



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

TOP CA CASE STUDY EXAMINATION - MAY 2014

**THE EXAMINATION QUESTIONS, 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.

Hamson Group

The Board of Directors of Hamson Group in its recent board meeting discussed the prospective business opportunities which will align with the current economic environment. The group CEO requested each business sector to come up with ambitious growth plans to cater to the rapidly changing business environment and to address the needs of its customers to achieve a competitive edge in its business excellence. Accordingly, the day following the meeting Mr. N.D Silva, CEO of Hamson Group, sent a reminder including extracts of board minutes to its members.

To: Directors/CEOs

From: CEO – Hamson Group

Subject: Reminder to provide information

This is a gentle reminder to provide the necessary information for the next board meeting on the following matters as discussed at the previous board meeting.

Information about:

- Acquisition of Rangiri Hotel Ltd – Mr. A.D. Amarasinghe, CEO of Hamson Leisure Ltd
- Construction of new hotel complex in Tissawava, Anuradapura – Mr. K. Jayasinghe, director, Hamson Leisure Ltd
- Application of Integrated Reporting to Hamson Group – Mr. S.A. Perera, senior manager, Hamson Group
- Start up of BPO business – Mr. M. Ramesh, director, Hamson Group

Your cooperation is highly appreciated in implementing the development initiatives of Hamson Group.

Thank you.

Best regards,
N.D Silva, CEO – Hamson Group

In response to the above reminder Mr. A.D. Amarasinghe, CEO of Hamson Leisure Ltd has sent an e-mail informing the progress of gathering information to assist the proposed acquisition of Rangiri Hotel Ltd.

To: CEO of Hamson Group

From: CEO of Hamson Leisure Ltd

Subject: Information on the acquisition of Rangiri Hotel Ltd

Dear Mr. Silva,

I would like to furnish the following forecasted financial information pertaining to Rangiri Hotel Ltd.

Forecasted financial information of Rangiri Hotel Ltd

	2015	2016	2017	2018	2019
Net Operating Profit After Tax (NOPAT) (Rs. '000)	253,470	278,817	306,699	337,368	371,105
Depreciation (Rs. '000)	55,000	60,000	60,000	70,000	70,000
Expected increase in working capital requirement (Rs. '000)	25,750			5,800	
Tax rate	32%				
Expected rate of return of shareholders in similar businesses	26%				
Average cost of debt	17%				

Further, I have noted that Rangiri Hotel Ltd recorded Rs.1.75 dividend per share in 2009 and it has grown to Rs. 4.64 in 2013¹.

¹ Expected weights of dividend growth for each year are as follows:

Year	2013	2012	2011	2010	2009
Weights	1	0.4	0.16	0.06	0.03

I noted that the CEO of Rangiri Hotel Ltd has disclosed in a business interview the bidding price range of Rs. 50 – Rs. 60 per share. He justified the bidding price by focusing on the industry prospects.

Thank you.

Best regards,
A.D. Amarasinghe, CEO – Hamson Leisure Ltd

Eco Friendly Hotel Project

The evaluation committee headed by the director of Hamson Leisure Ltd presented the following report as requested by the CEO of Hamson Group.

To: CEO of Hamson Group

From: Director, Hamson Leisure Ltd

Subject: Project - constructing a hotel complex in Anuradapura

This project is focused on implementing the eco-tourism green concept to cater to various goals such as bio diversity conservation, contribution to local sustainable development and eventually bringing profit to the group by achieving self sufficiency targets and starting organic farming by considering the location advantage. Due to the salient features of the country and its environment, the hospitality of the people, history, climate and global positioning, Sri Lanka is a tourism paradise and is becoming a popular destination worldwide for tourists to visit. Considering all these factors, this eco-tourism project covers the needs of the eco-tourism green concept and the real needs of tourists with sustainable development. Moreover, Sri Lanka is a peaceful tourist paradise comprising various attractions, picturesque beaches and shallow seas. These are the main reasons for Sri Lanka to be one of the best tourist attractions in the South Asian region.

This project would include 150 luxury rooms (focused to have either platinum or gold class LEED certification), bird watching, safari, organic farming, smart buildings, solar roofs, rainwater harvesting, solid waste management, shopping requirements, pleasure and leisure requirements, energy efficiency and management, sewerage management and a reforestation program. These would be implemented under the Star Class Hotel Management Team (Hamson Group's existing leisure sector management team).

The hotel will consist of food services, entertainment facilities, picturesque views, room variations such as size and additional amenities, spas and fitness centers, an ayurvedic treatment centre and a yoga centre. An accessible location, services of a 24-hour open reception with multilingual staff, doorman service, concierge, a reception hall, beverage service, personalized greetings for guests in the rooms, minibar, 24-hour room service facilities, internet and PC in room, Wi-Fi service, TV, building management system, ironing services, medical services, transport services, motor home services, ambulance and an air taxi service, will be considered in establishing the general standards which are acceptable in the leisure industry. All hotel services will be fully automated with the greenery approach and monitored continuously by establishing superior services to guests.

The hotel is designed and developed to ensure environmental protection and serve the regional people by way of generating various opportunities. Moreover, this project stands out from other counter parts due to its environmental friendly and socially responsible features.

Location

Province: North Central Province

Administrative District: Anuradapura

Divisional Secretary: Thirappane

Local Authority: Thirappane

Location: Wellamaduwwa

Ownership: Private

Land extent: 50 acres (can be extended up to 200 acres)

Infrastructure: 1.1km long approach road and other internal roads to be constructed together with High Tension (HT) power available 3.5km away. Ground water will be tested for human consumption. Surrounding area covers rural/forest over 2,500 acres, and the main three lakes (located within close proximity) would be used in this project as identified ecosystems. A fence or safety wall would be constructed to prevent elephants entering the hotel premises.

Geotechnical and Environmental Investigation

A study of the bed rock will be done according to engineering standards. A further study of the type of soil, depth up to which each layer occurs, bearing capacity and permeability of the soil will also be carried out.

The prescribed area has various ecosystems to be studied considering the bio diversity, and programs and plans need to be made for its conservation and sustainability. This will help to educate eco-tourists.

Water Demand and Supply System

For a 100-room hotel, the demand was estimated at 20,000 liters per day but for a 150-room hotel the demand will be 30,000 liters per day. Hence the storage facility should at least be 60,000 liters for smooth operation of the hotel. Plenty of water sources are available and Thuruwila Wewa has been selected to supply water for this project.

Waste Water Treatment

Depending on the water quality and quantity (i.e. taking in to account of Biological Oxygen Demand (BOD), Chemical Oxygen Demand (COD), Sewer System (SS) oil and grease etc.), a system would be designed. The average and maximum demand, treatment system, level of treatment required, reuse and recycling potential would be analyzed in the pre- design stage.

Kitchen Waste Management

Food waste is a global problem, and it usually goes to landfills, generating methane gas which is 23 times more harmful to the environment than carbon dioxide. This will be converted into a re-

usable form by introducing a technology which effectively controls the food odors with minimal usage of energy, thereby reducing the organic waste by 85-90%.

Solid Waste Management

After quantifying and identifying the types of solid waste (both perishable and non-perishable), they will be collected, stored and finally disposed of, reused or recycled.

Electrical System

To serve the hotel and all activities at maximum capacity, nearly 800KVA power is needed. Electricity will be taken from the national grid and standby power of a similar capacity generator together with a 250KVA auxiliary generator will be needed to serve this demand. Solar power would be used to preheat water and for day lighting in this hotel project.

Organic Farming and Bio Gas Production

The hotel itself will maintain a farm to provide their fresh milk, vegetables and fruits. A part of it will be implemented in farmer groups handled by a separate entity with the involvement of the Star Class Hotel Management Team which will help the farming families. They will be registered members and direct benefits will be given to them. Various advancement programs will also be launched by the hotel management with the involvement of volunteer tourists. A biogas plant will be designed and implemented for use in the kitchen of the hotel.

Implementation Process

The planning process of the typical development cycle for a hotel and theme park is included in this section. The first stage of the development cycle involves generating the original idea, getting a firm definition of the concept, understanding the economic feasibility of the project, organizing the shareholder group, and developing the master plan.

Once the concept, final feasibility and the master plan are developed, the public and local approval process, design development, financing of the project, construction drawings, actual construction of the hotel and the park, procuring the rides, events and other equipment for the

park, installing those rides and equipment and facilities, and the pre-opening which includes the operating plan for the hotel and park, takes place. The final step is opening the hotel and park, operating it and then expanding it over time.

In the case of this eco-friendly hotel project, the planning and development process, together with overall project management, the concept plan and master plan, and the detailed design of the project will be done by the project development team with consultants. Numerous other suppliers and contractors would also participate in the process.

Design Development Process

In general, the master plan for the project is developed over the course of approximately six months. The process begins with a kick off meeting with the project consultants, the development team and the customers. Site investigations, discussions with the client and vendor groups, hotel management consultants and other relevant parties are conducted and then discussed accordingly. This leads to the development of the final feasibility plans, development cycle, creation of models and layouts, and ultimately to the formulation of the master plan.

It is important to note that the master plan, sizing factors for components and investment will be based on the detailed economic feasibility study. This process moves from concept drawings to models to the actual master plan. The final plan utilized to design the entire hotel and park is labeled the “Master Plan”. Once the detailed design goes forward following the preparation of the master plan, various project management functions become important to the process. The overall project manager performs several tasks to help keep the project on time and in budget, including the master plan, the master schedule, and value engineering. The master plan outlines everything to be included in the hotel and park in terms of size, capacity, and cost. It is constantly reviewed in terms of the design changes to it.

The master schedule translates the master plan into a time frame. It outlines the process to develop the hotel and park over the two-year development cycle and assigns responsibility to accomplish each task. The project manager's job is to stick to the goals and objectives of the

master schedule. In this process it is important to measure the tradeoffs of lower costs with other considerations such as future maintenance costs and the entertainment value of the park whilst at the same time ensuring sustainability and social responsibility.

Pre-opening

For successful operation, set-up of all services and recruitment and training of staff should take place before the grand opening. Each engineering system needs to be commissioned before giving the training to the operational staff. The pre-opening process will be a period of three months.

Key items in the pre-opening budget include:

- 1) General management of hotels
- 2) Marketing
- 3) Team development in supply chain and local participation
- 4) Development of shows and entertainment aspects established in the hotel
- 5) All of the other functional areas of the hotel and farm operations.

Star Class Hotel Management Team

The Star Class Hotel Management Team is vital to achieve good end-results of the project. Project consultants would be hired and they would develop and train the team to achieve the desired results in various ways.

Expected Revenue Generation

The hotel consists of four main types of rooms: traditional featured rooms, cottage cluster type double rooms, cottage cluster type single rooms and cottage cluster type family bungalows.

Accordingly, 110 rooms will be completed as traditional featured rooms, 10 rooms as cottage cluster type double rooms, 10 rooms as cottage cluster type single rooms and 20 as cottage cluster type family bungalows.

Traditional featured rooms will be charged at Rs. 20,000 per day and cottage cluster type double rooms at Rs. 30,000 per day. Cottage cluster type single rooms will be charged at Rs. 25,000 per day and cottage cluster type family bungalows at Rs. 60,000 per day. A 10% increase in the rates of all types of rooms is expected each year over the first 5 years after completion of the hotel.

Implementation of the project will commence in 2015. Traditional featured rooms, cottage cluster double rooms and cottage cluster single rooms are expected to be completed by 2016. The cottage cluster family bungalows will be completed by 2017.

The average occupancy rate is expected to be 60% by 2017 for all types of rooms and it is expected to increase by 5% each year thereafter.

In addition to the income from room rentals mentioned above, income from food and other categories are as follows:

Year	2017 (Rs. million)	2018 (Rs. million)	2019 (Rs. million)	2020 (Rs. million)	2021 (Rs. million)
Food and other income	112	121	127	139	143

Operating expenses (which include all cost elements relating to the hotel) are as follows:

Year	2017 (Rs. million)	2018 (Rs. million)	2019 (Rs. million)	2020 (Rs. million)	2021 (Rs. million)
Operating expenses	523	610	742	787	825

Projection of the cash outflows of the project is given below:

No:	Description	Amount (Rs. million)	Remarks
1	Landscaping, roads, drainage etc	110.000	
2	Hotel (Luxury - 150 rooms)	1,648.700	Note 01
3	Electrical system	65.000	
4	Air conditioning system	100.000	
5	Fire safety system	45.000	
6	Plumbing system	35.000	
7	Building management system	38.000	
8	Guest Room control system	15.000	
9	Public address/TV/Data	30.000	
10	ELV system	30.000	
11	Bathroom fittings	82.500	
12	Water treatment & supply	10.500	
13	Sewerage treatment	14.250	
14	Furniture	75.000	
15	Office equipment	9.000	
16	Transport services/safari and sea flight	154.000	Note 02
17	Stores and kitchen	30.000	
18	Health care centre/Gym	30.000	
19	Contingency	10.695	
20	Implementation of green concepts/programs	10.000	
		2,542.645	

Note 01: The construction of 20 cottage cluster type family bungalows (each accommodating 5 guests) will be completed in 2017 and operations will commence in 2018. The expected cost of Rs. 360 million will be incurred evenly throughout 2015, 2016 and 2017. The balance cost of Rs. 1,288.7 million will be incurred in the proportion of 60% and 40% in 2015 and 2016 respectively.

Note 02: Construction of transport services, safari and sea flight services will commence in 2017 and business operations will start in 2018.

Note 03: All other cost items (apart from those costs and the details of how they will incurred which are disclosed in Note 1 and Note 2) will be incurred in the proportion of 60% and 40% in 2015 and 2016 respectively.

This project will be approved by the Board of Investment and as per the current rules and regulations, this business will be exempted from income tax.

Sources of Finance

It has been negotiated with one of the leading development banks in Sri Lanka to finance this project at the interest rate of 16% per annum.

Further information is to be provided as soon as possible.

Thank you.

K. Jayasinghe, Director - Hamson Leisure Ltd

Required:

Assuming that you are the CEO of Hamson Group,

1. Draft an environmental analysis for Hamson Group considering the impact of the proposed business strategies with reference to future trends in the hotel and leisure sectors.

(18 marks)

2. Prepare a report encompassing the suggested proposals to be submitted at the next board meeting. Your report should include **financial analysis** and **other factors** which must be considered to decide the viability of the proposals. Your answer must be justified by prioritizing the best option to be implemented in order to maximize the shareholders' wealth.

(65 marks)

3. Write a separate report to the Board of Directors emphasizing the importance of, implementation procedures and challenges of Integrated Reporting to Hamson Group.

(17 marks)

(Total: 100 marks)