



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

TOP CA CASE STUDY EXAMINATION – SEPTEMBER 2014

**THE EXAMINATION QUESTIONS, INSTRUCTIONS AND ADDITIONAL
(IMPACT) INFORMATION**

Instructions to candidates

- (1) **Time allowed** : 4 hours
- (2) **Marks** : 100 marks
- (3) This question paper should be answered entirely in the **ENGLISH** language.
- (4) Your answer must be submitted in the answer booklets provided at the Examination Hall.
- (5) Any pre-prepared papers included in your answer **WILL NOT** be marked.
- (6) After the instruction to stop writing at the end of the paper, you will be given five minutes to assemble your answer.

Siam IT Solutions (Pvt) Ltd (SITS)

Meeting of the senior management

After the board meeting held on 27 February 2014, Dilith started thinking as to why the others couldn't understand him. He believed that he has done everything in the best interest of SITS. He thought that he would first talk to Jinadaree at home. One evening at dinner, Dilith broke the silence saying, "Jinadaree, it seems that some of the members of our board don't trust me. Neither Thevis nor John wanted to understand what I tried to explain". Jinadaree replied saying, "Brother, I don't like you taking it that way. They are not mere individuals. They are answerable to their firms. Indeed, I agree with what they stated. If we continue like this we will be confronted with serious cash flow problems very soon". "What do you suggest I should do?" , Dilith asked. Jinadaree was waiting for this moment. Jinadaree replied saying, "You can appoint a good consultant to look into all these issues, but I rather like to have a meeting with our senior staff first as both Mr. Thevis Saparamadu and Mr. John Sivajilingm suggested. We should first listen to them". Dilith requested Jinadaree to organise a meeting on 15 March 2014 after work. They decided to invite the following people for the meeting:

- Sameera Ihalakaduwa, Director Operations
- Chamira Jayadewa, Senior Software Engineer
- Sisiliya Kodituwakku, Accountant
- Jeewaka Senadheera, Marketing Manager
- Three sectional heads from operations (i.e. programming, web designing, and data base designing & management sections)

The meeting started at 4.30 pm as scheduled. Since SITS never had cross functional meetings for years, the majority of the people who were invited did not have any clue as to what this meeting was about. Sameera and Chamira shared their thoughts before the meeting as to how they were going to express their views regarding the likely issues to be taken up at the meeting.

Jinadaree explained as to why the chairman decided to have a meeting with the senior staff, drawing some accounting numbers. She made a special reference to weakening operating profits consecutively over the last two years. According to her in 2012 and 2013, operating profits of the company dropped by 5.4% and 19.3% respectively. She put things across very nicely. At one point she stated that SITS has provided all of them 'bread and butter'. "I think it is our collective responsibility to find solutions for the ongoing problems".

Sameera replied saying, "Yes, I partially agree with what you mentioned Miss Jinadaree. But, I would like to think a bit broadly. Our clients are our bread and butter so we have to treat them with due respect. It's not happening now. SITS is no more what it was 6 or 7 years ago. People should be allowed to work independently with some supervision. We have to

develop project teams, and such teams can be given some targets. Their rewards should be linked to their performance. Moreover, nothing would work unless we hire one or two business analysts. Our marketing team can also be benefited from a business analyst”.

While agreeing with Sameera, Chamira stated, “We were a team and worked together to develop the company at the beginning. We never felt that we were working for someone else. Now things have changed a lot. I think we have got to change work arrangements in the operations department. I have highlighted these issues from time to time”.

At this point Dilith interrupted saying, “Can’t we manage our affairs without a business analyst. I mean, the company can’t afford to hire one right now. The type of business analyst you all are talking about would be very expensive”.

Among the other issues that came up at the meeting, the salary issue was serious. Senior employees invited to the meeting from the operations department (other than Sameera and Chamira) highlighted this issue. According to them, the company has not revised salaries of the employees for several years. They emphasised that employees were frustrated and eight employees left the operations department during the last two years (3 in 2012 and 5 in 2013). Growing unrest especially among employees at operations was highlighted as one of the major reasons for not meeting project deadlines. At this point, Jinadaree also supported the idea of introducing a proper incentive scheme, particularly for employees in the operations and marketing departments. She knew the gravity of not meeting deadlines. At one point she stated, “delays cost us a lot”. She recalled some instances where SITS had to lose as much as 25 percent from the contract value of the project due to delays. According to her, a 10 percent cut due to delays has become a norm now.

Dilith was worried. He thought that all these suggestions are very expensive which SITS could not afford at this moment in time. The meeting was an eye opener, but it ended up with no conclusions.

After about one week from the management meeting, discouraged Dilith met with Jayantha Welihinda, a life-long friend and a business consultant. Over lunch, Dilith briefed Jayantha about the ongoing problems at SITS. Though Dilith met him now and then, he never talked much about SITS with Jayantha. Therefore, Jayantha was rather surprised, but felt sorry for Dilith at the end. Nonetheless, Dilith indicated that he would formally invite Jayantha to look into the problems faced by SITS with the board approval.

Meeting of the board of directors held on 28 March 2014

This was a short meeting. First, Dilith briefed the board about the internal management meeting with senior staff. He stated, “It’s rather difficult for us to think of immediate solutions. Most of the suggestions that came up are expensive. I am not sure whether we can go for them”. His tone was rather apologetic. Before proceeding to the routine matters of the day he stated, “it is now high time for us to get the help of a good management consultant to look into our problems as we are technocrats after all”. In fact Dilith stated his intention of bringing in Jayantha for the job. He presented Jayantha’s credentials to the board. As both Thevis and John knew Jayantha’s calibre, they did not have any objections to the selection. However, they raised concerns over his fees. Dilith replied saying, “I am confident that he will do the job for me well below his standard rates”. Finally, the board agreed to get Jayantha’s services.

Jayantha as a consultant at SITS

Dilith met Jayantha on several occasions and discussed the issues at SITS, and the various options available, before he was formally appointed as a consultant. Once appointed, he worked more with Jinadaree than with Dilith. Jayantha found that it was easy to work with Jinadaree. Among issues Jinadaree brought to light, the delays at operations seemed to be the most serious one. According to her, such delays have created serious consequences on finance, for example, clients making deductions from contractual fees for delays as per agreements and taking more time to settle payments. Another reason she mentioned was the drop in the number of foreign projects in recent years (foreign projects are entitled for tax benefits). Finally, she stated, “after all, our operations are in a mess”.

Jayantha now silently wonders, *things are much worse than I expected, where am I going to start?*

The information provided in Annexures I to IV were prepared by Jinadaree on Jayantha’s request.

You are required to:

- (1) Describe which financial goal, in your opinion, Dilith seems to be primarily focused on.

In addition, explain whether you consider this goal to be the correct goal for SITS from the points of view of its stakeholders.

Provide reasons for your answers.

(18 marks)

- (2) Explain the potential corporate governance issues and agency problems prevalent in SITS, with special reference to Dilith's management style.

(18 marks)

- (3) Assuming that you are the management consultant (Jyantha Welihinda) appointed to look into the issues at SITS, prepare a report to be submitted to the board of directors. Your report should cover, inter alia, an analysis of the problems faced by SITS and your recommendations (with justifications) to resolve them.

(Note: carrying out financial analysis may help you to understand some key issues faced by the company).

(64 marks)

(Total: 100 marks)

Annexure I

Siam IT Solutions (Pvt) Ltd

Income statements for the years ended 31 December

	2013	2012
	Rs. '000	Rs. '000
Revenue	586,347	672,135
Cost of sales	<u>(320,486)</u>	<u>(358,668)</u>
Gross profit	265,861	313,467
Operating expenses:		
Administrative expenses	(88,217)	(89,875)
Promotional expenses	<u>(22,997)</u>	<u>(31,862)</u>
Total operating expenses	<u>(111,214)</u>	<u>(121,737)</u>
Profit from operations	154,647	191,730
Net finance expenses	(12,288)	(7,317)
Net profit before tax	142,359	184,413
Taxes	<u>(36,052)</u>	<u>(42,553)</u>
Net profit for the year	<u>106,307</u>	<u>141,860</u>
Dividends	60,000	80,000
Earnings per share (EPS)	5.32	7.09
Dividend per share (DPS)	3.00	4.00

Annexure II

Net finance expenses

	2013	2012
	Rs. '000	Rs. '000
Finance income	20,523	22,917
Finance expenses	<u>(32,811)</u>	<u>(30,234)</u>
Net finance expenses	<u>12,288</u>	<u>7,317</u>

Annexure III

Siam IT Solutions (Pvt) Ltd

Statements of financial position as at 31 December

	2013	2012
	Rs. '000	Rs. '000
Assets		
Non-current assets		
Land and buildings	398,200	402,840
Other fixed assets (net)	183,600	173,600
Investment	<u>130,000</u>	<u>140,000</u>
	711,800	716,440
Current assets		
Inventory	190,440	167,500
Short term investments	31,250	45,620
Accounts receivable	195,650	138,580
Cash and cash equivalents	<u>7,292</u>	<u>14,120</u>
	424,632	365,820
Total assets	1,136,432	1,082,260
Equity and liabilities		
Equity		
Stated capital (20,000,000 ordinary shares)	278,000	278,000
Retained earnings	<u>360,557</u>	<u>314,250</u>
Total equity	638,557	592,250
Non-current liabilities		
Interest bearing borrowings	124,324	110,685
Current liabilities		
Interest bearing borrowings due within one year	24,500	18,640
Short term interest bearing borrowings	172,000	168,304
Accounts payable	28,380	29,726
Tax payable	42,425	46,288
Dividend payable	60,000	80,000
Accruals	<u>46,246</u>	<u>36,367</u>
Total current liabilities	373,551	379,325
Total liabilities	497,875	490,010
Total equity and liabilities	1,136,432	1,082,260

Annexure IV

Selected financial ratios

	Company	Industry average
	2012	2013
Current ratio	0.96	1.42
Quick ratio	0.52	0.98
Average collection period	75 days	47 days
Total asset turnover	0.62	1.56
Debt ratio	10.2%*	21.5%
Time interest earned ratio (gross)	6.34 times	9.3 times
Time interest earned ratio (net)	26.2 times	18.3 times
Gross profit margin	46.6%	54.2%
Operating profit margin (before tax and net finance expenses)	28.5%	36.4%
Net profit margin	27.44%	34.5%
Return on assets (ROA)	13.1%	18.7%
Return on equity (ROE)	24.0%	32.3%

***Debt ratio covers only the non-current interest bearing borrowings of the company**