



TPE 2023 – Case Study – Part 2

Pagmari – Mock 2

Comprehensive Case Study
Case Study Description and Question
09.00 - 11.30 (2½ hours)
13.00 - 16.00 (3 hours)

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CASE STUDY

It is the next day and once again you find yourself sitting opposite Sam, only this time Jan is sitting next to you.

“I wanted to thank you for your input to the briefing paper; I found it very informative and it confirmed many of the concerns Februum and I had,” said Jan.

She continues, “This morning Februum and I had a very frank and robust ‘clear-the-air’ meeting with our husbands about the performance of the landscape division. Both Martius and Brian seemed genuinely surprised and upset at the true results of the division over the last two financial years. Brian even said ‘if only I had listened to the accountants’, which was a big admission on his part. To make things worse, Brian also admitted that about £60,000 worth of plants had been taken from the wholesale business for each of the last two years and that he had been using a timber merchant who sourced its wood from the Amazonian rainforests. I had an idea something like this was happening but was clueless as to the extent. Being a director of Pagmari, this doesn’t reflect very well on me. And it gets worse.

“Brian further went on to say that during the last two financial years he had borrowed approximately £50,000 each year from the landscape division. Seemingly, this idea came about when a friend of his, who has a business constructing new houses, paid him in cash for work carried out by the landscaping division. For each of the two years, Brian has taken approximately £500,000 cash from sales and from this has paid out £450,000 to suppliers and a local employment agency. Apparently, all the figures can be substantiated by appropriate paperwork, which has not been entered into the accounting records of the division. He says it was, and still is, his intention to pay back every penny when his inheritance of £150,000 comes through, which is expected within the next few weeks. He claimed he only borrowed it knowing he could pay it back and it was only to fund a temporary cash flow shortage. He said he was very, very sorry and should have asked first but is of the view that no harm has been done since the money will definitely be paid back.”

“That’s awkward, especially since the turnover is very close to the audit threshold anyway,” you blurt out without thinking. After hearing a cough from Sam, you stop talking.

“Yes, it is,” replies Jan. “Februum went ballistic and now understands how they could afford their lifestyle over the last couple of years. She nearly collapsed when she realised that the inheritance money she was expecting the family to receive had been spent and they would now most likely have to sell the house and move the children from their current school. Brian went on to explain that, up until 30 April Yr 16, he was scrupulous with ensuring every document was passed to the local bookkeeping firm for processing into the accounting records and that everything was correct. It was only after a chance meeting with the previous engagement partner, Jasper, in a park one day in April Yr 16 that his attitude towards business practices changed. He claims he was given some ‘practical suggestions on saving tax’, which I have attempted to summarise on this note.”

Jan hands over the note (Appendix 1) and continues.

“Sam, perhaps you can confirm with Jasper that what Brian states is true? My initial reaction is that I am surprised by the tone of the suggestions but let’s wait until we get all the facts and then we can decide on what to do next.”

Sam replies, “I agree. Let’s gather the facts and take it from there.”

Jan carries on. “The final conclusion of the meeting was that Februum and I have decided to close down the landscape division; there is simply too much risk involved over which we have had no control. We will employ our husbands in the wholesale business but Brian will not be able to impact our business in that way ever again.

“On a more positive note, we are planning to start selling non-plant related items such as giftware, kitchenware etc. along the lines of the other larger garden centres and to open an up-market restaurant to complement the offerings of the tearoom. However, I’m not completely sure this is a good idea and this is where you come in.

“Before the final decision to expand is taken, Februum and I would like a report on a number of issues including the implications and risks associated with closing down the landscape division. We want to make sure we comply with any legislation and do not want to do something we shouldn’t. I also want comments on the expansion plans and what we should consider and, of course, what we need to do about Brian’s confessions.

“There are a couple of other matters I would like you to include in the report. As you will be aware, one of the company’s objectives is to own its own land and premises and an opportunity to acquire a dilapidated farm and outbuildings with 25 acres of land about 30 miles away from our existing premises has arisen.

“We are very keen to go ahead with the purchase and redevelop the site. However, we want to know your views on the issues of purchasing and developing the site as compared to continuing to rent the existing site. We are acutely aware that we have a profitable business at the current location and do not want to move just for the sake of it. Here are some brief details of the site, which is called Peat Farm (Appendix 2).

“Assuming a property like Peat Farm or a commercial site is to be acquired, we are unsure whether to purchase it in the name of the company or via something else such as in our individual names. Would you please provide detailed comments on the pros and cons of either having the property owned by the company or owned outside of the company? I realise there are several tax issues but only mention the main ones and ignore VAT at this stage. I will come back to you for more detailed tax comments should we get closer to purchasing a property. However, do include any other relevant issues or points you consider should be brought to our attention.

“I had a look at the company bank account this morning and it shows a balance of £95,000. Although the business is profitable, the expansion into the wholesale market has meant that cash has been absorbed into working capital and cash flow is generally tight. Clearly, this will ease if we hold back on the expansion, but it is unlikely the company will have any more spare cash to fund the purchase by the closing date. Martius and I have savings of £130,000 we could invest but, given the current situation with Brian, he and Februum will be unlikely to contribute financially to the acquisition.

“Do you have any questions for me at this point?”

“None that I can think of at the moment,” says Sam. You nod your head in agreement.

“Great, then I’ll leave you to it and look forward to reading the report.”

After Jan had left the room Sam turns to you and says “Did you get all of that? That’s quite a lot to do in a short period of time so make sure your comments are relevant, concise and to the point.”

“Got it,” you reply as you get up to leave to start on the report. “I take it you also want a memo of any ethical issues I come across during my work?”

“Naturally; it should go without saying these days,” replies Sam. “Draft a memo to me setting out any ethical issues you identified during yesterday’s work as well as any you come across during your work this afternoon. Pay particular attention to Jan’s comments regarding Jasper.”

Required:

- Submit, without amendment, the briefing paper prepared this morning;
- Prepare the draft report from Sam to Jan and Februum; and
- Prepare the ethics memo to Sam.

APPENDIX 1

A summary of the ‘Practical suggestions on saving tax’ Brian alleges were verbally given to him by Jasper.

The following are Jan’s notes on Brian’s recollection of the verbal suggestions given to him by Jasper during April Yr 16:

“Jasper seemed to suggest that many local businesses claim expenses through the accounts that are debatable as to whether or not they are wholly and exclusively for the business. When asked to expand on this he gave a few examples. One was of a partnership that kept valuable stock outside in a yard and used guard dogs to protect the assets at night. All the expenditure relating to the dogs was claimed through the accounts although Jasper thought the partners also considered the dogs to be pets. Brian wondered if we could then claim for the upkeep of our dogs through the business?

Another example was expensive furniture such as antique bureaus, cabinets, tables, carpets and other ‘office furniture’. Brian was left with the impression Jasper was suggesting the company bought and paid for these items but that they were, in fact, to be used at our personal homes. Seemingly, Jasper went on to say that he is aware of many companies using very expensive first class travel instead of economy class travel so why not antique tables instead of chipboard tables?

His third and final example of this type was that if each of the management team were to be given company mobile phones rather than using our own personal phones then we would not have to pay tax for any personal calls, even if they were almost exclusively used for personal use.

Brian also claimed Jasper was not only hinting at putting the odd personal expense through the business, because everyone does it, but that we should be able to personally make use of materials bought that were surplus to requirements. Apparently, Jasper cited the example of the directors of a building company taking damaged sheets of plasterboard for their own use. Their argument was that since the corners had been damaged during storage that they were worthless and could not be sold on to customers, so why shouldn’t the directors use them rather than throw them away? It is also more environmentally-friendly, which is in line with one of Pagmari’s objectives.”

APPENDIX 2

Extracts from the sales particulars of Peat Farm

General

Asking price: Offers in the region of £1.75 million

- Four-bedroom farmhouse
- 2 x farm cottages (in need of some upgrading)
- 6 x outbuildings (would benefit from some refurbishment)
- 25 acres of land
- Superb views
- Easy access to amenities

Situated on the outskirts of the Loch Lomond & The Trossachs National Park, this property is ideally located for a family looking for a rural lifestyle or for a small rural business. Verbal outline planning permission has been obtained to convert the site into a rural business such as an equestrian centre.

Loans on generous terms may be available from the local council for businesses seeking to relocate into the area. Other funding and grants may be available for businesses that employ young persons between the ages of 16-21.

The closing date for offers is 31 May Yr 18.

END OF PAPER