



**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA**

**MULTIDISCIPLINARY CASE STUDY EXAMINATION**  
**MARCH 2009**

Important - This question paper should be answered entirely in the **ENGLISH** Language only.

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

**Time allowed : 4 Hours**

**Marks : 100 marks**

**EXAMINATION QUESTION**

You, Savithree Yogaratnam, are an executive at the firm of Ananda Yatiwelle, (AY), a firm of Chartered Accountants, and are working directly for Mr. Ananda Yatiwelle. Ananda Yatiwelle is in charge of the Business Advisory Section of the firm specializing in new client development. Techno Motors (Private) Limited, which is a new corporate finance client, is seeking AY's consultancy services for the furtherance of its future plans.

**Requirement**

You are to prepare an Internal Memorandum to Mr. Ananda Yatiwelle, in response to his Memorandum (Exhibit 4). State clearly any assumptions that you make.

**INSTRUCTIONS**

It is suggested that candidates spend about two hours for drafting the memorandum

**ADDITIONAL (IMPACT) INFORMATION : SEE PAGES 2 - 7**  
( Exhibits 1, 2 & 3 are included in Advance Information)

#### **Exhibit 4**

**From: Ananda Yatiwelle**  
**To: Savithree Yogaratnam**  
**Subject: Techno Motors (Private) Limited (TecMo)**  
**Date : 27 March 2009**

Savithree,

TecMo is currently seeking expansion. They need advice on:

1. The company financing structure and shareholding arrangements;
2. The development strategy of TecMo;
3. The venture capital offer; and
4. The tax and other legal implications.

#### *Three Wheeler Car Market*

TecMo is seeking a restructuring of debts and a new injection of long term finance. Their initial plan (see Exhibit 2 – Advance Information) envisaged an injection of Rs 5 million in equity and about Rs. 10 million in bank debt. Equity financing was expected from a private source. Piya wishes to bring his wife as a shareholder, and has no issue even for an enhanced amount.

TecMo's bank is willing to provide a maximum of Rs. 12 million. This is at an interest of 19% per annum.

TecMo's new strategy is developing and promoting a three wheeler car market in Sri Lanka. Piya and Kapila have already planned to develop provincial markets identified as medium contributors to the GDP of the country. This requires an initial investment of Rs. 70 million, to set up business locations and show rooms, promotions and importing 100 three wheeler cars. They have already obtained a dealership from China namely from Wildfire Inc. What is your opinion? Could you carry out an analysis?

TecMo's Directors are of the opinion that the business is currently worth around Rs.26 million (might be the net assets value). Kapila forecasts a sale of 60 three wheeler cars for the year 2010, and a minimum growth of 5% in each of the next 10 years.

You will need to provide me with an Internal Memorandum, including a summary of the key issues you have identified, containing:

1. Your proposal, with justifications, for the future financing structure of the company, taking into consideration the proposal from Orix Venture Capital Limited.( see Exhibit 6 )
2. A discussion of the relevant financial management, operational and strategic issues which may be of concern.

Although I will not be giving your memorandum to the directors, it will form the basis of our discussion with them tomorrow, ahead of the meeting with the financiers next week. Please can we meet to discuss your work tomorrow morning before that meeting with the TecMo directors.

Some important new developments at TecMo are being forwarded to you ( Exhibits 5,6,7 & 8), including cash flow forecasts for 2009 ( Exhibit 9 ). These cash flow forecasts do not reflect the cash flow implications of the new proposals.

Sgd

*AY*

**.Exhibit 5**

To: Ananda Yatiwelle  
From: TecMo  
Date : 26 March 2009

Dear Mr Ananda,

Orix Venture emailed us recently (see Exhibit 6 ) confirming details of the potential financing methods which might be available to us.

We have not had time to re-work the cash flow forecast nor the other financial statements. Given the proximity of the financial meeting next Wednesday we would welcome your comments and your help. Would you please review the forecasts and meet with us on Tuesday to discuss your findings.

Yours sincerely

*Piyal Hedeniya*

## **Exhibit 6**

**To: Piyal Hedeniya**

**Subject : TecMo Limited – funding arrangements**

**Date : 15 March 2009**

Dear Piyal,

As per the recent conversation we had concerning our future financing for TecMo Limited, we have undertaken a review of the deal taking into account the possibility of a higher level of required financing. From our side, there is the need for any investment to match our expected return of 30% per annum on the total investment and, for a business like TecMo, our normal valuation procedures would anticipate a projected P/E ratio of 6 on profits before tax.

Please find below an indicative offer, subject to modifications by agreement. We would expect to be able to exit fully from this investment by the end of ten years.

1. Total investment is to be disbursed immediately after the contract is signed.
2. **Investment of Rs. 45 mn split into two categories as:**
  - a. ordinary shares for Rs. 30 mn and the balance in preference shares; or,
  - b. ordinary shares for Rs. 15 mn and the balance in preference shares
3. 10% dividend on net profit before tax for ordinary shares
4. 10% dividend payment on preference shares
5. Redemption of preference shares:
  - 20% after 3 years
  - 30% after 6 years
  - 30% after 8 years
  - 20% after 10 years

This is subject to obtaining the approval of the Investment Committee.

Sgd

Orix Venture Capital Limited.



## **Exhibit 7**

### **Letter from Mr. R Hedeniya to his son Piyal**

Dear Piyal

As we have discussed within the family, with the changes proposed, your mother and I earlier agreed to a reduced role and reduced shareholding. However, we now think that with the Orix money and their potential future participation as shareholders in the business, we should be bought out from the business completely, as soon as possible.

We would expect to withdraw our capital approximately in three equal annual installments. However, I prefer if we could get a reasonable monthly cash flow to meet our living expenses. TecMo is our life; therefore I believe that you will secure the Hedeniya family business for the future. We handover to you the value of the “TecMo” image we have created throughout our life. Our shares however should remain within the Hedeniya family.

I think we need to resolve all the issues in 'one go' and hope you will agree that this is the right way to go.

Your loving father,

*RH*

*Date : 20 March 2009*

## **Exhibit 8**

**From: Piyal Hedeniya**  
**To: Ananda Yatiwelle**  
**Subject : Partnership taxation**

Dear AY,

I discussed this with the assessor and it seems that taxes are payable on an average revenue of about Rs. One million p.a. from 2003/2004 to 2007/2008 which are under enquiry because of the non-inclusion of 8 vehicles in the accounts. We had only 4 vehicles ( 4 Toyota dual purpose vehicles) at our home in 2005, 6 ( 2 Fiat cars in addition to 4 Toyota dual purpose vehicles) in 2006 and 9 ( 2 more Fiat cars and a Hyundai car in addition to above mentioned vehicles) in 2007. There were 8 vehicles when the tax inspectors visited last year. The Assessor rejected depreciation allowances too on these vehicles. These assets have been used for hire business and also for personal use and were kept at our house. These second hand vehicles have been paid for personally by our family members and are irrelevant to the business. However, running costs incurred by the business on these, have been already charged to the income statements in the relevant periods. The values of the vehicles are estimated as follows.

4 Toyota Dual purpose vehicles Rs. 7.0 mn

3 Fiat cars Rs. 8.7 mn

1 Hyundai car Rs. 1.4 mn

I appreciate your prompt action

*Piyal Hedeniya*



**Cash flow Forecast up to 31 .12. 2009**  
**Rs. '000**

**Exhibit - 9**

	Jan '09 Actual	Feb '09 Actual	Mar '09 Actual	Apr '09	May '09	Jun '09	Jul '09	Aug '09	Sep '09	Oct '09	Nov '09	Dec '09	Total
Sales receipts	17,010	18,320	19,000	19,950	20,948	21,995	23,095	24,249	25,462	26,735	28,072	29,475	274,310
Payments													-
Purchases & wages	14,800	14,930	15,990	16,790	17,629	18,510	19,436	20,408	21,428	22,500	23,625	24,806	230,851
Overheads	470	490	510	536	562	590	620	651	683	718	754	791	7,375
Capital expenditure	-	-	-	-	700	500	500	500	250	250	500	800	4,000
	15,270	15,420	16,500	17,325	18,891	19,601	20,556	21,559	22,362	23,467	24,878	26,397	242,225
Net Inflow/(Outflow)	1,740	2,900	2,500	2,625	2,056	2,394	2,539	2,691	3,100	3,268	3,194	3,078	32,085
Balance b/fwd	(12,670)	(10,930)	(8,030)	(5,530)	(2,905)	(849)	1,545	4,084	6,775	9,875	13,143	16,336	(12,670)
Balance c/fwd	(10,930)	(8,030)	(5,530)	(2,905)	(849)	1,545	4,084	6,775	9,875	13,143	16,336	19,415	19,415