



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

TOP CA CASE STUDY EXAMINATION - DECEMBER 2013

**THE EXAMINATION QUESTION, INSTRUCTIONS AND ADDITIONAL
(IMPACT) INFORMATION**

Instructions to candidates:

- (1) **Time allowed :** 4 hours
- (2) **Marks :** 100 marks
- (3) This question paper should be answered entirely in the **ENGLISH** language.
- (4) Your answer must be submitted in the answer booklets provided at the Examination Hall.
- (5) Any pre-prepared papers included in your answer **WILL NOT** be marked.
- (6) After the instruction to stop writing at the end of the paper, you will be given five minutes to assemble your answer.

Case Study Requirement

Back Ground:

Serendib Bank Limited (SBL) is one of the corporate finance and advisory clients of MDA Consulting Group. Being a consultant, the managing director of MDA Group - Mr. Manoj Ambani, has been representing the bank at meetings with various consultative committees of Serendib Government. He was recently appointed by the Treasury of Serendib Government, as a lead consultant of Special Executive Committee (SECo) to find a sustainable solution to SBL's ongoing issues. The main task of the SECo is to propose a recapitalization and restructuring plan which will ensure that SBL would stand as a leading banker in the microfinance sector of Serendib.

The SECo consists of six members (including lead consultant) of whom two are senior officials of ministry of finance and planning and two from SBL (current working director and chairman), while a director of Serendib Trust fund is also in the committee.

As mentioned in exhibit 2, the decision to merge STF with SBL has already been considered and identified as the first priority. However, no detailed analysis has been done as to how the decision is to be implemented in an efficient and effective manner.

Requirement

You (Nimran Jayadesh) are a senior consultant in the firm of MDA Consulting Group, working directly for Mr. Manoj Ambani. You have been working with Mr. Manoj for almost four years and have gained experience in diversified fields as a member of the consulting team.

You are required to prepare an internal memorandum as set out in the e-mail from Mr. Manoj (Exhibit 1) in your firm to you.

Your report should comprise of an executive summary with required appendices. State clearly any assumptions that you make. All workings should be attached to your answer.

The following time allocation is suggested to candidates:

Reading	1 hour
Planning, calculations and preparation of appendices	45 minutes
Drafting memorandum	2 hours and 15 minutes

Marks Allocation

All of the marks in the case study are awarded for professional skills, allocated broadly as follows:

Applied to the four elements of your report

▪ Assimilating and using information	20%
▪ Structuring problems and solutions	30%
▪ Applying judgment	25%
▪ Drawing conclusions and making recommendations	<u>20%</u>
	95%

Applied to your report as a whole

▪ Demonstrating integrative and multidisciplinary skills	<u>05%</u>
	100%

Approximately 15% of the marks are awarded for the executive summary.

In planning your report, you should be aware that not submitting an executive summary will have a significantly detrimental effect on your chances of success. In addition, as indicated above, all four skill areas will be assessed under each of the four elements of your report. Accordingly, not demonstrating your judgment and/or failing to include appropriate conclusions and recommendations in each element of your report will affect your chances of success.

Exhibit 1. - E-mail from Mr. Manoj to you;

From: manoj@MDA.com

To: nimran@MDA.com

Date: December 13, 2013

Subject: Proposed Merger – SBL and STF

There have been major changes in relation to the SBL work, which require careful consideration in order to present a clear picture to the SECo members, ahead of their meeting with the Secretary to the Treasury - Ministry of Finance & Planning in the next couple of weeks.

In addition to the information I have provided to you earlier, attached herewith is the new information and comprises:

- I. Exhibit 2. Extract of minutes of recent meeting held by SECo
- II. Exhibit 3. Additional information – STF
- III. Exhibit 4. Extracts from Inland Revenue Act
- IV. Exhibit 5. Extract: Value Added Tax Act (relevant section of VAT on Financial Service)
- V. Exhibit 6. Additional information on Withholding Taxes

You will need to prepare an internal memorandum on the following:

1. Evaluation of recapitalization proposals suggested by SECo

Your proposal, with justification, to re-capitalize SBL, taking into consideration the matters raised by SECo in the attached correspondence and your evaluation of each proposal (Please remember, you need to give a workable solution with detailed implementation plan).

2. Analyze and evaluate other issues faced by SBL/STF

A discussion of the relevant financial reporting, taxation, operational and strategic issues which may be of concern to the SECo when taking the final decision of merger of SBL and STF and how the incoming board of directors of new venture could address these concerns.

Although I will not be giving your report to the SECo members, it will form the basis for our discussion at the meeting on 16th December 2013. It would be better if we both can meet up tomorrow evening to discuss the draft report.

Regards!

Manoj

Exhibit 2. Extract of minutes of recent meeting held by SECo

Mr. Anita Kapur- chairman of SBL, briefed members about current position and ongoing issues of the bank. The chairman mentioned that FBS has granted only four months extension period to comply with minimum capital, which will end with effect from 1st January 2014. The chairman also emphasized that the Treasury being the owner of the bank should somehow make necessary arrangements to support the bank in this context. He further mentioned that the bank has to have adequate liquid funds to meet deposit and borrowing liabilities of MSDB. It was noted that as per the repayment scheme formulated by FBS, the bank has to repay all the liabilities (only MSDB) by 31st December 2016.

The committee discussed about the possible actions to be taken to meet capital adequacy.

- (i) Issuing new share capital by way of an IPO through Serendib Stock Exchange
- (ii) Treasury to Government (of Ministry of Finance and Planning) is to infuse new funds to strengthen the capital of the bank
- (iii) Merge with another government organization

All committee members were of the view that an IPO is a good idea but practically it takes time to implement. One of members of the committee also mentioned that given the already experienced issues with MSDB, the success of an IPO is at risk. But the committee decided that this can be considered in future in raising additional capital.

Treasury representatives were of the view that the possibility of cabinet approval to allocate funds from treasury will be remote in the current context.

Merging with another cash rich government organization was considered as the first priority subject to fulfillment of required regulatory approvals and other legal requirements.

Chairman of SBL mentioned that he has already forwarded a letter to HE President of Serendib to merge STF with SBL and disclosed that the President has responded positively in that regard as HE has already instructed relevant officials of the government to look in to the matter. In this context, it was considered that a merger between SBL and STF is a possible option.

The committee unanimously decided to offer a special assignment to MDA group in this regard and requested lead consultant Mr. Ambani to produce a detailed report evaluating possible recapitalization options. Special attention with detailed evaluation was requested on proposed merger.

The main concerns that the committee had in this regard include but are not limited to the following:

- i. If it is concluded that merger is the best viable option, what would the new venture be? (Is it a bank /continuation of SBL as it is or NPO or any other legal form.)
- ii. If there is any change to existing legal form of SBL, how MSDB liabilities can be met as per the scheme formulated by FBS.
- iii. How to overcome ongoing issues of SBL related to financial reporting, taxation, human resource, asset utilization (speedy recovery of MSDB) etc... and, in case of a merger, what change management measures to be taken to ensure smooth functioning of new organization in future.

Exhibit 3. Additional information – STF

➤ **Borrowings from ADB and other international institutions:**

According to loan agreements, capital portion of all these loans are due on or before 31 December 2021.

➤ **Accounting & financial reporting**

- STF maintains manual books of accounts for all general ledger and sub ledgers.
- Two partly qualified but well experienced officers handle accounting functions while seven assistants support them.

➤ **Loan disbursement and recovery process**

Four assistant directors (who are graduates and experts in microfinance sector with adequate experience) supported by seven field officers are involved in both disbursement and recovery processes. Both field officers and assistant directors have a close rapport with members of partner organizations (POs). They are considered to be as the operating team of STF while the board of directors including a managing director, represents the top management.

Regular awareness programmes for members of POs about entrepreneurship and financial management are part of any field visit by field officers. Field officers regularly report on financial position of POs and scrutinize recovery process by POs from end-borrowers.

Exhibit 4. Extracts from Inland Revenue Act

LOSS BROUGHT FORWARD FROM A PREVIOUS YEAR

The amount of a loss incurred by person in any trade, business, profession or vocation which if it had been a profit would have been assessable under Inland Revenue Act, can be deducted if following conditions are satisfied.

- supported by a statement of accounts certified by an approved accountant,
- up to a maximum limit of thirty five *per centum* of the excess of the total statutory income for that year over the aggregate of :
 - (i) statutory income from interest and dividends
 - (ii) any interest income
 - (iii) any reward , share of fine, any lottery winning and any interest on compensation payable, for that year and any loss which cannot be deducted may be carried forward to the next year of assessment and so on :

Provided however,

- (A) no loss incurred on the disposal of shares, rights or warrants in a company shall be a loss deductible.
- (B) no loss can be carried forward beyond the year of assessment in which the death of such person occurred in the case of an individual, or liquidation of such person occurred in the case of a company or other body of persons;
- (C) where any person has been declared or adjudged insolvent by a competent court, no loss incurred prior to the date of bankruptcy or insolvency shall be deducted from income arising subsequent to such declaration of insolvency ;
- (D) no loss can be deducted which is incurred by a company in which there had been a change of ownership otherwise than by way of testate or intestate succession, except against the statutory income of such trade or business of the company as that in which the loss was incurred. For the purposes of this paragraph, a change of ownership of a company is deemed to have occurred where more than one-third of the issued share capital of the company is held, at any time in the year of assessment for which the claim for deduction is made, either directly or through nominees, by persons who did not hold such share capital, at any time in the year of assessment in which the loss was incurred.

Exhibit 5. Extract: Value Added Tax Act (relevant section of VAT on Financial Service)

IMPOSITION OF VALUE ADDED TAX ON THE SUPPLY OF FINANCIAL SERVICES

Value Added Tax shall be charged on the supply of financial services in Serendib, made by any specified institution which carries on a business of supplying such financial services.

Every specified institution, carrying on the business of supplying any financial service in Serendib, shall be required to be registered considering the relevant thresholds.

For the purposes of this Chapter supply of financial services means

- (a) the operation of any current, deposit or savings account;
- (b) the exchange of currency ;
- (c) the issue, payment, collection or transfer of ownership of any note, order for payment, cheque or letter of credit ;
- (d) the issue, allotment, transfer of ownership, drawing, acceptance or endorsement of any debt security, being any interest in or right to be paid money owing by any person ;
- (e) the issue, allotment, transfer of ownership of any equity security or a participatory security ;
- (f) underwriting or sub-underwriting the issue of any equity security, debt security or participatory security ;
- (g) the provision of any loan

specified institution means

- (a) a licenced commercial bank within the meaning of the Banking Act, No. 05 of 1991;
- (b) a licenced specialized bank within the meaning of the Banking Act, No. 10 of 1991
- (c) a finance company registered under the Finance Companies Act, No. 78 of 1995 ;

The supply of financial services by a Unit Trust or a Mutual Fund shall not be treated as a financial service for the purpose of Financial Services VAT.

Exhibit 6. Additional information on Withholding Taxes

Interest Payable by Banks and Financial Institutions

Liability

Section 133 of Inland Revenue Act imposes a tax on the interest payable to any person or partnership by any bank or Financial institution on moneys deposited by him or in his name or without the name.

The deduction with effect from 01st April 2013 is as follows.

- On any company (other than a charitable institution) at the rate of 10%
- On any partnership or body of persons (other than a charitable institution) at the rate of 8%
- A charitable institution where assessable income is over SR. 500,000 at the rate of 8%
- On individuals the rates applicable are as follows:

Assessable income (including Interest) up to SR. 500,000	- Nil
Assessable income (including Interest) from SR. 500,000 – SR. 1,500,000	- 2 ½%
Assessable income (including Interest) above SR. 1,500,000	- 8%

- The above thresholds will not apply to
 - Savings Certificates, certificates of deposit, government rupee loans
 - Deposits made by non-individuals such as clubs, associations, societies other than charitable institutions
- In the case of charitable institution, the deduction is made only on the interest where the assessable income is in excess of SR. 500,000 a year.
- In the case of joint deposits, the interest on such joint deposit is apportioned.
- In the case of any receiver, trustee, executer, administrator, guardian etc. the interest on deposits is treated in the same manner as above.