ACT
PAST PAPER

Diploma in Treasury Management (AMCT)

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

July 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, students should 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 3 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	1 case study based question	50
Section B	2 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

1 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

Luxa Marine Yacht (LMY) is a private luxury yacht charter company specialising in high-end, tailor-made sailing experiences across Southern Europe and France. Founded in 2008 and headquartered in Paris, it quickly became a market leader, catering to affluent travellers seeking bespoke yacht holidays. The highly seasonal business thrived prior to the COVID-19 pandemic. LMY expanded its fleet and secured long-term marina leases in key destinations, including the South of France, Greece, and Italy, all of which are operated as separate legal entities. The pandemic brought operations to a near standstill but since 2022, LMY has rebounded, with strong summer bookings and increasing demand as it expanded its business into the East Asian market. In 2024, LMY acquired a company in Singapore to enhance its East Asian presence.

Financial performance

The financial statements are consolidated financial statements for the group with the group reporting currency being EUR. Below are excerpts from the consolidated management accounts.
The chief executive officer (CEO) prefers to report on earnings before interest, tax, depreciation, and amortisation (EBITDA) as the bank covenants requirements are based on EBITDA.

EUR'm	FY2024	FY2023	FY2022
Revenue	115.0	75.0	50.0
Staff costs	(3.0)	(2.0)	(1.5)
Administrative expenses	(11.5)	(10.0)	(9.5)
EBITDA	**8.5**	**7.0**	**3.0**
Exceptional items	(5.0)	(3.0)	(2.4)
Finance costs	(5.1)	(4.5)	(4.4)

Notes:
Administrative expenses include the crystallised hedge gains/losses on financial derivatives taken out to hedge foreign exchange risks. The related mark-to-market on unsettled derivative contracts are taken below EBITDA.

Cash management

LMY generates 70% of its revenue through bespoke yacht charters where pricing varies based on yacht type and duration. The remaining 30% of revenue comes from premium add-ons such as tailored itineraries and partnerships with luxury hotels. Costs of sales include yacht maintenance, crew wages, fuel and port fees, with significant expenses tied to vessel leasing and marina fees. Variable costs fluctuate with charter demand and length.

Since COVID-19, the company has experienced some issues with cashflow and cashflow forecasts. The CEO has recently raised concerns with the chief financial officer (CFO), questioning why cash continues to be a struggle during the low season, despite the company's healthy revenue and EBITDA growth.

The seasonality of LMY shows high-season from May to October when the weather is better, and a low season November to April. Cash from customers would typically be received 30 days in advance of travel and some suppliers would be paid within 30 days after the travel date. However there are some suppliers that take a long time to invoice or would invoice at the end of the season for the entire season.

LMY ended the 2024 financial year with minimal trade receivables on the balance sheet as all cash was already collected and EUR4m trade payables. At the end of Q1 2025, that balance decreased as payments were being made when cash was available however in some cases, payment plans had to be negotiated which were dependent on cash collections from the low season.

During the pandemic, LMY put most of its staff on furlough and reduced executive pay. Since 2022, LMY has had to re-invest heavily into business transformation which included re-hiring operational and administrative staff and incentivising existing staff to stay with the business.

LMY took out a EUR3m EURIBOR loan with its banking partner in 2015 which is due for repayment in 2025. The company settles interest on a quarterly basis and there are no principal repayments. The bank requires a 13-week cashflow provided every month for covenant purposes with a minimum liquidity threshold of EUR2.5m at the calendar month end.

Once a month, a 13-week cash-flow forecast is produced from consolidated figures provided by the local finance entities. Some of the finance teams are inexperienced, new to the business and have not gone through a typical season.

LMY has many leases on yachts and marinas which are accounted under IFRS16. The treasury team has been including the financing costs in the liquidity cash flows, which the CFO does not think is the right methodology.

Foreign exchange

It is the first year that the new Singaporean entity is consolidated into the group accounts and the CEO is increasingly concerned about how the foreign translation will impact the group's consolidated accounts. The Singaporean entity's functional currency is SGD whilst the consolidated accounts are reported in EUR.

To satisfy customer demands and the wide private customer base, LMY allows customer invoicing to be done in GBP, EUR, USD, and CHF but will accommodate other currencies if the customers specifically ask. The cost base is mainly in EUR but now will also include SGD.

The complexities of working with multiple currencies means non-traditional banking is used that allows exchange into the home currency (EUR) to be done automatically by the bank. There is no official foreign exchange hedging policies or hedge accounting used, but some derivatives are used in the business on a more ad hoc basis.

The CFO wishes to hedge a portion of the company's fuel costs during the year in order to protect the budget from price volatility. Fuel price risk is managed through a contract for difference (CfD), typically settled in USD. As LMY typically holds lower levels of USD, there would be further situations where EUR or GBP would need to be sold to purchase USD.

Intercompany cash pools and loans are a key component of LMY's liquidity management. This is particularly true during the low season when cash management is crucial and requires liquidity to be spread across the appropriate companies to satisfy fixed costs.

Environmental, Social & Governance (ESG)

LMY has recently faced scrutiny over the environmental impact of luxury yacht charters, particularly concerning fuel consumption, marine pollution, and the sustainability of yacht manufacturing. This is important not only to LMY's public image but is also to its high-net-worth customers who themselves face scrutiny from the public. Given the growing emphasis on ESG initiatives, LMY is actively exploring greener alternatives to reduce its carbon footprint and overall focus on environmental, social and governance practices.

This includes transitioning to hybrid and electric propulsion systems, using sustainable materials in yacht interiors, and partnering with charities that promote ocean plastic clean-up operations. Additionally, LMY is committed to reducing water usage and minimising the environmental impact of on-board amenities.

LMY is dedicated to maintaining high standards of safety, fair wages, and ethical working conditions across its global network of crew and support staff, in particular with the recent acquisition in Singapore. LMY ensures that all partner shipyards and service providers comply with strict labour standards. LMY also invests in crew training programmes to improve service quality and promote workplace safety.

In terms of governance, LMY has faced challenges with executive compensation transparency, as it deals with high-net-worth clients who value exclusivity and privacy. While executives are paid well, this has raised concerns about clarity in pay practices. LMY recognises the need to improve transparency in executive pay and align its governance practices with best practice.

QUESTION 1

a.	Analyse the key cash management risks faced by LMY.	**15 marks**
b.	Recommend, with reference to short-term, medium-term and long-term cash-flow forecasts, LMY might improve and manage its cash-flow forecasting.	**10 marks**
c.	Assess the foreign exchange risks faced by LMY.	**10 marks**
d.	Discuss the importance of ESG reporting to LMY and recommend relevant metrics to be included in an annual report under each of the ESG headings.	**15 marks**
		Total: 50 marks

Mark scheme

Q1a

EBITDA does not equal cash. Despite the business performing better in revenue and EBITDA, the finance costs and exceptional spend is increasing which is all cash based therefore having a negative impact on cash.	2 marks
LMY's revenue is heavily concentrated between May and October, creating a cash flow imbalance in the off-season (November to April).	1 mark
If suppliers bill on a timely basis this will create significant negative cashflow and LMY will need to manage the timing of the payments and supplier relationships.	1 mark
Costs such as yacht leases, marina fees, and crew wages are significant fixed costs that must be paid even in the off-season.	1 mark
Some suppliers delay invoicing until the end of the season, creating large trade payables that accumulate and require settlement in the off-season when cash inflows are minimal.	1 mark
Local finance teams in different regions, particularly those newly integrated, lack experience in LMY's seasonal cash cycles, leading to forecasting errors.	1 mark
A lack of visibility over when large supplier payments will be made affects cash flow predictability.	1 mark

LMY has a €3 million EURIBOR loan due in 2025, and interest payments are settled quarterly. The timing of the interest payments will be relevant irrespective of the seasonality.	1 mark
The interest on the debt is variable and therefore is the impact on cash during settlement periods.	1 mark
The bank requires a 13-week rolling cash flow forecast with a minimum liquidity threshold of €2.5m at the month-end, adding pressure to maintain adequate cash reserves. Assumption that cash reserves have all been used up due to the pandemic.	1 mark
Payables were already overdue at year end which meant payment plans had to be negotiated but if they were not followed through this can impact supplier relationships due to low season cash inflows.	1 mark
Significant exceptional spend is seen year on year which is assumed to be cash accounted. The business needs to find a way of managing and controlling the spend in line with cash forecasting.	2 mark
Exceptional spend is itself not budgeted due to its nature, therefore it is harder for teams to forecast cash impacts.	1 mark

Q1b

Recommendations for Improving & Managing Cash Flow Forecasting (10 marks max)	
Short-Term Forecasting	
Enhance the 13-Week cash flow forecast: Ensure weekly updates, incorporating supplier payment expectations and customer deposits.	1 mark
Supplier payment smoothing: Negotiate with key suppliers to avoid bulk invoicing at the season's end and implement structured payment schedules to spread cash outflows. Negotiate a discount for paying earlier if possible.	2 marks

Better tracking of late supplier invoices: Implement a system requiring suppliers to submit invoices and conduct frequent supplier statement reconciliations.	1 mark
Dedicated cash flow monitoring team: Assign experienced finance personnel to review cash flows weekly, particularly during the low season.	1 mark
Medium-Term Forecasting	
Establish a low season liquidity buffer: Ensure sufficient cash reserves are accumulated during the high season to sustain operations in the low season.	1 mark
Refine revenue & cost forecasting models: Use historical trends and market demand projections to better estimate revenue inflows and expected costs.	1 mark
Improve trade payables management: Classify supplier payments into critical (e.g., crew wages) and flexible (e.g., marina fees, maintenance) to better align cash outflows with revenue seasonality.	1 mark
Short-term credit facilities or overdraft facilities to also be considered to support low season liquidity.	1 mark
Review IFRS16 Treatment in Liquidity Forecasts: Exclude financing lease costs from short-term cash flow models to align with best treasury practices.	1 mark
Long-Term Forecasting	
Debt restructuring strategy: Evaluate refinancing or extending the €3m EURIBOR loan beyond 2025 to ease future liquidity pressure.	1 mark
Diversify revenue streams: Expand non-seasonal income sources such as yacht maintenance contracts, winter charters in warmer regions, or strategic partnerships with luxury brands.	1 mark
Investment in financial training: Provide structured training for regional finance teams to improve cash flow forecasting accuracy and align methodologies	

across the business, refining forecasting models, improving cash visibility, and negotiating better supplier payment terms.	1 mark
New premium on re hiring staff: strategic long-term planning on future staff changes or expansion to include a premium on staff hire as likelihood of salary changes.	1 mark

Q1c

Translation Risk – Consolidating the Singaporean entity (SGD) into group accounts (EUR) exposes LMY to currency fluctuations, affecting reported financial performance.	1 mark
Transaction Risk – LMY invoices customers in multiple currencies (GBP, EUR, USD, CHF) while its cost base is primarily in EUR and SGD, leading to potential FX gains or losses that can impact EBITDA and profitability in the company.	1 mark
Mismatched Revenue and Costs – Revenue from different currencies may not align with costs, creating FX exposure when converting earnings to cover expenses.	1 mark
Fuel Cost Hedging – Fuel purchases are hedged using USD derivatives, but fluctuations in USD/EUR exchange rates impact cost predictability and financial planning. Given that the hedges are taken to EBITDA means gains/losses on the hedges will have a direct impact on covenants if done incorrectly	2 marks
Intercompany cash pooling – Managing liquidity across different legal entities requires currency conversions, increasing exposure to FX volatility.	1 mark
Lack of formal hedging policy – The absence of a structured FX hedging strategy increases LMY's vulnerability to unpredictable currency movements.	1 mark
Market dependency – Expanding into East Asia (SGD-based operations) adds complexity, as EUR/SGD fluctuations may impact profitability and investment returns.	1 mark
Settlement timing risk – Delayed settlements on transactions in different currencies can lead to unexpected FX losses due to rate changes between invoice issuance and payment.	1 mark

Non-traditional banking exposure – Using non-traditional banking for currency conversions increases reliance on third-party platforms, which may have higher fees or unfavourable exchange rates.	1 mark
Customer pricing risk – Offering invoicing in various currencies without proper FX management could lead to unintended price discrepancies and margin erosion.	1 mark
ESG reporting is crucial for LMY as it enhances transparency, strengthens stakeholder trust, and aligns with the sustainability expectations of high-net-worth clients. As environmental concerns grow, luxury brands must demonstrate commitment to sustainability. Additionally, investors and regulators increasingly expect strong ESG disclosures, particularly in industries with high environmental impact. Improved social and governance practices can also enhance employee satisfaction and reduce reputational risks.	3 marks

Q1d

Environmental Metrics (4 marks max)	
Carbon emissions reduction: Measure and report CO_2 emissions from yacht operations, with targets for reduction through hybrid/electric propulsion adoption.	1 mark
Sustainable fuel usage: Track the percentage of fleet operating on hybrid/electric or alternative sustainable fuels.	1 mark
Eco-friendly materials: Report on the proportion of yachts using sustainable materials in interiors and construction.	1 mark
Waste & water management: Disclose waste recycling rates and water consumption per yacht trip, with targets for reduction.	1 mark
Social Metrics (4 marks max)	
Fair wages & ethical labour compliance: Ensure and report adherence to international labour laws, fair wage policies, and working condition standards.	1 mark

Crew training & safety: Track annual training hours per crew member and report incident rates related to workplace safety.	1 mark
Diversity & Inclusion in workforce: Disclose gender and nationality diversity across crew and corporate staff, with improvement targets.	1 mark
Local community impact: Report on partnerships with local businesses and marine conservation initiatives to support sustainable tourism.	1 mark
Governance Metrics (4 marks max)	
Executive compensation transparency: Disclose executive pay structures, including variable compensation linked to ESG performance.	1 mark
ESG policy oversight: Report on board-level ESG governance, including roles responsible for sustainability initiatives.	1 mark
Anti-corruption & ethical business practices: Measure adherence to anti-bribery laws, compliance training completion rates, and any reported violations.	1 mark
Client & stakeholder ESG engagement: Track customer feedback on sustainability efforts and disclose ESG-related client policies, such as carbon offsetting options.	1 mark
This mark scheme is not exhaustive – all valid points within answers will be awarded marks.	
Syllabus refs: LO16, LO17, LO20	
	Total: 50 marks

SECTION B – 50 MARKS

2 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

Lontech AI Ltd. (LAI) is a London-based AI technology company specialising in predictive analytics and automation. LAI has expanded rapidly across the UK and Europe. However, it has struggled with retaining clients and achieving sustainable recurring revenue growth. While LAI has developed cutting-edge AI-driven solutions, its reliance on project-based contracts rather than long-term service agreements has created revenue volatility.

LAI is a private equity-owned business, and with mounting pressure from investors to drive profitability and stabilise cash flow, the executive board explored potential merger and acquisition opportunities to strengthen its market position. The board identified strategic acquisitions as a way to diversify its service offerings, enhance technological capabilities and secure a larger enterprise client base.

Merger

LAI completed a strategic merger with a Manchester-based data intelligence company, strengthening its AI-driven solutions and expanding its corporate client base. The merger created significant operational synergies, combining expertise and resources to drive innovation and scalability.

As a result of the merger, LAI welcomed an additional 50 employees, increasing its workforce from 20 to 70. To optimise costs and streamline operations, the executive team decided to terminate LAI's existing London office lease and relocate its employees to Manchester. The acquired company's premises, with a capacity for 100 employees, offered ample space at a significantly lower rental cost than London, making it a financially and operationally strategic move for the combined business.

Business strategy

The recent financial results are outlined below, with FY2023 figures reflecting LAI's performance pre-merger and FY2024 incorporating the impact of the acquisition. While the merger drove an increase in revenue, EBITDA growth lagged due to the substantial costs incurred during the integration process. Significant investments were required to align systems, consolidate operations, and manage transitional expenses, impacting overall profitability in the short term. As a result, the chief executive officer (CEO) and the board were concerned over covenant breaches.

GBP'000	FY2024	FY2023
Revenue	704.5	680.7
EBITDA	114.5	130.5
Finance costs	(25.0)	(12.5)

Leases

Following the acquisition of the Manchester-based entity on 1 January 2024, LAI's chief financial officer (CFO) identified a compliance issue with IFRS 16 lease accounting. The local finance team had continued to classify the office lease as an operational expense in the P&L rather than recognising it as a lease liability under IFRS 16. Concerned about the financial and reporting implications, the board of LAI requested a detailed assessment of the impact.

The office building lease has payments of GBP55,000 per annum which commenced 1 January 2022. The Manchester entity incurred initial direct costs of GBP35,000. The lease term is ten years and LAI's implicit interest rate is 5%.

Covenants

To finance the merger, LAI had to increase its borrowing arrangements with its bank from an initial loan balance of GBP250,000 to GBP500,000. The bank agreed to retain the variable interest rate pricing. As at 31 December 2024, LAI had the following covenant stipulations:

- a minimum EBITDA covenant of 20% of revenue must be maintained annually. This is calculated as the earnings before interest, tax, depreciation, and amortisation (EBITDA)
- interest cover must not fall below 4.0. This is to be calculated as EBITDA divided by finance cost per the financial statements annually.

QUESTION 1

a.	Calculate the present value of the lease liability at the commencement date. You are required to show your workings	**5 marks**
b.	Calculate the lease liability and the carrying amount of the right of use asset under IFRS 16 on the acquired entity building lease at 31 December 2024 and as a result, recalculate the EBITDA and Finance Costs as at 31 December 2024. You are required to show your workings.	**15 marks**
c.	Analyse the impact on the banking covenants with the changes to the leases under IFRS16.	**5 marks**
		Total: 25 marks

Mark Scheme

Q1a

Present value of the lease liability PV lease payments = 55,000*(1-1/(1+5%)^10)/5% = 424,695	5 marks

Q1b

Present value of the lease liability — 6 marks (0.5 marks for each correct number excluding the first as that is marked in part i)

Lease Liability

Year	Balance BF	Finance Cost (5%)	Rental GBP	Balance c/f
31/12/2022	424,695	21,235	(55,000)	390,930
31/12/2023	390,930	19,547	(55,000)	355,477
31/12/2024	355,477	**17,774**	**(55,000)**	**318,251**

Right of use asset — 0.5 mark

Balance BF = 424,695 + 35,000 = 459,695 — 4.5 marks (0.5 marks

	Right of use Asset Year Balance BF Depreciation Rental USD 31/12/2022 459,695 (45,970) 413,726 31/12/2023 413,726 (45,970) 367,756 31/12/2024 367,756 (45,970) **321,787**	for each correct number)
	EBITDA as at 31/12/2024 = 114.5 + 55.0 = 169.5	2 marks
	Finance Costs as at 31/12/2024 = -25 – 17.8 = -42.8	2 marks
Q1c		
	Revenue is GBP704.5 in FY2024. At 20% this required a minimum EBITDA level GBP140.9 in FY2024 which LAI is currently breaching.	1 mark
	Interest cover before the changes to IFRS 16 would be 114.5/25 = 4.6 which is currently not breaching covenant.	1 mark
	Upon changing to IFRS16, the previously recognised lease rental costs of GBP55 were taken to EBITDA which now need to be added back to EBITDA, therefore increasing it from GBP114.5 to EUR169.5 meaning LAI is no longer breaching covenant.	1 mark
	The interest cover is also changing because the finance costs have changed as a result of IFRS 16. Finance costs are now 42.8 meaning interest cover is now 169.5/42.8 = 4 (or 3.9 also accepted).	1 mark
	Either conclusion can be drawn here as it depends to how many decimal points that bank covenant will be accepted. If it is 1 d.p. then at 4 times cover, there is no breach but if it is at 2d.p. then there is a breach. Either answer is acceptable as long as it is sensibly explained.	1 mark
	This mark scheme is not exhaustive – all valid points within answers will be awarded marks. **Syllabus refs: .LO17, LO19**	
		Total: 25 marks

QUESTION 2: CASE STUDY

Horizon Chemical Group (HCG) is a multinational chemical manufacturing company headquartered in London, UK, and listed on the New York Stock Exchange (NYSE) as a foreign private issuer (FPI). HCG specialises in the production of industrial chemicals, fertilisers and specialty coatings, serving customers in agriculture, construction, and automotive industries. With an annual revenue exceeding USD15bn, HCG has established a strong presence in Europe and operates subsidiaries in Germany, France, Italy, and the Netherlands.

Corporate and treasury structure

HCG Holdco is the main holding company which acts as a central cost centre and has investments in nine subsidiaries across Europe that are all separate trading entities. The European subsidiaries generate revenue through sales of specialty chemicals and fertilisers.

Due to its global operations, the treasury function plays a critical role in managing liquidity, funding, and financial risk across multiple jurisdictions. HCG currently operates a centralised treasury function. A dedicated treasury team oversees cash management, FX exposure, and funding requirements through cash pooling and intercompany loans. The group treasurer and chief financial officer (CFO) are old friends and often make decisions on policy and procedure outside formal documentation.

HCG uses a bespoke treasury management system (TMS) that required significant capital investment and is complex. One of the modules analyses excess cash from the European subsidiaries and automates the sweeping of it into a central cash pool maintained by the treasury team.

One of the UK subsidiaries of HCG acts as a financing entity and maintains all hedging arrangements, specifically forward contracts to hedge forecast transactions in the European subsidiaries. The money is then transferred to the subsidiaries for trading purposes which typically involves significant amounts of administrative work from the treasury team and bank cut-off times can impact efficiency. The monthly mark-to-market (MtM) on existing trades is recognised in the financing entity.

The group's treasury employs a mix of debt and equity funding. External debt is raised primarily through USD-denominated bonds, while intercompany loans are used to optimise capital allocation across subsidiaries. The group treasurer makes decisions based on optimal structure but often does not include local finance managers in the discussions.

Tax implications

Given its international structure, HCG must navigate complex tax considerations. The board has raised some questions around the tax complexities and challenges because it thinks HCG is currently tax inefficient. The group treasurer who also oversees tax planning has suggested this is not their strongest area.

HCG Holdco, as the cost centre entity, consists mainly of marketing, IT, central finance, and HR departments and is itself not revenue generating. The monthly management accounts suggest strong margins in the European subsidiaries and significant losses in HCG Holdco as a separate legal entity. HCG Holdco holds all the key intercompany loans and transactions as some are recharged monthly between HCG Holdco and the European subsidiaries. The board is concerned with the tax implications of these arrangements.

The CFO has asked the group treasurer about potential tax inefficiencies related to the intercompany loan arrangements. Specifically, some borrowing subsidiaries are in jurisdictions with lower tax rates compared to the lending financing entity which is UK based and is subject to a corporate tax rate of 25%. Some subsidiaries pay interest on the loans, whilst others pay dividends.

The board is considering acquisitions but would require new financing in the form of fixed rate preference shares which the CFO has said will be classified as debt but has asked the group treasurer to clarify if that is valid.

QUESTION 2

a.	Assess the current structure of HCG's treasury function in relation to centralised and decentralised functions. Within your answer you are required to consider issues relating to liquidity management, hedging and governance factors.	**13 marks**
b.	Analyse the key tax risks faced by HCG and recommend **THREE** solutions the group treasurer could suggest to the board.	**12 marks**
		Total: 25 marks

Mark Scheme
Q2a

Liquidity Management	(5 marks total)
Centralised cash pooling: The treasury team operates a central cash pool, allowing better visibility and control over group liquidity, reducing idle cash balances across subsidiaries. If this was to be decentralised, then the oversight across the whole group can be lost or would create extra admin work to consolidate and report the group positions.	1 mark
Efficient cash sweeping: The Treasury Management System (TMS) automates the sweeping of excess cash from European subsidiaries, improving liquidity utilisation which creates efficiencies. However, this is a complex system and may only be known to a few users, who if they leave could be a risk to the business.	1 mark
Intercompany loans for capital allocation: HCG relies on intercompany loans to distribute funds across subsidiaries, but this process is highly administrative and subject to tax risks. Leaving this centrally means better control but there could be more localised expertise that may be useful instead.	1 mark
Timing and bank cut-off constraints: Bank cut-off times impact fund transfers, potentially leading to inefficiencies and delays in meeting working capital requirements. This is something that may be mitigated if this was decentralised.	1 mark
Lack of local finance input: The group treasurer makes funding decisions without consulting local finance teams, which may result in misalignment with subsidiary needs.	1 mark

Hedging	(4 marks total)
Potential tax risks: Hedges are taken out in the financing entity led by the group treasurer which is a convenient way of working and allows for tax efficiencies across the Group.	1 mark
Admin burden: Holding all hedges locally means admin and time is spent on transfer of cash around which can cause delays and potentially have a trading impact on the local businesses.	1 mark
MtM recognition in financing entity: Mark-to-market (MtM) adjustments are recorded at the financing entity level where gains and losses are taxable.	1 mark
Lack of subsidiary involvement in hedging: Local finance teams are not included in hedging decisions, which may result in misaligned risk management strategies at the subsidiary level and lack of transparency of change in contracts and positions.	1 mark (4 marks total)
Governance	1 mark
HCG currently has a qualified, dedicated treasury function, having a local one could mean varied levels of experience and qualifications.	1 mark
Scrutiny and potential bias: The CFO and Group Treasurer are old friends which may result in some bias or unobjective decision making.	1 mark
Informal decision making: Some key decisions are currently being made centrally without consultation from the local finance managers which may mean some decisions may not be the best outcome.	1 mark
Lack of formal documentation: The absence of structured policies may expose HCG to regulatory scrutiny, particularly as a NYSE-listed foreign private issuer.	1 marks
Lack of tax experts: could lead to further governance issues with poor processes and controls in place	

Q2b

Transfer pricing risk: HCG's intercompany loan arrangements may trigger transfer pricing scrutiny, as tax authorities could challenge whether interest rates reflect arm's length principles.	1 mark
Interest deductibility limits: Some borrowing subsidiaries in lower-tax jurisdictions may have restrictions on interest deductibility, reducing the tax efficiency of the financing structure.	1 mark
Withholding tax exposure: Interest and dividend payments between entities may be subject to withholding taxes, which could erode tax efficiency if not structured correctly.	1 mark
Lack of documentation: It is unclear if there is proper intercompany loan documentation as mentioned "some" and therefore also unclear if the right accounting is being done across the entities.	1 mark
Tax losses utilisation: The significant losses in HCG may not be fully offset against profits in European subsidiaries due to restrictions on group relief across different tax jurisdictions.	1 mark
Thin capitalisation: If subsidiaries are deemed excessively debt-financed relative to equity, tax authorities may disallow interest deductions, increasing taxable profits.	1 mark
Tax compliance and reporting risk: The complex international structure increases the risk of non-compliance with local tax laws and reporting requirements, potentially leading to fines or penalties.	1 mark
In the UK, the legal form is followed for tax purposes which means the preference shares/coupons are not tax deductible therefore may end up costing HCG more as this will not see the benefit from the corporate tax rate of 25%.	2 marks
Recommendations 1) Transfer pricing and documentation: Implement a formal transfer pricing policy with clear documentation of intercompany loan terms and interest rates to ensure compliance with tax regulations and reduce audit risks.	1 mark

2) Group financing structure: Assess the tax efficiency of intercompany loan arrangements, considering alternative financing structures (e.g., equity v debt) to minimise tax inefficiency. Ensure interest rates align with local deductibility rules and explore opportunities to consolidate losses where possible.	1 mark
3) Tax governance and expertise: Given the complexity of international tax matters, the company should consider appointing a dedicated tax specialist or engaging external tax consultants to support decision-making.	1 mark
This mark scheme is not exhaustive – all valid points within answers will be awarded marks. **Syllabus refs: LO16, LO18**	
	Total: 25 marks

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