



TPE 2023 – Case Study Sample Solution

Pagmari

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PRIVATE AND CONFIDENTIAL

Report to Jan and Feb
Future Strategic Plans of Pagmari

Prepared by: Tyme

22 May Yr 18

CONTENTS

1. Introduction
2. Executive Summary
3. Expansion plan considerations
4. Implications and risks of closing the landscape division
5. Brian's confession
6. Issues purchasing and developing a new site
7. Purchase site in name of company or individual

1. Introduction

We have prepared this report using the information that you provided to us. The report considers the closing of the landscape division, expansion plans, and issues in developing a new site and pros and cons of purchasing in the name of an individual.

The information contained in this report is for the sole use of Pagmari and should not be relied upon by any other party without our prior written consent.

Where tax advice has been provided, this is based on tax rates and regulations at the date of writing and could be subject to change in the future.

2. Executive Summary

- Brian needs to repay the outstanding loans as soon as possible. The accounts and tax computations for Yr17 and Yr18 should be updated to reflect the amendments. Full disclosure should be made to HMRC and payment of the additional tax liability, approximately £19k.
- We recommend Pagmari expands into the non-plant related sales if there is demand for this. Market research will be required to understand the demand and to assess the impact of COVID before forecasting figures. An up-market restaurant is a deviation from the skills in the business and may not even open due to COVID restrictions so should not be considered further.
- Funding will be required for the expansion, but this should be relatively small (estimate of £10k) as it is building on the business that Pagmari already has and no new assets are required.
- When closing the landscape division redundancy of the staff needs careful consideration. Staff should be offered jobs in the retail and wholesale division, if possible, before being made redundant.
- It is imperative that all liabilities of the landscape division are settled and a specialist employment lawyer is hired.
- Peat farm should not be purchased. The current premises should continue to be rented as there is room for expansion and a solid customer base has been built up. There are too many unknown factors with peat farm, including the lack of planning permission and the cost to develop the site.
- Any site purchases made should be in Jan's name and rented to Pagmari. She will pay income tax on the rental income, but the company will get tax relief at 19% on rental payments. However, the company will not have the asset on the balance sheet, which will make it harder to obtain bank funding in the business.

3. Expansion plan considerations

Demand

The first thing that needs to be considered before you embark on the selling of non-plant related items is whether there is demand for this or not. If there is not sufficient demand there is no point in continuing in looking into this any further as it will be a waste of time and money. Therefore, sufficient market research needs to be done now to understand the demand. This will cost the business but will save in the long run on an unsuccessful venture.

Detraction from existing business

Expansion takes time. It will be important that sight is not lost of Pagmari's current objectives as it is a profit-making company. If too much focus is given to expansion, customers of Pagmari could be lost in the process. It could also prove risky to detract from the normal business during a period of economic uncertainty and COVID restrictions.

Funding

Expansion will require funding. Pagmari will need to consider where the additional funding is going to come from. If the new Peat Farm is also acquired, bank funding will be exceeded, and the company will be very highly geared. This would mean that it would be more difficult to get bank funding in future.

Additional equity could be an option for raising additional funding in the business. This will mean that lower dividends are received by Jan and Februum, but it is also the option to getting a new investor with knowledge into the company. There will be lost control, but a new investor could be kept to a minority shareholder.

Experience

Jan and Februum do not have experience of operating an up-market restaurant and it is not the same as operating a cafe. Concentration should be focused on selling non-plant related items as these could be sold from the garden centre. An up-market restaurant would require a new premise, or a very significant capital spend in a very competitive market. However, there is a significant risk that it will not even be possible to open the new restaurant for some time, due to COVID restrictions.

The new investor that could provide the funding for the sales of giftware and kitchenware should be someone with knowledge of the industry and with key contacts in the industry. This will ensure stock is obtained at good value and sold at a high profit.

Staff

Additional staff will be needed for the expansion. Although Pagmari has a good chef, experience of restaurants would be required. It may not be easy to find the appropriate experience locally.

Synergy

The non-plant related items should be sold online as part of the expansion of the website. This will increase the market that Pagmari is targeting. Delivery services will be required, and this will be a cost that will need to be factored into pricing.

Licenses

If the restaurant will sell alcohol the correct licences must be applied for and obtained. It is possible to operate without a licence and not sell alcohol however customers would expect this to be offered.

Systems

It is possible to sell the giftware through the website which will need to be updated. The accounts and stock system will also need to be updated for the new expansion.

Handling customer details online will need to be managed carefully. There is legislation ; General Data Protection Regulation (GDPR), in place. This relatively new legislation has heightened the requirement of companies to protect consumer data in a bid to harmonise data privacy laws across Europe.

Forecasting

Once market research is done, forecast figures should be drawn up for three years to see the potential profit to be made from the new business.

Conclusion

The company should expand into the non-plant related sales if there is demand for this. Market research will be required to understand the demand and whether it is worthwhile. An up-market restaurant is a deviation from the skills in the business and so should not be considered further.

Funding will be required for the expansion, but this should be relatively small (estimate of £10k) as it is building on the business that Pagmari already has. The added incentive to sell through the internet will help generate turnover.

4. Implications and risks of closing the landscape division

Redundancy

The closure of the landscape business will result in redundancies if the roles of the employees no longer exist. There are set procedures to follow when making employees redundant. Statutory redundancy is due after two years of employment and all staff have been at the company for more than this. An employment lawyer should be consulted to help with the process.

It may be possible to review the need for resourcing in the remaining retail and wholesale division, to see if the employees could be transferred.

Subcontractors

The five contractors, if deemed to be employees also may claim for statutory redundancy pay. Legal advice should be sought on this issue to determine if there are any liabilities.

Assets

The landscaping division has a lot of assets which they have hired on a full-time basis. The contracts should be reviewed to understand whether they can be given back early and if any payments are due if exiting the contracts early.

Transfer of trade

The landscaping division has built up a turnover of £2.5 m in YR18. It is possible that there are some customer contracts which have some value. If they could be transferred this should be considered.

Convert building

The building used for the landscape division should be used to expand the new business of selling household goods. This will require some minor adaptations and there will be a capital cost of this.

5. Brian's confession

Brian

Although Brian has admitted what has happened, a review should be carried out in Pagmari to ensure that this is the full extent of the issues. Brian has suggested there is paperwork to substantiate the amounts and this should be reviewed.

Jan and Februum, as directors, will need to review the controls of the retail and wholesale division to ensure they are sufficiently robust to prevent the recurrence of Brian's actions.

Brian needs to repay the money as soon as possible to the company. As Brian is Februum's husband, Pagmari will need to pay tax on the borrowings which is repaid once the loan is repaid.

Audit

As a result of Brian's confession to taking cash for the job, the accounts have been understated by £1m over a two-year period. This means they will no longer qualify for an audit exemption for the last two years. The company should have been audited, as the number of full-time equivalent employees means that two out of the three criteria for audit have been reached. An auditor will need to be appointed to carry out an audit for Yr17 and Yr18.

Tax

The division would still have made a loss for the two periods but the profits of the company as a whole would be £50k higher in both years. Therefore, the tax paid has been understated by about £19k over the two periods ($19\% \times £100k$). The tax computation for Yr17 should be amended and resubmitted. The Yr18 tax computation should include reflect this before it is submitted. This will not have been submitted yet.

6. Issues purchasing and developing a new site

Purchasing

Funding

The asking price is in the region of £1.75 m. A professional surveyor should be tasked with carrying out a valuation to see what they should pay.

If this value is deemed reasonable the funding will need to be secured. At present Jan has only £130k in savings and Februum has nothing. Therefore, an agreement would need to be reached between both shareholders as to whether Jan should get an additional stake in the company if her personal borrowings are used to fund the purchase. This would give her a majority share in the company.

Interest rates are currently low. However, for a loan of this size the bank would require a charge over the assets of the company. The bank may also want a charge over the personal homes of Jan and Februum until the new site is developed which would be a significant risk for both parties.

Grants

There is also the option for grants for companies that hire staff from the age of 16-21. Pagmari does not employ any staff in this age group so these grants will not be available at present. Pagmari's recruit policy should be amended for this age discrimination and allow such grants to be available to them.

Moving site

The site is 20 minutes away and so it is not guaranteed that all existing customers would be willing to travel to the new premises. If not, the company will need to find new customers. The views at the existing site are marvellous and that is one of the reasons for attracting people to the area. The new site is on the outskirts of the Trossachs national park where views may not be as good.

Cost of developing

The new site has two farm cottages and fix outbuilding which are all in need of repair. The cost of this should be analysed by the surveyor as it is likely to be very large and make the overall cost far in excess of £2m.

Planning permission

Verbal planning permission is for an equestrian centre which is a different requirement from a garden centre and store which is attracting people on a day out who want to bring their dogs for a roam. Planning permission may not be granted. Planning authorities can take a long time to finalise planning and this should be factored into any decision.

Timing

The timescale is relatively short. There will not be enough time to determine if the planning permission will be granted and to get the site valued and funding secured for the purchase.

Tax

Any capital spend on building will be recognised as a fixed asset on the balance sheet. Tax relief is not available on the actual capital spend of the buildings until the time that these are sold in future.

Rented site

Tax

The rental payments are tax deductible and so tax relief on rent is 19%. Rent is currently £150k so tax relief of £28k is obtained on this. That means the cost of renting is £122k for the company when we consider the tax impact. It would take 16 years to pay back the cost of the move based on the capital spend of £2m. This does not factor in interest costs on debt.

Rental agreement

The rental agreement is currently on a month by month basis, so this should be negotiated with the forestry board to provide certainty for the company. As it stands, if the company wish to cease trading at the end of the month they would not have any costs to get out of the lease.

Site

The current site which is being lease is in a lovely area and it is bringing a large profit to the company. There is space to expand the site in the future if needed.

Conclusion

The current premises should be continued to be rented as it is reliable and there is room for expansion. Customers have loyalty to that site and will continue to go there.

There are too many unknown factors with the move including the planning permission and the cost to develop the site. It is unlikely to be as attractive a location as the current site, so the company should continue to rent the current site.

7. Purchase site in name of company or individual

Funding

How the property is funded may determine who owns the property. The current funds available in the company are approximately £95k. It may be likely that the funding can only be raised personally.

If the company 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.

If the property is to be purchased personally, the bank will still 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

Asset on balance sheet

If a company buys the site, the company will own the asset and it will go on the balance sheet. This will make the company more valuable as it will hold an asset worth £2m.

Rental agreement

If the company rents the property from a shareholder, they will get tax relief on the rental payments made to the shareholder. This will be tax relief at 19%.

The amount of this rent can be set at a level that is most desirable to the owner if that owner controls the company. If it is only owned by Jan, for example, it may make it difficult to negotiate a good rental cost that is in the best interest of both Pagmari and Jan.

Maintenance of property

If owned by an individual, they will have to pay for upkeep to the building which would otherwise be a cost to the company.

Tax

If the property is rented to the company by an individual, the individual will pay income tax on the rental income. Jan would become a higher rate taxpayer and the rental would be taxed at 41%.

If the property is owned by the company, 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 by an individual, such as Jan, then any gain is taxed under capital gains tax rules.

Conclusion

Any site purchases made should be in Jan's name and rented to Pagmari. Jan will pay income tax on the rental income, but the company will get tax relief at 19% on rental payments. However, the company will not have the asset on the balance sheet, which will make it harder to obtain bank funding in the business.

INTERNAL MEMO

To: Sam
 From: Rosemary
 Date: 9 May Yr 17
 Subject: Ethics at Pagmari

Dear Sam,

I would like to draw your attention to some possible evidence of unethical behaviour I encountered whilst working on Pagmari.

Money Laundering

Brian has borrowed £100k from Pagmari in the last two years. This is profit on landscaping contracts which have not been recognised in the accounts of Pagmari. Brian has admitted to committing a fraud and stealing money from the company and he said he always intended paying it back.

The impact of this is that the accounts of Pagmari have been understated by £1m revenue and profit of £100k. This should be investigated further to establish that this is the full amount of errors. The relevant taxes should be calculated on these amounts and full disclosure made to HRMC.

This should be reported to the firm's MLRO. The MLRO can decide whether to issue a report to the NCA. This may depend on whether Brian does actually pay the money back. We need to be careful not to tip off that we have reported the potential money laundering.

This potential evidence of money laundering questions the integrity of Brian and his involvement in the business.

Pagmari should also ensure that the entity wide controls are in place, and this may include adequate training of staff in money laundering and fraud responsibilities.

Jasper

The previous engagement partner has a reputation for getting thing done. This does not mean he has done anything wrong. However, there is an implication that all compliance at Pagmari may not have been adhered to. This should be investigated to establish the correct facts so that appropriate actions can be taken. We do not want this to damage the reputation of Tyme.

Brian's verbal recollection of a conversation with Jasper does not immediately suggest that fraudulent activities have been advised. As Brian's integrity has been questioned by his involvement in the money laundering, the accounts of Pagmari should be checked for compliance in the following areas.

Dogs as business expenses

Pagmari do have dogs which attract customers to the business. As these dogs are part of the business activities, any expenses related to them could be seen as partly business related. If these expenses have been claimed we would expect to see an element of private use added back.

Travel

There is £30 k going through the accounts of Pagmari for travel and communication. Jasper advised on very expensive first-class travel. This is not professional behaviour even though it is a business expense. Therefore, an expenses policy should be implemented to stop this occurring. The implication of expensive travel is lost profit for Pagmari and does not point towards fraudulent activities.

Phones

It seems as though management may have phones provided for personal calls. This is a benefit, but a work mobile phone can be provided as a non-taxable benefit.

Excess material

If staff are to use excess material it should only be provided to them at the cost to the company. This is a taxable benefit to the employee and should be taxed based on the cost to the company of the material initially. This should be reviewed to see what has actually taken place.

Minimum wage

Some staff are paid £7 an hour which is less than the minimum wage. There could be a fine for the company. We may not want to be associated with a company that has been breaking the law.

There will be damage to the reputation if the public find out that staff are underpaid. Pagmari policies need to be reviewed to ensure that legislation is being complied with going forward.

Sales between the two divisions

There is no paperwork for the landscape division taking plants with a revenue value of £120k from the wholesale division without recording the relevant transactions.

This questions the integrity and professional competence of the directors of Pagmari. We do not know the extent of the volume of plant taken, it may be higher than this. The directors have been made aware that we need to clarify the exact amount of stock taken by the landscape division and if there was any deliberate intent.

Kind regards

Rosemary

Briefing Note

To: Sam CA
 From: Jan
 Date: May Yr 18
 Subject: Pagmari Limited

This briefing note sets out analysis in relation to the areas detailed below:

1. Appraisal of Pagmari
2. Comparison of two suppliers

1. Appraisal of Pagmari

Overall Sales

Retail turnover has decreased by 3.9% and transaction numbers have decreased by 6.6%. A review should be carried out to understand the reason for the fall in transactions.

Café sales have increased due to an increase in customer numbers by 3.9%. However, the spend per customer remains the same. A review of customer visits should be undertaken to establish if the centre attraction is the café. If so there may be scope for expansion. See section below.

Wholesale sales are not correct. Brian has estimated the landscape division has acquired approximately £120k, over the last two years, of the high-value plants. The correct sales figures should be £2.35m and £2.5m for Yr 17 and Yr 18. The £120k variance should be investigated to ensure that this is the accurate amount.

Retail Division

Internet sales

The website currently only shows basic information and needs to be improved immediately. An expert will need to be employed for this and all horticultural accessories should be sold on there. The modern customer is more likely to buy a higher value product online than to go into the store to do it. Plants and café revenue will be generated through footfall in the store.

Social media

Jan is a regular user of social media. She used this to connect with suppliers for the garden centre. She should set up a social media page for the garden centre showing the views of the local landscape as well as the horticultural designed garden areas. This would essentially be free advertising as she would not need to employ an expert. Social media is a great way to connect with a lot of people in the area.

Café

Chef and sale of own cooked food

The company grow a lot of produce and sales of this in the café is very popular, especially with such a good chef. Turnover is up 3.8% with scope to keep increasing revenue. The café facilities need to be reviewed to see if there is scope to extend the areas further. With Jan's contacts in the building trade a good quote could be given for this. There will be a capital outlay up front, but this will be offset by the profits made in the first few years.

The café should have a shop selling cakes to take away as this would have another income stream for the café. The cakes can be healthier versions to keep in line with the company objective to promote a healthy lifestyle.

Wholesale Division

Suppliers

Currently the business is reliant on two customers who control the gross profit and sale prices are fixed. Having a new supplier will mean the company can set prices as they wish and control profits. The business is very reliant on these customers and Pagmari need to attract new customers.

The contracts with the two main customers should be reviewed to ensure the company does not breach any restrictions of business clauses, if they exist, if they attract new customers.

High value Plants

The focus is currently on high value items to be sold. Lower value plant should also be sold. These could be grown in the additional space rented from the Forestry commission. Customers want to have a wide choice of options which will help sales and help with planning for the types of plants going forward.

Minimum Wage

The minimum hourly rate at Pagmari is £7 for persons aged 21 and over. This is below minimum wage legislation. The minimum wages should be £7.708.20 for those aged between 21-24 and £8.218.72 for 25 and over and should be amended immediately.

A review of any potential under payment for past years needs to be carried out to assess the magnitude of any likely problem.

Landscape Division

Inaccurate figures

The retail and wholesale division include has £95k of costs which should be in the landscape division for plants (£60k), administration (£10k) and repairs (£25k). This will increase the retail division EBIT to £626k and increase the loss of the landscape division to £242k. The management accounts are not showing an accurate reflection of the true losses being made by the landscape division.

A thorough detailed analysis of the management account figures should be undertaken with explanations sought as to why the results were as they are.

Inventory

The landscape business buys inventory weekly. This is not cost efficient and they should keep better control of stock. An order once a month would make more sense with weekly stock counts to ensure there is no risk of running out. Buying in bulk is likely to secure discounts, reducing costs.

Amazonian Wood

Purchasing Amazonian wood. Is not supporting the company objective of being environmentally friendly. A new supplier should be sought as soon as possible to ensure the company objective is being met.

Experience

The landscape division does not have a person in charge of sales. Februum should look into this as she is in charge of sales for the wholesale and retail division. She will have the skills necessary to increase sales and it will give her some oversight into the operations at the landscaping division.

This may take some time away from her existing role, but if she could spare half a day a week, it will help the business overall as the landscaping division is loss making.

Subcontractors

There are five contractors who work full time for the division and a review should be carried out to ascertain if they are actually employees.

If HMRC perceive them to be employees, then payments made to them are classified as net of income tax and national insurance. This could potentially result in a substantial tax bill for Pagmari as they will be liable for the tax so far unpaid and any interest/penalties.

Controls

There are inadequate controls at the company. The landscaping business has been able to take stock from the retail division without paying for it. The stock value should be quantified, and controls put in place as soon as possible to stop this happening again.

There is no attempt to split costs between the divisions, but this should be done to understand which sectors need to be looked into for profit improvement.

Market

The landscaping division should target the domestic market as there is a huge market for them in summer. This will require additional funding to advertise but will utilise the skills in the business.

Other

Rental Agreement

The rental agreement is on a rolling month by month contract. If the forestry commission wanted to take back the premises, Pagmari would need to relocate and lose a lot of custom in the process.

A longer-term rental agreement should be negotiated with the Forestry Commission. This will give certainty to the business and ensure that fees are not increased unexpectedly.

Equipment Hire

Currently in the Landscape division equipment is hired rather than owned and it is very high value equipment. This is an expensive option compared to purchasing the equipment, especially over a long period of time.

Equipment should be purchased if being used full time. It is possible that the equipment could also be hired out by Pagmari to other landscapers when it is not used.

Beautiful site

Pagmari is beside Loch Lomond and Trossachs national park. This means people will be willing to come to the area to see these and it will be a case of enticing them to the garden centre when they are there.

People are happy to come to the garden centre to play with the dogs which is a great attraction. There may be scoping to have areas of the garden centre where dogs are allowed. This may attract additional custom for the cafe.

2. Comparison of two suppliers

National supplier

Supply

The national supplier has more options than the local quarry in that a combination of shapes and colours are readily available. However, these are not always in stock and there can be a two-month lead time on these.

The implication of this is that if Pagmari wanted a stone that they didn't have in stock, they will have to wait two months for this. A customer who has a job in process will not want this delay and this could potentially lead to lost custom in future if a job is started but halted for a product that is out of stock.

Time of Deliver

If a phone order is made, delivery can be made the following day. There is a risk with phone orders that the order is missed, and the stock is not delivered. If this option is chosen, it should be discussed with the supplier that orders will be in via email. This will give Pagmari some recourse if an order is missed.

It says that the order is likely to be delivered a day later than the order made. We need to understand if the delivery is coming from far away if this will be longer. If it is longer, there needs to be certainty of the delivery time so adequate planning can be made with subcontractors who are waiting on materials.

One tonne sacks

All deliveries are in one tonne sacks. There is no option to get a delivery of stones from the back of a lorry which is sometime more convenient for a big job. It can be more labour intensive for staff to take stones out of a big bag than if they were spread in a pile. This should be considered based on the jobs that Pagmari have on.

Cost

It is expected that 2k tonnes will be needed in the year. There will only be a discount on any stones bought in excess of this. This is a big downfall as there is no discount to be gained from the existing demand.

Delivery is free unless the order is less than 10 tonnes when there is a £25 charge. There will be several times in the year when there will be a demand for less than 10 tonnes, so this charge will be incurred.

This supplier will deliver direct to client site which is advantageous and save labour time and delivery costs for Pagmari.

Local quarry

Local

The biggest benefit of the local quarry is the convenience. It is very close to the site and therefore there is the option to pick up from them direct which was not available at the national supplier. This is helpful if one bag of stones was required at short notice and someone from Pagmari could go and pick it up. This would avoid delay finishing off a job nearby.

Promoting local jobs is also good for the image of Pagmari. Customers will be more likely to come to the garden centre if they can see Pagmari supporting local jobs in the community rather than using a national supplier.

Safety

This supplier meets the corporate goals of Pagmari as it helps provide local jobs. The quarry operates under highly controlled and regulated conditions which also meets the corporate goals of the company.

Lifespan

In 52 years, the quarry will have to close but this is sufficient time for Pagmari to utilise the products from it. After this time, the site will be landscaped to its original condition, so it is environmentally friendly like the objectives of Pagmari.

Stone

The colours of stone are slightly limited. However, for some of the stone from the national supplier, there is a two-month lead time. Pagmari could order stone which the quarry does not stock direct and it will be delivered in less than two months. An agreement should be made with another supplier for types of stone which the local quarry don't produce.

There is also a restriction on the size of the stone from the local quarry. The extra charge is £100 per order. This will raise the cost for Pagmari. However, stone size is not hugely important once it looks pretty on a job. The regular size should be offered to customers and the additional cost passed on to them if they so wish. This will keep costs to Pagmari at a minimum.

Deliver

The local quarry does same day delivery which is very convenient, and delivery is free if orders under two tonnes are not commonplace. This should not be a problem as orders of that size could be collected directly.

Costs

There is flexibility as the orders can come in bags or from a trailer which will suit certain jobs. There is a refundable £3 for the bags, if used.

Unlike the national supplier, there is a discount once the 2k tonne mark is hit. It is provided retrospectively and on all orders above this. Although the cost is £15 per tonne more, when the discount is applied, the cost is only £3.5 more per tonne. The total cost to the company is £207k assuming that the additional cost will be passed on to the customer.

Recommendation

The local quarry should be used as it provides much greater flexibility for the company. There is an extra cost of £6k over the year but this assumes that small orders are not required from the national supplier which would actually make the difference in cost much less.

The local quarry promotes local jobs and is environmentally friendly in that there is less travel emissions and also sacks are reused. Therefore, it aligns more with ethos of the company and could generate more custom by promoting the local economy.