



TPE 2023 – Practice Case Study

Andka – Case Study Part 1

Comprehensive Case Study
Initial Information

You have **2½ hours** to complete this paper

History

TPE examination, May 2019.
Pass rate 77%.
2½hrs in the morning
3hrs in the afternoon.

Technical Content

FA 2022

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This assessment is taking place remotely.

ICAS would remind you to continue to be ethical and observe the exam conditions applicable to the TPE exam.

Background notes

It is Tuesday 7th May Yr59.

You are Lee, a chartered accountant, who set up in July Yr58 as a sole practitioner based in Brentwood, Essex in England. You provide a range of accountancy, audit and business management services including bookkeeping, accounts preparation, tax returns, business plan preparation etc. You have several clients, but your largest client, in terms of revenue, is Andka Vehicle Rentals Ltd ('Andka') which accounts for £8,500 out of your total revenue to date of £62,000.

Andka is a car and van rental company and has been a client for a few months. You became involved with Andka following a recommendation to the owners by a partner at the firm you trained at. You met with the owners, Chloe Andrews ('Chloe') and Hamad Kapoor ('Hamad') and agreed to prepare the necessary tax returns and annual accounts and to provide general business advice as they do not have a finance director. Additionally, you have agreed to conduct their first statutory audit for the year ended 31 March Yr59, as the company now meets the requirement for an annual audit.

You keep a client information file for every client, which includes details of the business and the owners. You also record any possible ethical issues on the file, including any actions or mitigations which you need to undertake. The client information file for Andka can be found in Section 1.

This morning, you have a meeting with Chloe, who has told you she and Hamad need your help with a few things. You have set up an online meeting with Chloe, who is at Andka's headquarters, in Romford, Essex, just to the east of London.

"Hello Lee. How are you?" says Chloe. "Unfortunately, Hamad is not able to join us as he's tied up with other matters. As I said on the phone, we have a few things that we need your help with today.

"Our finance manager, Laura, has prepared these draft financial statements to 31 March Yr59 (Section 2). The results are not as good as Hamad and I would have liked. Despite the slight increase in revenue, the profitability of the business has not really increased and so we need your advice. As you know we have three divisions; car rental in the UK, van rental in the UK and car rental in Dubai."

"We don't think that COVID 19 has been the main problem. Social use of rental cars declined sharply but a lot of people still had to travel and saw hire cars as a way of avoiding public transport, which helped to keep demand up. Business van rentals held up well as a lot of businesses became more dependent on courier deliveries. Although Dubai has been affected by COVID 19, travel into the country has mostly been allowed, subject to infection testing."

"We have a few things in the pipeline that I'll fill you in on later. I've managed to secure a meeting with the bank next week to talk through our current and future funding needs."

“To help us prepare for the meeting, I’d like you to prepare a briefing paper for us, analysing the financial performance of each division over the year along with advice as to how we might improve the performance. If you think of any general business improvements, be sure to include those as well. We’ve taken specialist advice about how to comply with the law and best practice in relation to COVID 19, so I’d like you to focus more on general improvements in how we operate, with your usual commercial perspective. I’ve emailed you copies of the key quarterly financial information along with Hamad’s notes about each division (Section 3).”

“OK, that sounds straightforward enough,” you respond. “I can make a start straight after this meeting.”

“Perfect. The sooner we can get your comments and recommendations, the longer we have to prepare,” states Chloe. “One of the reasons that I’ve arranged the meeting with the bank is that we are considering branching into the luxury car rental market in Dubai. I’ve pulled together what we found out so far (Section 4), but I’d like you to look over this and evaluate our proposal. If you could add this to the briefing paper, that would be helpful.”

“That sounds like an interesting way to expand the business,” you reply. “I can certainly take a look at what you’ve prepared and provide an evaluation of the proposal for you. I assume you’d also like my recommendation on how to proceed?”

“Definitely,” laughs Chloe. “We do pay you for your advice after all! And you will get significantly higher fees from us if the venture goes ahead. We may even want you to go out to Dubai regularly, to check that everything is fine out there.”

You nod as you scribble down notes and reply. “To summarise, I will prepare a briefing paper for you and Hamad analysing the financial performance of each division and will provide my suggestions for general business improvements.”

You leave the meeting and check your email prior to getting on with the work assigned to you by Chloe. You notice that you’ve had an email from the finance manager of Andka (Section 5). You make a mental note to read it before you start your briefing paper.

In preparation for answering the case study question this afternoon you will find it useful to undertake the following tasks during the morning session:

- read all the information carefully and note any points you feel are significant; and
- prepare the briefing paper requested by Chloe.

Section 1

Andka client information file

Background

Andka was set up in Yr49 by Chloe and Hamad, each of whom own 50% of the share capital. Chloe and Hamad had both previously worked for global car rental companies. They bought land near Romford, to the east of London, and purchased 20 vans which they began to rent to businesses for a month at a time. There was good demand and within 18 months they were able to purchase more vans and a property to open a second depot around 20 miles away in a prime location in Chelmsford, Essex. The head office and administrative activities are based at the Romford depot.

In Yr53, Andka purchased a number of cars, and began offering daily car hire from each location in addition to the van rental.

Hamad had previously worked in Dubai, United Arab Emirates and in Yr55, Andka set up a car rental depot in Dubai.

Directors and owners

Chloe Andrews (39)	Director and 50% shareholder. Chloe focusses her time on van rental. She is based in the Romford head office.
Hamad Kapoor (42)	Director and 50% shareholder. Hamad looks after the car rental side of the business, both in the UK and in Dubai. He often works from his home in Chelmsford or from Dubai.

Both directors are based in the Romford head office, although Hamad does sometimes work in Dubai.

Staffing, including finance function

At 31 March Yr59, Andka had 52 members of staff, including the two directors. Each UK rental depot has a manager, front office/sales staff and a team of mechanics/car care staff. Some of the front office staff have been redeployed to enhance cleaning of vehicles and public areas, in response to COVID 19 risks. Head office staff, based in Romford, include a small finance team, an IT manager and a vehicle purchasing manager. 'Desk-based' staff in the UK have often worked from home but are expected to return to their usual locations as restrictions ease. There are 26 members of staff based in Romford, including the directors, 18 in Chelmsford and 8 in Dubai.

The finance team consists of a finance manager, Laura, and two accounts assistants. Laura prepares the monthly management accounts, but she is not a qualified accountant. There is also an accounts assistant in Dubai.

Each depot is staffed 24 hours a day to allow clients to return vehicles at their convenience and also to provide security cover for the premises and vehicles.

Vehicle rental market

The UK vehicle rental market has two core markets:

- Business customers – business rentals for cars and vans, short or longer-term rentals, locations UK-wide
- Personal customers – mostly tourist rentals, cars only, daily rentals, locations at airports, train stations etc.

It is a competitive marketplace with a number of large global operators but there are an increasing number of independent operators.

More recently, there has been additional demand for daily car rentals from city dwellers who occasionally rent a car when needed.

Key costs include the purchase and maintenance of the fleet of vehicles, staff costs and fleet insurance. One of the key performance measures used in the industry is fleet utilisation, calculated as actual revenue / potential revenue. Average industry utilisation is 80% for both cars and vans.

The global operators have gross profit margins in excess of 50% and operating profit margins of around 30%. No data is available for independent operators.

Rental revenue

Car hires, in both the UK and Dubai, are almost exclusively made to personal customers. Cars are rented on a daily basis. Vans (UK only) are only rented to business customers, on a monthly basis.

Rentals can be made directly with the company via the website or telephone, or via a third-party booking website. Most of the car rentals for personal customers are made via third-party booking websites which take commission of 10% - 20%.

The Andka website was designed several years ago. It is quite a basic site and has not been optimised for mobile devices.

VAT is charged on rentals at 20% in the UK and at 5% in Dubai.

For personal customers, credit card details are taken to confirm the booking, but they are only charged at the start of the rental period. Business rentals are invoiced at the start of each month, and 90-day credit terms are generally offered.

Vehicle rental rates include full insurance for theft, collision and third-party insurance.

Vehicles

The vehicle purchasing manager, Wes O'Reilly, manages both the van and car fleets, including fleet insurance. Andka has contracts with two different vehicle manufacturers to buy new cars and vans. A mixture of small and mid-size cars, and small and large vans are purchased each year. Due to the volume purchased, a bulk discount is received from both manufacturers of approximately 15%.

The policy is to keep all vehicles for two years, or until they've reached 50,000 miles, whichever comes first. Vehicles are purchased and sold each quarter, on a rolling-basis and the total number of vehicles has remained steady for the last couple of years.

Andka disposes of vehicles by sending them to auction. On average, Andka receives 50% of the original cost at auction, and Laura has put in place a straight-line depreciation policy of 25% per year on each vehicle.

Fleet insurance is negotiated on an annual basis in September. Prices can fluctuate significantly year-on-year, but it is possible to negotiate with most of the big insurance providers.

The Dubai and UK depots source tyres and other spare parts from local suppliers as they are required so that they can get the parts as quickly as possible.

Dubai

The Dubai depot is based close to the airport in Dubai, with regular airport shuttles running from the airport terminal to transfer customers.

Quarterly financial returns in United Arab Emirates Dirhams ('AED') are received from the Dubai depot and are translated into sterling at the exchange rate at the end of each quarter. The exchange rate is approximately 5 AED : £1 GBP.

Section 2

Andka Vehicle Rentals Ltd

Draft financial statements

Statement of profit or loss for the year ended 31 March Yr59		Yr59	Yr58
	Notes	£'000	£'000
Turnover		10,081	9,658
Cost of Sales	1,2	<u>(6,536)</u>	<u>(5,764)</u>
Gross profit		3,545	3,894
Staff costs		(1,568)	(1,493)
Property costs	3	(329)	(295)
Management charges		(262)	(260)
Administrative expenses	4	<u>(148)</u>	<u>(125)</u>
Operating profit		1,238	1,721
Finance costs		<u>(360)</u>	<u>(360)</u>
Profit before tax		878	1,361
Corporation tax		<u>(170)</u>	<u>(265)</u>
Profit for the year		<u>708</u>	<u>1,096</u>

Notes:

1. Commission paid to web-based booking agents is included in cost of sales.
2. Cost of sales also includes vehicle maintenance, vehicle depreciation and fleet insurance.
3. Property costs include rates, property depreciation and other property-related costs.
4. Administrative expenses include lease expenses for office and garage equipment.
5. Dividends of £64,000 were paid during the year ended 31 March Yr59.

Statement of financial position as at 31 March Yr59

	Yr59 £'000	Yr58 £'000
<i>Tangible fixed assets</i>		
Land & buildings	2,650	2,800
UK cars held for rental	3,752	4,960
UK vans held for rental	9,490	9,380
Dubai cars held for rental	1,480	1,400
Plant & equipment	<u>90</u>	<u>96</u>
	<u>17,462</u>	<u>18,636</u>
<i>Current assets</i>		
Debtors	1,162	940
Cash in hand	<u>2,690</u>	<u>680</u>
	<u>3,852</u>	<u>1,620</u>
<i>Creditors: amount falling due within one year</i>	<u>1,384</u>	<u>1,035</u>
<i>Net current assets</i>	<u>2,468</u>	<u>585</u>
<i>Creditors: amount falling due after more than one year</i>		
Bank loan	15,000	15,000
<i>Provision for liabilities</i>		
Deferred tax	<u>420</u>	<u>355</u>
	<u>15,420</u>	<u>15,355</u>
Net assets	<u>4,510</u>	<u>3,866</u>
<i>Capital and reserves</i>		
Called up share capital	5	5
Profit and loss account	<u>4,505</u>	<u>3,861</u>
	<u>4,510</u>	<u>3,866</u>

Section 3

Key quarterly information by division and Hamad's notes

UK car division

	Q1	Q2	Q3	Q4	Year ended 31 March Yr59	Year ended 31 March Yr58
	£'000	£'000	£'000	£'000	£'000	£'000
Turnover	934	961	796	761	3,452	3,362
Cost of sales	(705)	(728)	(592)	(571)	(2,596)	(2,202)
Gross profit	229	233	204	190	856	1,160
Staff costs	(154)	(154)	(150)	(152)	(610)	(594)
Property costs	(18)	(18)	(18)	(18)	(72)	(69)
Management charges	(8)	(8)	(8)	(8)	(32)	(30)
Administrative expenses	(5)	(5)	(5)	(4)	(19)	(13)
Operating profit	44	48	23	8	123	454

The UK car division has vehicles in both the Romford and Chelmsford depots. On average, we had 675 operational vehicles during the year, with half of these based in each depot. Average daily rental is £20 per car excluding VAT.

Revenue is generally higher in the spring and summer months, as we get a boost from the tourist market. Although COVID affected the mix of users, the typical revenue seasonal pattern continues and it is also expected to continue into the future, as restrictions are eased further.

UK Van division

	Q1	Q2	Q3	Q4	Year ended 31 March Yr59	Year ended 31 March Yr58
	£'000	£'000	£'000	£'000	£'000	£'000
Turnover	1,260	1,189	1,210	1,179	4,838	4,685
Cost of sales	(770)	(745)	(759)	(772)	(3,046)	(2,732)
Gross profit	490	444	451	407	1,792	1,953
Staff costs	(235)	(226)	(226)	(221)	(908)	(856)
Property costs	(38)	(38)	(39)	(39)	(154)	(164)
Management charges	(12)	(12)	(13)	(13)	(50)	(58)
Administrative expenses	(20)	(20)	(20)	(20)	(80)	(67)
Operating profit	185	148	153	114	600	808

The UK van division also operates out of both UK depots. There are on average 1,000 vans, and two-thirds of these are based in Romford. Average monthly rental is £480 per van excluding VAT.

Dubai division

	Q1	Q2	Q3	Q4	Year ended 31 March Yr59	Year ended 31 March Yr58
	£'000	£'000	£'000	£'000	£'000	£'000
Turnover	430	371	380	610	1,791	1,611
Cost of sales	(225)	(219)	(217)	(233)	(894)	(830)
Gross profit	205	152	163	377	897	781
Staff costs	(12)	(12)	(13)	(13)	(50)	(43)
Property costs	(25)	(26)	(26)	(26)	(103)	(62)
Management charges	(30)	(60)	(30)	(60)	(180)	(172)
Administrative expenses	(13)	(10)	(10)	(16)	(49)	(45)
Operating profit	125	44	84	262	515	459

The Dubai tourist market is less seasonal, with visitors all year round. This is a relatively new market for us, but business is going well and my brother, Viraj, seems to be doing an excellent job as the depot manager since he took over in July Yr58.

Average rental rates were 225 AED excluding VAT per day for Yr58/59 and we currently have around 120 cars in Dubai, although I suspect we may need to buy some more soon.

Section 4

Proposal to expand into the luxury car market in Dubai

Our current fleet of cars in Dubai consists of mainly small and economy cars and the majority of our rentals are to individual 'personal' customers, mainly tourists and short-term business customers. Although the depot is doing well, we believe that we can grow the business further by expanding into the luxury car rental market. The Dubai depot manager, Viraj, has contacts at several of the global car hire companies with operations in Dubai. These car hire companies are expanding the range of higher price cars that they offer. As you will know, Dubai is a premium holiday destination and many people like to rent a premium car.

Initially we would purchase 60 top-range cars, a mixture of sports cars, executive 4x4 cars and executive saloon cars. These cars cost, on average, 300,000 AED excluding VAT but we would expect to pay around 15% less than this with our bulk discount. Daily rental rates would start from 350 AED including VAT for a saloon car going up to 750 AED including VAT for a performance sports car. Our research with existing customers has indicated that some renters would prefer to have a driver, as driving in Dubai can be quite daunting. We would provide drivers as required, for an additional 50% of the rental cost. Some of the existing depot staff have indicated that they would be interested in becoming drivers.

Based on our research we have pulled together the following projections for the new proposal.

		Year 1	Year 2	Year 3
		'000	'000	'000
	Note	AED	AED	AED
Turnover – rental only	1, 6	5,912	6,504	7,154
Turnover – rental with driver	2	8,870	9,756	10,732
Turnover		14,782	16,260	17,886
Cost of sales	3	(7,391)	(8,130)	(8,943)
Gross profit		7,391	8,130	8,943
Staff costs	4	(177)	(195)	(215)
Administration expenses	5	(10)	(10)	(10)
Operating expenses		7,204	7,295	8,718

Notes:

1. Assumed average daily rental of 600 AED
2. Assumed average daily rental of 900 AED
3. Assumed to be 50% of turnover
4. 3% of turnover based on Dubai division Yr58/19 figures
5. Marketing costs
6. Assumed 10% growth in years 2 and 3

Section 5

Email from Laura, finance manager

To: LeeCA@email.com

From: Finance.Manager@andkarental.co.uk

Date: 7th May Yr59

Time: 10.30

Dear Lee

Chloe asked me to send you some information about the UK car and van fleet. The quarterly net book value figures for the UK car and van fleet for the year ended 31 March Yr59 are as follows:

	UK CARS				UK VANS			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Opening cost	6,280	6,380	6,505	6,530	16,500	16,660	16,800	16,700
Additions	200	165	70	15	2,040	2,075	2,060	2,040
Disposals	(100)	(40)	(45)	(15)	(1,880)	(1,935)	(2,160)	(2,010)
Closing cost	6,380	6,505	6,530	6,530	16,660	16,800	16,700	16,730
Opening depreciation	1,320	1,635	1,999	2,387	7,120	7,050	6,950	7,040
Depreciation charge	405	409	411	409	1,160	1,170	1,180	1,175
Disposals	(90)	(45)	(23)	(18)	(1,230)	(1,270)	(1,090)	(975)
Closing depreciation	1,635	1,999	2,387	2,778	7,050	6,950	7,040	7,240
Closing NBV	4,745	4,506	4,143	3,752	9,610	9,850	9,660	9,490

Depreciation amounts for both cars and vans were pretty similar in the previous year too.

Repairs and maintenance figures are included within cost of sales, but the quarterly figures for the year ended 31 March Yr 59 and the total figures for the previous year are as follows:

	Q1	Q2	Q3	Q4	Y/e	Y/e
	£'000	£'000	£'000	£'000	31/3/59	31/3/58
	£'000	£'000	£'000	£'000	£'000	£'000
UK cars	52	54	53	56	215	156
UK vans	75	80	84	120	359	273
Dubai	7	8	9	10	34	23
Total	134	142	146	186	608	452

Wes O'Reilly, the fleet manager, has been absent from work since the summer of Yr58 with health issues. His role has been spread between the two UK depot managers – the Romford manager has looked after vans and the Chelmsford manager has looked after cars.

I don't have a lot of information I can give you for the Dubai division. I just get sent quarterly figures from the depot manager and Hamad has told me just to enter them into the system without question. I don't get details of any individual transactions or access to the Dubai systems, you'd need to contact Dubai for that.

If you need anything else, just let me know.

Laura

END OF PAPER