? Draw a conclusion as to whether we would be prepared to extend the lending further.”

“In addition, Pep needs to convince the directors that Skene can adapt its offering and continue to operate.”

“We need to analyse the business from a marketing point of view and advise Pep of our findings. Finally, remember to go through the usual channels if you come across anything unusual.”

“That’s fine”, you say, “I’ll have an initial draft report for Pep to you by lunchtime today. Is there anything else?”

“Yes, Fred, as a new employee of the bank you’ll have undergone your induction training. I am sure you will be familiar with ethical issues from your previous career as a consultant and have had to deal with such matters accordingly. The contact point for ethical concerns is whistleblowing@albabank.co.uk.” You recall from your induction that banking is a ‘regulated sector’ and Alba is thus bound by the same money laundering regulations that applied when you worked in practice.

“Thanks, Tessa, that’s helpful.” You say before ending the call.

In preparation for answering the case study question this afternoon you will find it useful to undertake the following tasks during the morning session:

- Read all the information carefully and note any points you feel are significant; and
- Prepare the draft report as requested by Tessa for Pep.

SECTION 1

Notes on Skene Park Country Club

Prepared by Robert Alloway, Ayr branch manager, Alba bank.

History

The Skene family were major employers in the Ayrshire area. At their peak, in the 1920s, the family's companies carried out shipbuilding, had major farming interests and operated several coal mines, all within Ayrshire. Following the inspiration of other industrial leaders, Henry Skene decided that a park should be created to look after the recreation and welfare of the companies' employees and their wider families. A suitable site was identified, and Skene Park Country Club was created, initially with extensive, well-tended gardens, walking rights and two bowling greens. Henry Skene was a keen horticulturalist with an interest in roses. The gardens contain a collection of modern rose varieties and, each year since then, 25-30 new varieties are submitted by rose breeders and rose growers from various countries for the prestigious annual Rose Trials, which always attract a good attendance during the Bank holiday weekend in August.

By the 1970s, the Skene family had retired from business. Following the death of Sir Henry, son of the original founder, the Country Park was passed into a company, limited by guarantee. This was to be run by an elected Board. The objectives of the company were to continue the supply of recreation and welfare to retired and redundant employees and their families of the shipbuilding, farming and coal mining industries who continued to reside within Ayrshire. The Skene family were opposed to borrowing money and the articles of the company do not allow the directors to give any of the assets as security to the bank.

In recent years, sporting facilities such as all-weather tennis courts, six five-a-side football pitches and a golf practice driving range have been added to the Park. There is also a garden shop, mainly a tearoom, which also sells an assortment of products for the garden. There is also a social clubhouse on the site which includes a bar area.

Banking relationships

The club originally banked with Ayr County Bank, but it was taken over by MGBG bank, a global banking group. Its branch manager was replaced by a relationship manager from London and the club decided that it was time to change banks. They approached Alba, through a personal connection with myself. We took on its account in September Yr19 and an initial overdraft of £35,000 was agreed.

Over the past few years, we have received requests for temporary increases to the facility to assist with cash flow, mainly prior to the collection of the annual club membership subscriptions. The increases in the overdraft have always been repaid in a few months without any problems.

The club currently has two term loans with the bank, on which repayments are up-to-date. These relate to the football pitches and tennis courts.

The income and expenditure account for the year ended 30 June Yr25 showed a surplus of £93,407. However, the club subsequently suffered a fall in membership which caused problems with both cash flow and profitability. It is difficult to determine what caused the fall in numbers, but there was some adverse publicity when the Chairman of the Board had to resign from that position, as well as his elected position on the local council, due to a scandal in relation to excessive claiming of expenses from public funds. Court proceedings are now pending but the local paper spent many weeks covering the issues and, whilst the club was not affected in any financial manner, it has been associated with it through the newspaper coverage.

In addition to this, the COVID-19 outbreak did not help trading, but the effects were not too severe as most activities are based outside and were able to continue in some form. This has been quite fortunate as the dependency on outdoor activities has previously caused the club problems when summer seasons have been affected by poor weather.

Management & systems

Pep has been the General Manager of the club, in charge of the day-to-day operations, for the past five years. He reports to a volunteer Board, elected from the members of the club. The Board consists of nine individuals, currently mainly retired coal miners together with a retired welder and riveter. The Board members are elected annually at the annual general meeting and sometimes only serve for one year.

Pep has seen the declining membership figures and has ideas for expansion which would involve external financial support. He has already been accepting 'guest' memberships from individuals who have no real connection to any other members to increase income. He sees smaller costs of finance on secured loans and wonders if the articles of the company can be amended so that all land and buildings can be given to the bank as security for borrowings. A few Board members are not happy about these changes and there have been heated and robust exchanges during Board meetings.

Other than Pep and the operational staff, the only other paid member of staff is Don Wimble, the tennis coach. He is part time and gets paid a retainer to run coaching courses for the club, however, he is free to earn more by giving private tennis lessons for which he can use the club facilities.

The club has tried to take some initiatives to update the way it operates. There is no longer a requirement for players to wear white when on the tennis courts. However, there has been some consternation and friction due to some players wearing unsuitable clothing, such as ripped jeans and football strips.

An informal agreement was in force regarding playing on the tennis courts, in that if a member turned up wanting to play and no court was free, they wrote their name on a blackboard. After 20 minutes, a group would stop playing to allow the next group from the queue to play. Latterly, this was completely unworkable with numerous arguments and one unfortunate incident involving the police when a stand-up fight erupted at the side of the courts. The local paper ran this story under the headline "You cannot be serious, there was chalk – Dust up at local tennis club". The members involved in the incident were barred from membership for five years. Subsequently, a stand-alone online booking system was implemented, added to the existing information-only website, but I have heard that it doesn't really work on mobile devices.

Members are now able to pay their subscriptions by monthly standing order throughout the year of membership. Until last year, the whole subscription was due on 1 July each year. Whilst this has been helpful in allowing members

to budget better, there has been a significant number of members cancelling standing orders, particularly around November and December. This has involved much staff administrative time chasing up non-payment.

Pep has recently been approached by the organisers of a local music festival to enquire as to whether they could use part of the club's land to host a weekend music festival. They would be willing to pay the club £50,000 and the club would require to be shut over the weekend of the festival. Pep is keen to accept this business, but the Board has so far not approved the initiative. The festival is due to take place at the end of August and organisers need to know whether they can use the club grounds within the next two weeks.

The club is registered for VAT purposes and has partial exemption status. Income from sporting pitches is treated as a supply of land and buildings because of the length of the leases and is, therefore, exempt. The club is subject to VAT on catering and bar income and on 10% of the subscriptions. Usually, the club is in a net VAT payment position each quarter.

The tearoom has not been as successful as had been hoped. The three staff who operate it are on general club employment contracts and not specifically employed in the tearoom area. They are often utilised elsewhere in the club when the tearoom is quiet. It does not seem to be making any money. In Yr25, this was put down to COVID-19, but Pep is not so sure as the tearoom is large enough to allow effective distancing and Pep feels that trade has actually been fairly slow.

Systems at the club are very manual and paper-based. As part of our normal lending monitoring arrangements, we requested a copy of the latest letter of comment to management from the auditors (Section 2).

The club is heavily dependent on cash. Our bank charges are based on the volume of cash being lodged into the account. Skene's account charges are high because of the amount of cash involved. Only recently did they start accepting debit and credit card payments at the club. This was only because many members had been demanding it. It was inconvenient for them to have to carry cash on each visit. The agreed bank overdraft limit is £35,000.

Requirements

Pep has provided extracts from the accounts (Section 3) and a cash flow projection (Section 4) that shows that the club will be close to the current overdraft limit when the bulk of the fees are received at the beginning of July. A significant number of members still pay by one instalment on 1 July. Pep has asked us to support the level of overdraft required until that time.

I have intimated to Pep that, should we extend this overdraft facility, the account will need to go back into credit and he and I will have to meet to consider their requirements moving forward. I have suggested we meet at the end of August when the accounts for the year to 30 June Yr26 should be available, together with Skene's budget for Yr26/27. Any further lending would be subject to this and to quarterly review meetings, to assess performance against budget.

Robert Alloway

April Yr26

SECTION 2

Extract from Letter of Comment to Management received by Skene from its auditors for the year ended 30 June Yr25.

We would raise again a point which we have made in several previous management letters. We recommend that the club looks to decrease its dependency on cash receipts and to install facilities to accept card payments within the club.

It was noted that we were unable to reconcile the sales figures from the tearoom to either the bank statements or to menu order pads. Not all sales appear to be rung through the till due to some customers taking items and paying for them in the main clubhouse area. In addition, not every order in the tearoom is noted on an order pad.

There are several members of staff on the casual payroll who are paid in cash. Whilst this is not an issue, we would encourage the club to ensure that they hold correct records of employment for each member of staff. There were several casual bar staff from other European countries for whom no payroll record or employment details could be located.

We discovered several errors in the VAT returns. From talking to members of staff, the club disagrees with the partial exemption calculation method previously agreed with HMRC for the VAT returns. They have applied a different method in recent VAT returns. However, it is our understanding that dialogue has yet to be opened with HMRC over the issue.

SECTION 3

Extracts from the accounts information

Skene Park Country Club

Income and expenditure accounts

	Notes	Actual to March Yr26 (9 months) £	Budget to March Yr26 (9 months) £	Actual to June Yr25 (12 months) £
INCOME				
Subscriptions & fees	1	382,541	412,500	535,000
Bar gross profit	2	125,985	141,500	188,699
Tearoom gross profit	3	759	11,250	15,005
Other income	4	6,000	-	-
		<u>515,285</u>	<u>565,250</u>	<u>738,704</u>
EXPENDITURE				
Salaries		217,546	198,500	264,728
Power & water		42,123	39,000	51,425
Insurance		12,542	12,500	16,667
Repairs & maintenance		105,897	104,500	139,419
Marketing & advertising		5,421	5,000	6,667
Cleaning materials		8,253	9,500	12,727
Audit & accountancy		14,000	14,000	18,667
Stationery & telephone		19,524	19,000	25,333
Hospitality		4,213	4,500	6,000
General expenses		3,525	4,000	5,333
Irrecoverable VAT		14,215	16,000	21,417
Bank interest & charges	9	13,500	10,000	13,894
Depreciation		<u>47,265</u>	<u>47,265</u>	<u>63,020</u>
		<u>508,024</u>	<u>483,765</u>	<u>645,297</u>
SURPLUS		<u>7,261</u>	<u>81,485</u>	<u>93,407</u>

Notes to the income and expenditure accounts

	Actual to March Yr26 (9 months) £	Budget to March Yr26 (9 months) £	Actual to June Yr25 (12 months) £
1. Subscriptions & fees			
General club subscriptions	265,465	283,000	365,196
Tennis coaching courses	23,984	25,000	29,546
Football pitch hire	65,219	75,000	100,000
Golf driving range	22,485	25,000	35,000
Bowling club casual play	<u>5,388</u>	<u>4,500</u>	<u>5,258</u>
	<u>382,541</u>	<u>412,500</u>	<u>535,000</u>
2. Bar gross profit			
Sales	221,960	239,500	310,245
Less: Cost of sales	<u>95,975</u>	<u>98,000</u>	<u>121,546</u>
	<u>125,985</u>	<u>141,500</u>	<u>188,699</u>
3. Tearoom gross profit			
Sales	15,468	18,750	25,008
Less: Cost of sales	<u>14,709</u>	<u>7,500</u>	<u>10,003</u>
	<u>759</u>	<u>11,250</u>	<u>15,005</u>
4. Other income			
'Tennis for All' grant to provide activities for youngsters during school holidays	5,000	-	-
Donation from 'Horticulture Europe' towards Rose Trials	<u>1,000</u>	-	-
	<u>6,000</u>	-	-

Skene Park Country Club

Balance Sheet as at 31 March Yr26 and 30 June Yr25

		31 March Yr26		30 June Yr25	
	Notes	£	£	£	£
Non-current assets					
Land & buildings	5		340,587		342,587
Machinery & plant	6		87,645		84,514
Motor vehicles			<u>31,245</u>		<u>33,241</u>
			<u>459,477</u>		<u>460,342</u>
Current assets					
Non-clubhouse inventories	7	75,412		74,589	
Clubhouse & tearoom inventories		94,985		94,524	
Receivables		41,569		37,490	
Bank and cash		<u>1,021</u>		<u>987</u>	
		<u>212,987</u>		<u>207,590</u>	
Current liabilities					
Trade payables		98,515		99,515	
Hire purchase payables		21,054		24,054	
PAYE, NIC & VAT	8	45,645		26,985	
Loyalty card credits		16,548		19,542	
Brewer loan		47,854		52,854	
Bank loans & overdraft	9	<u>46,587</u>		<u>48,512</u>	
		<u>276,203</u>		<u>271,462</u>	
Net current (liabilities)			(63,216)		(63,872)
			396,261		396,470
Long-term liabilities					
Bank loan	9		<u>99,654</u>		<u>107,124</u>
Net assets			<u>296,607</u>		<u>289,346</u>
Represented by:					
Opening reserve account			289,346		195,939
Surplus for the period			<u>7,261</u>		<u>93,407</u>
			<u>296,607</u>		<u>289,346</u>

Notes to the balance sheet

5. Land & buildings are included at the original 1970s value plus enhancements, such as the tennis courts and football pitches, at cost less depreciation (where appropriate).
6. Machinery & plant consists of items such as lawn mowers and other agricultural machinery, together with bar and tearoom equipment.
7. Non-clubhouse inventories include items such as sand, compost and plant stock. The club has a plant nursery, although there are relatively few annually planted beds.
8. VAT of £19,275 for the quarter ended 31 January Yr26 was unpaid at 31 March Yr26 and remains unpaid in May Yr26.
9. Two bank loans were taken out with Alba to fund improvements to the football pitches and the tennis courts. Both loans are paid from the day-to-day current account facility with an overdraft. The overdraft per the bank statement at 31 March Yr26 stood at £28,423. The monthly capital repayment on the first term loan is £650 and, for the second term loan, is £454. All loans and overdrafts are charged at +3.5% on Alba's base rate. Alba's base rate is currently 0.5%.

SECTION 4

Projected fortnightly statement of cash flows to mid-August Yr26

Fortnight beginning	04/05/Yr26	18/05/Yr26	01/06/Yr26	15/06/Yr26	29/06/Yr26	13/07/Yr26	27/07/Yr26	Total
Receipts	£	£	£	£	£	£	£	£
General club subscriptions	23,000	-	23,000	-	55,000	-	23,000	124,000
Tennis coaching	1,220	1,300	1,380	1,500	1,500	1,500	1,500	9,900
Football pitch hire	3,575	3,450	3,350	3,200	3,150	3,100	3,100	22,925
Golf driving range	1,265	1,320	1,369	1,419	1,469	1,519	1,569	9,930
Bowling club casual play	325	425	500	500	500	500	500	3,250
Bar takings	12,250	13,150	14,250	14,900	15,000	15,000	15,000	99,550
Tearoom	925	1,025	1,210	1,350	1,500	1,500	1,500	9,010
Total receipts	<u>42,560</u>	<u>20,670</u>	<u>45,059</u>	<u>22,869</u>	<u>78,119</u>	<u>23,119</u>	<u>46,169</u>	<u>278,565</u>
Payments								
Wages	11,250	12,250	13,000	13,000	13,000	13,000	13,000	88,500
PAYE & NIC	2,500	2,500	2,500	2,500	2,500	2,500	2,500	17,500
VAT	-	-	-	12,000	-	-	-	12,000
Bar purchases	5,268	5,654	6,128	6,407	6,450	12,675	9,675	52,257
Tearoom purchases	879	974	1,150	1,283	1,425	2,138	2,138	9,987
Power & water	5,000	-	5,500	-	5,500	-	5,500	21,500
Insurance	1,400	-	1,400	-	1,400	-	1,400	5,600
Repairs & maintenance	9,500	-	13,500	-	13,500	-	13,500	50,000
Marketing & advertising	600	-	600	-	600	-	600	2,400
Stationery, post & telephone	2,200	-	2,200	-	2,200	-	2,200	8,800
Cleaning materials	850	-	900	-	950	-	1,000	3,700
General expenses	850	-	900	-	950	-	950	3,650
Audit & accountancy	1,600	-	1,600	-	1,600	-	1,600	6,400
Bank interest & charges	1,200	-	1,200	-	1,200	-	1,200	4,800
Loan payments	3,550	-	3,550	-	3,550	-	3,550	14,200
Total payments	<u>46,647</u>	<u>21,378</u>	<u>54,128</u>	<u>35,190</u>	<u>54,825</u>	<u>30,313</u>	<u>58,813</u>	<u>301,294</u>
Opening cash balance	(28,153)	(32,240)	(32,948)	(42,017)	(54,338)	(31,044)	(38,238)	(28,153)
Surplus/ Deficit for fortnight	<u>(4,087)</u>	<u>(708)</u>	<u>(9,069)</u>	<u>(12,321)</u>	<u>23,294</u>	<u>(7,194)</u>	<u>(12,644)</u>	<u>(22,729)</u>
Closing cash balance	<u>(32,240)</u>	<u>(32,948)</u>	<u>(42,017)</u>	<u>(54,338)</u>	<u>(31,044)</u>	<u>(38,238)</u>	<u>(50,882)</u>	<u>(50,882)</u>