TPE 2023

Andka – Case Study Sample Solution

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Briefing Paper

For: Chloe Andrews, Hamad Kapoor

Subject: Andka Vehicle Rentals Ltd - financial performance review, general business improvements and an evaluation of luxury car proposal (including recommendation)

Financial performance review of Andka Vehicle Rentals Ltd

The financial performance of Andka Vehicle Rentals Ltd ('Andka') has been reviewed, initially at a company level, before providing a detailed review of each division of the organisation. Within this review, where applicable profit improvements have been suggested to assist with the future management of the company.

Andka Vehicle Rentals Ltd

Overall, the company has achieved a profit for the year of £708,000, compared to a prior year profit of £1,096,000. The reason for the reduction to profit in the year is as a result of increased cost of sales, which have increased at a higher rate than the turnover in the period, resulting in a lower gross margin across the company (35%, compared to 40% in prior year).

Turnover within the business has continued to increase compared to prior year, which suggests that Andka has a reputable and recognisable brand, and possibly suggested that customers are willing to re-use the services of Andka.

Finance costs of the company remain large at £360,000. Potential improvements to this position have been considered in the *General business improvements* section of this briefing paper.

Below is a summary of the gross and operating profit margins achieved by each division. These are discussed in more detail within the sections of each division (a full breakdown of the calculation is available in appendix 1).

	Gross margin		*Operating margin*	
Division	*Year ended 31 March Yr58*	*Year ended 31 March Yr59*	*Year ended 31 March Yr58*	*Year ended 31 March Yr59*
UK car division	35%	25%	14%	4%
UK van division	42%	37%	17%	12%
Dubai division	48%	50%	28%	29%

UK car division

As mentioned above, the gross and operating profit margins for the UK car division in the year to 31 March Yr59 are 25% and 4%. This is a reduction in comparison to prior year, where the margins were 35% and 14% respectively.

The UK car division's gross margin of 25% is well below industry average for global operators of 50%. This performance is somewhat impacted as a result of the commission owed to third-party booking sites, which take commission of between 10-20%. If Andka are able to upgrade their website and mobile facilities (along with a targeted marketing campaign), they may be able to increase their gross margin by achieving more sales through their own website rather than having to rely on third parties to help generate sales.

The staff costs for this section of the business are high, currently at 18%[1], and similar to the percentage in the prior year. Andka should review its allocation of costs between divisions, to confirm whether this represents a fair level of costs in comparison to its van division. Moreover, Andka should consider that, whether based on the utilisation figures discussed below, the company needs this level of staff costs – or if certain / any members of staff would be willing to reduce their hours in order to improve the profitability of this division.

The UK car division is currently operating at a utilisation of 70%[2], based on the average daily rental per car and the number of operational vehicles within the fleet. This is lower than the industry average of 80%, and Andka should take steps to consider why they have fallen below this average, and whether the company would be well-advised to sell several of the vehicles currently in its possession.

On this point, it appears that the company has reduced its number of acquisitions of cars in its fourth quarter, where only 15 vehicles were purchased compared to the average across the prior three quarters of 145 vehicles per quarter. Although this may be a sensible decision based on the utilisation of the current fleet, it is not in keeping with company policy. The grounds for this decision should be established with the Chelmsford manager, who is currently overseeing the operations of the UK car division, to confirm the rationale for this decision.

It is noted that there is currently increased demand from city dwellers who wish to take advantage of the opportunity of renting a car for a day or two. Andka should consider the possibility of creating a depot in London, or another city centre, which could cater to this expanding market. Alternatively, Andka could consider offering free public transport to its facilities in Romford for individuals who are living in the London city centre but may otherwise wish to take up Andka on their offerings.

UK van division

The UK van division remains profitable, contributing almost half (600 / 1238 = 48%) of the company's overall operating profit. However, operating profit has fallen by £208k when compared to prior year, and as a result operating margin has fallen from 17% to 12% in the year to 31 March Yr59.

The largest issue currently faced by the UK van division appears to be the increased cost of repairs required in the year to 31 March Yr59, which have resulted in an increased outlay of £86k. It would be useful to receive more information as to the nature of these repairs, to understand whether they are in relation to the treatment

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[1] Staff costs for UK car division
- 31/03/59 = 610 / 3452 = 17.6%
- 31/03/58 = 594 / 3362 = 17.7%

[2] UK car utilisation = 3452 / (675 x 20 x 365) = 3452 / 4927.5 = 70%

of the vehicles by Andka's customers (and if so, whether any of these repairs could be chargeable to the customer) or if they are simply as a result of operating a larger fleet of vehicles. In any case, Andka should reconsider their repairs policy, and if there is a more cost-effective way to repair the vehicles (for example, the company may choose to hire an in-house mechanic who could offer his/her services at a cheaper rate than sending the vehicles to a garage for all necessary repairs and maintenance).

The UK van division has operated at an above average utilisation of 84%[3], which indicates that the company has a strong client base, and that the current level of vans owned by the company is appropriate for their requirements. However, if Andka wished to increase its utilisation in this area, they may choose to advertise in the local trade press, or contact organisations who already rent one or more vehicle from the company, and perhaps provide a discounted rate to these firms in exchange for the rental of an additional vehicle.

Alternatively, the van division may find that increasing their prices would be beneficial to its overall profit position. A small increase of prices, by 5% for example, may reduce the utilisation of these vehicles to 80% (in line with industry average) but actually increase the profit made by the company. A feasibility study, and projections of future performance, should be drafted to confirm whether this policy should be adopted by the van division (this may also be a worthwhile exercise to conduct within the *Dubai division*, based on the utilisation levels reflected in quarter 4).

Additionally, during the COVID 19 pandemic, the demand for couriers has increased with the increase in online shopping. Therefore, the demand for hiring vans may also increase as a result and Andka should look to benefit from this opportunity.

Dubai division

The Dubai division appears to the be the division which has achieved the largest gross and operating margins across the company, and these margins have increased in comparison to prior year (currently 50% and 29% for gross and operating margin respectively, compared to 48% and 28% in prior year). These margins are also similar on average to that of the global operators, which suggests that Andka are performing successfully in this division and have managed to adopt the principles of globe leading firms.

Sales within the fleet have increased drastically in quarter 4, however it would be useful to see more information on the actual transactions which make up this value. From a rough calculation, it is expected that the total revenue which could be obtained within a quarter would be £486,000[4]. However, in quarter 4, we see revenue of £610,000. It may be that increased rental rates were charged in this quarter, as a result of excess demand, however as above an overview of the actual prices charged to customer for each vehicle would be useful to understand the difference between the expected maximum and actual revenue.

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[3] UK van utilisation = 4838 / (1000 x 480 x 12) = 4838 / 5760 = 84%
[4] Total revenue available for one quarter in Dubai (based on estimates supplied and assuming full capacity)
= 225 AED x 120 cars x 90 days = 2,430,000 AED
Amount in GBP = 2,430,000 / 5 = £486,000

It is also noted that within the Dubai division, staff costs are only £50,000 for the 8 members of staff employed in this area. This is a large reason behind the higher operational margin received by the division, but again it would be useful to receive a more comprehensive breakdown of this number to ensure that all staff are being paid the minimum wage within this jurisdiction, and that the company is therefore in compliance with Dubai employment law.

Management charges within this division are £180k, over 10% of revenue for the period to 31 March Yr59. This is much higher than the other, UK divisions, where management charges are equal to 1% of turnover. It may be that these management charges are as a result of cultural factors, and the costs are necessary to reflect the cost of director travel, or the entertaining of suppliers or clients. However, this figure should be managed, and if possible reduced, in order to increase the company’s operating profit going forwards.

General business improvements

The company holds a relatively large amount of cash at the financial year-end, with reserves of £2.69 million compared to a prior year total of £680,000. Holding excess cash within the business is generally inefficient, as the cash can be better used elsewhere. This point is especially pertinent given that the company has a bank loan of £15 million, and is currently accruing finance costs of £360,000 (presumably in relation to this loan). The cash held in the business should either be used to purchase new cars for the company, or to pay off some of the existing debt, in order to reduce the company’s interest costs going forwards. The company operates a stock system where vehicles are sold at the earlier of two years or when the vehicles have accumulated 50,000 miles. This represents a significant outlay to the business over a cyclical period, given that the company only receives 50% of the original cost when the vehicles are sold at auction. There is no currently available information to suggest how many vehicles have been sold before accumulating 50,000 miles, but it would be useful to receive a breakdown of this information.

Initially, the company should review its sales policy, and conduct market research to ascertain whether consumers would be willing to hire vehicles which have been owned by the company for more than two years. In any case, the company should consider whether an auction dealer is the most useful method of selling its vehicles. There may be more value to be obtained for its vehicles by agreeing a contract with a garage, or vehicle-selling company, which could recoup more than the 50% obtained at auction and provide more funds to Andka to use on future vehicles going forwards.

The Andka website has not been updated in several years, and has not been optimised for mobile devices. In today’s economy, almost every business which sells products to customers should consider their IT functionalities, and whether these are optimised in relation to the competition. It is likely that other businesses in the industry have higher quality websites, and presumably mobile apps – which could be the decisive factor for some customers, reducing the potential revenue available to Andka. Therefore the company should prepare a feasibility study in relation to creating an app, to understand whether this would be useful to sales and what the associated costs of this venture would be. It is likely that this would be popular with customers, given the shift towards online purchasing seen during the COVID 19 pandemic.

The company offers generous credit terms to their debtors of 90 days. This may assist business relationships, but offers a large time lag between Andka providing services to their debtors and the cash actually being received. It is also noted that the closing debtor figure has increased in comparison to last year by £222k[5]. If Andka's credit terms were reduced to 30 days for example, this would result in cash being received more quickly, which could be used on other projects as required by the company (or could be used to reduce the company's bank debt).

At present, the company relies on staff members to man each depot 24 hours a day, allowing customers to return vehicles at their convenience and to provide security cover for the premises. However, it would be useful to understand what % of customers return their vehicles out with the hours of 10pm – 6am, for example, to ascertain whether the cost of paying staff for these hours is worth the associated benefits to the customer (and to confirm whether customers understand the depots are open 24 hours). If it is found that no vehicles are generally returned within this 8 hour window, the company may find it beneficial to close the depots within these hours, and instead introduce CCTV and other security equipment to provide security to the facilities. Although this would represent a larger up-front cost, it is likely that the company would increase their margins for future periods as a result.

As you are aware, the current fleet manager, Wes O'Reilly, has been absent from work since last summer. This has resulted in what appears to be a change in purchase policy for the UK car division, as discussed in the *UK car division* section. It is suggested that the company contacts Wes (if this has not been done already), providing support to him and to understand if he would be available to return to work in the near future. If this is not the case, it is recommended a temporary fleet manager is appointed to provide assistance to the UK depot managers, and held improve the performance of the company.

Evaluation and recommendation of luxury car proposal

Based on my evaluation of the proposal in its current form, it is recommended that Andka do not continue with their expansion into the luxury car market, until additional market research and a feasibility study have been conducted into this potential expansion.

Following the completion of these studies, if they provide evidence to suggest the enterprise could be profitable and that Andka offers a unique alternative to the global operators in this industry, bank should be contacted in relation to the purchases.

The below analysis has been separated into two categories, which discuss the financial and non-financial points to be considered prior to agreeing terms with the bank in relation to this project.

Financial

The first, and largest, point to consider in relation to this proposal is how the expansion will be funded. In order to purchase 60 top-of-the range vehicles with an average price of 315,000 AED[6], based on an approximate exchange rate of 5 AED : 1 GBP, a bank would need to provide Andka with £3.78 million in funding. Including

[5] Closing debtor change = £1,162k - £940k = £222k

[6] 315,000 AED is equal to 300,000 AED plus 5% VAT, the assumed rate of VAT applicable to the purchase of motor vehicles in Dubai. If this information is not correct, please let me know and I will update my analysis to reflect this.

initial start-up costs, including the purchase of a depot befitting the clientele, assuming the current depot is not used in this capacity, the total start-up costs of the enterprise may be £5 million.

It is likely a bank, prior to offering Andka finances of £5 million, would require a full business plan in relation to this project. The current version of the proposal would need to be revised, providing more detailed explanation of the assumptions and considerations within the financial data. The bank is also likely to request security over certain assets of the company, potentially the motor vehicles themselves. This should be considered, and in the event of default, the bank would have the right to seize the vehicles, which would leave the division without a form of revenue.

It is also noted that within the financial information provided, there are no finance costs included. On the assumption that the terms of any loan offered to Andka would be similar to the loan the company currently has in place with the bank (where £360k of interest is paid annually) on a £15m principal), this would represent an additional expense of £120k per annum.

Cost of sales within the financial data has been estimated to be 50% of turnover. On the assumption that the information provided for the Dubai division is accurate, this estimate is agreeable. If the information provided by the Dubai division is not accurate, this assumption may need to be adjusted by the company. Additionally, the turnover figures should be considered with care, given the impact of Coronavirus, despite Dubai remaining open for travel, fewer people may be willing to travel.

The proposal expects a 90% utilisation for all its vehicles from year one, and these amounts increase year-on-year, to the point where turnover is above the 100% utilisation threshold. For future years, we have assumed this would be as a result of an increase in price or the purchase of additional vehicles, but in any case, it appears unrealistic to suggest that in year 1 the company will achieve utilisation of 90% on its vehicles, given the industry average of 90% and the competition discussed in the *non-financial* section. It is recommended that this utilisation projection is reduced to 60-70%, which would reduce the revenue and operating profit of the suggested plan.

Non-financial

It is mentioned within the proposal that several of the global car hire operators are expanding into the range of higher priced cars. Although it can be useful to benchmark against the globe's leading competitors, this competition may reduce the likelihood that Andka's venture is successful. Full market research should be conducted to understand the number of potential customers who require premium cars, and whether there is already a saturated market within Dubai for this type of service.

Moreover, the financial data provided appears to be based on a number of assumptions – for example that as 'some renters' would prefer to have a driver, this can be taken to mean that 50% of all sales will be of this nature. Again, through market research the company will be able to better understand the make-up of its customers, which will allow for a more accurate financial projection to be drawn up.

There is no mention within the proposal of the number of staff, or experience of staff who will operate within this facility. Andka may choose to use the same staff within its current Dubai depot for this offering, but this will limit the amount of work which can be provided on the current Dubai division in relation to their small and economy cars. On this basis, the current, profitable venture in Dubai should not be forgotten in order to continue with the higher priced, and riskier proposed venture.

Finally, staff members of the depot have indicated they would be interested in becoming drivers. Again, this may lead to the company under-delivering on certain areas of its business, and moreover, the company should ensure that their staff members have the relevant qualifications to act as a professional driver before agreeing to such a change in operations.

Appendix 1 – Gross and operating profit margins of Andka Vehicle Rentals Ltd

Note: All numbers represented to nearest £'000

UK Car Division

	Year ended 31 March Yr59	*Year ended 31 March Yr58*
Turnover	3,452	3,362
Cost of sales	2,596	2,,202
Gross Profit	856	1160
Operating Profit	123	454
Gross margin	856 / 3452 = 25%	1160 / 3362 = 35%
Operating margin	123 / 3452 = 4%	454 / 3362 = 14%

UK van division

	Year ended 31 March Yr59	*Year ended 31 March Yr58*
Turnover	4,838	4,685
Cost of sales	3,046	2,732
Gross Profit	1,792	1,953
Operating Profit	600	808
Gross margin	1792 / 4838 = 37%	1953 / 4685 = 42%
Operating margin	600 / 4838 = 12%	808 / 4685 = 17%

Dubai division

	Year ended 31 March Yr59	*Year ended 31 March Yr58*
Turnover	1,791	1,611
Cost of sales	894	830
Gross Profit	897	781
Operating Profit	515	459
Gross margin	897 / 1791 = 50%	781 / 1611 = 48%
Operating margin	515 / 1791 = 29%	459 / 1611 = 28%

Report to: The directors of Andka Vehicle Rentals Ltd

Evaluation of Chelmsford offer and RNC proposal

May Yr59

Private & Confidential

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Introduction

This report has been prepared for the sole benefit of Andka Vehicle Rentals Ltd (‘Andka’) and is based on their specific facts and circumstances. It should not be relied upon by any other person. Any other person who chooses to rely on this report does so at their own risk.

The conclusions contained in this document are based on information provided by Andka’s management and employees. If any of the facts or assumptions are incomplete or inaccurate, it is imperative that we are informed immediately as inaccurate or incomplete information could materially affect the analytical conclusions presented in this memo.

Executive Summary

- The potential purchaser of the Chelmsford depot should be approached to confirm their business intentions, and whether they would be willing to purchase the entire trade and assets of the UK car division.
- You should strongly consider the sale of the Chelmsford division, having discussed the disposal with your current lender prior to the commitment stage, and having conducted the necessary diligence steps required on the potential purchaser.
- It is recommended that the current franchise offer received from RNC is rejected, and that negotiations are held with RNC and Birmingham city council to ascertain whether the associated costs with the offer in its current form could be reduced.
- If the Chelmsford depot is sold individually rather than as a sale of trade and assets, we recommend RNC are contacted to confirm whether any of the cars currently held by Andka’s UK car division would be suitable for use under RNC’s approved list of models.
- Andka should review and implement the recommended IT improvements listed in section 3 of this report, in order to comply with The Data Protection Act.

Section 1 – Offer to purchase Chelmsford depot

Recommendation

Based on the factors considered below, it is recommended that the offer to purchase the Chelmsford depot is strongly considered, and the potential purchaser is contacted and offered the opportunity to purchase the rest of the trade and assets associated with the UK car division.

This recommendation is based on an analysis of the impact to the rest of the business, and the impact a sale would have on the funding requirements of the business, and other considerations which have been brought to your attention.

Sale considerations

There is little information available with regards to the potential purchaser of the business. It would be useful to understand the intentions of the purchaser (i.e. what he/she plans to use the depot for), as it may be that the purchaser would be interested in purchasing the trade and assets of the UK car division in addition to the depot. In this case, a sales price of £8-10 million which would be an achievable target for Andka, based on the net book value of the property, vehicles and previous profitable trading history of the division.

This would also allow for the current employees of the company to be transferred into the ownership of the potential purchaser. If this situation occurs, you should consider the TUPE legislation and ensure the company complies with the steps required under this legislation.

Prior to the sale of property or the trade and assets to a potential purchaser, you should ensure the necessary due diligence steps are carried out to confirm the identity of the purchaser and the legitimacy of funds which are being provided. This is especially pertinent where the purchaser is keen to acquire the company for cash, as discussed at our meeting this afternoon.

Practically, you will also be well advised to consider the timing of the sale, and whether there is scope to negotiate with the initial price offered by the purchaser. These are steps which would be analysed as part of your diligence exercise.

The sale of the business is likely to result in a chargeable gain for the company for corporate tax purposes. Based on the cost of the property (£2.15 million including refurbishment costs), and allowing for indexation and legal costs in association with the sale of the property at an assumed total of £100,000, the company would therefore generate an indexed gain on sale of £359,000 if the offer of £3 million in relation to the property was expected. This would generate a tax charge of £68,210[7] payable by Andka, which would be payable 9 months and a day after the accounting period the asset was sold in (for example, if the asset was sold in August Yr59, tax would be payable on 1 January Yr61, 9 months and a day after 31 March Yr60).

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[7] Tax on sale = £359,000 x 19% (current rate of tax)

Impact to the rest of the business

If the Chelmsford depot was to be sold, the main concern is the employment status of the 18 members of staff who currently operate within this division. Given that the UK car rental division would be discontinued as a result of the sale of the Chelmsford depot, it is likely that not all of the staff members in Chelmsford could be transferred to the Romford depot (and in actuality, some of the staff members may choose not to or be unwilling to relocate to this depot). Therefore, the company will need to consider whether any roles within the firm will be made redundant as a result of a disposal. If this is the case, employment lawyers should be contacted to confirm the quantum of payments owed to any individuals made redundant, and ensure Andka operates within the relevant UK employment legislation.

The vehicles currently contained in the car division are unlikely to be useful to the business going forwards, and it is noted that you have already considered the potential value of these vehicles in the event the offer is accepted. On the assumption that none of the vehicles currently owned are in line with RNC's approved manufacture list (or on the assumption the proposal is rejected) the sale of the cars would result in a cash inflow of £3.78m[8].

Funding requirements

Andka Vehicle Rentals Ltd currently has an agreement with the bank under which they have received a £15 million bank loan, upon which interest of £360,000 is paid annually. The company currently has cash reserves of £2.69 million, and based on the expected sale value and subsequent corporation tax thereon any gain would still have cash reserves of over £5 million following the sale of the depot.

On this basis, Andka may wish to contact its lending provider and discuss the potential to reduce the amount owed to the bank, ideally to £10 million. On the assumption that interest is incurred on a straight-line basis linked to the principal borrowed, this would therefore reduce the interest paid annually by the company by £120k.

You should also contact the bank prior to the sale of the Chelmsford depot to review the current arrangements held in place with the bank, specifically with regards to whether the Chelmsford depot was held as a security by the bank in the event of default. Given that you are expecting to reduce your liability to the bank in the future, this may not be a serious concern, but it would be prudent to discuss this with the bank before proceeding with the sale.

Alternatively, Andka could use the funds received from the sale of the depot to assist with the proposal received by RNC. It is important to remember that these options are somewhat restrictive of one another, such that by agreeing to the RNC proposal, there is unlikely to be additional funds available to reduce the borrowings of the company.

[8] Cash inflow = 675 x £5,600 = £3,780,000

Section 2 – RNC Proposal

A review of the letter received by RightNowCar Rentals ('RNC') as requested gives rise to the following points to note and recommendations:

Risks

There are a number of risks in association with the offer as set out by RNC in its current form.

Risk	**Implications**	**Risk rating**
The franchise will run for four years from the acceptance of the offer	By agreeing a contract with RNC for four years, Andka would be required to maintain and keep their vehicles for this period regardless of the demand for their services. Entering into a long contract, with a company who have only adopted this policy in London thus far, therefore represents a risk to the business.	High – Andka should consider whether this term can be negotiated, to two years with a review after one year, and option to extend for an additional two years after the initial term expires.
Andka are required to arrange the lease of parking spaces from the local council	Andka do not currently have knowledge of dealing with local authorities to acquire parking spaces. This process may be long-winded and result in significant, and unexpected, administrative burdens. There is also no information as to whether the Birmingham city council are aware of these plans, or have sufficient parking spaces available which could be provided to Andka for their operations.	Medium – an ability to acquire leased parking spaces quickly will result in Andka being unable to generate revenue. Contact should be made to confirm the Birmingham city council are aware of the proposals prior to acceptance.

Risk	**Implications**	**Risk rating**
Andka are required to supply vehicles	Andka are required to maintain a fleet of at least 500 vehicles, and no more than 800 vehicles, for the duration of their four year contract. It is not clear whether any of the cars currently owned by Andka are suitable under RNC's approved list of manufacturers and models, but this could prove to be a huge expense to the business (maximum of £10.4 million as show in Appendix I). Moreover, as a result of RNC's fixed limits for the number of cars in the fleet, Andka are restricted in their marketing and sales strategy. If it appears that after 1 year, there is capacity for 2,000 vehicles in the area, Andka would not be able to supply this amount under the terms of their contract, and competitors may take advantage of this opportunity (conversely, if demand is not high, Andka will need to maintain the cost of running a 500 car fleet without the associated revenues).	Medium – RNC should be contacted to confirm whether these limits are negotiable, and can be adjusted during the length of the contract depending on customer demand.
Andka are required to check vehicles and clean/repair as necessary	Andka will need to employ a team of staff who clean and inspect their vehicles after every use. Andka do not currently have operations in Birmingham, so this will involve hiring new staff (and training them / welcoming them into the Andka brand).	Low – Andka should contact a local recruiter in the agency, who can put the company in touch with individuals who would be willing and able to fulfil the roles required.

Risk	Implications	Risk rating
RNC's operations have previously only taken place in London	Given that RNC have previously only operated their facilities in London, there is a general risk that there will not be demand for the services in Birmingham. However, given that RNC have started to offer the franchises in other major UK cities, it appears this product is viable and can be brought into a city such as Birmingham.	Low

Benefits of a franchisee

The benefits of operating as a franchisee of RNC are:

- *Experience of management* – RNC have already implemented this model within London, successfully according to its sales director. As a result, the company will already have experience of the challenges faced when providing this service to customers, and will have ideas and proposals as to the best way to operate the system. This will assist Andka in their delivery of this product and service, especially considering the technology required to implement such a system.
- *Established brand* – The existence of the RNC brand in the London region, will accelerate the process for Andka and increase the company's likelihood of achieving profitable results sooner than they otherwise would if they were to embark on such an opportunity without the assistance of RNC.
- *Mobile app* – RNC has already developed an, assumed to be successful, app which their customers use on a daily basis to access their vehicles. Andka are not currently operating or contacting their customers through an app, so the ability to utilise the app generated by RNC is another example of how, by working in partnership alongside RNC, Andka will have access to customers and technologies they would otherwise not be capable of, at least in the infancy of their new venture.

Potential profitability

Based on a review of the financial information provided by RNC, we estimate that Andka would make a loss of £154k per annum if they were to agree to the franchise offer in its current form. Please see appendix 1 for a detailed breakdown of the assumptions and calculations which support this estimation.

The loss of £154k per annum is expected as a result of the high commission charged by RNC in relation to this engagement, and the annual lease cost for a parking space in Birmingham city centre, currently valued at £12,000 per annum. If either of these amounts could be negotiated, or if the Chelmsford property was disposed of such that Andka did not have to source external bank funding in order to purchase the vehicles required for this offer, this would change the conclusions reached in this document. Based on this expected loss per annum in the years 2 to 4 of the arrangement, the company's bank balance will be equal to £752,000 at the end of the franchise agreement (on the assumption that no cash is generated or lost through the van rental or Dubai division during this period)

Please note that this analysis has assumed that each vehicle will received the average income represented by RNC per annum. In actuality, demand for the product may not reach this level in the first year or two of trading, and losses made as a result of the contract may be larger. It is therefore recommended that sensitivity analysis is conducted on the numbers provided below, to understand the potential results if demand was not to match the levels suggested by RNC.

Appraisal and recommendation

Based on the current terms offered by RNC in their franchise offer dated 14 May Yr59, it is estimated that a financial loss of £413,000[9] would be generated across the length of the franchise agreement. As a result, and with consideration to the risks associated with the arrangement offered by RNC, it is not recommended that Andka accept the offer in its current form.

Instead, we recommend that negotiations are undertaken with RNC and Birmingham city council, to ascertain whether discounts could be received in relation to the level of commission paid to RNC, or the cost of an annual lease parking space. You should also contact RNC to confirm whether any of the cars currently owned by Andka could be utilised in any franchise agreement.

[9] Financial loss over 4 years = £49k – (£154k x 3) = £413k

Section 3 – Data Breach

Any data breach is a serious matter for companies and their directors, and should be used as an opportunity to review the policies and procedures currently in place at the firm.

The Data Protection Act was introduced as the UK's implementation of the General Data Protection Regulation, and under this act those responsible for personal data are to abide by the data protection principles. The following are potential improvements which could be implemented with Andka to their current IT protection policies – if they are not currently included in the policies to date.

- The consent of customers should be obtained prior to the collection and storing of information. It is likely that as part of the sales process, consumers currently sign a document which allows Andka the right (or otherwise) to store their personal information. You should review the documents currently signed by clients on arrival of the depot, and ensure these documents make specific reference to the new Data Protection Act, and provide a clear option for customers to opt-out of the system if they do not wish for their information to be stored by the company.
- You should ensure that data held in relation to customers is only held for as long as is required. Generally, this can appear a grey area to businesses where you may have repeat customers. As a rule, I would suggest that, for customers who have accepted the terms and conditions of Andka's privacy policy, and agreed for their information to be stored, this information is stored for no longer than 3 months after the customer's initial rental of a vehicle. If the customer re-uses the services of Andka within this 3 month window, their data could be held on the system for another 3 months thereafter.
- It is recommended that firewalls are adopted in order to protect the firm's current IT systems from external access, such as that which has occurred in this instance. Firewalls, along with virus scanning software, would help to reduce the likelihood of anyone external to Andka gaining access to any private or confidential information.
- Andka should monitor its internal access to information. This should include a review of which individuals have access to the current customer list, and where possible these lists should be password protected with only individuals who **need** access to this information provided the password. The password to information such as this should be routinely changed, and changed in the event of a staff dismissal, in order to protect against future cases of this nature.

You will be aware that should Andka fail to comply with the Data Protection Act, there is scope for customers to raise legal action against the company. The negative reputational impact associated with this, along with fines which can be imposed on companies guilty of non-compliance with data protection regulation, are obvious reasons to take the necessary steps to protect the data your company currently has on your customers and employees.

Appendix 1 – Calculations in relation to RNC proposal

Assumptions:

- All figures shown are £'000
- Y0 represents the date the contract is signed, assumed to be within Yr59
- Opening cash balance reflects cash as at 31 March Yr59
- We have assumed that Andka will operate with a fleet of 650 cars across the length of the contract, and that all cars currently in possession of Andka are not on the approved list of manufacturers and models supplied by RNC

	Notes	*Y0*	*Y1*	*Y2*	*Y3*	*Y4*
Opening cash balance		2,690	1,165	1,214	1,060	906
Cash In						
Operating profit			49			
Bank loan	2	10,000				
Cash Out						
Purchase of vehicles per RNC's approved list	1	(10,400)				
Cost of fitting new vehicles with RNC technology / logo	4	(325)				
Initial franchise cost		(800)				
Operating loss				154	154	154
Closing cash balance		1,165	1,214	1,060	906	752

1. Purchase price of vehicles per RNC's approved list = 16,000 * 650 = £10,400,000
2. A bank loan of £10 million, rather than the funding received from the sale of Chelmsford funding, has been included in order to reflect a "worst-case" scenario solution to Andka, where interest of £240k is payable on the loan received from the bank
3. Profit and Loss per annum on RNC proposal listed below
4. Cost of fitting new vehicles with RNC technology = 500 *650 = £325,000

Expected Profit and Loss A/C of Andka Vehicle Rentals Ltd

Note:

- Based on the calculations provided by RNC in its letter dated May Yr59)
- All figures presented are in relation to years 2 - 4

	Notes	£
Turnover	1	13,000
Less		
Commission due to RNC	2	(2,600)
Annual lease cost	3	(7,800)
Gross profit		1,600
Annual fixed fee payable to RNC		(250)
Staff costs	4	(1,300)
Interest		(240)
Operating Loss before tax		(190)
Tax	5	36.1
Operating loss after tax		(154)

1. Average rental income received = 20,000 * 650 = £13,000,000
2. RNC commission = £13,000,000 x 20% =
3. Average annual lease cost for a parking space = 12,000 * 650 = £7,800,000
4. Staff costs assumed to be 10% of turnover, based on the fact this is likely to be lower than the current UK car division (due to the inclusion of an app and mobile functionality)

NB – In Yr1, a profit of £49k will be generated, as below:

Operating loss before tax (years 2-4)	(190)
Add	
Annual fee payable to RNC (not applicable year 1)	250
Operating profit before tax (year 1)	60
Tax payable (60k @ 19%)	(11)
Operating profit after tax (year 1)	49

INTERNAL FILE NOTE

To: File
From: Lee
Date: May Yr59
Subject: Andka Vehicle Rentals Ltd

This document provides a summary of the considerations and ethical dilemmas which have arisen under the Andka Vehicle Rentals Ltd engagement. The file note has been prepared under the headings of the ICAS code of Ethics, and I have provided my expected actions as a result of these points aide memoir for future reference.

Confidentiality

Andka have been guilty of a data breach after a former employee gained access to their systems, including information in relation to customer names and addressed. The directors of the company have been reminded of their obligations under data protection regulation, to ensure that all customer data is stored securely and for no longer than required. If this advice is ignored, and there appears to be consistent breaches of customer information, I will need to consider reporting the directors of the company to the authorities under the Data Protection Act, and subsequently resigning as auditor / adviser of the firm.

Objectivity

As the business and tax adviser to Andka Vehicle Rentals Ltd, my activity has been of an advisory nature and I have assisted the company in their decisions, which ultimately have affected their profit and loss position. Having agreed to conduct the company's first statutory audit for the year ended 31 March Yr59, there is a risk that I will be reviewing information pertaining to projects I have assisted the company on. As a result, I will need to be vigilant to ensure my objectivity is not compromised as a result of this self-review threat.

At a client meeting on 7 May Yr59, Chloe Andrews, director of Andka, mentioned that the fees offered by the company may increase if their Dubai operations expanded. There was also mention of business trips to Dubai in order to assist with the company. Although this offer appeared to be in good faith, as the company's statutory auditor there is a requirement to be independent, and seen to be independent, of the company. This would be compromised if any of these business trips to Dubai were arranged, so if these are offered I will need to reject these offers and remind Chloe of my professional responsibilities (and potentially consider resigning from the audit).

Professional behaviour

Viraj, the depot manager of the Dubai division, has been accused by an accounts assistant in the Dubai division of potential money laundering, as a result of 5 unknown deposits of 200 000 AED which have been made into the bank account of this division. This is in breach of professional behaviour, not least as it has overstated the performance of the division and inflated the company's profits. I have recommended that Chloe looks to redeem this situation, first by discussing the matter delicately with Viraj, before seeking public authority assistance if required. In my role, if it comes to light that Hamad has assisted Viraj in this activity and is therefore eligible to have court proceedings brought against him under the Proceeds of Crime Act, I will need to consider whether I can continue to provide services to Andka, or if I need to resign from the audit and advisory engagement.

Integrity

Hamad, Andka's other director, has told Laura, the finance manager of Andka, not to question any of the numbers which are supplied from the Dubai branch. In my opinion, Hamad is not acting with integrity through this action, and in his duty as a director to prepare financial statements which are true and fair to the position of the company, Hamad may be in breach of this requirement, given the information which has come to light regarding his brother's potential money laundering (in professional behaviour section).

Email

To: Chloe.Andrews@andkarental.co.uk
From: Lee@BrentwoodAccountancy.co.uk
Date: May Yr59
Subject: Andka **-** Advice and recommendations re Dubai emails

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Hi Chloe,

Thank you for your time this afternoon to discuss the business proposals currently being considered by Andka Vehicle Rentals Ltd. Provided below are comments in relation to the two emails received to you from the Dubai branch. Please read these emails carefully, and consider the suggested recommendations, particularly in relation to the email received from Jayesh.

Please let me know if you have any further questions on these matters.

Email received from Viraj

The email from Viraj provides an opportunity to purchase luxury sports cars from Dubai, of which 10 would be imported to the UK. The cost of this investment would be roughly £9 million, or 45 000 000 AED. In addition to this initial expenditure, payable to Viraj's contact in Dubai, in order to send 10 of the vehicles to the United Kingdom, Viraj has estimated additional costs (shipping, insurance and customs duties) of £450,000.

<u>On this basis, it is recommended you should reject Viraj's idea to purchase these cars, for a number of reasons</u>:

An investment of £9 million into such a venture would require funding from a bank or third party. Based on conversations with yourself and Hamad this afternoon, you have confirmed that Andka are no longer pursuing the expansion of operations into the luxury rental market in Dubai. Viraj should be made aware that the business needs of the company have changed substantially in the last fortnight, such that a purchase of this magnitude would not be worthwhile.

Moreover, the suggestion that vehicles would be brought to the UK appears inconsistent with the company's strategic aims – given that there has been no suggestions of trying to enter the luxury rental market within the UK. Again, Viraj should be made aware of the type of operations conducted in the UK, to confirm that this would not be beneficial to the company.

Finally, based on the contents of the other email received by yourself from Dubai, the lack of information surrounding the seller of these vehicles raises some concern. Even if this was proven to be a useful and profitable business decision, further diligence would be required to understand the manufacturer of these vehicles, and ensure the quality of products offered were worthwhile to compensate for such a large financial outlay.

Email received from Jayesh

The information contained in Jayesh's email represents a claim that Viraj is depositing cash into the business which has not, as far as we are aware, been generated by the company itself. As a starting point, this has resulted in the Dubai division's profits being significantly higher than they would have been otherwise (revenue, and therefore profit appears to be overstated by £100k, a reduction to operating profit of 19%). As director of the company, you have a duty to ensure the accounts prepared by the company give a true and fair view of the entity at the date they are prepared. Given that you are awaiting your first statutory audit this year, the revenue for this division would need to be adjusted to reflect the true sales received by the division through its business operations

Perhaps more importantly, there are money laundering implications as a result of Jayesh's suggestion. Where an employee of the business is moving cash into the business, with no additional information of how they have come to obtain this cash, there are concerns that this cash may have been sourced as a result of illegal activity. I believe you should consider contacting Hamad in relation to this point, and together you should approach Viraj and explain that you require additional information on the sales of the company, in order to understand if there are legitimate reasons for these deposits (although based on the information provided by Jayesh, and the false invoices which Viraj has asked to be processed, this appears unlikely). However, it may be that Hamad is aware of these deposits, given that Hamad suggested to Laura that there should be no further questions in relation to the figures supplied by the Dubai division. If, you are concerned that Hamad is involved and complicit in this potential activity, you should contact Viraj directly with your request for additional information (and consider whether public authorities need to be made aware of this behaviour based on his response).

You should be mindful not to inform Viraj that you are considering his actions to be criminal in nature – and as a company, you should review whether you have money laundering policies in place. If the company does not have appropriate regulations or policies in relation to money laundering, it may be that you or Hamad as directors are considered implicit in any wrongdoing. It is therefore strongly recommended you review these policies as a priority.

Finally, you may be best to consider whether the division in Dubai require additional support to prepare their financial information. Laura may be well placed to assist the Dubai team on a one or two month secondment, if she is open to the idea. This could potentially set in place stronger controls within the branch, which will improve the division's accountability to the company going forwards.

Kind regards,

Lee