ACT EXAMINATION PAPER

Diploma in Treasury Management (AMCT)

Unit 4a: Financial reporting, tax and regulation for treasury

November 2025

This is a past paper for Unit 4a of the Diploma in Treasury Management (AMCT)

Based on the syllabus assessed from 1 August 2022.

INTRODUCTION

This past paper has been produced by the Awarding Body at the Association of Corporate Treasurers (ACT) to assist students in their preparation for the Diploma in Treasury Management assessments. It is important to highlight that the answers provided in this paper are not exhaustive and that any other reasonable answers would be awarded marks where necessary in a marked assessment. It contains a past exam for the specified unit as well as past answers. Ideally, students should have completed the majority of their Diploma in Treasury Management studies for Unit 4a before attempting this past paper.

Students should allow themselves 180 minutes to complete the exam plus an additional 15 minutes reading time. They should then review their performance to identify areas of weakness on which to concentrate the remainder of their study time. Although the past exam in this guide is typical of a Diploma in Treasury Management assessment, it should be noted that it is not possible to test every single aspect of the syllabus in any one particular exam.

To prepare properly for the examination, candidates students make full use of the tuition options where available and read as widely as possible to ensure that the whole syllabus has been covered.

ASSESSMENT TECHNIQUE

This paper is a professional paper that as well as testing theory expects application to practice at a managerial level.

The best way to approach written assessments is to work methodically through the questions. You should not spend too much time on any one question if you are struggling to think of an adequate answer. Remember you can flag any question to come back to later should you want to continue your way through the exam.

When all of the questions have been answered, it is prudent to use any remaining time to go through each question again, carefully, to double-check that nothing has been missed. Altering just one response could make the difference between passing and failing.

Please ensure you show your workings within your answer when prompted as this means there are marks available for the workings out. You will be able to make rough workings on a piece of paper during the exam and on screen should you wish to, however these will not count towards your final mark.

ASSESSMENT INFORMATION AND TEST SPECIFICATION

The Diploma in Treasury Management Units 4A and 4B each have three mandatory written questions. The papers will be split into sections A and B and will involve a pre-seen case study for Section A that is released no later than two weeks prior to the assessment date. Each unit exam is worth a total of 100 marks. For the purpose of this past paper the questions follow each case study.

Diploma in treasury management assessment test specification:

Section	Amount of questions	Marks available
Section A	one case study based question	50
Section B	two shorter case study based questions	25 marks each
Total	**3**	**100**

Under exam conditions, **3 hours** (180 minutes) is allowed for the Diploma in Treasury Management assessments plus an additional 15 minutes reading time.

When you take your actual exam, you will be sitting online using your own PC/Laptop. You have access to an online scientific calculator, but for the purpose of this past paper, you may use a non-programmable scientific calculator.

In order for you to determine how well you have performed, sample mark schemes are provided after each question. Please note that these are mark schemes only and not model answers. They provide lists of points that are expected to be covered within answers, although the content of your answers must be much more detailed (satisfying the command word used in the question, for example 'analyse'). As with all mark schemes, the content is indicative only, i.e. the lists of points featured are not exhaustive. It is highly likely that there are other perspectives and, provided these are valid and

supported fully, marks would be awarded for these in a live exam. There are also references to the relevant Learning Outcomes if you need to revisit the associated material.

SECTION A

ONE long form question worth 50 marks based on a pre-seen case study. This question should test knowledge, analysis, application insight, evaluation and justification as appropriate to level descriptors. This is a professional paper and application to practice should be at 'management' level.

Total available for Section A: 50 marks

QUESTION 1: CASE STUDY

Eco Vis Naturae Ltd (EVN) is a privately owned UK-based company that designs and supplies sustainable smart technologies for commercial buildings. Its product range includes solar-powered lighting, rainwater harvesting units, and energy-efficient control systems for buildings. Founded five years ago, EVN has experienced substantial growth. Revenues have increased from GBP5m to over GBP90m in the past three years, driven by public-sector contracts and private demand as the push for ESG continues socially and politically.

EVN was founded by a group of scientists and over time has expanded its headcount to include finance, marketing and sales and holds impressive names on its board as non-executive directors. EVN recently hired a chief finance officer (CFO) for the first time who has been building up a strong finance team previously made up of outsourced consultants and temporary junior accountants. There are no specialist teams in tax, treasury or ESG reporting. Most decisions were previously centralised around the chief executive officer (CEO) and board before the CFO's appointment. Given EVN's rapid growth, it has no formal treasury policy nor governance framework, and its systems and internal controls have not kept pace with its growth.

Potential expansion

Given its success in the UK, EVN recently acquired a French company for EUR55m. The structure involved a mix of internal cash, a EUR40m drawdown on a multicurrency revolving credit facility, and the sale of intellectual property rights from the UK to the French subsidiary.

At the same time, there were some opportunities for government contracts in Brazil, therefore EVN's board decided to incorporate a small subsidiary to handle those contracts. EVN now has a fully owned subsidiary reporting in Brazilian Real (BRL) and consolidated into the UK group. The revenue will be reported in BRL and the team uses the same suppliers as the UK to purchase parts.

Upon the initial set up, this subsidiary was funded by intercompany loans and investments. The terms of these loans are loosely documented, have not been priced at arm's length, and are denominated in local currency BRL in the UK books of account. The CFO has also raised some

inquiries on the VAT set up in the Brazilian entity, when it was noticed that certain purchased parts were being recorded at gross and not net of VAT.

The management team has limited knowledge of cross-border tax and legal requirements. As a result, there is no consideration of withholding tax (WHT) on interest or service payments. There is also no awareness of thin capitalisation rules, transfer pricing documentation, nor deductibility limitations in France and Brazil.

Brazil in particular imposes strict rules around WHT and misapplication could result in penalties and loss of deductibility. Additionally, EVN has no mechanism in place to ensure that local finance teams maintain consistent accounting treatment nor reconcile intercompany balances correctly.

An external audit partner has warned that if EVN proceeds with further overseas expansion without addressing its tax governance gaps, it may face challenges with future financing or exit due diligence.

Cash management and foreign exchange

EVN operates 60% of the business through commercial contracts, 30% government contracts and 10% private sales. In order to win business and provide favourable customer terms, sales are typically done in the currency of the customer, and customers demand payment links to be sent so they can pay easily through a method of their choice, with EVN typically taking on the interchange and FX risk. Customers will typically pay a 20% deposit on the project and the remainder on completion. The duration of the contract can be anywhere between one month and six months. There is also a 30-day warranty period for refunds and replacements. After the 30-day period there is a five-year guarantee on all contracts. The teams are trying to forecast the cash conversion cycle, but it is proving difficult with the variation in contract lengths.

EVN relies heavily on sourcing specialised equipment. 80% of product supply is bought mainly from China and other parts of Asia and settled in USD. 20% is harder to procure and involves being on the lookout for the right suppliers at the time, which can be time consuming and difficult to confirm delivery dates. This in turn means contract delivery can have delays. Typically, this 20% is sourced from lesser-known suppliers who require settlement in their own local currency. A majority of the purchased parts require upfront payment, but some larger suppliers have started offering 30-day credit terms.

EVN uses outsourced storage units to store all the relevant supplies and will often order in bulk for anticipated projects without a contract order, just to have the materials ready for assembly. This puts pressure on logistics and delivery and sometimes too much warehouse space is utilised without sensible stock turnover.

The subsidiaries in France and Brazil rely on the supplier relationships that the UK has with the Asian market. The CFO found out that locally in Brazil, the procurement team was sourcing parts from unreputable sources and paying significantly more than expected, which meant the margins on the reported contracts were lower than in France or the UK. As a result, a significant value of

intercompany funding has been occurring between the UK and Brazil to help aid cash levels to purchase parts in Brazil.

To date EVN has not hedged any of its FX exposures. The French subsidiary holds EUR12m across three local bank accounts, and the Brazilian subsidiary similarly holds BRL15m. Both report daily balances to London via manual spreadsheets with no pre-determined submission time. Intra-group payments are made ad hoc via Swift orders to their clearing banks resulting in these banks transacting the exchange.

Cash is being handled by each subsidiary's own finance teams, while the group finance team in London funds the requirements of France and Brazil as and when needed. There is no specific cash pooling arrangement set in place and currencies are constantly being traded to satisfy the exposures across the business.

ESG reporting and green bond aspirations

Given its environmentally focused product line, EVN is seeking to raise GBP25m - GBP50m through a Green Bond or Sustainability-Linked Loan (SLL) to fund international growth and R&D. Discussions have been held with two banks and one impact-focused private debt fund, all of whom require evidence of ESG strategy and robust environmental performance reporting.

EVN's ESG figures are stored in excel files run by the product and operations teams. Each quarter they pull together how much solar energy was generated, how much rainwater was harvested, and an estimate of CO_2 avoided, then publish a simple "Impact Overview" PDF on the website. This is published in a largely unstandardised format and whilst some measures are reported, key metrics are not. For example, these are not split into direct or indirect emissions and the published level of detail in the report is often limited.

The banks have advised that without transparent allocation reporting, clear use-of-proceeds governance, and impact KPIs, EVN will not qualify for green-labelled financing. EVN has no internal process to support post-issuance reporting, and no one within the business has experience of investor ESG disclosures. The CFO is concerned that EVN's failure to demonstrate environmental impact or control frameworks may delay or jeopardise access to sustainability-linked capital.

QUESTION 1

a.	Evaluate the foreign exchange risks faced by EVN. You are also required to recommend and justify **THREE** ways the EVN group treasury team could improve its policy, controls and hedging strategy.	16 marks
b.	Assess the tax risks faced by EVN in relation to its group financing and licensing structures. You are also required to recommend and justify **THREE** ways EVN could improve tax efficiency and compliance.	12 marks
c.	Analyse the liquidity and cash management challenges at EVN. You are also required to recommend and justify **THREE** ways EVN could improve its liquidity.	14 marks
d.	Assume the floating interest rate for the MHC EUR890m loan has increased from 5% during 2023 to 6% during throughout 2024 due to a rise in inflation. Calculate and comment on the change in interest cover before and after the interest rate change in light of the covenant agreed. You are required to show your workings.	8 marks
		Total: 50 marks

Mark scheme

Q1a

• EVN's intercompany loans in BRL and EUR are entirely unhedged, leaving the group exposed to transaction losses if either currency weakens against GBP. • Any consolidation and retranslation of the foreign subsidiaries under ISA 21 which can cause volatility in the P&L and statement of changes in equity. • Customer payments made in USD, EUR, BRL and other currencies carry FX risk between invoice date and collection. • Purchases settled in USD and various local currencies expose EVN's outflows to adverse rate movements. • Intra-group funding via one-off uncontrolled bank spot trades often locks in unfavourable exchange rates and fluctuating costs. • Multiple local bank accounts for example EUR 12 million in France and BRL 15 million in Brazil sit idle and generate translation exposures under IAS 21. • Subsidiaries report cash balances at different cut-off times, preventing an accurate, consolidated view of FX positions. • Manual spreadsheets are used to track exposures, increasing the risk of errors and delaying recognition of currency movements.	1 mark for each valid point

- Monthly retranslation of foreign monetary items introduces P&L volatility and could lead to covenant breaches or other potential reporting/commercial issues like volatility to budget.
- EVN lacks any natural hedges, such as borrowing in BRL to finance Brazilian operations, to offset local-currency costs.
- Central funding of local-currency needs from London's RCF exposes EVN to FX risk on both disbursement and repayment
- EVN has no Treasury Management System or ERP integration to provide real-time FX position-keeping. Therefore, has to rely on other source data, which is risky and prone to human error when extracting data.
- Recommend: Establish a formal FX policy with defined risk limits, approved instruments, and centralised decision-making under a dedicated treasury function.
- Recommend: Implement a Treasury Management System integrated with the ERP to automate netting, pooling, and real-time exposure reporting.
- Recommend: Adopt a structured hedging strategy—using forwards, options, and natural hedges—and apply cash-flow and net-investment hedge accounting under IFRS 9.

Total marks: 16

Q1b

No withholding tax deducted on interest paid by the Brazilian subsidiary, exposing EVN to penalties and disallowed deductions.

No withholding tax deducted on service fees or royalties paid to the UK parent by France, risking local fines.

Informal, unpriced intercompany loans may breach Brazil's thin-capitalisation rules, leading to denied interest relief.

Informal, unpriced intercompany loans may breach France's thin-capitalisation rules, leading to denied interest relief.

Absence of transfer-pricing documentation for IP royalties risks tax authority adjustments and penalties.

Absence of transfer-pricing documentation for shared support services risks TP audits and profit re-allocation.

Transferring IP without a proper valuation exposes EVN to taxable hidden reserves and transfer pricing disputes.

No assessment of VAT recovery on cross-border intercompany payments risks VAT being irrecoverable.

1 mark for each valid point

Failure to account for Brazilian import duties and local VAT on imported parts risks unexpected tax liabilities and penalties. Recommend formal loan agreements with arm's-length interest rates and clear repayment schedules. Recommend benchmarking studies or advance pricing agreements to validate debt/equity ratios for thin-cap compliance. Recommend drafting and maintaining TP policies and local TP reports for all intercompany charges. Recommend registering for local WHT, applying treaty relief where available, and implementing gross-up mechanics.	**Total marks: 12**
Q1c	
No consolidated group cash-flow forecast, leaving EVN unaware of total liquidity needs. Local finance teams use different templates and reporting dates, preventing timely visibility. Significant working capital stretch between payment of suppliers and cash collections from customers. In some cases, 100% of the costs would need to be paid upfront with only 20% collected from the customer and a further potential 5 month delays in collection of the remainder of the contract revenue which causes delays on working capital cycle and conversion and adds pressure and instability. 20% deposit from customers is very low considering some projects may last 6 months, the pricing model should be varied across different contracts and their complexities to support the business. Bulk "just-in-case" ordering without firm contracts inflates warehouse costs and cash outflows. No cash-pooling or in-house bank: subsidiaries hold idle balances (EUR 12 m/BRL 15 m) locally. Emergency drawdown from London creates admin issues and time delays but also incurs bank charges and other potential FX transaction costs. Manual SWIFT transfers and spreadsheets for intra-group payments introduce delays and errors. Lack of automated cash-position reporting prevents real-time decision-making. No defined liquidity KPIs or targets in monthly management reports. Recommend: Implement a single weekly/monthly group cash-flow forecast with standard templates and cut-off times to provide early warning of liquidity gaps.	1 mark for each valid point

Recommend: Establish an in-house bank or payment-factory structure to centralise cash, net payables against receivables, and minimise unnecessary cash movements. Recommend: Working-Capital Optimisation: Reduce DSO via standardised payment terms and e-invoicing; extend DPO with key suppliers; and trim inventory to target levels, through demand-driven ordering or vendor-managed inventory.	**Total marks: 14**
Q1d	
Adopt recognised ESG frameworks (e.g. GRI for sustainability reporting and TCFD for climate-related disclosures) and map eligibility under the EU Taxonomy. Appoint a dedicated ESG officer and establish a board-level ESG committee to oversee strategy, data integrity, and compliance. Define clear, quantitative KPIs (such as scope 1–3 greenhouse gas emissions, water usage, and energy savings) with baseline measurements and public targets. Implement a dedicated green bond proceeds sub-account or virtual ledger to ring-fence funds and ensure transparent allocation to eligible projects. Develop a use-of-proceeds framework that specifies which projects qualify (e.g., R&D into energy-efficient controls or solar installations) and the look-back period for refinancing. Publish annual impact reports showing both financial allocations and measurable environmental outcomes (e.g., MWh of solar capacity added, CO_2 reductions achieved). Engage an independent verifier (second-party opinion or limited assurance provider) to review the use-of-proceeds framework and impact data each year. Integrate ESG data collection into the company's financial close and reporting cycles, using simple digital tools at each site to automate metric capture and ensure consistency. This mark scheme is not exhaustive – all valid points within answers will be awarded marks. **Syllabus refs: 4.1.3; 4.1.4; 4.2.4; 4.3.2; 4.3.3; 4.5.3.**	1 mark for each valid point **Total marks: 8**
	Total: 50 marks

SECTION B – 50 MARKS

TWO longer form questions, based on mini case studies, of which both are compulsory (2 x 25 marks).

Questions test knowledge, analysis, application, insight, evaluation and justification as appropriate to level descriptors. This is a professional paper and application to practice should be at 'management' level. Candidates are expected to be able to synthesise knowledge from different elements of the syllabus rather than be tested on discrete areas.

Total available for Section B: 50 marks

QUESTION 1: CASE STUDY

TerveysPharma (TVP) is a pharmaceutical company, headquartered in the UK, with significant operations across Scandinavia. TVP reports under IFRS and its functional and reporting currency is GBP. In a new strategic move in commercial operations, TVP now enters into customer contracts to deliver pharmaceutical products to major buyers in Norway and Finland. The total forecasted revenue exposure for the year ahead is NOK800m and EUR50m.

Hedging

Historically, TVP did not actively hedge its currency exposures, relying instead on the commercial and finance teams experience to adjust pricing. However, following a year of volatile earnings due to sharp fluctuations in GBP/NOK and GBP/EUR, the board asked the treasury team to implement a more robust foreign exchange (FX) risk management strategy.

As a result, TVP entered into a series of forward foreign exchange (FX) contracts to lock in GBP values for its expected NOK and EUR revenues. These contracts were designed to hedge the highly probable forecast sales in foreign currencies. Treasury has classified these instruments as cash flow hedges under IFRS 9 and has documented the hedging relationships accordingly.

On a monthly basis, the treasury team would receive the valuation of the forward contracts which fluctuates significantly due to exchange rate movements. The treasury team is unsure how to present these fair value gains/losses in the financial statements. Additionally, external auditors have questioned the hedging relationships as several contracts with EU customers are still being negotiated and no firm commitments have been signed.

TVP's finance team is aware that under IFRS 13, all derivatives (including FX forward contracts) must be measured at fair value at each reporting date. They want to ensure that the valuation of the

contracts is compliant with IFRS 13 and are currently relying on the valuation data provided by the hedging partner which is a major global bank.

This will also be the first-year end that TVP will be reporting disclosures surrounding the risks and hedging relationships in the annual accounts and the chief finance officer (CFO) has asked for a clear explanation of the following:

how hedge accounting rules interact with fair value measurement

how to improve transparency around FX risk in TVP's reporting

what are the proposed disclosures under IFRS 7.

Data protection

80% of TVP's revenue comes from customer contracts with large multinationals whilst 20% is driven by an online pharmacy, where registered individuals can purchase medicine via doctor referrals, also provided by TVP. Customers can make an account on the website using personal data, including their names, date of birth, addresses, credit card details and social security number.

Employees can access data as and when necessary to perform their tasks. For example, the finance team has access to the billing information whilst the operations team (mainly medical professionals) has access to the medical history. Commercial teams have capacity to access data to give customers specialised discounts and targeted ads based on their purchase and viewing history.

The chief information officer (CIO) wants to get more assurance on the central database, specifically focusing on segregation of duties and access rights. It has been highlighted to them that several employees in the UK and EU commercial teams had access to customer financial data. In addition, some employees in the finance team have emailed customer information to their personal email accounts when there have been system faults or when they have been required to work overtime.

QUESTION 1

a.	Analyse the key issues faced by TVP in relation to its hedging strategy. Your analysis must specifically focus on the requirements under IFRS 9, IFRS 7 and IFRS 13.	15 marks
b.	Evaluate the impact of data protection regulations on TVP. Within your answer you are required to recommend and justify THREE ways that TVP can improve its data protection and to be compliant.	10 marks
		Total: 25 marks

Mark Scheme

Q1a

IFRS 9 – Financial instruments	
• Lack of firm commitments – FX forwards were designated as cash flow hedges before contracts were signed, which may breach IFRS 9's "highly probable" requirement.	1 mark
• Incomplete hedge documentation – IFRS 9 requires formal documentation at inception, which may not be valid for contracts still under negotiation.	1 mark
• Hedge ineffectiveness risk – Variability in forecast cash flows makes it difficult to ensure effectiveness, potentially leading to reclassification of OCI amounts to P&L.	1 mark
• Incorrect accounting treatment – TVP may have recorded gains/losses in OCI without verifying hedge qualification, risking misstatement.	1 mark
• Audit challenge – External auditors have raised concerns, indicating possible non-compliance with hedge accounting under IFRS 9.	1 mark
IFRS 13 – Fair value measurement	
• Valuation hierarchy classification – TVP must determine if bank valuations are Level 2 (observable) or Level 3 (unobservable), which affects disclosures.	1 mark
• Transparency of valuation techniques – IFRS 13 requires disclosure of inputs/methods used; TVP may be relying on bank pricing without understanding the methodology.	1 mark
• Lack of independent validation – Sole reliance on the bank could be challenged by auditors; an internal check or external verification may be needed.	1 mark
• Need for regular revaluation – TVP must ensure all derivatives are revalued at each reporting date, not just when contracts	
• mature.	1 mark

• IFRS 13 disclosures – TVP should also consider those assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.	1 mark
IFRS 7 – Financial instruments: Disclosures	
• Explain hedging strategy – TVP must clearly state its FX hedging objectives, instruments used, and currencies involved (EUR and NOK). • Effectiveness and impact disclosure – IFRS 7 requires showing how effective hedges are, and movements in OCI and P&L from hedging. • Breakdown of derivative positions – Disclose notional amounts, maturity dates, and fair values of forward contracts by currency. • Disclosure of FX risk exposure – Provide both qualitative and quantitative information on FX exposures and how they're managed. • Explanation of strategy change – As this is TVP's first year using hedge accounting, explain the rationale behind the new policy.	1 mark 1 mark 1 mark 1 mark 1 mark
	Total marks: 15

Q1b

Data Protection	
• Cash managers need to be aware of the specific policies and guidelines set by their organisations and how these cover the various jurisdictions the company operates in. • GDPR applies to all organisations that process, or control personal data connected to individuals within the EU regardless of the organisation's' geographical location. TVP should ensure that any subsidiaries that have access to data of EU customers have not committed similar breaches • In the EU, the GDPR has harmonised data protection laws, specifically governing the handling of personal data which is defined as any information that identifies, or can be used to identify, an individual. TVP is currently in breach of these regulations by allowing customer data to be stored on personal devices, which poses significant security and compliance risks.	1 mark 3 marks 3 marks
Recommendations	
• Data protection officer - TVP should consider appointing a data protection officer who will be responsible for correct data handling and protection and if able to be consulted in complex situations. • Training for all staff – Across all the entities in UK and EU, ensuring data security and GDPR training is mandatory.	1 mark 1 mark

• Conduct a full data review and cleanup – Especially ahead of audits and other investigations, a full investigation and cleanup should be launched to review data incorrectly stored and handled, on personal and company laptops. This mark scheme is not exhaustive – all valid points within answers will be awarded marks. **Syllabus refs: 4.2.2; 4.2.3; 4.2.4; 4.5.1.**	1 mark **Total marks: 10**

Total: 25 marks

QUESTION 2: CASE STUDY

Verde Motion Ltd (VML) is a UK private equity owned electric vehicle manufacturer with international operations across North America and Europe. VML was initially set up through equity investment and transacts in GBP. VML uses new technology to create luxury electric vehicles but is still going through a period of research and development, including significant investment in the development of the technology. The majority of the key components are sourced from China and there have recently been delays and increased prices due to significant political shifts.

Debt

To support its continued growth strategy, VML recently secured a 5%, GBP100m unsecured syndicated loan governed by the Loan Market Association (LMA) documentation. The facility includes typical terms such as maintenance covenants. These covenants are:

- a maximum net debt to EBITDA ratio
- a minimum interest cover ratio
- non-financial covenants including a negative pledge and obligations to provide regular financial information.

To hedge its foreign exchange exposures arising from USD procurement from China, VML also entered into a series of OTC derivative contracts with a less prominent FX provider. The chief finance officer (CFO) was keen to obtain better pricing than a traditional bank and therefore agreed to the terms provided. These are governed by a 2002 ISDA Master Agreement and are supported by a Credit Support Annex (CSA).

Recently, VML encountered a series of financial difficulties. One of VML's key suppliers in China experienced severe quality control failures, resulting in a large batch of unusable parts. The finance team at VML were unsure where to book the GBP3m in unusable inventory in the profit and loss statement.

The OTC derivative contracts VML entered into were designed to hedge future foreign exchange risk rather than current procurement exposures. As a result, they offered no protection against the recent surge in USD costs driven by political and economic instability affecting imports from China. This timing mismatch led to significant unhedged cost increases on key components and an impact on EBITDA. Volatile currency movements caused one of VML's FX hedge positions to move significantly out of the money. As a result, the counterparty issued a margin call for GBP4m in collateral under the CSA. This created significant confusion and distress across the finance and treasury departments, especially when the head of treasury said they were not aware of this clause.

Covenants and financial data

GBPm	FY2025
EBITDA	18.0
Long term borrowings	100.0
Revolving credit facility 5%	4.5
Cash and cash equivalents	50.0

Covenants	
Maximum net debt to EBITDA	3x
Minimum EBITDA interest cover	2.5x

The CFO is under significant pressure, with questions from the private equity owners, the lending syndicate and the board. Each stakeholder is demanding clarity on the financial impact, the covenant breach and VML's ability to manage its risks going forward.

QUESTION 2

a.	Assess whether VML is in breach of its financial covenants after taking into account the unusable inventory and margin call.	6 marks
b.	Evaluate the potential consequences of such a breach under LMA documentation and the steps that VML should take to address the breach with the lenders.	15 marks
c.	Discuss the key weaknesses of VML's approach to foreign exchange risk management and recommend **ONE** way it could mitigate the risk.	4 marks
		Total: 25 marks

Mark Scheme

Q2a

Reworked results after financial difficulties:	
EBITDA: £18 million - £3 million = £15 million	1 mark
Cash and cash equivalents: £50 million - £4 million = £46 million	1 mark
Net Debt calculated as: Long term borrowings + revolving credit facility – cash and cash equivalents	
Net debt/EBITDA = (£100 million + £4.5 million - £46 million)/ £15 million = 3.9 x = BREACH	2 marks
Minimum interest cover	
Financing costs = 5% * £100 million + £4.5 million = £5.23 million	1 mark
Minimum interest cover = £15 million /£5.23 million = 2.9 x = NO BREACH	1 mark
	Total marks: 6

Q2b

Potential consequences	
CSA - Under the CSA terms, either party is required to post collateral when the net market value of the derivative positions moves against them. The Treasurer/CFO should have been familiar with this as part of the contract.	1 mark
Event of Default under LMA – Breach of the net debt to EBITDA covenant (exceeding 3x) is typically classified as an Event of Default unless waived by lenders.	1 mark
Acceleration of the loan – If uncured, lenders may demand immediate repayment of the entire £100m loan and £4.5m RCF, posing a major liquidity risk for VML.	1 mark
Suspension of drawdowns – VML may be prevented from drawing further on the RCF while in default, tightening cash during a capital-intensive R&D period.	1 mark
Cross-default risk – A default under the syndicated facility could trigger defaults under other financial agreements or supplier contracts with cross-default clauses.	1 mark
Loss of lender confidence – Continued breaches or poor communication could damage relationships with the lending syndicate, leading to stricter terms or future financing difficulty.	1 mark
Increased reporting obligations – Lenders may impose more frequent covenant testing or require updated forecasts and liquidity reporting to monitor risk.	1 mark
Reputational and commercial impact – The breach may cause concern for private equity owners and counterparties, affecting strategic options or valuation.	1 mark
Next steps	
Notify lenders immediately – Under LMA terms, VML must formally and promptly inform the agent bank of the breach, with details of the cause and timing.	1 mark

Request a waiver – Submit a waiver request explaining the breach is due to identifiable and one-off issues (e.g. supplier failure and FX mismatch), not long-term decline.	1 mark
Provide revised forecasts – Share updated financial models and assumptions to demonstrate the company's recovery plan and future covenant compliance.	1 mark
Present a mitigation plan – Outline operational actions being taken: supplier remediation, cost controls, reassessment of hedging policy, and strengthening of treasury oversight.	1 mark
Propose covenant amendment if needed – If future headroom remains tight, propose temporary covenant relaxation in exchange for a margin ratchet, additional fee, or reporting undertakings.	1 mark
Align stakeholders – Keep PE owners and the board aligned on the narrative before engaging lenders, ensuring consistency of messaging and support.	1 mark
Engage external advisors – Consider using legal or financial advisors to assist in lender negotiations, especially if waivers or amendments become complex.	1 mark
Review hedging governance – Commit to reassessing FX hedging strategy and CSA terms to prevent mismatches and better manage margin call risk in future.	1 mark
	Total marks: 15
Q2c	
Weaknesses in foreign exchange risk management Timing mismatch in hedge coverage – The FX forwards were structured to hedge future procurement, not current exposures. As a result, VML was left unhedged during a period of rising USD costs.	1 mark
Poor alignment of hedge with actual cash flows – hedging based on forecast assumptions, without aligning to committed or contracted purchases, increased the risk of hedge ineffectiveness or irrelevance.	1 mark

	Inadequate counterparty assessment – The CFO opted for a less prominent FX provider based on pricing, potentially exposing VML to greater counterparty and operational risk, including less flexible CSA terms.	1 mark
	Lack of internal FX governance or strategy – The decision-making appears ad hoc, with limited reference to a structured treasury policy or risk appetite framework.	1 mark
	Recommendation	
	Implement a formal FX risk management policy – Establish a documented policy that includes clear rules on hedge timing, instruments, limits, counterparty selection, and governance. This would improve strategic alignment and reduce the risk of mismatch or ineffective hedges.	1 mark
	This mark scheme is not exhaustive – all valid points within answers will be awarded marks. **Syllabus refs: 4.1.4; 4.4.1; 4.4.2; 4.4.3.**	**Total marks: 4**
		Total: 25 marks

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