



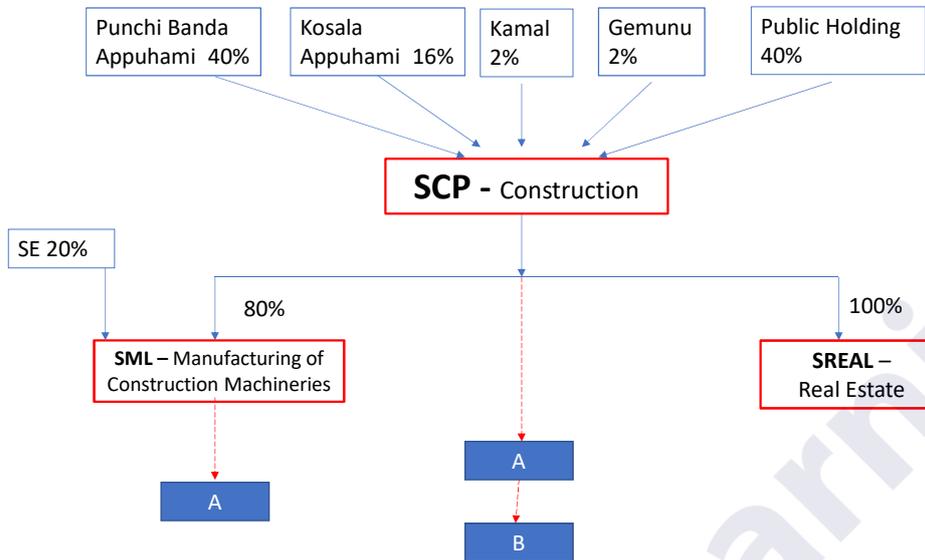
Strategic Level Examination
December 2023

Common Pre-Seen Analysis Advanced Business Reporting

Syllabus

- Materiality
- Going concern
- MMS/ SLFRS & LKAS
- Internal Control & CG
- Ethics
- Acquisitions
- Disposals
- Restructurings

Group Structure



Board Structure

Name	status
Punchi Banda Appuhami	chairman
Brother 01	???
Gemunu	Executive Director
Kamal	Executive Director
Hemaka	Independent Director
Buwaneka	Independent Director

- Board composition ?
- Sub-committees ?
- Application of corporate governance practices?
- Possible management override

Important Inputs

- **acquiring one or two local manufacturing establishments as a strategy to have good quality products and maintain the company's vision.**
- **few investors of SCP are not happy with the management's decision and are willing to dispose of their shares**
- The board of directors requested the finance director to re-negotiate with the bank explaining the current situation of the group and the fact that existing interest rates offered by the **bank for overdrafts is 17% and term loans is 15%** respectively, which are excessive compared to the current average market rates of **14%** and **12%**.
- Chairman stated that the **industry will not bounce back quickly** even though there are some positive signs of recovery of the Sri Lankan economy following the domestic debt restructuring process
- collaborating with the research and development unit of the Road Development Authority (RDA) to develop an innovative solution to appropriately modify the asphalt wearing course and binder to enhance the durability of road surfaces.
- **will enhance the scope of the committee and help improve the internal control systems as well as the financial reporting standards of SCP.** Since there were no objections, the company secretary was directed to seek advice and take necessary action to prepare an appropriate board paper for the next board meeting

Financials

PLS refer pre-seen



Key Highlights

SCP

Sunshine Group has been successfully involved in the construction of buildings, highways, roads, apartments and bridges

Some of the ongoing projects were held up due to the current economic downturn of the country with majority of the completed government projects remaining unpaid for by the government.

The management of SCP has taken a decision not to quote for new government tenders until the government settles the outstanding payments

the board of directors of SCP requested its independent director Buwaneka to explore **new overseas markets such as India, Bangladesh, the Maldives, the Middle East, and African countries, to secure new projects to bridge the potential shortfall in revenue of the company.**

Buwaneka, one of the independent directors who heads the audit committee is not interested in having regular financial review committee meetings, since he is not well versed in financial accounting as well as the internal control procedures of an organisation – the major areas to be reviewed by an audit committee.

majority of the directors proposed that in order to have an effective audit committee, it is best for Buwaneka to be replaced by Kosala as the chairman of the audit committee since he is knowledgeable in finance and the systems of SCP.

further observed that this **will enhance the scope of the committee and help improve the internal control systems as well as the financial reporting standards of SCP.** Since there were no objections, the company secretary was directed to seek advice and take necessary action to prepare an appropriate board paper for the next board meeting.

SML

SML has steadily increased its presence across the construction value chain through strategic investments in setting up production plants that provide key construction-related inputs to support SCP's project operations around the country

SML uses the following strategies in its manufacturing operations.

- Make-to-Stock (MTS): Goods are produced by predicting the market, and they are produced regardless of orders being received.
- Make-to-Order (MTO): Goods are produced when orders are received, making it easier to control inventory.

Plant capacity expansions are planned of time through the annual capital expenditure plan, while annual budget allocations drive continuous and ongoing maintenance and improvements at all plants

collaborating with the research and development unit of the Road Development Authority (RDA) to develop an innovative solution to appropriately modify the asphalt wearing course and binder to enhance the durability of road surfaces.

However, due to the current economic setback, SML has lost the local market share and incurred losses during FY 2022/23.

SREAL

SRERL is a real estate and property development company

Kollupitiya Project: marketing strategy and a campaign to attract the diaspora overseas especially in Canada, the United Kingdom, and the United States.

Kotte Project: was held up due to the scarcity of raw materials and high prices caused by the restriction on imports.

Currently, after the relaxation of import restrictions, the prices have come down./ management decided to restart the project and market it amongst the locals as well as overseas buyers.

Financial Highlights

- group revenue had dropped by 13% compared to the previous year while the revenue of the company (SCP) had decreased by 24%.
- The gross profit ratio of the group had come down to 14% from 22% in the previous year, while SCP's gross profit had come down to 16.6% from 19% in FY 2022/23. He further pointed out that this was mainly due to the low revenue of SML and SML's loss of Rs. 38 million for FY 2022/23.
- The chairman wanted to have a special board meeting after going through the financial performance of FY 2022/23. The chairman highlighted the continuous drop in performance especially at SML with the market demand for products dropping by 60% compared to FY 2018/19 and the company (SML) incurring losses and experiencing a rise in trade receivables (from the government and corporate sector) by 50% compared to FY 2018/19.
- He stated that the **industry will not bounce back quickly** even though there are some positive signs of recovery of the Sri Lankan economy following the domestic debt restructuring process

Financial Highlights

- The chairman further pointed out that the **group working capital management policy should be reviewed** since the large pending projects were accounted for under inventories, and last year's progress of these projects was poor.
- Also, the trade receivables of the group and SCP have gone beyond the group credit policy of a maximum of 45 days.
- He requested the vice chairman of SCP, Kosala to recommend alternative strategies to overcome this situation which has an adverse effect on the group since there were very **expensive modern plant and machinery that were not utilised at full capacity due to the low demand and tight financial position.**
- Moreover, the bank is also putting pressure due to the outstanding overdraft facility, urging that debts of the group need to be restructured.
- The board of directors requested the finance director to re-negotiate with the bank explaining the current situation of the group and the fact that existing interest rates offered by the **bank for overdrafts is 17% and term loans is 15%** respectively, which are excessive compared to the current average market rates of **14%** and **12%**.

Financial Highlights

- Kosala, whilst agreeing with his father about the current financial status of SCP, said that the proposal of the bank for **restructuring of debt should be viewed positively** as the construction industry has bright prospects.
- However, increasing the value-added tax rate from 15% to 18% with effect from January 2024 will have an impact on the future operations of the group.
- The finance director pointed out that due to the existing import restrictions enforced by the government of Sri Lanka, the supply chain of the group has been adversely affected, and poor-quality raw materials were being purchased to meet the current requirement of the group at a higher cost after accounting for waste.
- **He suggested acquiring one or two local manufacturing establishments as a strategy to have good quality products and maintain the company's vision.**

- Sunshine Group did not declare dividends for the last four years although the group had a good reputation for declaring dividends of 50% – 60% of profits attributable to the equity holders previously, all the way since its inception.
- The chairman brought to the notice of the directors that until the economy reaches stability and the company becomes financially strong, profits will not be distributed as they need to be accumulated to meet future development/expansion needs.
- **A few investors of SCP are not happy with the management's decision and are willing to dispose of their shares.**
- Five years forecast for the group and SML & SREAL

Possibilities.....

✓ Corporate Governance

1. Audit committee – responsibilities/ charter/ composition
2. Board Composition
3. page no 872 – practice question

✓ Risk of Material Misstatement in Financial Reporting

1. Material risk on revenue recognition/ R&D expenditure/ ERP recognition/ Employee benefit
2. Internal control issues in above areas & recommend actions in internal controls

✓ Going Concern – SREAL

✓ Restructuring

1. acquisition of one or two local manufacturing establishments- complex Group
2. Disposal of SREAL
3. Acquisition of SCP by a Foreign Investor – Group restructuring

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Possible Acquisitions

- ✓ SCP will acquire another group – complex group structure
- ✓ SML will acquire another entity or group – complex group structure
- ✓ amalgamating with similar entity - SML - amalgamations

Possible Restructurings

- Local or foreign investor will acquire significant shareholding of SCP and will control SCP Jointly with PUNCHI Banda
- Local or foreign investor will acquire significant shareholding of SCP and will receive control via shareholder agreement (**control without majority shares**)

Disposals

- SREAL disposal alone with new acquisitions
- SML disposal with new similar acquisition

Possible SLFRS/LKAS

- how to restructure a financial asset or Liability when interest rate changed ***
- How to account R&D expenses when 3 party involves

