



TPE 2023 – Guide to Answer

Skene

The Test of Professional Expertise multi-discipline case study is designed to encourage students to provide alternative creative answers and there is no “right answer” at TPE level. This Guide to Answer illustrates the structure and the depth of analysis and explanation the examiners are seeking.

In assessing candidates’ scripts, credit is always given for appropriate answers even if not contained in this published guide.

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MORNING PAPER

Candidates are expected to present their work in the form of a report and their recommendations and conclusions should be appropriately presented in the executive summary. An example of the possible wording for the executive summary is shown below:

Example Executive Summary

- The bank is not currently in a position to be able to lend further to Skene. This is based on the uncertainty surrounding their figures as considered in the report below.
- The bank acknowledges that renewal of the overdraft facility is critical to Skene's business and further lending may be possible if Skene implements the business improvements outlined in our report.
- Skene needs to address, in particular, the non-payment of VAT, and the shortcomings in HR administration as these could lead to regulatory challenge and possible financial penalties.

Section 1: Appraisal of the business

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

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

“The club is struggling.... losing members, struggling with cash flow.....”

1.1 Review of management account information

Ratio analysis

Ratio analysis is only relevant if it leads to points being made on the implications of the analysed figures. In order to achieve credit students were expected to comment on trends and provide reasons, where possible.

- Subscriptions

Membership numbers and income are falling due to a change in demographic and this is the biggest income stream for Skene. Families of retired farmers and miners may have left the area. Over time the family links will be diminished as people move away. They need to consider changing the objective to benefit people of Ayrshire generally so that anyone can become a member. They could have a loyalty scheme for family members of retired farmers and miners to maintain some of the original objectives.

- High staff costs

Staff costs continue to increase when turnover has decreased. Staff costs, as a percentage of turnover, have increased from 36% (£264,728/£738,704) in the 12 months to 30 June Yr25 to 42% (£217,546/£515,285) in the 9 months to 31 March Yr26. Skene need to consider why this is the case.

- Bank interest and charges

In the income and expenditure account bank interest and charges is materially higher than budget. We would have expected these to have decreased if the club are accepting card payments and depositing less cash in the branch. Are there other costs included in this figure? (Perhaps, the increase is due to breaching the authorised overdraft level and paying penalty interest. However, as you work at the bank, you would know if that is the case).

- Loan

The bank interest rate for the loan is high at 4% per month however this is due to the lack of security offered on the loan.

It is not clear whether the hire purchase payments have been included in the cash flows as these payments seem to be low especially if the Brewer's loan is also included. If hire purchase payments have not been included, this will increase the overdraft facility required by Skene.

- Tearoom

The gross profit of the tearoom is low at 5% (£759/£15,468) in the 9 months to 31 March Yr26. This has dropped significantly from 60% (£15,005/£25,008) in the 12 months to 30 June Yr25. Skene need to investigate what the problem is here. Is there a lack of control which is responsible for the low gross profit? What is the club doing about it?

There could be a fraud issue with the tearoom through stock being stolen and/or omission of cash resulting in sales not being recorded. The tearoom sales may have been wrongly allocated to the clubhouse. This will impact any analysis carried out on the different sectors of the business.

If the situation is not resolved, they may have to consider the impact on HMRC in terms of VAT and ultimately possibly, closing down the tearoom operation.

- Cashflow

The company is struggling to keep on top of their overdraft facility. Annual subscription fees are due on 1 July which would suggest that July is when Skene should have the most cash, but this is not the case.

The overdraft is being used as a constant source of finance. Skene is constantly needing to increase the facility to get them through some crucial months. Although they are able to pay the facility back on time they need to manage their cash flow better.

Skene is not a viable business as it currently stands as costs far exceed income and therefore cannot achieve their aim to make a profit that can be re-invested in the club for member's benefits. Skene will not be able to reduce the overdraft back down again under current conditions and a temporary increase is not enough.

- Ability to pay debts

Skene's liquidity position is poor with a current ratio of 0.77 (CA:CL). Skene currently cannot pay back its current liabilities in full. Although they are not all due at once this is a dangerous position to be in and a key concern for the bank. The quick ratio (which excludes inventory as this is often relatively illiquid) of 15% is even more alarming.

- VAT

The £19,275 payment of VAT due to HMRC has been omitted from the cash flow statement and it will have a material effect on the figures. No additional lending will be possible until this position has been made clear to us.

The £50,000 funding from the music festival is necessary to cover the outstanding HMRC payment and will go some way towards the structural overdraft problem. We need to be sure that Pep is aware that the cash flow situation is symptomatic of the wider problems with the Club's business model, not the other way around.

The extract from the letter of comment to management also raises the suggestion of a disagreement with HMRC over partial exemption status. Contact requires to be made in order to resolve this issue. If the returns have not been made penalties may be due. There will also likely be surcharge penalties on the late payment of the liability. Any non-payment of tax (other than VAT) or penalties are not considered within this cash flow, so the funding requirement might actually be greater than stated in this regard.

- Inventory levels

The clubhouse and tearoom inventories value is high at £94,985 in the 9 months to 31 March Yr26. This seems unusual for a business that can normally get supplies on a next day delivery basis or that is likely to be dealing with perishable goods. Skene needs to examine why it seems higher than might be expected. Given that Skene has cash flow issues it does not make sense for them to have money tied up in stock; purchasing should be closely controlled while stocks are brought back to more appropriate levels.

1.2 Management and governance

Management is a sensitive area and addressing this with Pep needs to be handled with care. There is information provided in relation to the General Manager (Pep), the former Chairman of the Board, the current Board make up, and the tennis coach.

The integrity of management needs to be considered in relation to the club. The former chairman has already resigned due to an issue of integrity concerning expenses, albeit not at the club. Pep does not seem to have the necessary skills and experience to run the club although it does look as if it has been successfully run up until recently when the nature of its market has changed.

There is a lack of accountancy knowledge. There are issues regarding the management accounting information, and it may be that the club needs additional skills in this area.

We don't know much about the governance of the club. We are not told what Pep's field of experience is, other than he is the general manager of the club. Some of the difficulties and lack of strategic direction may be due to the inexperience, or lack of skills among board members, none of whom appear to hold relevant business experience. The directors appear to change on a regular basis with some serving as little as one year, this means a lack of consistency of approach and depth of understanding of the business is difficult.

The board structure needs to be reviewed as a matter of urgency to ensure that there is a balance of skills on the board and relevant experience to run Skene.

1.3 Risks assessment

Land/security

The balance sheet of the club shows substantial tangible assets. However, there are insufficient current assets to cover the current liabilities. This means that Skene is insolvent and the bank (alongside other creditors of Skene) is exposed to considerable risk. Skene should take immediate action to address the insolvency, to reduce the risk of wrongful trading.

The land is a major asset, but we have no knowledge of whether all or part of it could be sold to raise funds. The bank is unable to obtain security suggesting that the sale of the land and the interaction with the original passing of the land to the club will be legally complex and off-putting to potential purchasers.

Cost reduction

A main challenge for the club is to cut costs to fit the reduction in income it has received. If costs cannot be cut accordingly it will lead to losses for this year. As discussed above, high staff costs and the viability of the tearoom operation should be considered in more depth to cut overall costs. Any further reduction in members and income could seriously affect the viability of the club.

Control environment

From the accounts information it looks as if there is an issue with the tearoom. If purchases are processed centrally and tightly controlled, it could be that sales are understated, suggesting control issues at best, and potentially fraud as well, due to the system being pre-dominantly paper based and not integrated. Refer to section 1.5 for an integrated electronic system to improve control.

Seasonality

The club is weather dependent, and this represents a considerable risk, particularly during the summer months. While the dependency on outdoor pursuits has eased the impact of COVID, it is risky in the long term and diversifying would be advisable, potentially by utilising the indoor Tearoom space in a different way.

Reputation

There have been a couple of high-profile articles in the local press showing the club in a very poor light. This potentially represents a serious reputational risk to the club. Addressing the issues raised in the governance section above should improve the reputational risk.

Business improvement advice

Section 3 of the paper gives some examples of areas picked up in the previous letter of comment which should have given an indication of the direction for this section.

1.4 Public relations

Part of the publicity involved the Chairman of the Board having to resign. Members of the board need to be aware of their roles and responsibilities to avoid any bad publicity from their actions. A competency framework could be put in place for directors, with training and development. A succession plan should be developed.

1.5 General systems improvements

Integrated electronic system

Suggest moving away from paper-based system to a more integrated system. The impression given from the scenario is that the systems are manual and inefficient. Suggest tearoom being integrated with main bar system for stock control, ordering efficiency, completeness and accuracy of sales, daily reconciliation of cash etc.

Need to consider how the accounts are prepared – the purchases and nominal ledger could be integrated. The business is small so a basic accounting package like Sage would be ideal. Suggestions such as SAP or Oracle would be completely inappropriate for the size and resources of this business.

Moving to card-based sales must be a major consideration. It is cheaper to process card payments than to pay the cash into the bank, the security issues are far less, and the practical considerations of moving so much cash around are also mitigated.

Reduce seasonality

The business needs to be made less seasonal, and a balanced level of trade should be encouraged throughout the year. Indoor facilities should be investigated. There is scope to use the plant nursery (which is relatively empty) as a play area to encourage members to attend on rainy days. Other events such as football parties and guided walks could be offered.

Reduced membership

Restricted memberships could be offered to allow more people to pay on the courts for example, at certain times of the day, whilst still maintaining the peak times for original members. Access could be allowed to the tearoom for non-member wishing to use the tearoom only. This could generate more revenue for the club.

Tearoom to shop

If the tearoom is not performing well it could be changed into a shop selling merchandise for the various sporting activities held at the club.

1.6 HR Record keeping

The letter of comment states that Skene employs casual bar staff from other European countries. It is important that they take a copy of the passport and right to work in the UK documentation. Failure to do so can mean a £20,000 penalty per employee. This penalty could increase if Skene knew or had reason to know that the individual did not have a right to work yet still employed them

It is essential to keep accurate payroll records so that HMRC can make sure that:

- employees are paying the right amount of PAYE tax and national insurance contributions (NICs);
- employees are getting any statutory pay they're entitled to; and
- the club is complying with legislation on things like the national minimum wage.

The records are also required so that real time submissions can be made and to provide evidence to support the entries made on submissions - if HMRC asks for such evidence. The records must be kept for the current and previous three tax years. If the club has not maintained proper records they might have to pay a penalty of up to £3,000 per tax year. In addition, if they have not paid the correct amount of PAYE tax or NICs, or if the payments were late, they might also be charged a penalty.

Lending Assessment

“...consider what the bank would be looking for if we were to support the business further...what additional terms and conditions we might propose ..”

“...draw a conclusion as to whether we would be prepared to extend the lending further...”

“..political rhetoric is that banks such as Alba should be lending more to businesses such as Skene.....”

In practice this happens. The client will discuss their needs with their bank manager and then a proposal is put forward to the lending committee to determine if funding will be provided.

1.7 Repayment/Ability to service the facility

The overdraft extension is to assist the club with the cash flow shortfall until membership fees are gathered in at the beginning of July Yr26.

Total loans and overdrafts outstanding at 31 March are £146,241 with monthly capital repayments on the loans of £1,104. Monthly interest on an overdraft of £28,423 is £95. If the full requested facility were used for a year (say £47k), interest would amount to £1,880.

The reason for the facility is to cover a cash flow shortage until the membership fees are received in July when the overdraft reduces to £31k. However, the fact that it is not eliminated at this point is a concern in that it is indicating a long-term element to the overdraft requirement and future plans for reducing this to zero, or possibly converting it to a term loan, will need to be discussed with the club.

1.8 Other considerations

VAT

The January VAT quarter liability remains unpaid. It has been omitted from the cash flow and the overdraft requirement will be significantly increased when this is paid. Potentially this is a threat to the viability of the club.

Security

Currently the articles restrict Skene giving assets as support for funding. In order for security to be given the articles would need to be amended. This is easy to do however the members will not be happy about this. This would need to be managed carefully.

It may be difficult to value any security; against the debt i.e. how much is a piece of ground worth?

Reduction in membership

The club suffered a large reduction in membership numbers during the last year. Further reduction in club income and loss of membership could lead to serious reduction in profits impacting ability to pay the debt back.

Other

- Existing connection, well known to the bank
- Long history of apparently competent financial management. However, there is further possibility of downturn due to economic climate
- Quality of assets in the balance sheet may be insufficient to cover liabilities

1.9 Pricing & Pre-conditions

Any further lending will be subject to full accounts and projections being presented as well as quarterly review meetings.

There is little information in the scenario to give an indication of what pricing might be used for the lending. The existing rate is given as Alba base rate + 3.5%, and in the absence of any other information, for candidates to suggest the same rate would not be unreasonable. There would also likely be a fee for the facility. Either a straightforward amount or a percentage of the facility.

In terms of pre-conditions, it is suggested that security should be taken. The bank would need it to be in place and they would look to see an extract minute from a Board meeting authorising the increased facility.

If the bank does extend further credit facilities, further covenants may be imposed (beyond interest cover and gearing). For example, no further capital spending above a certain amount without prior bank approval is a reasonable suggestion.

A wash out clause could be included. A washout clause typically ensures that the company operates in a credit bank balance for a specified period of time, eg 6 months. The introduction of a washout clause will address the over-reliance that Skene places on the overdraft at present. Other clauses that could be introduced would give the bank the ability to call in the lending should a particular event occur. For example, if the bank insisted on all parts of the business being operationally profitable, if the tearoom was loss making, it would allow the bank to review the whole banking facility of Skene.

1.10 Recommendation

A clear recommendation should be drawn. On the basis of the information presented before the meeting with Pep it would be difficult to conclude anything other than the facility could not be approved at present.

The facility is currently unsecured and the potential issue with HMRC (failure to pay, the unapproved partial exemption method and potentially VAT on undisclosed tearoom sales) provide too much uncertainty. The bank

will require additional information before a decision can be made e.g. updated accurate cash flow and budget projections. The bank would need to see full year accounts to June as soon as they are available.

There is scope to extend in the future if security can be provided and proper governance is in place. The business improvements suggested are critical to the survival of Skene.

1.11 Marketing mix

The clubs marketing strategy should concentrate on product, price and promotion.

Product

This is anything that can be offered to the market for attention, acquisition or consumption. It includes physical objects, services, personalities, places, organisations and ideas.

- Local, community-based recreation club
- Pro-active approach to business (change membership system, online booking, move into football and tennis)
- Park with gardens
- Social clubhouse with bar
- Annual Rose Trials

Price

The marketing view on price is different to that of an economist. With pricing strategy there are three options:

1. price above competitors
 2. price the same as competitors
 3. price below competitors
- Move to monthly payment of subscriptions makes membership more affordable
 - Loyalty card for club purchases – this could be given free to families of retired farmers and miners and purchased as an add on for other members. (Note, if given free this will cause income to fall further and should be carefully researched before implementing).
 - Additional income from tennis courses
 - No mention of external use of clubhouse for functions. This could potentially be a useful revenue stream.
 - Diverse and complementary income streams i.e. football tends to be a winter sport, tennis and bowling summer activities

Promotion

Many retailers operate a policy of advertising money-back coupons as a means of boosting sales without having to cut the price. This policy is often adopted because it avoids the possibility of an all-out price war with competitors.

- Annual Rose Trials lead to increased publicity and people coming to the park could be built on the back of the Rose Trials
- The promotional content of the website could be enhanced
- Aside from raising money, the proposed concert could raise the profile of Skene
- Sponsoring a competition on the football pitches or sponsoring a local youth team could be a cost-effective way of promoting the pitches offered by Skene

Place

Although not a manufacturing company or a service company where placement of the product can be significantly influenced, the location of the Club and the attractiveness of the grounds are important in terms of how it could be promoted. The limited website functionality could be improved to allow improved online booking through additional channels such as mobile devices. This may be of particular importance if trying to attract younger market segments to Skene.

Other marketing strategy comments

The club should try to develop innovative or interesting approaches to tackle at least some of their issues, possibly looking at:

- reduced membership fees to give specific assistance for young people,
- making links with schools and other organisations,
- marketing initiatives (such as websites, social media and the promotion of events),
- making investment in facilities,
- offering corporate days, and
- consider sponsoring and /or advertising commercial employers.

Section 2. Review of Options from Pep

“I will have a look at each option, outlining the risks and rewards we see for you....what conditions we might place on any lending associated with each..... I’ll also include some information on exiting from the tearoom business....”

“I’ll pull it all together into a report for Tessa and draw some conclusions on any terms of lending....”

2.1 Option 1: Risk & Rewards

A basic cash flow with a few limited assumptions is required (see Appendix 1). It shows that a loan or overdraft facility would be needed for 12 months if the hotel gets planning permission.

The impact on this option if the planning permission is not granted needs to be considered. This is key as they will not know for definite before they commit to the debt. Based on Pep’s assumptions, the loan or overdraft facility would be needed for 18 months, if the hotel does not get planning permission. The positive cash position at the end of 18 months is also not as strong as it would be if planning permission were granted, as the final payment of £100k would not be received by Skene. It would thus be in the financial interests of Skene to work closely with the hotel chain to improve the likelihood of a successful application.

Skene would need to consider the building disruption/noise and the impact this will have on the local community as well as the business. There may be complaints from residents about this.

If planning permission is not obtained by the hotel chain, Skene could end up with excess football pitch capacity and be unable to obtain the income levels which Pep estimates. Pep has stated that each new pitch could realise an income of £750 per month but no support has been provided for this estimate. Pitch income is currently falling which suggests that usage is falling and there may be no latent demand for additional bookings. Market research should be conducted and an outline marketing plan drafted to assess whether this risk can be managed.

The tax position will require to be investigated further. Rollover relief will be available, at least partially, for the corporation tax on any chargeable gain.

There is a risk the club members do not like the plans for a hotel and this may cause strained relations. This would need to be handled carefully. Alternatively, the hotel could provide a pool of potential visitors to the club and a new source of income.

2.2 Option 1: VAT

The club could opt to charge VAT on the sporting facilities. This would mean that they would be able to recover a higher proportion of the input VAT associated with the activity. As they are partially exempt it would likely involve a substantial review of their partial exemption calculation which could be time consuming and costly. Another downside would be that they would have to charge standard rate VAT to members for use of the facilities and this would likely involve a substantial increase in prices charged, which may affect business.

2.3 Option 1: Lending conditions

There are two different types of lending to consider:

Firstly, the short-term option (1 year) possibly in the form of an overdraft. Under this option, the bank would require to be safe in the knowledge that the hotel chain would complete the deal if they sign up for it – but there is no way such assurance could be given. This would basically be an unsecured overdraft for around £100k and it is unlikely the bank would consider this option. If Pep could get the articles amended as is mentioned in the morning paper, it is possible that security over some land or buildings could be given and the bank could look upon the proposal more favourably.

Secondly the medium-term option (around 3 years). It is more likely that this could be accommodated in the form of a term loan. However, the bank could not consider lending until there was a much more significant business case built to suggest that there was a sound basis to support the projections which Pep asserts will be possible for future income. The same comments as in the paragraph above are relevant regarding security and rate (however, in addition it is acceptable to consider that there could be base rate change within the three-year period which would influence the projections).

2.4 Option 2: Risks and Rewards

These options look like reasonable options for the club to consider. They will bring non-members into the facilities and will bring in extra funds in a profitable fashion. There are other opportunities here as well. Since the chef is likely to be employed on a full-time basis, it could be that there is potential to offer a profitable meal service to members at other times during the year.

There are a number of factors to be considered such as; How much market research has been undertaken to arrive at the estimates for wedding business in the local area? How will they set about prising customers away from the castle or local hotels? What is the estimated spend per guest and associated cost based on? How have the figures been calculated? Have they considered that they might have to employ an expert wedding manager? Has such a cost been considered as part of the projections? How will prospective couples be made aware that the club is running weddings? What marketing strategies and plans does it have? Have they considered stressing the plans (performing a sensitivity analysis) to see what might happen if they don't make the estimated income figures – the projections are based on 140/120 wedding guests – it could be fewer? What will be the effect of COVID and, hopefully, the easing of restrictions on the wedding market? It may depress initial demand but there may be a peak in demand as those who postponed their weddings catch up as restrictions ease.

A basic statement of profit or loss for each option might be:

Options 2		Basic	Upmarket	
Sales excluding VAT	1	£250,000	£400,000	Standard rated for VAT
Costs excluding VAT	2	<u>(£90,000)</u>	<u>(£120,000)</u>	See 2.5
Gross Profit		£160,000	£280,000	
Extra Catering staff		<u>(£100,000)</u>	<u>(£100,000)</u>	
Earnings before interest, tax & dep'n		£60,000	£180,000	
Dep'n of bar area	3	<u>(£5,000)</u>	<u>(£10,000)</u>	
Clubhouse dep'n (say over 10 years)	4	<u>(£20,000)</u>	<u>(£50,000)</u>	
Earnings before interest & tax		<u>£35,000</u>	<u>£120,000</u>	

Notes:

- 1) Basic sales: $£50 \times 150 \times 40 \times 5/6 = £250,000$
Upmarket sales: $£100 \times 120 \times 40 \times 5/6 = £400,000$
- 2) Basic costs: $£15 \times 150 \times 40 \times = £90,000$
Upmarket costs: $£25 \times 120 \times 40 = £120,000$
- 3) Basic: $£25,000/5\text{years} = £5,000$
Upmarket: $£50,000/5\text{years} = £10,000$
- 4) Basic: Clubhouse extension capitalised $£200,000/10 \text{ years} = £20,000$
Upmarket: Clubhouse extension capitalised $£500,000/10 \text{ years} = £50,000$

These options are not mutually exclusive; therefore, it is reasonable to consider whether the club should undertake both projects. Consideration would need to be given to the hotel in the grounds - would it be a help or a hindrance to the wedding guests?

Weddings are booked a long time in advance. How would they get over the initial period when they would have very few, if any bookings?

2.5 Option 2: VAT

As the extension will be used exclusively for the purposes of the standard rated part of the business, any Input VAT suffered on the building process should be repayable to the club.

Output VAT will be chargeable on the function income and the figures need to take this into consideration. Inputs for the function business will be mixed ie: some food may be zero-rated but alcohol and some luxury foods will incur VAT. More detailed information would be required to quantify the additional costs.

2.6 Option 2: Lending conditions

The bank would require security, probably in the form of a standard security over the extension, but again the same issues as referred to in option 1 of access to the security and the powers of the club to grant such a security need to be addressed. Pep would need to get the members to agree to changing the articles. The bank would also require a detailed business plan which should include a clear strategy and cash flows which have been subjected to stress testing.

Lending in this situation would likely be a combination of term loan to cover the building and refurbishment costs and overdraft to assist with day to day cash flow in the trading account.

2.7 Exiting the tearoom business

The decision to exit a business is a difficult one, and there are a number of considerations which the club will have to make when ceasing trading the tearoom.

The tearoom is part of the club, so there is no disposal of any separate business. The tearoom will have assets such as tables, chairs and catering equipment and it may be that these can be sold or utilised in another part of the club. Perhaps, in the catering area if they undertake the new initiative for weddings.

As mentioned earlier there are high stock levels which may relate to the tearoom. The stock should be reviewed to see whether it could all be utilised elsewhere. Given the probable perishable nature of the stock it is unlikely it could be sold on.

There could be a knock-on effect for other areas of the business. Need to consider whether there are customers who only use the tearoom and not the other facilities.

There are staff employed in the tearoom and there may be a need to consider redundancies. Under UK law you do not make a person redundant, you make a position redundant because:

- the work is no longer needed;
- the location is being moved; or
- the work is going to be done in a different way.

This is the situation here and so consultation with the employees may be required. However, they are on general term contracts and often work elsewhere in the club which means that they could be utilised elsewhere rather than being made redundant.

The club is considering expanding its services in terms of the catering option so it will have to consider if the staff from the tearoom could be moved to the new initiative. Failure to manage this carefully could result in the redundancies being grounds for unfair dismissal.

It is possible that students could suggest getting a third party to come in and run the tearoom independently of the club. They could pay rent to the club, or there could be a profit-sharing arrangement.

Section 3: Inheritance email

“..aunt.... passed away....has bequeathed £300,000 in cash to me...I’m thinking of using it to purchase a flat....in Manchester and selling it again once she graduates.....two bedrooms....likely that we will rent the other room to another student at the college.

3.1 Deed of variation

If Pep purchases the flat in his name, CGT will be payable when the flat is sold, based on any growth in value during his ownership. This is because the flat will not be his only or main residence and so principal private residence (PPR) relief will not be available.

If the extra room is let out to a third party ‘Rent a Room’ relief would not be available if Pep owns the property.

There would be no IHT implications for Pep as there is no transfer of value – Pep has used the money to buy property.

It is possible for Pep to buy the property and gift it to Maria. There would be CGT implications as this would be treated as a disposal at market value. Neither gift relief nor PPR would apply however any gain would be minimal as the proceeds and cost would be the current market value. The property would then belong to Maria. Assuming Maria lives in the flat as her main residence PPR would be available to her when she sells the property when she graduates.

Purchasing a flat in Manchester will give rise to Stamp Duty Land Tax when the flat is purchased. Assuming the flat costs approximately £300,000, the first £125,000 of the property purchase price is taxed at 0%. Thereafter SDLT is payable at 2% on £125,000 and 5% on the remaining £50,000. This cost should be built into your budget for purchasing as it will be required to be paid on the date of signing the purchase. Assuming this would be a second property for Pep, then this would result in an additional 3% tax payable, which would not be applicable should Maria buy the flat as her first property.

Alternatively, Pep could give the cash to Maria to purchase the flat in her name there would be no CGT implications for Pep as cash is an exempt asset. This would be treated as potentially exempt transfer for IHT purposes with no IHT implications as long as Pep survives 7 years from making this gift to Maria. As a first-time buyer in England, Maria could also buy a property up to £300,000 at 0% SDLT.

Assuming Maria would be a first-time property buyer she may benefit from opening a LISA (lifetime ISA). Maria could put some of the cash given to her into this ISA and receive an additional 25% contribution from the government when she comes to use the money for a deposit for the property. There is a limit on how much can be contributed into the LISA each year. She would, however, need to keep the money in the LISA for at least 12 months to be able to withdraw it without a charge, so the timing of her intended purchase must be carefully considered.

If Maria owns the property and rents a room out up to £7,500 a year can be received tax-free through ‘Rent a Room’ relief. This would apply whether she had been given the cash to buy the property or it was gifted from Pep.

The advantage of the deed of variation is that IHT skips a generation (Pep's) without any implications on death estates. The £300,000 would be deemed to have been left to Maria instead of Pep therefore it would transfer from Pep's aunt's death estate to Maria's estate. This would be a similar situation to Pep giving Maria the money except there would be no potentially exempt transfer for Pep.

Pep is concerned about Maria having access to a large sum of money early in life and if the flat is in her name she could sell it and use the funds for some other purpose. Therefore, the option of gifting the flat to Maria, giving her the cash or using the deed of variation may not be appealing to Pep.

Section 4: Project A & Ethical matters

'I could cut you in at a special rate if you are willing to help us?...'

'...if you and Robert can arrange the finance, I can find out what they are offering and offer a better deal....'

'...You smile nervously realising that SACI Property Developments are a customer of the bank....'

'...require a contribution of around 30% from us, but I am sure you can find a way around that....'

4.1 Whistleblowing

Project A introduces several serious ethical concerns including:

- Pep offers to cut Fred in at a special rate if Fred is willing to help which could be construed as a bribe with the relevant implications of the Bribery Act. This is further supported by the assertion that Pep is sure Fred will "find a way around" the bank's required contribution. It does seem as if Fred is being offered personal financial compensation to facilitate this deal. Fred is being encouraged to reduce the income that the bank will receive to the benefit of Fred, Pep and Robert.
- In addition, Pep is going to find out inside information about the deal and undercut competitors to ensure that they are successful.
- The other interested party in the deal is also a client of the bank which is a conflict of interest.
- Robert, a bank employee, appears to have full knowledge of the Project A arrangement, and is currently facilitating it. He is also currently advising Skene as well as advising Pep and being involved with Project A – this impacts on Robert's objectivity.

In keeping with other financial organisations, the bank will have a whistleblowing policy and it is in accordance with this policy that Fred should disclose his concerns in relation to Project A.

The suggestion that Fred/Robert should be involved in a private venture with Pep is not in itself an issue. The manipulation and lack of integrity involved though give a serious ethical problem. There is no indication that Tessa is involved or aware of Project A.

It looks as if Robert has already agreed to get involved with Pep so there is already an objectivity problem in existence. There is the direct inference that Robert will bend the lending rules/manipulate the proposal to the credit committee, and there is the matter of using knowledge from inside the bank to undercut another customer, SACI Property Developments. There is also the invitation to Fred to get involved personally. In addition, there is the fact that Pep, as an existing customer, is trying to involve you in the scheme as well.

An email to whistleblowing@albabank.co.uk should be made pointing out the issues above and stating clearly that Fred will not get involved with Project A as this would breach the ethical principles of integrity, professional behaviour and confidentiality. The email should also point out that some of the information provided raises concerns about potential money laundering and, given that Alba is operating in a regulated sector, this must be reported to Alba's MLO.

4.2 Other ethical matters

In addition to the whistleblowing matters there are a number of other issues which could be brought to the attention of Tessa such as:

- the lack of foreign employee documentation; or
- the potential fraud in the tearoom; or
- the VAT issues as potential ethical problems.

If a matter is identified which you think should be highlighted and the reasons why are explained, along with the implications, credit is awarded.

Appendix 1 – Option 1 calculations

Option 1

Hotel goes ahead

Month	1	2	3	4	5	6	7	8	9	10	11	12
	£	£	£	£	£	£	£	£	£	£	£	£
Hotel Chain	10,000					90,000						100,000
Re-development of 5 a side pitches	(16,667)	(16,667)	(16,667)	(16,667)	(16,667)	(16,667)						
Loss of income during development	(3,624)	(3,624)	(3,624)	(3,624)	(3,624)	(3,624)						
Arrangement fee	(1,500)											
Monthly interest		<u>(80)</u>	<u>(219)</u>	<u>(359)</u>	<u>(500)</u>	<u>(642)</u>	<u>(171)</u>	<u>(172)</u>	<u>(173)</u>	<u>(174)</u>	<u>(176)</u>	<u>(177)</u>
Cash inflow/outflow	(11,791)	(20,371)	(20,510)	(20,650)	(20,791)	69,067	(171)	(172)	(173)	(174)	(176)	99,823
Cumulative cash position	<u>(11,791)</u>	<u>(32,162)</u>	<u>(52,672)</u>	<u>(73,322)</u>	<u>(94,113)</u>	<u>(25,045)</u>	<u>(25,216)</u>	<u>(25,388)</u>	<u>(25,561)</u>	<u>(25,735)</u>	<u>(25,911)</u>	<u>73,912</u>

Assumptions

1. Re-development costs £100,000 spread evenly over 6 months
2. 9 months 5 a side income in Yr26 is £65,219. Assume this occurs evenly over 9 months using 6 pitches. Income lost for 3 pitches per month is therefore £3,624.
3. Monthly interest calculated at 0.68% per month

Hotel does not get planning permission

Month	1	2	3	4	5	6	7	8	9	10	11	12
	£	£	£	£	£	£	£	£	£	£	£	£
Hotel Chain	10,000					90,000						
Re-development of 5 a side pitches	-16,667	-16,667	-16,667	-16,667	-16,667	-16,667	2,250	2,250	2,250	2,250	2,250	2,250
Loss of income during development	-3,624	-3,624	-3,624	-3,624	-3,624	-3,624						
Arrangement fee	-1,500											
Monthly interest		<u>-80</u>	<u>-219</u>	<u>-359</u>	<u>-500</u>	<u>-642</u>	<u>-170</u>	<u>-156</u>	<u>-142</u>	<u>-128</u>	<u>-113</u>	<u>-99</u>
Cash inflow/outflow	-11,791	-20,371	-20,510	-20,650	-20,791	69,067	2,080	2,094	2,108	2,122	2,137	2,151
Cumulative cash position	<u>-11,791</u>	<u>-32,162</u>	<u>-52,672</u>	<u>-73,322</u>	<u>-94,113</u>	<u>-25,046</u>	<u>-22,966</u>	<u>-20,872</u>	<u>-18,764</u>	<u>-16,642</u>	<u>-14,505</u>	<u>-12,354</u>

Hotel does not get planning permission

Month	13	14	15	16	17	18
	£	£	£	£	£	£
Hotel Chain						
Re-development of 5 a side pitches	2,250	2,250	2,250	2,250	2,250	2,250
Loss of income during development						
Arrangement fee						
Monthly interest	<u>-84</u>	<u>-69</u>	<u>-54</u>	<u>-40</u>	<u>-24</u>	<u>-9</u>
Cash inflow/outflow	2,166	2,181	2,196	2,210	2,226	2,241
Cumulative cash position	<u>-10,188</u>	<u>-8,007</u>	<u>-5,812</u>	<u>-3,601</u>	<u>-1,376</u>	<u>865</u>