TPE 2023 – Guide to Answer

Pagmari

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BRIEFING PAPER FOR JAN REGARDING PAGMARI LTD ("PAGMARI")

This briefing paper sets out comments in relation to the two issues raised by Jan at a recent informal meeting with Sam. The issues and comments are set out as follows:

- An appraisal of the Pagmari business as it is today with suggestions for improvement; and
- An assessment of the two aggregate supplier proposals with recommendation.

1. Appraisal of Pagmari business with suggestions for improvement

The following appraisal will cover the general financial analysis of the company followed by a more detailed overall appraisal of each division. The calculations and figures are shown in the Appendix and/or the draft management trading accounts unless otherwise stated.

1.1 Overall Pagmari business

1.1.1 General financial overview

Gross year-on-year movements

The company turnover has decreased slightly over the last two years falling £29k (0.3%) from £9,935k in Yr17 to £9,906k in Yr18. The combination of a fall in overall gross profit of £98k (8%) plus an increase in the overhead expenses of £68k (10%) has resulted in a decrease of the EBIT of £166k (30%).

Unrecorded transactions

Although a more detailed analysis is shown below, it is noted that Brian does not seem to be prepared to allow all transactions to be recorded appropriately (e.g., not recording the landscape division's use of the high-value plants and not allocating costs correctly between the two divisions). This may save him some time but it will mean any analysis of trading figures will not be very meaningful and, possibly, misleading. It also raises the question as to what else is not being recorded. It is recommended that steps are put in place to ensure the information and transactions are recorded correctly and in a timeous manner. This will enable on-going monitoring of the business to be undertaken and management decisions made based on correct divisional information.

Other

Without a balance sheet, the financial analysis is incomplete. It would be useful to understand the latest position regarding the company's debt and related interest. This will enable return ratios to be calculated such as return on capital employed, although clearly a longer-term trend would need to be established before a meaningful pattern can emerge.

The company has not declared dividends during the last two years and thus the profits of the business are being retained within the company. This additional capital should drive turnover and profitability, but this is not the case with the fall in turnover and profit between Yr17 and Yr18. This should be investigated to see if there is an underlying reason as to why this has occurred or whether it is a 'one-off'.

Pagmari pays bank charges of £79,000 in Yr18. At £6,583 per month, this seems quite high. Given the competitive nature of the banking industry a review of these charges should be undertaken to ensure the company is getting 'the best deal'. Most of these charges will be generated from credit card sales and banking of cash, which can vary in rate from bank to bank and from time to time.

1.1.2 Revised financial divisional analysis

Based on the management trading accounts, the retail and wholesale division is clearly the more profitable of the two divisions. However, a number of known adjustments need to be made in order to calculate a more accurate picture of the performance of the divisions:

	Note	**Yr18**	**Yr18**	**Yr17**	**Yr17**
		Retail and wholesale	Landscape	Retail and wholesale	Landscape
		£'000	£'000	£'000	£'000
EBIT per unadjusted management accounts		531	(147)	649	(99)
Adjustments:					
Plants used in landscape	1	60	(60)	60	(60)
Admin expenses	2	10	(10)	10	(10)
Repairs	3	25	(25)	0	0
Adjusted EBIT		**626**	**(242)**	**719**	**(169)**

Notes:

1. Brian estimates £60k of plants were acquired from the wholesale business and unaccounted for.
2. £10,000 of admin expenses incurred by the retail and wholesale division relate to the landscape division.
3. Approximately 50% of the £50k roofing repair relates to the landscape division.

For both years, the above analysis shows the landscape division has performed significantly worse than the original figures suggest.

1.1.3 Other

Rental agreement

The company has a flexible rent agreement with the Forestry Commission, which has benefits for an expanding company. The downside is that, should the Forestry Commission want to take back possession of the land, they only need to provide one month's notice period, which does provide an element of uncertainty. Depending on the progress or likelihood of acquiring suitable owned land, it would be worth considering approaching the Forestry Commission with the view of entering into a more permanent rental agreement. This, of course, does have its drawbacks, such as lack of flexibility and being tied into a long-term agreement, as well as its advantages.

Perhaps the Forestry Commission may be prepared to sell the land, which would satisfy one of the company's objectives.

Salary structure

The existing salary structure has Martius and Brian each earning a salary of £10,000 per annum, which is below the personal allowance, and Jan and Februum each earning £50,000. Jan and Februum are on the cusp of paying tax at the higher rate, while Martius and Brian do not appear to be using their full personal allowances, nor their basic rate bands (depending on any other income they may have). This is not tax-efficient.

Although tax should not be the only driving force behind commercial decisions it is worth reconsidering the split of the remuneration package of each family to ensure it is the most mutually beneficial. The situation is exacerbated should future dividends be declared due to Jan and Februum owning 50% each of the company and thus receiving all of the dividends.

1.2 Retail and wholesale division

1.2.1 Financial

Retail business

Turnover

The turnover has decreased by £164k (3.9%), which is a result of the 2.9% increase in the average sale per visitor being more than offset by an £11k (6.6%) fall in transaction numbers.

A review should be undertaken to ascertain the reason for the fall in transaction numbers but it is most likely that this is a direct effect of the garden centre and tearoom being shut in March and April. Have prices increased to such an extent that it is having an impact on sales?

Cost of sales

The percentage of cost of sales has increased from 80% to 81%. Have prices been increased to try to compensate for the increase in costs?

If this is the case it would be more profitable to keep prices the same as last year (if there is a relationship between average sale per visitor and the average selling price) and to absorb the cost increase. Assuming the same turnover as in Yr17 but with the Yr18 margin of 19% gives a profit of £804k[1], which although is lower than last year is £31k higher than in Yr18.

Approximately two-thirds of the company's gross profit is generated from retail sales, which comprise only 41% of the turnover and, thus, this business is still very important to the company. Research into how customers rate their shopping experience would be advised, perhaps by short questionnaires and interviews. It would be useful to have a breakdown of the administrative expenses between each line of business so that the impact at the net profit level can be assessed and compared. On the face of it, retail would likely take the largest share of the administrative expenses.

Visitor numbers

At present, the 10-acre site is sufficiently large to accommodate about 600 visitors per day without it starting to feel overly crowded. This will need to be reassessed for appropriate social distancing. Assuming the garden centre is open 360 days a year, based solely on the transaction number of 155,000, this suggests an average of 431 visitors per day are purchasing items. Given that not all visitors will make purchases and that some visitors will visit the centre in groups (e.g., with families and friends) this means that there were times when the garden centre may have had significantly more than 600 visitors per day.

[1] £4,233 x 19% = £804 (gross profit), or £4,233 x 81% = £3,429 (cost of sales)

High numbers of customers may detract from the shopping experience thus discouraging repeat visits. If the above analysis is even approximately accurate it is recommended action is taken to alleviate the potential bottleneck e.g.

- rent more land from the Forestry Commission to extend the 10 acres
- review how much of the 10 acres is accessible to the public as opposed to viewing gardens
- charge a nominal entry fee of £2 for those walking round the gardens but which can be redeemed against any purchase from the garden centre or café

Redesign of garden centre grounds

Has there been any market research, or a cost/ benefit analysis undertaken to support the redesigning and replanting of two acres of the garden centre each year? Would it be more cost effective to change a different area each year, say one acre? This may save not only on the cost of replanting and redesigning but it would mean a greater display/ sales area is available more of the time thus enhancing the ‘customer experience’.

The use of a relevant specialist with a proven track record on advising on managing customer experiences within garden centres could be engaged to see if this side of the business can be improved.

Horticultural accessories

What is the financial impact of selling the range of horticultural accessories and do figures exist to provide this information? If not, it is recommended a system is established to provide the figures otherwise, although it may be generating moderately successful sales, it may not be generating a contribution to the overall profit. Has any market research been undertaken to find out if the items being offered for sale are the optimum range of accessories e.g. do customers expect a higher quality range of products to be sold? Is the range too wide/too narrow?

<u>Tearoom</u>

Turnover

Although the average sale per customer has remained unchanged at £7.50, the tearoom, which is operating at close to capacity, has increased the customer numbers by 4,500 (3.9%) whilst maintaining a gross margin of 28%.

If there is considered to be a correlation between visitor numbers and tearoom customer numbers, it is recommended research is undertaken to find out how the tearoom numbers have increased given the decrease in the retail business transaction numbers. Perhaps a greater percentage of visitors are attending the garden centre for the tearoom. However, social distancing and restrictions may mean it is not worthwhile to expand the tearoom currently, At present, the garden centre can accommodate about 600 visitors per day which equates to around 216k per year (600 x 360 days), without it starting to feel overly crowded. The tearoom had 119k customers during the year, so it is clear the tearoom is very popular. Consideration will need to be given to social-distancing and maxaimum numbers permitted due to covid restrictions.

Cost of sales

Although cost of sales has remained constant at 72% the individual cost elements of this should be examined to see if there is any obvious wastage that can bereduced. It is recommended this review takes into consideration the full cost of using home-grown produce so that the current composition of the cost of sales is understood. A 10% cost of sales saving will have a 26%[2] increase in the tearoom gross profit margin.

Further information is required on the administrative expenses that relate to the tearoom. With a gross margin of 28%, once administrative expenses are apportioned to the tearoom the net margin may actually be very low. As part of the consideration of any expansion this should be reviewed in detail.

<u>Wholesale business</u>

Gross figures

The average plant sale has decreased from £5.05 in Yr17 to £4.85 in Yr18 i.e. a 4% drop. However, the gross profit made on this business has risen 6.6% from £229k to £244k as a result of the 11% increase in the transaction numbers. It is recommended a meeting is held with the buyers to ascertain their future intentions with regards to future prices. If there is a clear link between volume and price this information would be useful to facilitate forward planning. Clearly the difference in price and volumes may be down to the mix of sales and the demand for a particular plant during a given year. An understanding of this will also assist in forward planning.

Unrecorded sales to landscape division

We have been advised that Brian has estimated the landscape division has acquired approximately £60k (valued at wholesale selling prices) per annum for the last two years of the high-value plants. If this is the case then the 'true' turnover is £2,352k and £2,499k for Yr17 and Yr18 respectively with a corresponding gross profit percentage of 12.3% and 12.2%[3] respectively.

[2] Cost of sales percentage would drop to 65% i.e. gross profit would increase to 35% from 28% of tearoom costs: £7.5 x 119.1k x 72% = £643k x 10% = £64k. £64k/(£7.5 x 119.1k x 28%) = 26%)
[3] Yr17: gross profit will increase by £60k to £289k on sales of £2,352K
Yr18: gross profit will increase by £60k to £304k on sales of £2,499K

One of the conditions of the wholesale agreements with the two large retail chains is that the gross margin was to be no more than 10%. The figures, as per the management accounts, show the margin is exactly 10%. However, after adjusting for the £60k missing sales it is clear the margin is greater than 10% and the reason as to how this occurred needs to be understood. It is, of course, possible the margin for the two large retail chains is no greater than 10% and the overall margin is increased by possible larger margins on the remaining 10% of wholesale customers. This information needs to be made available in order to undertake a thorough analysis.

If the figures have been adjusted to show a margin of 10% then either expenses have been supressed or changed/ misposted which, depending on the exact circumstances, is cause for concern and may be in contravention of the agreement with the retail chains. If this is the case and the retail chains decided to inspect the underlying records, then not only is a penalty likely but they may also rescind the contract due to ‘underhand’ accounting practices.

One of the objectives of the investigation would be to substantiate the accuracy of the £60k as advised by Brian and to find out the true extent of the problem and how long this has been going on.

The deals stipulate that Pagmari must make no more than a 10% gross profit. It is, therefore, recommended to scrutinise the contracts to fully understand what may be charged as cost of sales. Whilst this may not affect the amount paid by the wholesale customers, if more expenses could be charged to cost of sales, this would relieve the commercial pressure of meeting the 10% target.

It is strongly recommended this is investigated as a matter of urgency.

1.2.2 Non-Financial

Retail business

Dogs

It is great that the young Bernese Mountain Dogs act as an additional attraction to the centre. However, does the centre have sufficient insurance to cover the dogs roaming round the site? The obvious risks are injury/ accidents and allergies as well as other risks associated with the animals. Clearly it would be a shame not to allow them on site but given today’s litigious society it is worth thinking about the worst-case scenario. Perhaps they can be restricted to an area less than 40 acres so that there are some ‘dog-free’ zones? It is worth at least reconsidering allowing such unrestricted access to the dogs.

Internet

The internet presence is very basic. Given the rapid trend towards the use of internet shopping, especially during COVID restrictions, should this be considered further? Consider engaging the services of a consultant with internet experience in the horticultural industry to find out the latest trends and what may work. A garden centre with a tearoom would not want to move predominantly online since much of the turnover is likely to be from impulse sales, especially after a walk round the gardens; the tearoom business may also suffer. However, expanding the website to perhaps selling the 'high profit' products may be worth at least experimenting with.

Currently social media is not used to market the business. Use relevant experience with social media to enhance marketing.

<u>Tearoom</u>

Chef

The tea-room/ café has been successful largely as the result of the reputation of the chef, who has been with the company since the tearoom opened. This could be a risk to the business if they decide to leave. If not already in place, steps should be taken to encourage the chef to remain with the company (e.g., by introducing financial incentives such as bonuses or pension arrangements and/ or non-financial incentives such as flexible working conditions). Consideration should be given to ensuring any sous-chefs/ assistants are of sufficient standard to take over from the chef if required.

Research could be undertaken to monitor the customer feedback of the tearoom. If designed appropriately this may generate useful information on the customer experience when the chef is absent.

Produce

The tearoom sells doughnuts and presumably other such produce. Whilst these may be profitable and popular they are contrary to one of Pagmari's Principles, namely, to promote a healthy lifestyle. If the principles are part of the staff training and included in any marketing to customers, then the company is open to criticisms of hypocrisy and potentially misleading customers. Any message that is promoted in this way needs to be consistent with the actions of the company or dropped if the company has moved away from the original principles. Perhaps they should be revisited as part of this review to see if they are still relevant.

<u>Wholesale business</u>

Wholesale customers

90% of the wholesale business comes from two customers, both of whom dictate the selling price and gross profit margin. Clearly, the business is very reliant on these customers and, if a recent marketing exercise has not already been undertaken, then a campaign to attract new wholesale customers should be considered. Any legal contract with the two main customers should be reviewed to ensure the company does not breach any restrictions of business clauses, if they exist.

Contracts should be reviewed going forward to ensure the best terms are negotiated for Pagmari.

Equipment

Is the high-tech computer-controlled equipment being used to optimum capacity? A review of the operating practices should be undertaken to ensure the equipment is being used in the most efficient manner.

<u>General</u>

Minimum wage

The hourly rate of the division ranges from between £7 and £15 per hour for persons aged 21 and over is breaking minimum wage legislation and needs to be addressed immediately. A review of any potential under-payment for past years need to be carried out to assess the magnitude of any likely problem.

Discrimination

It is recommended the company should take steps to become fully conversant with discrimination legislation and put policies in place to comply with this legislation. Currently, they are discriminating based on age, which is unlawful per the Equality Act 2010. If necessary, an employment specialist should be consulted with a view to advising on the apparent age discrimination that is taking place.

1.3 Landscape division

1.3.1 Financial

Gross figures

The turnover has decreased marginally from £2,550k to £2,505k, a drop of nearly 2%. This, coupled with a 1% increase in both of the cost of sales percentages, has resulted in an increase in the gross loss from £77k to £125k. This has increased the EBIT loss from £99k in Yr17 to £147k in Yr18.

Irrespective of the impact of the adjustments as shown in section 1.1.2, a review should be undertaken as to why the cost of sale percentages have increased. Although it is 'only' 1% this has a significant impact on the gross profit. More detailed analysis of the cost of sales figures for the two years should be reviewed in more detail. It is accepted that a fixed depreciation charge will result in a higher percentage given a drop in sales, but this does not explain the increase in the 'workers' costs. A 1% change in the cost of sales has an impact of £25k on the costs/profit.

Adjusted figures

After making adjustments for items accounted for within the retail and wholesale division that really relate to the landscape division, the adjusted EBIT loss increases to £169k and £242k for Yr17 and Yr18 respectively (section 1.1.2). Clearly, this increase in losses is very large and unsustainable and so is the absolute loss. Arguably, £25k of the loss relates to a one-off repair, which may have had to be incurred irrespective of the occupier but this does not alter the fact that the division is highly loss making.

It is recommended a detailed analysis of the historical figures is undertaken with explanations sought as to why the results were as they were. Moreover, a business plan with detailed monthly financial projections should be produced to see if the losses are likely to continue.

Controls

The value of high-value plants acquired from the retail and wholesale division should be quantified and controls put in place so that any future acquisitions are approved and recorded accordingly.

Subcontractors

A detailed and urgent review should be carried out to establish whether or not the five subcontractors who have been working full-time for the division since it was started are really subcontractors or should be classified as employees. This review should be a balanced, open-minded consideration since, if HMRC make enquiries and are of the opinion they are employees, then the payments made to the subcontractors will be classified as net of income tax and national insurance.

If this is the case, the company could be liable for undeclared tax, interest and penalties that would likely be at least a 'six figure sum' and will depend on the level of individual earnings, tax rates and level of penalties. If HMRC discover this rather than be informed of the situation, the percentage applied as a penalty would be considerably higher.

1.3.2 Non-Financial

Employee checks

All employees need to have adequate checks performed on them to ensure they are suitable for the role. When employing staff, it is important to ensure background checks such as 'are they legally allowed to work in UK?' have been undertaken and that all the paperwork is in place to demonstrate that this has been carried out.

Auto-Enrolment

The material is silent on pension contributions, but it is important to ensure that the Auto-Enrolment and pension contribution legislation has been complied with.

Frequency of payroll processing

The Eastern European employees are paid weekly. This will involve running at least 52 payrolls a year, which is more costly than running, say, 12 monthly payrolls. It is recommended these employees are moved towards monthly payments. If this causes undue hardship in the short-term then this can be alleviated by providing them with 'salary advances' over a three- or four-month period.

The right to remain for workers, post Brexit, may also be considered for those workers that are not UK residents.

Local jobs for local people

One of the company's objectives is '.. to provide local jobs for local people'. The engaging of Eastern European employees perhaps goes against this objective although it will depend on their individual circumstances and they may, of course, be UK residents living in the local area. The company objective should be reconsidered and perhaps reworded to be more specific without breaching any discrimination legislation.

Agency workers

Agency workers will be more expensive to hire than the equivalent full-time employee; the agency needs to make their profit. If the division is using agency workers all of the time then consideration should be given to employing the worker, or an equivalent, on a full-time basis. Depending on the number of workers involved this could produce a saving amounting to tens of thousands of pounds a year.

Hire of equipment

A similar point is the continual hiring of equipment such as scaffolding and forklift trucks. Short-term hire is useful when there is an uncertain requirement for the equipment or if it is only needed occasionally. However, hiring long-term will almost certainly be more expensive as compared to purchasing and owning the equipment. Scaffolding, for example, does not need regular everyday maintenance and, thus, there is no need to pay for a third party's expertise in continually hiring this. Without a doubt, safety regulations and inspections/maintenance need to be adhered to, but consideration should be given to acquiring this equipment rather than continual hire.

Purchasing of materials

The practice of purchasing materials etc on a week-to-week basis from the internet can be time-consuming and is unlikely to build-up any customer loyalty thus losing out on any potential bulk discounts. It is also likely to involve a lot of 'carbon miles', which goes against the '..in an environmentally-friendly manner' ethos of the company goal as is the purchasing of the Amazonian wood.

It is recommended a decision to use one of the two aggregate suppliers is made as soon as possible. It is also recommended a similar exercise is carried out to find similar regular suppliers for other materials such as wood.

2. Assessment of the two aggregate supplier options

2.1 Assessment

The decision as to which supplier to choose will come down to the relative importance placed on some of the criteria, for example, is supporting a local business more important than the final cost of the material? The following analysis will provide commentary on the main distinguishing features between the quotations.

(Note: as always, marks are not available for repeating the question but awarded for the use of that information i.e. ***the quality*** of the assessment comments)

Issue	National supplier	Local quarry	Assessment
Price	£100 per tonne for first 2k tonnes and £90 per tonne thereafter. Imported aggregates may increase in price due to potential post-Brexit tariffs.	£115 per tonne for first 2k tonnes and £103.50 per tonne thereafter plus a £23k rebate. No tariffs on locally produced goods.	The local quarry will be more expensive irrespective of the quantities ordered especially if the annual order is less than 2k tonnes.
Carbon footprint – environmental impact	Global transportation will inevitably incur a high carbon footprint cost.	Due to the locality the carbon footprint will be minimised, and it operates under highly controlled regulations. The quarry will be returned to its original condition as the end of its economic life.	The local quarry is more environmentally friendly and more in keeping with the corporate philosophy.
Working conditions	There is no control over the working conditions of the ultimate aggregate producers.	The regulations under which the local quarry operates will likely ensure safe working conditions for the employees.	The local quarry will be more in keeping with the corporate ideals.

Delivery: times	Either next day or the following day. No mention of being able to offer emergency deliveries.	Can deliver on the same day and provides an emergency delivery and collection service.	The local quarry provides a more flexible delivery service.
Delivery: sacks	Disposable one-tonne sacks are used.	The use of tail-end tipper trucks minimises the use of sacks. Where they are used they are reusable via a refund system.	The local quarry delivers the aggregate in a more environmentally friendly manner in keeping with the corporate ethos.
Delivery: charge	Free unless the order is for less than 10 tonnes in which case a £25 charge is applied.	Free but will be reviewed if orders of 2 tonnes or less are commonplace.	The local quarry's delivery charges are cheaper.
Product colour range	Can supply over 1,000 varieties of aggregate but only in standard sizes.	Only supplies aggregate based on the grey/blue spectrum but can provide aggregates of any size for an extra cost of £100 per order.	The national supplier enables a greater choice to be offered to customers, but this may not be important consideration.
Local business/jobs	Will provide jobs around the world.	Will provide local jobs.	The local quarry is more in keeping with a stated corporate objective.
Relationship	Orders are placed at a central contact centre in Birmingham.	Orders will be placed at the local quarry.	It is more likely a personal relationship will be developed using the local quarry.

2.2 Overall Assessment

Prices

The national supplier is cheaper than the local quarry. For an annual order of 2,000 tonnes of standard aggregate the national supplier would charge £200,000 whereas the local quarry would charge £207,000[4]. However, if the order was for less than 2,000 tonnes the additional cost of using the local quarry could rise by as much as £22,885[5] (based on 1,999 tonnes).

Non-price issues – for example range of aggregate

On balance, the local quarry 'ticks more boxes', regarding the corporate principles, flexibility and convenience as compared to the national supplier. One of the drawbacks to the local quarry is the limited colour range. However, unless the aggregate is used as a finishing material it is unlikely that the colour and variation will be important to the division's customers. In the event that this is the case then one-off orders can be made from the national supplier.

Ownership/ Risk

A family-owned company is likely to be less financially sound as compared to a national company, although it has been in existence for at least three generations. It is recommended a company search is carried out to ascertain the viability of the company before any contract is entered into.

[4] 2,000 x £115 = £230,000 less 10% rebate of £23,000 = £207,000
[5] 1,999 x £115 = £229,885 - £207,000 = £22,885

Overall

Based on the above, if there is any doubt as to at least 2,000 tonnes being ordered in a year then the national supplier should be selected. However, if the estimate of requiring at least 2,000 tonnes per year is accurate then the convenience and flexibility of the local quarry is probably worth paying a little extra for, especially if it can be recharged to clients. In this case, it is recommended the local quarry supplier is used but try to negotiate on the final price before the contract is concluded.

Report to Jan and Februum

(NOTES: Jan has asked for 'a report on the…..'. This should be written in the style of a report and include the following sections:

Title Page: Report on issues concerning Pagmari Ltd as requested by Jan Paganowski and prepared by Tyme and Co on Tuesday XX May Yr18

Contents:

Introduction

This report has been prepared at the request of Jan Paganowski. It provides advice concerning a number of matters set out in the contents section.

It should not be shown or used by any third party without our prior written consent. We have prepared this report based on the draft management information and other documents as provided by Jan Paganowski. Tyme & Co does not accept any liability if this report is used for an alternative purpose from which it is intended, nor to any third party.

Executive Summary

- We recommend you do not purchase Peat Farm due to its lack of suitability for the current and future structure of the business and the imminent closing date does not allow sufficient time to fully consider the implications of such a move.
- Based on current information and tax legislation we recommend that any future land and buildings are purchased outside of the company, if financially possible, due to its flexibility and avoidance of potential future double taxation issues. We also suggest approaching the Forestry Commission to ascertain whether or not they would contemplate selling the existing site, although the financing of such a purchase should be considered beforehand.
- We recommend a specialist is consulted with regards to drawing up contracts in connection with the closing down of the landscape division. It is likely redundancy costs will be incurred although these may be mitigated if a third party would be interested in purchasing/taking over the division.
- Expansion of the retail business to include gift items is likely to be a low-risk venture and should be undertaken. However, we recommend market research is undertaken on the demand for a restaurant to see if this venture is likely to be viable, particularly with the covid restrictions.
- We recommend HMRC are advised of the tax implications of the 'borrowing' by Brian and the appropriate amended returns lodged as soon as possible.

3. Implications and risks associated with closing down landscape division

Although it is straightforward to close down a division of a company it is important to ensure the legislation and regulations impacting this area are followed. There is the risk that any breach could result in financial penalties in addition to reputational damage, which may have an impact on the company as a whole.

3.1 Redundancy

(NOTE: Students are not expected to state the level of detail below. Marks are awarded for knowledge of each of the principles rather than the minutiae.)

If the role of the former employees no longer exists there should not be any issues making employees redundant. The correct procedures should be followed, and the former employees will be entitled to any unpaid work to the date of termination plus redundancy pay, depending on their length of service. The main issues to be aware of are:

- Redundancy should not discriminate in any way e.g. by age, gender or disability. This should not be an issue if the whole division is to be closed down. However, consideration should be given to transferring as many of the staff to the retail and wholesale division as possible, especially if they have the appropriate skills and/or can be suitably trained. Care needs to be taken if staff within the retail and wholesale division are displaced by these employees since they would then have a claim for unfair dismissal if their old job/role is still in existence.
- The employees should receive the minimum statutory redundancy notice period depending on how long they have been employees. Assuming no employees have been with the company for a period longer than the existence of the landscape division it is likely this notice of period will be no more than four weeks (one week for each year worked).
- The employees will be entitled to redundancy pay for each years' service ranging from half a week's pay (if aged under 22) to one and a half years' pay for those who worked when they were over 41 years of age.

Subcontractors

One issue to consider is that the five subcontractors, who have been working full-time for the division since it was established, may try to claim redundancy rights even though they are not employees. This will increase the cost of closing down the division. It is recommended a lawyer is consulted to discuss what steps, if any, can be implemented to mitigate any such exposure.

3.2 Existing business

Contracts

A review of the existing supplier and customer contracts should take place to ensure the division complies with its legal obligations. This could include any long-term contracts such as for maintenance or penalty clauses for non-completion of work. Any such ongoing customer contracts will need to be discharged in an orderly manner. This may involve selling the contracts to other landscaping firms (if permitted by the contract) or otherwise agreeing terms with the customer to end the contract. If the contract was to be unilaterally ended, this would be a breach of contract, which would give rise to the possibility of a payment of damages.

If there is any doubt about any of the clauses in the contracts it is recommended a suitably qualified lawyer is engaged to review and advise on the legal position.

Sale of business/ contracts

Is it possible the division has any value to its customers or to a competitor? Given the losses produced during the last two years and the lack of tangible assets it is considered unlikely. However, some contracts may have a value provided they can be appropriately assigned. It is suggested Brian and Martius review the situation and, if there is any potential value, consider approaching potentially interested parties, including organisations that specialise in selling businesses.

3.3 Reputation

Approach

The closing down of the business should be dealt with professionally and with care. If this is not done then disgruntled employees may start to 'bad-mouth' the company, which may harm the general reputation of the garden centre.

The process of re-assigning Brian and Martius to the wholesale business should be handled with tact, especially if done at the same time as the employees are made redundant. It is recommended the employees are made redundant first with Brian and Martius retained to tidy up loose ends. After a period of time, the transfer could take place 'after the dust has settled'.

Lawyer

It is recommended a lawyer or redundancy expert is engaged to draw up suitable redundancy contracts for employees to sign upon receiving their redundancy pay. It is recommended to have the strongest worded legally binding clauses possible, with penalties, to deter former employees from discussing any aspects of the company after their dismissal.

4. Expansion Plans

(Note: the points listed below are the main considerations - students may come up with others. Sensible points in the context of the case study and more than just one/two-word comments may also be awarded credit.)

The assessment of any major expansion plan will involve many detailed considerations, some of which can only be commented on once more information is available rather than just a very brief outline. In addition to comments on the two individual ideas, many of the points will be common to both the up-market restaurant and the non-plant related item expansion plans. These, plus the individual comments are as follows:

4.1 General

- Significant consideration must be given to whether it is the right time to expand, with COVID restrictions and potential lockdowns ongoing
- The plans are a departure from the initial aims and objectives of the company.
- There is no evidence that market research has been undertaken in respect of either plan. This should be carried out to assess the level of demand.
- There are no financial projections for the plans. The plans need to be costed to see if they are financially viable. Projections should be produced
- Additional selling space will be required. It is not clear if there Is sufficient space available.
- Local employees will be needed and there is no guarantee of availability.
- A marketing strategy should be considered for the plans.

4.2 Non-plant related items

- The expansion may dilute the existing visitor experience of a local garden centre selling high-quality, locally grown plants.
- Larger garden centres already do this. Need to assess what will differentiate Pagmari from these garden centres.
- What products to stock and where to purchase them from will need to be decided.
- Expertise will be required in this area. It is not clear how easy it will it be to employ the appropriate local expertise.
- The accounting and inventory control systems may need to be updated to accommodate the expansion.
- The existing site may not be suitable for such expansion. There is a big difference between selling plants, many of which will be stored outdoors, and selling a range of giftware indoors.
- The company would need to ensure it had adequate insurance and security arrangements in place. Excluding any cash held, the second-hand resale value of plants is low and, thus, the centre is not currently likely to be a target for theft. However, giftware items have a second-hand value that can be sold easily on the various well-known selling platforms.

4.3. Up-market restaurant

- Expanding to an up-market restaurants when restaurants may be shut for some considerable time due to COVID restrictions would not be advised
- Knowledge/ Expertise to run an up-market restaurant will be required, since it is completely different to running a tearoom.
- It is not clear whether the restaurant will specialise in an area of cuisine or be a ‘general restaurant’. It is important to be clear of the target market and what is meant by ‘up-market’ when setting a price bracket e.g. is it in the region of £50 per head, £100 per head or something else?
- If the plan is to sell alcohol the correct licences must be applied for and obtained.
- The premises may need to be adapted for an up-market restaurant, which will be open during the evenings (e.g., a rustic feel carpark may be appropriate for a garden centre but not for an up-market restaurant).
- Opening times will need to be considered. If open for it may clash with the tearoom being open at the same time.
- As an ‘interim’ step towards assessing the demand for a new service, offering home-cooked ‘take-away’ meals and baked goods from the existing kitchen, via the retail shop, could be considered.

4.4. Overall

Financial

Given the issue with the landscape division it is not recommended the company pursues any immediate expansion plans until the full financial impact of the closing down of the division is known. It would be detrimental to the company if it embarked upon any expansion plans but then had to curtail them due to possible cash flow constraints.

Assuming the plans will be appropriately researched and costed it is recommended they are implemented one at a time to avoid over-stretching the management team. Invariably there will be unforeseen costs and issues and too much should not be undertaken at the same time.

Project risk

The selling of non-plant related items is a relatively low-risk venture, provided any expansion is controlled (i.e., the investment in the property and initial stock is modest). If the venture is less successful than anticipated, it is a relatively cheap exercise to either scale back the business or to withdraw from this market.

This is in contrast with an up-market restaurant, which is likely to incur significant set-up costs including training and marketing and is, therefore, a higher-risk venture. If this venture were not to succeed it is likely the costs of withdrawing from the business will be much higher. Taking the risks into consideration, it is recommended the lower risk venture of selling non-plant related items is undertaken before the establishment of an up-market restaurant.

5. Brian's confessions

5.1 Introduction/ Legal

Introduction

On the face of it, by saying that he has 'borrowed approximately £50,000 each year from the division' he has admitted to theft and the actions should be reported to the police. However, given the family relationship and that he is to be re-assigned to working in the wholesale business, this suggests that the shareholders have retrospectively agreed to the loan.

Responsibility of directors

Although it was Brian, an employee, who failed to facilitate the recording of the transactions, it is the directors who are prima facie responsible for failing to establish sufficient controls in the first instance that allowed this to happen. It will be necessary to review the controls of the retail and wholesale division to ensure they are sufficiently robust to prevent the recurrence of Brian's actions.

Assessment of admission

The first course of action would be to substantiate his statement by reviewing the information. After all, if he has covered up this theft for the last two years then what other inappropriate activities have taken place? At the very least, there is a motivation for him to understate the amount of the theft so that he is in a position to repay it. That having been stated, it was Brian who came forward with the admission as opposed to it being uncovered. This, together with the claim that the amount can be substantiated by the appropriate paperwork, does make the figures look credible.

Assessment of further issue/ collusion

Assuming the paperwork is genuine and all in order, this suggests there is no collusion on behalf of the customer and suppliers. Otherwise, it is likely the paperwork would not have been raised and, thus, it is unlikely the problem extends beyond Pagmari. If this is the case, then the problem is limited to Brian not providing the information to the bookkeeper to enable the recording of the transactions in the accounting records of Pagmari.

5.2 Corporate Tax Issues

The accounting figures and tax implications of such ‘borrowing’ should be worked through immediately and the appropriate authorities informed. The areas that will be impacted will include:

VAT

If the undeclared sales were in relation to the construction of new houses and the appropriate certification is in place, then it is likely there will be no output VAT to declare (sales of new houses are zero-rated). On the positive side, input tax may be claimable on some of the expenses. There are two methods of advising HMRC of the VAT error and the method to use will depend on the magnitude of the error. Based on the figures, it is likely a separate disclosure will have to be made setting out the full facts. It is recommended this exercise is carried out as soon as possible.

Corporation tax

The inclusion of the net sales and net expenses will increase the taxable profits for both Yr17 and Yr18 and, thus, the corporation tax will increase accordingly. An amended Yr17 tax return should be submitted as soon as possible. The time limit for amending the Yr17 return is 30 April Yr19 although there will be interest on any tax that is payable after the due date of 1 February Yr18.

Tax on loan to participators (s455 tax)

Since Brian is Februum’s husband the company will have to pay 32.5% of the ‘borrowing’ to HMRC and declare this on the company tax return. Assuming the loan at 30 April Yr17 is £50,000 this will result in an additional liability of £16,250, which was payable by 1 February Yr18. This tax is repayable by HMRC nine months and one day after the end of the accounting period in which the loan was repaid.

If he repays the full £100,000 loan from his inheritance within the next few weeks the £16,250 will be due to be repaid back to Pagmari by 1 February Yr20. Since the loan taken out during Yr18 would have been repaid within nine months of the year end, the tax would not be payable on this second £50k of borrowings.

If the loan is not repaid, then the amount of borrowings would be £100k in total and the figures increased accordingly.

5.3 Beneficial Loan Issues

Brian

Brian has received an interest free loan on which he should pay tax on the interest calculated using the official interest rate. Assuming a figure of 3%, the deemed interest will be approximately £1,500[6] for the first tax year that the loan is outstanding and £3,000 for the second year.

On the assumption Brian now has a liability to tax he should be advised he will need inform HMRC of the omission and the amount of under-declared tax. It is recommended this is done in conjunction with the company informing HMRC of the situation.

Pagmari

The company will need to contact HMRC to advise of their failure to submit a correct P11d for Brian and will have to pay the relevant class 1A national insurance of 13.8% on the deemed interest.

There may be a penalty to pay for non-compliance of PAYE regulations but if the company makes full immediate disclosure to HMRC it is likely this will be small.

5.4 Accounting/ Auditing

Restating Yr17 figures

It is likely the Yr17 figures will need to be restated if the adjustment is considered to be a 'material' and a fundamental error. The EBIT for Yr17 is £550k and thus the minimum 'error' of £50k is likely to be material (9% of EBIT). The question as to whether or not it is fundamental is debatable.

Audit

However, irrespective of the decision as to whether or not it is classified as a fundament error, the fact that the unrecorded sales of £500k when added to the Yr17 turnover of £9,935k gives a total of £10,435k. This means the company should have been audited as the number of full-time equivalent employees (exceeding 50) means that two out of the three criteria for audit have been reached. An audit may also be required on the Yr16 figures.

A similar situation exists in Yr18. The increased turnover to £10,406k means it is likely an audit will have to be carried out on the accounts. Since the 'error' is likely to be material, the Yr17 figures will need to be adjusted (e.g. opening reserves) to avoid a modified audit opinion, assuming nothing else is uncovered during the audit.

[6] £50,000 x 3% = £1,500 per year

5.5 Jasper's Alleged Comments

Introduction/ Scene setting

Although the facts of what was actually said between Jasper and Brian need to be established it is nonetheless recommended that enquires are made to ascertain whether or not any of Jasper's alleged practical suggestions were implemented within the Landscape division. As directors, you are ultimately responsible for the transactions undertaken by the company and thus this will provide a degree of assurance that the issue, as confessed by Brian, is limited to the £100,000 loan and does not extend beyond this.

A review of sundry expenses

Sundry expenses should be reviewed to identify any expenditure relating to personal expenditure and, specifically, to the dogs. If there is any such expenditure it should be established whether or not it is genuinely wholly and exclusively for the company. Our background notes on the company state the dogs are pets rather than dogs used for marketing purposes. If this is the case, the expenditure should be treated as relating to Jan and thus posted to her director's loan account. If any VAT has been reclaimed on these expenses this should be repaid in the following VAT return.

A review of capital expenditure

A review of the purchase of expensive furniture should be undertaken to establish what and how much was bought. This should be expanded to recording details of the whereabouts of the furniture, if not already recorded on the non-current asset register. Presumably it would be a straightforward matter for Brian and/or Februum to confirm if any such assets are at their home? If this is the case, then the personal tax charge can be quantified, and the appropriate action taken (e.g., disclose the information to HMRC and to decide whether the assets are to remain in the custody of Brian and Februum or returned to Pagmari/ sold).

A review of telephone expenses

An employee having one mobile phone where the contract is between Pagmari and the telephone company does not present any tax or accounting issues. However, if an employee had more than one telephone or if the contract is not between Pagmari and the telephone company then there are tax implications. We recommend the expenses and contracts relating to mobile telephones are reviewed to establish the facts. The tax consequences (e.g., personal tax charge on P11d and Class 1 and 1A national insurance contributions) can then be considered.

A review of stock/write offs

It should be established if any of the stock acquired by the Landscape division has been used for personal gain (e.g., by reviewing addresses on delivery notes) and, if this is the case, the amount quantified. Particular attention should be given to any damaged stock 'written off' and how it was disposed. If material of the same nature as that used by the Landscape division has been used at either of the homes of Jan or Februum, it is recommended receipts proving it has been bought and paid for personally are obtained/ retained. This will defend against any suggestion by HMRC that material has been bought and paid for by Pagmari but used privately. If material bought by Pagmari has been used personally the tax impact will need to be quantified and HMRC advised accordingly.

6. Peat Farm: renting existing site vs buying and ownership issues

The objective of owning the premises from which the company will trade is very appealing. However, ownership comes with its own risks and responsibilities. The main points to consider at this early stage of considering acquiring Peat Farm are set out in the table below.

6.1 Summary of the issues of renting vs buying

Issue	Renting existing site	Purchasing and developing new site
Affordability	n/a	Can the funds be made available to purchase the site? The available cash in Pagmari plus any contribution by the directors still leaves a shortfall of over £1.4m, which would need to be borrowed. Loans on generous terms from local councils may be available to assist with the purchase. However, the employment policy would need to be changed to employ young persons between the ages of 16-21.
Location: profits/ goodwill	The business has been profitable since it was established and there is no indication this will not continue to be the case if the business remains at the site.	The profitability may not ‘transfer’ to the new site and neither may some of the existing staff, which could result in a drop in service quality. At the very least, it is likely the profits will drop in the first two or three years of trading at the new site.
Asset	The ownership of the site will remain with the Forestry Commission.	The site will be owned by the directors and/ or company and will thus be of some future value. The flip side is the loan/ finance to purchase it.
Security of occupation	The existing site is rented and, thus, the Forestry Commission may demand repossession of the site at any time, however unlikely.	The site will be owned/ controlled by the directors and, thus, there is little risk of being asked to vacate the site.

Location: physical expansion	The existing site can accommodate significant expansion, which fits in very well with the nature of the business.	It may not be possible to purchase or rent additional land adjacent to the new site, which will limit future expansion plans.
Location: development (existing)	As a result of the existing development of the site, only maintenance costs will be incurred over the next year or so.	Substantial unquantified costs will be incurred bringing the site into a condition from which it can trade (e.g., restoration of buildings, construction of greenhouses, etc.).
Location: development (future)	Development costs at the existing site are incurred on a project-by-project basis and so the cash flow can be absorbed from trading activities. It is likely the proposed expansion plans can be pursued.	Due to likely pressure on cash flow any future development plans, such as the restaurant and non-plant related items, may have to be deferred. However, the site can be developed with these expansion plans in mind.
Time scale	n/a	Is there sufficient time to assess the viability of the site, arrange the relevant professionals to be involved and to produce a realistic business plan and then approach lenders for finance?
Planning permission	Already granted.	Planning permission may not be granted to use the site for a garden centre and associated businesses. Verbal outline planning permission is meaningless.
Company Objective	The objective to "own the land and buildings from which the company trades" is not being met.	Purchasing the new site would allow the company objective to be met regarding the owning the property, either personally or through the company.
Future plans	Is there an exit plan for the business? If one or more of the parties involved wants to move on, then it is less complicated if the site is rented.	Purchasing the site is a long-term commitment and, thus, may not be suitable if one the parties is not looking to remain in the business for 'years to come'.

Effective cost	Tax relief is available for the rental payments.	Tax relief is only available for any interest payable on loans to purchase the site.

6.2 Recommendation

Reasoning

With only seeing the extracts from the Sales Particulars of Peat Farm it is too early to make a conclusive recommendation. The company/directors would probably find it difficult to raise over £1.4m[7] to finance the purchase of Peat Farm and this may prevent the deal from proceeding. Irrespective of the financing, based on the summaries of the issues in Table 1 it seems that this site will be too restrictive for the company in that it only has 25 acres of land and there is no indication of being able to rent/ acquire any more.

There is no indication that appropriate planning permission will be given, and the availability of funding and grants is not relevant given the company's existing policy of not employing anyone under the age of 21. Furthermore, the closing date for offers is probably too soon to undertake the appropriate 'due-diligence'.

Recommendation

Unless there are other compelling reasons to purchase Peat Farm it is recommended not to proceed with an offer at this stage.

6.3 Pros and cons of ownership personally or via a company

(Note: The guide to answer compares a company with personal ownership. If students mention other relevant structures e.g. holding via a personal pension plan or a group structure of companies then marks awarded as appropriate.)

The decision on who /what is to own the land and buildings will depend on many factors, several of which are tax related. The discussion will be limited to comparing owning the property personally (or as a partnership) as against via a company. If an acquisition is to go ahead in the future, further tailored advice can be given to suit the circumstances at the time.

[7] Purchase price of £1,75m. Known funds: £95k in bank, £130k from Jan and £100k repaid from Brian

6.3.1 Acquisition/ Financing of the property

Funding

Assuming the price of a suitable property is in the region of £1.75m, the main practical issue is how can it be financed? If, for example, the finance can only be raised either personally or via a company then this will dictate the ownership of the property. The current funds available are approximately £95k in the company, £130k via Jan and Martius and £100k to be repaid by Brian, which in total would give a ‘deposit’ of 18% thus requiring at least £1,425k to be raised elsewhere.

As a result of its trading status. it is more likely Pagmari will attract grants for purchasing property as opposed to a personal investment purchase, albeit that it may still be used within the same business. It is recommended the policy of not employing anyone under the age of 21 is reconsidered so that this not only increases the availability of suitable grants and loans on generous terms but also ensures the company is no longer being discriminatory against employing young persons.

Potential conflict of interests between Jan and Februum

If the purchase is to be via the company would Jan and Martius be prepared to lend the company the money without any further financial contribution from Februum and Brian? Can the Marikos borrow any funds from either their friends or family or consider re-mortgaging their five-bedroom house? This could bring some parity to the funding, which may be more acceptable to both parties.

If the two families introduce/ provide different amounts of funding, Jan and Februum will need to be comfortable that the differing amounts will not have an impact on their future working relationship.

Bank

With the current tightening up of lending criteria by lenders it is likely a deposit significantly greater than 18% will be required since this is a loan-to-value (’LTV’) of 82%, which will be considered high risk by lenders. Assuming a lender is prepared to lend at this LTV, they will charge a relatively high interest rate to compensate for the additional risk associated with the loan. It is likely lenders will charge a higher rate of interest for company commercial loans as compared to personal commercial loans, although the market rates do change constantly.

Business plan

A business plan will be required to support any loan application. This will have to show there is sufficient ‘headroom’ in both the forecast profit and cash flow to comfortably afford the loan. Various stress tests/sensitivity analysis will have to be included showing the impact of worst-case scenarios on the main drivers underpinning the figures e.g. transaction and visitor numbers to the garden centre.

Company purchase – charge/ guarantees over the asset

If the company is to purchase the property, the bank will probably require a fixed charge over the property and probably a fixed and floating charge over the other assets of the company. Restrictive covenants and personal guarantees may also be sought. These should be negotiated and kept to a minimum and preferably decrease as the outstanding loan decreases. This is especially the case with any personal guarantees which, to a large extent, negates one of the main advantages of trading via a company, namely limited liability status.

Personal purchase – charge/ guarantees over the asset

If the property is to be purchased personally, the bank will want a fixed charge over the property but may also require other personal guarantees. It is advisable to ensure these other guarantees are kept to a minimum and should decrease as the loan is repaid. However, all of the assets of the person(s) who are party to the loan will effectively have unlimited liability.

If this is an important issue, then the number of persons signing up to the loan should be minimised wherever possible.

6.3.2 Ownership/ Flexibility

Company insolvency

At the moment Pagmari has positive net assets and is trading profitably. However, should the company, for whatever reason, be put into insolvency, all of the assets of the company are available to meet the claims of the creditors. If the property is owned by the company this will be sold, subject to any charges, to meet these claims. Whereas if the property is owned outside of the company it does not form part of the assets available to creditors and is, therefore 'safe', subject to any personal guarantees being given.

Rental expense

Ordinarily Pagmari will have to pay rent if the property is owned outside the company. The amount of this rent can be set at a level that is most desirable to the owner if that owner controls the company (e.g., if the property is in the names of both Jan and Februum). However, this flexibility is less likely to be available if it is only owned by either Jan or Februum, say, due to one party appearing to gain financially over the other, notwithstanding the cost to acquire the property in the first instance.

The rental agreement can be 'made to fit' (e.g., a tenant repairing lease where the company is responsible for the upkeep and maintenance of the property). In any event, it is recommended a solicitor is engaged to draw up a legally binding lease agreement should this scenario arise.

Expansion/ Disposal

Should the company own the property and it outgrows the premises, it may not have any use for the property. In this scenario, the property may have to be sold in order to raise finance for purchasing a new premises. If it is a ‘forced sale’, the market conditions may be less than ideal and a lower than expected price may have to be accepted. If the property is retained and not used in the business, it could be let out to a third party. However, the company is then no longer purely a trading company, which may divert management time away from the main business of the company as well as having other potential tax implications, such as the possible restriction of entrepreneurs’ relief if the company is eventually sold.

If the property is held outside of the company, there is likely to be less pressure to sell the property and it could be retained and let to another third party or sold at a time when the market conditions are favourable.

From the company’s perspective, should there be a possibility of moving location, then renting would be a more flexible option, as the sale of commercial buildings can take a considerable period of time and market prices can be volatile. However, as the owners and company are in substance, if not legally, the same, in this instance this advantage would be nullified.

When the business is eventually disposed of there would be greater flexibility if the property was held outside of the company. A potential purchaser would then have the option of purchasing only the shares/ trade or purchasing the shares /trade and the property if it is required. This could be advantageous if the acquirer would prefer to rent the property rather than purchase it. If the property was owned by the company and the purchaser did not want the property, it would have to be removed from the company, with the potential of a double taxation charge (assuming the purchaser wanted to purchase the shares and not the trade).

In either scenario it would not be a ‘deal-breaker’ and the disposal of the business may not occur for many years but it is, nonetheless, a consideration.

6.3.3 Tax considerations

A summary of the main tax issues is set out below. It has been assumed that the property will be retained for many years and, thus, the comments on its eventual disposal, while still relevant, have been kept general on the basis that the legislation may change in the intervening years.

Tax Issue	Company ownership	Personal ownership
Double taxation	Any gain made on the disposal of a property in Pagmari will suffer a taxation charge. If the proceeds are distributed (e.g., via a dividend or bonus, a further tax charge will be levied).	Capital gains tax is only charged once on the disposal of a property if owned by Jan/ in partnership since the proceeds will already be in the hands of the vendor(s).
Capital gains	When the property is sold any chargeable gain is taxed as part of the company profits during the year of disposal.	If the property is held personally then any gain is taxed at the personal capital gains tax rates at the date of disposal (currently 10% and 20% for basic and higher rate taxpayers respectively).
Entrepreneurs' relief	Assuming the intention is for the garden centre to be the main trade of the company and the property used for this purpose, entrepreneurs' relief is likely to be available on the disposal of the shares. This effectively means the tax charge on the gain is 10%, assuming other conditions are met.	Entrepreneurs' relief may be available on disposal depending on the value of the rent charged for the use of the property (associated disposal).
Income tax	n/a	Any rental income charged to Pagmari will be taxed at the recipient's marginal income tax rate. Both Jan and Februum are currently on the cusp of being higher rate taxpayers and, thus, any rental profit will be taxed at a rate of at least 41% whereas the company only receives tax relief at a lower rate (i.e.,19%). However, this does allow

		profits to be extracted from the company free of NIC. Interest on the loan to purchase the property can be offset against the rental income thus reducing the profit. However, there is no tax relief for any losses unless Jan or Februum have other rental income during the year of the loss.
Inheritance tax	100% Business Property Relief is likely to be available on the value of the shares, which is likely to have an uplift due to the value of the property.	If the property is rented to Pagmari the Business Property Relief is restricted to 50%.

Reasoned recommendation

Clearly, the relative importance of each of the above taxes will depend on what Jan and Februum perceive as being important to themselves. On the assumption that the inheritance tax issue is not important, then it is likely the following will be the most important points to consider:

- Should the company fail, the property will be protected from creditors pursuing the company if it is held outside of the company.
- The potential double tax charge will be avoided if the property is held outside of the company.
- There could be a restriction on entrepreneurs' relief on the sale of shares of Pagmari if the property is held in the name of the company and not used in the trade of the company, although at present this is not considered to be an important issue.
- Can finance be raised personally? If not, then the only option is to purchase the property in the name of the company.
- Subject to any restrictions on future entrepreneurs' relief, the rent can be set at a level that covers the interest charge on any personal loans thus avoiding a personal income tax charge, if the property is owned personally.

On balance, it would seem the better option would be to hold the property personally rather than in the name of Pagmari especially if the balance of salaries between the spouses is reviewed.

Ethics

To: Sam
Date: May Yr18
From: Rosemary
Subject: Pagmari and associated ethical issues

Sam,

Please find attached as requested:

1. Briefing paper to Jan and Februum
2. Draft report to Jan on issues discussed on Tuesday afternoon
3. A summary below on matters I need to draw to your attention

Advice by Jasper (integrity and objectivity)

The comments from Jan about Jasper are serious and give cause for concern. However, we must first establish the facts since they could have been deliberately distorted by Brian in order to deflect part of the blame away from himself onto us. Some points to consider:

- Can we approach Jasper to get his side of the story, notwithstanding his health?
- We should consider each 'suggestion' in turn although, at first reading, it could be argued that the comments are not overtly suggesting Brian should undertake any fraudulent action.
- The 'suggestions' seem to fall into two categories:
    - **Claiming personal expenses through the business**. The example of a business claiming for the expenditure on guard dogs is not unreasonable and there is no mention as to whether or not a personal add back is made in the tax computations. Similarly, there is nothing wrong with companies incurring expenditure on expensive items although they do have to be for the business. The comment regarding the telephone is not contentious. We need to ascertain exactly what advice was given since all of the comments by Brian involve a degree of interpretation and subjectivity and it may be that Brian heard what he wanted to hear rather than what Jasper actual said.
    - **Employees using company assets for their own purposes.** This clearly has tax implications, assuming the use has been sanctioned by the appropriate managers. The example given by Jasper may well be absolutely fine if the value of the boards taken by the directors had been agreed with HMRC. However, if Jasper did advise that surplus assets were able to be used personally by the directors without expanding on the tax and legal implications then this is a concern.

- What evidence, other than the word of someone who has committed theft, do we have to substantiate the facts? Is any of this advice given in writing e.g. by email, text or by some other means? Were there any other witnesses to this conversation e.g. members of our firm or employees of Pagmari? If we are able to discuss this with Brian, we should be mindful of adhering to any legislation and guidelines relating to this and ensure the conversation is witnessed and documented. If in doubt, we should seek legal advice on the procedure.

The first step in resolving this situation is to obtain the facts as best we can and to then decide on what course of action to take. My initial reaction is that there is a ‘big leap’ from the relatively small subjective items mentioned in the ‘Practical Suggestions on Saving Tax’ to taking £1,000,000 in cash sales albeit offset by £900,000 alleged expenditure.

If Jan is determined to pursue this matter, and it can be proven that Jasper has given incorrect advice, we may have to inform our professional indemnity insurers depending on what claim, if any, Jan makes against Tyme & Co.

Jan (integrity and professional behaviour)

Jan is a CA and must comply with ICAS ethical standards, which apply to all ICAS members. One of the main aspects of the code is that a member must maintain the reputation of the accountancy profession and that personal self-interest must not prevail over such a duty.

At present, she is a director and co-owner of a company that, on the face of it, has not complied with Companies Act legislation (failure to keep adequate records and failure to have an audit carried out despite breaching the audit limits) and has not implemented sufficient controls to ensure that large scale fraud gets detected.

Jan has also, seemingly, signed a statement declaring that the company is entitled to an exemption from an audit when this is not the case, again a technical breach, even if inadvertent.

Pagmari is discriminating against employing young people and, in some cases, paying below the minimum wage. This is contrary to employment legislation and she should be advised to remedy the situation.

Based on the contents of our recent discussion with Jan it would appear that she is taking these matters seriously. However, only time will tell, especially with the re-assigning of Brian after his admission of theft or borrowing as he calls it.

I would suggest we tactfully remind Jan of her duties and monitor how she deals with the issues at hand. One breach is unfortunate, two breaches careless but three or more breaches!? If Jan does not start to rectify the situation we should consider whether or not the firm should consider acting for her.

Audit (professional behaviour*)*

As a result of the omission of the £500,000 cash sales for each of Yr17 and Yr18 the management accounts show the company does not require an audit. However, after the figures have been adjusted for the cash sales it is clear the audit turnover threshold has been breached and, given the number of employees, the company may require an audit.

Given that the audit turnover threshold limit increased to £10.2m from £6.5m for accounting periods beginning from 1 January 2016 it is possible the prior year figures should also have been audited and we should check this.

We will need to establish the facts first, but it looks like Jan has signed a declaration that the company was entitled to an audit exemption when, in fact, this is not the case. It is appreciated Jan was unaware of the 'borrowing' and thus signed the declaration in good faith. The potential audit implications need to be considered and advice sought on whether the Yr17 figures need to be audited retrospectively.

Discrimination (professional behaviour)

Pagmari seems to be discriminating against young people and is paying below the minimum wage. Aside from the fact that there could be a contingent liability, are we comfortable acting for a company that is breaking the law?

Jan should be advised to seek specialist advice to correct the situation and to ensure the company complies with this and any other employment legislation in the future.

Landscape division (professional competence)

Brian has admitted that the landscape division has used £60k of plants from the wholesale business without the transactions being recorded. Had the transactions been recorded then the gross margin of the wholesale business would have exceeded 10%. The figures could be distorted by the remaining 10% of wholesale customers but it is possible Pagmari would be in breach of the agreement with the company's two main wholesale customers. However, the current management accounts show a gross margin of 10%, which suggests the figures have been altered to show 10%. This needs to be investigated to be fully understood and to ascertain whether or not there has been any deliberate manipulation of the figures.

Brian (integrity, objectivity and professional competence)

Brian has admitted to committing fraud and stealing money from the company. Although he said he always intended paying it back, we might suspect that he would not have had the poor performance of the division not been brought up. Jan should be advised to carry out a full audit of the situation, preferably with ourselves involved. This would involve contacting the parties involved, without explaining the reason why. Once the facts have been established, the tax and VAT adjustments should be calculated, and the authorities informed immediately.

Assuming Brian is correct and that it is ‘only’ the case of not recording financial transactions as opposed to a wider spread intentional fraud, then it should be made clear to Brian that he must pay back the money immediately; if he is due an inheritance he can borrow using this as security. If he does not do this then we will have a duty to forward a report to our Money Laundering Officer to report him under the Proceeds of Crime Act. If he does repay the money to the company and pays the undeclared personal tax and both we and Jan are satisfied the figures are correct then we still need to forward the facts to our Money Laundering Officer for them to decide whether or not the actions need to be reported.