STRATEGIC CORPORATE FINANCE

PROFESSIONAL 2 EXAMINATION - APRIL 2018

NOTES:
Section A - Answer Question 1; **and**
Section B - Answer **any two** from Questions 2,3 and 4.
Should you provide answers to more questions than required in Section B, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first two answers provided will be marked.

STRATEGIC CORPORATE FINANCE TABLES ARE PROVIDED

Time Allowed
3.5 hours plus **20 minutes** to read the paper.

Examination Format
This is an open book examination. Hard copy material may be consulted during this examination subject to the limitations advised on the Institute's website.

Reading Time
During the reading time you may write notes on the examination paper, but you may not commence writing in your answer booklet.

Marks
Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

Answers
Start your answer to each question on a new page.

You are reminded to pay particular attention to your communication skills. Care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which the answers are supported with relevant legislation, case law or examples, where appropriate.

Answer Booklets
List on the cover of each answer booklet, in the space provided, the number of each question attempted. Additional instructions are shown on the front cover of each answer booklet.

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

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CASE STUDY – Waste Supreme Plc

Waste Supreme Plc is one of the most successful waste management companies in Ireland and is involved in many key areas of waste management including: recycling and the collection and disposal of household, commercial, construction and demolition waste. The company has grown significantly over the past four to five years. Some of the main reasons for the growth of the company include: the recent demographic changes in Ireland which have brought substantial extra demand for the company's services; the privatisation of waste collection services by the 31 Irish local authorities; and the fact that many local authorities have privatised waste disposal services. Waste Supreme Plc operates mainly in the greater Dublin metropolitan area (where approximately 40% of the population of Ireland live).

The company was founded by Barry Brown in 1997. Prior to starting his waste business, Barry had owned a very successful haulage business. He decided to move into the waste sector as he saw huge potential to make significant profits. Barry also knew, from his haulage company and his dealings with local government, that local authorities were starting to move out of the waste business. He saw this as an opportunity to set himself up as a major player in the Dublin market in particular as there were only two other private sector service providers in the market at that time.

In 1997, with the successful sale of his haulage business, Barry bought three waste collection lorries and entered the waste business where he initially employed 12 staff. He used most of his own capital to buy the lorries but also raised some debt capital to fund the venture. At the turn of this century, Barry decided that he wanted to expand his business. In order to attract substantial capital he decided to incorporate in 2001 with an initial IPO in November of that year. This raised substantial share capital which has enabled Barry to expand the business significantly since then. By the end of 2017, Waste Supreme Plc had 60 waste collection lorries on its books, employed 240 staff and had a headquarters in a south Dublin business park. The enterprise value of Waste Supreme Plc, as at 31 December 2017, was €450 million euro.

Because of the success of the business, Barry has been approached with proposals to invest in, and sometimes buy, similar enterprises. Up until now, he wished to focus on his own company and did not want to be distracted as a result of buying or investing in other businesses which he always thought would involve a massive amount of risk for him and his company. He has a fundamental knowledge of the waste management business and has become a very astute businessman over the years by building up such a successful enterprise. However, Barry has always felt uncomfortable with figures and he relies on his son Paul, a qualified accountant who is the financial director of Waste Supreme Plc, to give him financial advice on an ongoing basis. Also, in developing the waste management business, and indeed his previous haulage company, Barry always believed that it would be better to have members of his own, and the extended family, involved in running the company. He has said that he didn't trust outsiders (as he called them) involved in the key decision-making processes of the company. Along with his son Paul, Barry's daughter Anna, a qualified HR specialist, is HR Director for the business. His wife, Mary, is a non-executive director and chair of the board.

In January 2018, Barry was approached by John Stack (who owns a UK waste management business) enquiring would he be interested in buying John's entire company. John confided that he had personal reasons for getting out of the business completely, including health grounds and he thought he would give Barry the opportunity to make the first offer. He told Barry it is a very lucrative business, noting that its share capital has a market value of £50 million sterling. However, John believes that the company is worth considerably more than this, and is willing to sell the entire business to Barry for £60 million. John also said to Barry that he expects the business to grow at a rate of 2.5% per year for the next four to five years. Barry knows John quite well, having first met him over ten years ago. John's enterprise is smaller than Barry's, but has nonetheless grown quite a lot over the last ten years. The business (Stack Waste Experts Plc) operates in the UK and is involved in all aspects of waste management, including collection; recycling; and disposal of waste. Most of John's customers are in the UK but he does export some of the recycling business to Europe and China. Nearly 15% of John's total business relates to exports.

In relation to recycling, Stack Waste Experts Plc owns three substantial recycling centres in the UK where it charges for some items and accepts others free of charge. The key items that are accepted free of charge are as follows: paper; cardboard; cartons; tins and cans; glass bottles and jars ; clean plastic packaging; clothes; Waste Electrical and Electronic Equipment (WEEE); fluorescent tubes and energy-saving bulbs; car and household batteries; cooking oil and engine oil. The items charged for are as follows: bulky waste (e.g. furniture, carpet); wood; metal; green waste (restricted to cars and small trailers); soil and stones; duvets and pillows; household hazardous waste (paint, herbicides, household cleaners etc.). Overall, the recycling part of John's business is very lucrative for both the export and domestic UK markets.

In relation to the overall running of the business, John buys a significant amount of supplies and materials from outside Britain (particularly from EU countries) which are mainly invoiced in euros.

However, all of John's business (and indeed Barry's also) is subject to a significant number of EU regulations and directives. Compliance with these directives and regulations have a big cost implication for their respective businesses.

Barry immediately was reluctant to consider the proposal, but later decided to request Paul to conduct some research in order to assess its viability. One of the primary reasons for his initial reluctance concerned the potential impact that Brexit could have on Stack Waste Experts Plc over the coming years. Even though Barry has been risk averse in the past in relation to investing in other businesses, he now feels this proposal might be worth exploring further. He also had a desire in the past to break into other markets including the UK waste management market sector. The reason for the latter was his great affinity with the UK, as both of his parents were natives of Birmingham and he had spent much of his youth there. He requested his son Paul to perform a detailed analysis of this proposal and to give him advice regarding the potential investment. If Paul comes back with a positive response, Barry will then develop a comprehensive business proposal to present to his board. He felt that he lacked in-depth knowledge about mergers and acquisitions and expects Paul to give him some advice on this area.

As Barry was initially reflecting on John's proposal, he considered himself to be a risk-averse person deep down. However, if his son Paul had not convinced him, a number of years ago, to expand his business and get extra capital into the company it wouldn't be the enterprise it is today. Maybe now is the time (he thought to himself) to start investing in other businesses which may yield significant returns to him in the future.

Table 1 sets out the current shareholders in Waste Supreme Plc:

Table 1: Shareholders in Waste Supreme Plc as at 31 January 2018

Name	**Ownership**
Barry Brown (owner)	35%
Bloggs Assurance Plc – Pension Fund (Ireland)	20%
Water Bright Hedge Fund (Ireland)	15%
Mason Goodman Hedge Fund (uk)	15%
Mary Brown (wife of owner)	5 %
Paul Brown (son of owner)	5 %
Anna Brown (daughter of owner)	5 %

Paul advised Barry that, particularly after a floatation, he should consider changing the composition of his board of directors to ensure that membership of the board complies with good governance practices and codes. However, even with this advice, Barry has been very reluctant to invite new and additional people onto the board, notwithstanding advice from his auditors (over the past couple of years) to do so. Thus, the board of Waste Supreme Plc is currently structured as follows as per Table 2 on Page 3:

Table 2: Board of Waste Supreme Plc

Barry Brown, CEO	Founder of Company
Paul Brown, Financial Director	Has been with Waste Supreme since 1998. Paul is currently the Board Secretary
Anna Brown, HR Director	She has been with Waste Supreme since 2000
Mary Brown, wife of CEO	Non- executive Chairperson of the business since 1997
Eoin Murphy	Owner of a South Dublin Haulage Firm and a personal friend of Barry Brown. Non-executive member of the board since 2002.
Philip Downes	Former investment banker and non-executive member of the board since 2007. Philip is also a personal friend of Barry.
Eamonn Lloyd	Brother of Mary Brown and former fund manager. He has been a non-executive director since 2004.
Christine Malone	Nominee of Bloggs Assurance Plc – Pension Fund (Ireland). She has been a non-executive board member since 2008.

The board meets on average six times a year and the meetings last approximately two hours. Minutes of each meeting are always kept and any reports that are required are sent out in advance to each member of the board by Paul. Mary has been an effective chair of the board over the years and has ensured that all items on the agenda are dealt with at each meeting. Paul, who qualified as an accountant in 1996, is very aware of the need to ensure good governance practices for board members including the importance of all members of the board being familiar with their fiduciary and statutory roles and responsibilities. However, he is of the opinion that there is a fundamental weakness in this area as many members of the board are not familiar with their fiduciary and statutory roles and responsibilities. Paul knows that there have been changes in this area with the introduction of the 2014 Companies Act, but he isn't aware of the details of these changes.

Barry had a meeting with Paul, in early January 2018, and asked him to contact John and get some forecasts of the Profit and Loss accounts and Balance Sheets for Stack Waste Experts Plc. Paul tells Barry that the company do not produce Profit and Loss Accounts and Balance Sheets anymore; they now produce Statements of Profit or Loss and other Comprehensive Income and Statements of Financial Position.

John's financial accountant sends Paul the information he was seeking and this information is set out in the following tables:

- Table 3: Last two years of Statement of Profit or Loss and Other Comprehensive Income (For Stack Waste Experts Plc) for years ending 31 January;
- Table 4: Last two years of Statements of Financial Position (For Stack Waste Experts Plc) as at 31 January;
- Table 5: Projected Statements of Profit or Loss and Other Comprehensive Income (For Stack Waste Experts Plc) for four years up until 2022;
- Table 6: Four years' Projected Statements of Financial Position (For Stack Waste Experts Plc) as at year end 31 January.

Table 3: Stack Waste Experts Plc Statement of Profit or Loss and other Comprehensive Income for the Years Ending 31 January

	2017 **£'000**	**2018** **£'000**
Sales	90,500	110,500
Operating Expenses	75,300	93,300
Operating Income	15,200	17,200
Interest	225	225
Profit before Tax (PBT)	14,975	16,975
Taxation	1,872	2,122
Net Profit after Tax	13,103	14,853
Dividends	400	600
Retained Earnings	12,703	14,253

Table 4: Stack Waste Experts Plc Statement of Financial Position as at 31 January

	2017 £'000	2018 £'000
Fixed Assets	20,500	28,500
Net Current Assets	2,000	3,300
Operating Assets	22,500	31,800
Cash	450	200
Net Assets	22,950	32,000
Shareholder's Equity	16,950	26,000
Debt	6,000	6,000
Total Financing	22,950	32,000

Table 5: Projected Statements of Profit or Loss or Other Comprehensive Income for Stack Waste Experts Plc for the years ending 31 January

	2019 £'000	2020 £'000	2021 £'000	2022 £'000
Sales	113,263	116,095	118,997	121,972
Operating Expenses	95,633	98,024	100,475	102,987
Operating Income	17,730	18,071	18,522	18,985
Interest	195	218	201	185
PBT	17,535	17,853	18,321	18,800
Taxation	2,192	2,232	2,290	2,350
Net Profit After Tax	15,343	15,621	16,031	16,450
Dividends	600	600	600	600
Retained Earnings	14,743	15,021	15,431	15,850

Table 6: Projected Statements of Financial Position for Stack Waste Experts Plc as at 31 January

	2019 £'000	2020 £'000	2021 £'000	2022 £'000
Fixed Assets	40,643	53,254	66,925	81,315
Net Current Assets	5,050	8,000	9,200	10,100
Operating Assets	45,693	61,254	76,125	91,415
Cash	250	310	420	550
Net Assets	**45,943**	**61,564**	**76,545**	**91,965**
Shareholder's Equity	40,743	55,764	71,195	87,025
Debt	5,200	5,800	5,350	4,940
Total Financing	**45,943**	**61,564**	**76,545**	**91,965**

Paul is somewhat concerned about carrying out the analysis for Barry as he knows it will require a deep understanding of many strategic corporate finance issues, including estimating the appropriate cost of Stack's capital using Weighted Average Cost of Capital (WACC), Capital Asset Pricing Model (CAPM), Free Cash Flow (FCF) and determining the enterprise value of Stack's business using Discounted Cash Flow (DCF) analysis. An independent financial consultant has ascertained the following information in relation to Stack's business:

- The risk-free rate of interest is 0.175 of one per cent.
- The interest rate on Stack's debt is expected to remain constant for the four-year period at 3.75%.
- Stack is paying corporation tax at 12.5% per annum, and this is expected to continue for the next four years.
- The market risk premium is 5.75%.
- The beta of Stack Waste Experts Plc is 0.95.

END OF CASE STUDY

SECTION A - Compulsory Question

1. As the recently appointed Financial Consultant, you have been asked by Paul Brown to prepare a brief report for him in which you:

REQUIREMENT:

(a) Critically evaluate John Stack's proposal that Barry Brown should acquire Stack Waste Experts Plc for £60 million sterling. Based on the projections given to you by Paul Brown, justify your answer and establish the valuation of Stack's enterprise using the following strategic corporate finance techniques: CAPM; WACC; FCF; DCF analysis.

(30 Marks)

(b) Critically appraise the key risks, associated with Brexit, facing Barry Brown's company if it acquires Stack Waste Experts Plc.

(20 Marks)

[Total: 50 Marks]

SECTION B – Answer only 2 questions

2.

REQUIREMENT:

(a) Advise Barry on the key advantages and disadvantages associated with acquiring John Stack's business.

(15 marks)

(b) Barry has heard that there is a concept in corporate finance called 'agency theory' and that if he acquires Stack Waste Experts Plc he would require an understanding of the latter. Analyse the issues of agency theory in relation to the potential acquisition.

(10 Marks)

[Total: 25 Marks]

3.

REQUIREMENT:

(a) Appraise the primary currency risks facing Waste Supreme Plc if the company acquires Stack Waste Experts Plc.

(12 Marks)

(b) Critically analyse how Waste Supreme Plc can effectively manage the currency risks. (13 Marks)

[Total: 25 Marks]

4.

REQUIREMENT:

(a) Paul Brown, as company secretary of Waste Supreme Plc, is concerned that the board members of the company are unaware of their key fiduciary and statutory responsibilities.

Advise Paul regarding the fiduciary and statutory roles and responsibilities for his board members as required by the Combined Code on Corporate Governance and the Companies Act 2014.

(10 Marks)

(b) In relation to the membership of the board of Waste Supreme Plc, critically evaluate the corporate governance arrangements in place in the company and propose appropriate actions to improve same.

(15 Marks)

[Total: 25 Marks]

END OF PAPER

STRATEGIC CORPORATE FINANCE

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SOLUTION 1

Briefing Report
To : Paul Brown, Financial Controller, Waste Supreme Plc
From: Financial Consultant
Re: Financial Evaluation of the acquisition of Stack Waste Experts Plc
Date: xx 02 2018

Having examined all the financial data you have provided, I would caution you and Barry regarding the proposed acquisition of Stack Waste Experts Plc. Having applied the financial techniques as requested I have established that Stack Waste Experts Plc is currently valued at £53.9 million. See appendix 1 for all my calculations. Whilst Stack's projections look healthy in terms of growth of revenue and net assets, his estimated valuation of £60 million is £6.1 million less than what the business is worth using DCF analysis. In other words, Barry would be making an 11% loss on his investment. The actual loss on the investment could actually be much greater if there was sensitivities built into the figures as a consequence of the negative costs of Brexit and the potential impacts it could have on Sterling.

(Solution to Part B of question 1.)
My caution to you and Barry is not just based on the financial data it is also based on the potential costs Brexit will have on Barry if he acquires Stack's business. Firstly, there is no doubt that exports in the UK will take a big hit if the UK leaves the EU without negotiating a new trade agreement with the EU. If the UK negotiates a favourable trade agreement with the EU there will still be some tariffs imposed on UK companies in relation to exports. The most likely scenario is that Barry's new business costs will increase because primarily of increased tariffs. As John's business currently exports around 15% of its business in terms of recyclable products to the EU and to China this is turn could make Barry's new acquisition less competitive in relation to exporting to the EU markets and indeed in the global markets. If Barry did acquire Stack's business he could counter the latter by lowering his prices in relation to potential tariffs in exporting his recyclable products to Europe and aboard. However decreasing his prices would in turn most likely result in a decrease in profits.

There is also a possibility that if there are higher trade costs or indeed higher tariffs that it could have a negative impact on future investors investing in Barry's new company. This would certainly be the case if Barry wanted to raise extra share capital from potential investors from Europe or abroad in the future.

However, the scenario is not all doom and gloom. Although detailed current figures are not available, it is reasonable to assume that a significant portion of Stack's cost base can be attributed to complying with EU directives and regulations. That could mean that Stack Waste Experts Plc would no longer have to pay substantial money on implementing EU law and it could instead invest this money on growing the business.

Appendix 1

Answer to Part A of Question 1:
Step 1: Establish the cost of equity by using the CAPM formula:

CAPM formula

$$E(R_i) = R_f + \beta_i[E(R_M) - R_f]$$

$E(R_i)$ = expected return on an asset i
R_f = risk-free rate
β_i = beta of asset I; a measure of systematic risk
$E(R_M)$ = expected return on the market portfolio that contains all assets
$E(R_M) - R_f$
= Market risk premium, a measure of the excess return of the market portfolio over the risk-free rate

R f = .175
R m - R f = 5.75
Beta =.95
Cost of Equity = .175 + .95 (5.75) = 5.638

Step 2: Establish the cost of debt

Market Value of Equity = 50
Value of Debt = 6
Value of Company = 56
E/V = 50/56 = .892857
D/V = 6/56 = .107143
Cost of Debt = .0375

Step 3: Establish the cost of Capital using WACC

$$\mathrm{WACC} = \frac{\mathrm{Debt}}{\mathrm{Assets}}\left(1 - \mathrm{Tax}_{\mathrm{Corporate}}\right)R_{\mathrm{Debt}} + \frac{\mathrm{Equity}}{\mathrm{Assets}}\left(R_{\mathrm{Equity}}\right)$$

$\frac{\mathrm{Debt}}{\mathrm{Assets}}$ Market value of debt over market value of assets

$\frac{\mathrm{Equity}}{\mathrm{Assets}}$ Market value of equity over market value of assets

R_{Debt} Cost of debt

$\mathrm{Tax}_{\mathrm{Corporate}}$ Corporate tax rate

$\left(1 - \mathrm{Tax}_{\mathrm{Corporate}}\right)R_{\mathrm{Debt}}$ After tax cost of debt

R_{Equity} Cost of equity

WACC = (.107143 (1-.125).0375) + (.892857(5.638)) = 5.0667402%

Thus rounded off the cost of capital is 5%.

Step 4: Establish the Free Cash Flow (FCF) from projected financial statements:

	2019	**2020**	**2021**	**2022**
	€'000	**€'000**	**€'000**	**€'000**
Dividends	600	600	600	600
Increase (reduction) in cash	50	60	110	130
Reduction (Increase in Debt)	800	(600)	450	410
Interest on Debt	195	218	201	185
	1,645	278	1,361	1,345

Confirm FCF using (OI - ∆NOA) method.

	2019	**2020**	**2021**	**2022**
	€'000	**€'000**	**€'000**	**€'000**
Operating Income after Tax (OI)	15,538	15,839	16,232	16,635
∆NOA	13,893	15,561	14,871	15,290
FCF (OI - ∆NOA)	1,645	278	1,361	1,345

Step 5: Establish the Enterprise Value

	2019	**2020**	**2021**	**2022**
	€'000	**€'000**	**€'000**	**€'000**
FCF	1,645	278	1,361	1,345
Discount Factor	1.050	1.103	1.158	1.216
DFCF	1,567	252	1,175	1.106
Terminal Value				55,160
PVDFCF	4,100			
PVTV	49,873			
Enterprise Value	53,973			

Terminal Value $= \frac{FCF\ n \times (1+g)}{WACC - g} = \frac{1{,}345 \times (1+.025)}{.05 - .025} = 55{,}160$

SOLUTION 2

(a) The advantages or disadvantages associated with any potential acquisition are dependent on many factors including the acquired company's short-term and long-term strategies and efforts. Also factors such as the market environment, variations in business culture, acquisition costs and changes to financial power surrounding the business acquired are key issues to be taken on board.

The following are some of the key advantages with the potential acquisition:

- Barry would be able to enter new markets (i.e the UK waste market and the EU market for waste recycable products) that he wouldn't otherwise be in and which, in turn, could yield more profits for his waste management enterprises and increase his overall position in the EU waste management sector.

- Barry could bring his expertise of running a larger waste enterprise to the table which in turn should allow for increased value efficiencies of the new entity in the shape of greater profit returns and cost savings.

- If Barry acquires Stack Waste Experts Plc and decides to share his resources and services between the two entities there is huge potential for economies of scale to take place. This in turn could lead to further cost reduction and competitive advantage. Depending on the number of players, in the UK waste market, greater economies of scale between Waste Supreme Plc and Stack Waste Experts Plc could have the possibility of increasing Barry's share of the UK waste market sector.

- Another potential advantage of acquiring John's company is that Barry can utilise Waste Supreme Plc's financial management expertise which in turn could further increase the competitiveness of the new acquisition and ultimately increase market share.

- There is also the possibility of a financial advantage for Barry by acquiring a UK corporation in relation to the potential use of use of tax- shields and tax benefits.

The following are some of the key disadvantages associated with the potential acquisition.

- If Barry acquires Stack Waste Experts Plc and decides to let some of the key personnel from the company go, or indeed some key personnel from the company leave as a consequence of the acquisition, the potential loss (i.e people leaving the business who would have detailed knowledge of the UK and EU waste markets) could have a devastating impact on the new proposition.

- Increased costs might result if there is a delay in employing the key personnel for the new venture.

- If Barry decides to bring staff from his Irish waste management business into the new workforce he could face frictions and internal competition that may also push up costs.

(b) Agency theory examines the conflicts of interests between people with different interests in the same company. Key examples of this include the conflicts between the shareholders and managers of companies and/or shareholders and bond holders. The theory explains the relationship between principals, such as shareholders, and agents, such as a company's managers. In this relationship the theory attempts to deal with two specific problems: how to align the goals of the principal so that they are not in conflict (agency problem), and that the principal and agent reconcile tolerances of risk. Thus in relation to the potential acquisition of Stack waste Experts Plc agency theory could apply between Barry (and his management team) and the shareholders depending if there is more share capital to fund the new venture than debt capital. It will also depend on what percentage of the share capital Barry has. If Barry is not the majority shareholder in the new venture then he could be the agent in this case and thus there could be agency costs involved in the new venture.

Agency costs are defined as those costs borne by shareholders to encourage CEOs and senior managers to maximize shareholder wealth rather than behave in their own self-interests. There are three major types of agency costs: (1) expenditures to monitor managerial activities, such as audit costs; (2) expenditures to structure the organisation in a way that will limit undesirable managerial behaviour, such as appointing outside members to the board of directors or restructuring the company's business units and management hierarchy; and (3) opportunity costs which are incurred when shareholder-imposed restrictions, such as requirements for shareholder votes on specific issues, limit the ability of managers to take actions that advance shareholder wealth. If Barry is not the majority shareholder in the new entity it is quite possible that the above type of costs would exist which in turn could have a negative profit impact for Barry going forward. If the acquisition goes ahead and Barry perceives a potential conflict between the principals (i.e the shareholders) and the agent (i.e himself) he may try to alleviate the problem in relation to constructive dialogue surrounding dividends being paid out, dividends be retained for future capital investment purposes to grow the business etc.

SOLUTION 3

(a) One of the primary currency risks facing Barry's company if he decides to buy Stack Waste Experts Plc is the assurance given to him that there has been a proper analysis carried out of the quantification of the business's exposure to any potential changes in the currency (sterling) as a consequence of Brexit. The quantification of the exposure is not only important for the UK waste market (which Stack Waste Experts business is primarily concerned with) but also for the global market, particularly in relation to selling the recyclable products.

Quantifying the exposure would involve John Stack critically examining all of his costs and revenues in order to establish the extent to which an exposure to a change in the currency could have.

As Stack Waste Experts buy a significant amount of their supplies from EU countries, and are invoiced in euros, if sterling weakens against the euro (as a consequence of Brexit) it will simply mean that each pound will buy less and less euros and the company will end up paying more in sterling terms for the supply of that material.

When the company is exporting its recyclable products to Europe and China, that in relation to the finished goods that are exported, the company will receive Euros or Yuan Renminbi in return. It could be argued that the business would have an natural offset or "hedge" against deterioration in the Sterling – v - Euro exchange rate (or in the Sterling – v – Renminbi), as the company's UK costs can be matched against the Euro or Renminbi receipts. It could also be argued that if Stack currently receives payment for his UK sales in Euros or Renminbi, and is paying for production inputs in Sterling, then he is running the risk that a change in the exchange rate could substantially reduce, or indeed, wipe out his potentials profit from the sales.

(b) There is no legal or accounting requirement for Stack to protect his business against currency risk and it is extremely difficult to assess the impact Brexit will have on his business. However, it would be prudent of Stack, and indeed if Barry acquires his business, to use some of the following common sense financial management tools in order to manage any potential currency risk:

Dual invoices
As Stack is currently buying a significant amount of materials outside of the UK and also exporting 15% of his business outside the UK, seeking two prices for anything he purchases from abroad – one in sterling and one in the supplier's domestic currency and paying the cheaper , is a clever way of managing the currency risk. By getting two prices Stack can clearly see the change in the cost based on exchange rate differences and subsequently choose the cheaper and use that method of payment.

There may be times when it would be more favourable for a business to pay in sterling (usually for once-off small amounts), but by using dual invoicing, it will be clear to the business which payment method is cheaper and you can then make a more informed decision.

Overall dual invoicing has the benefit of reducing currency conversion costs, and potentially offering potential savings. Dual invoicing can also offer Stack more information to choose the best payment option and thereby strengthen his buying power when dealing with suppliers.

Forward contracts
A forward contract, is a financial hedging instrument where there is an agreement with the bank to exchange a specified amount of foreign currency at a specified date in the future, with the exchange rate fixed at the time the contract is entered into. As there is an extremely strong likelihood that sterling will weaken as a consequence of Brexit a forward contracting arrangement would be the most logical methodology for Stack (and indeed if Barry acquires his business) to use in managing the currency risk. It would have the benefit to allow Stack to know his cashflow , which in turn would make his budgeting and forecasting much easier. Not only would a forward contract eliminate the foreign exchange risk it would also provide Stack with the opportunity of availing of attractive foreign exchange rates prevailing in the market for delivery at a date in the future. However one of the disadvantages of forward contracts is that if Stack organised a forward contract he would be locked in with the contract once it has been arranged it, regardless of whether the circumstances change and because the rate is fixed, the business can't benefit from any favourable movement in the exchange rate. Thus if sterling strengthened as a consequence of Brexit Stack could potentially loose out and loose profits (however the latter is very unlikely).

Foreign currency accounts
As Stack currently imports a significant amount of his waste management materials in Europe it may be worth his while considering foreign currency accounts. For example, if Stack knows that he needs want to buy EURO €10,000 worth of a certain type of waste materials (say from Germany) then it might be worth Stack's time entering into a one-month forward contract that 'locks in' the exchange rate at which he will transfer the EUR10,000 from the UK. If after 30 days sterling has weakened against the euro, it will have no bearing on the

currency transfer, as the rate at which he is exchanging the EURO €10,000 from the UK has been previously agreed one. Stack would have effectively mitigated the risk of adverse currency fluctuations. Thus a currency account is an account where the receipts and payments are in the same currency. Therefore the benefits to Stack in having foreign currency accounts is that it would offer him the ability to "net off" foreign currency payables and receivables and pay his suppliers from the money that he has received for sales in that currency. This would be particularly beneficial for Stack's recyclable products. However, if this is not managed correctly Stack could be exposed to foreign currency translation risk. This could mean for example that potentially at the end of the year for Stack the foreign currency (e.g Euros and/or Renminbi) in his account may be worth a lot less than it was worth during the year, depending on exchange rate movements.

SOLUTION 4

(a) The most recent codes of governance in both Ireland (for both the private and public sectors) and the UK require board members to be aware of the following fiduciary responsibilities which are now set out in the 2014 Companies Act:

Fiduciary Responsibilities
- Directors must act in good faith in what they consider to be the best interest of the company;
- Directors must act honestly and responsibly when conducting the affairs of the company;
- Directors must act in accordance with the company's constitution and exercise their powers only for the purposes allowed by law;
- Directors must not use the company's property information or opportunities for their own or anyone else's benefit unless expressly permitted by the company's constitution or approved by a resolution in a general meeting;
- Directors must not restrict a director's power to exercise independent judgement unless expressly permitted by the company's constitution or approved by a resolution in a general meeting;
- Directors must avoid any conflict between the director's duties to the company and their others, including their personal interests;
- Directors must exercise the care, skills and diligence which would be exercised in the same circumstances by a reasonable person having the knowledge and experience of a director;
- Directors must have regard to the interests of both employees and members.

Statutory Duties
There are also a range of statutory duties (as set out in the 2014 Companies Act) that people who are appointed directors, are expected to be aware of. In essence, it is the duty of each director of a company to ensure that the Companies Act is complied with by the company. An officer is in default if he or she is in breach of their duty as an officer of a company or authorises or permits a default to take place. The duties are as follows:

- Duty to keep adequate accounting records;
- Duty to prepare annual financial statements;
- Duty to have financial statements audited;
- Duty to maintain certain registers and documents;
- Duty to file certain documents with the registrar of companies;
- Duty of disclosure of certain personal information;
- Duty to convene general meetings of the company;

In essence the main implications of the above requires that the individual board member of Waste Supreme Plc appreciate the very significant duties and responsibilities and their compliance role. It is important for Paul Brown to inform each of the board directors that they can be personably liable in certain circumstances if these duties are breached.

One of the striking implications of the responsibilities and roles is the fact that no matter what or where the Director's other responsibilities and interests are, while acting as a Board member, they must act in the best interest of the company at all times. It is the most important fiduciary duty of a Director: the duty of loyalty. Directors, if they are also shareholders (of which there are five in Waste Supreme Plc; Barry, Paul, Anna, Mary and Christine), need to be aware that they are wearing two different 'hats'. Shareholders are allowed to act and vote in their own self-interest. Directors, by contrast, must always consider their duties and act in the best interest of the business. It is important not to confuse the two roles – blurring the lines between them is a common problem in companies where the directors and shareholders are one and the same. Another core duty of directors is the duty of care and diligence. The implication is that Directors must pay attention and try to make good decisions. Directors must also have all the necessary skills to carry out their duties. Directors must also have an understanding and knowledge of the organisation's stakeholders or particular business sectors. A Director should also bring specific personal skills and attributes to complement the current Board .

(b) It would appear, that in relation to the board membership of Waste Supreme Plc there is a very weak governance arrangement in place particularly as 4 out of the 8 members of the board are from the same family. According the 2016 UK code of Corporate Governance "A conflict of interest exists in any situation where the personal or other interest of a director or a connected party might in any way affect the discharge by a director of his/her duties or his/her deliberations in a situation where a director or a connected party could benefit. It makes no difference that the Company does not suffer by the conflict of interest. A director or his/her relatives, friends or associates must not under any circumstances obtain any such benefit."

Thus there could be a situation, at board level, where Barry could influence Mary (the chair of the board) and indeed Paul (the board secretary) in relation to a major decision relating to the company (which could be a bad decision for the company) where a decision could be pushed through by the board to favour Barry and indeed put the company in jeopardy. For example, it would appear from the analysis carried out by the financial consultant that it would be unwise for Barry to push head with the acquisition. If Barry ignored all the advice and ignored all the potential business and currency risks associated with the new potential acquisition (but wanted to go ahead because of personal and selfish reasons) it would be a classical example of very bad corporate governance.

In relation to evaluating the corporate governance arrangements in the company the following issues need to be taken into account. According to the above mentioned code there are six guiding core principles (and supporting principles) to effective corporate governance. They are as follows:

CORE PRINCIPLE 1

Good governance means focusing on the purpose of the company, on outcomes and on implementing a vision for the company.

SUPPORTING PRINCIPLES

- Exercising strategic leadership by developing and clearly communicating the company's purpose and vision through the corporate plan and ensuring that service users receive a high-quality service.
- Ensuring that the company, through its business plan priorities, makes best use of resources to ensure achievement of outcomes is optimised.

There is not enough information in the case study to evaluate this principle and supporting principles but if the company is moving towards good governance practice adherence to the above is essential.

CORE PRINCIPLE 2

Good governance means that the board of the company and the senior management team have a common purpose within a framework of clearly defined functions and roles.

SUPPORTING PRINCIPLES

- Exercising effective leadership throughout the company, being clear about the respective roles and responsibilities of members of the board and the senior management.
- Creating a constructive and respectful working relationship between members and senior management and ensuring that the functions of the company are performed to a high standard.

It would appear from the case study that this principle (and supporting principles) is not being adhered to as four members of the same family and a brother in-law are members of a board of eight and it would be very difficult to ensure working and respectful working relationships without some sort of family interference particularly from Barry Brown. One way to address this perhaps would be to form a new board with no conflicts of interest and also with more members and the prerequisite skill base.

CORE PRINCIPLE 3

Good governance means promoting and demonstrating ethical values through upholding high standards of conduct and behaviour.

SUPPORTING PRINCIPLES

- Ensuring board members and senior management, in exercising leadership, behave in ways that exemplify high standards of conduct, ethical behaviour and effective governance.

- Fostering a culture and ensuring mechanisms that encourage and enforce adherence to ethical values and to the organisational values as espoused in the corporate plan.

There is no evidence in the case study that there is a lack of ethical values or misconduct or fraudulent behaviour occurring.

CORE PRINCIPLE 4

Good governance means taking well informed and transparent decisions and managing risks and performance.

SUPPORTING PRINCIPLES

- Being rigorous and transparent about the decision-making process and having good-quality information, advice and support available to decision makers.
- Ensuring that effective risk, financial and performance management systems are in place which address uncertainties and exposures, enforce financial discipline, and emphasise strategic resource allocation and

the efficient and effective delivery of services.

It would appear that this principle is being adhered to as Barry Brown has carried out a lot of analysis about the risk associated with the potential acquisition and he has been transparent and analysed any uncertainties and exposures.

CORE PRINCIPLE 5

Good governance means developing the organisational capacity and the leadership capability and competencies of board members and senior management to operate effectively and fulfil the purpose of the company.

SUPPORTING PRINCIPLES

- Ensuring that board members and senior management have the supports and appropriate structures they need to perform effectively in their roles.
- Developing the capability of those with governance and leadership responsibilities to ensure outcomes achieved are consistent with good governance obligations.

It would also appear that the company is attempting to adhere to this principle as Paul Brown is attempting to ensure that all the board members are of their fiduciary and statutory responsibilities.

CORE PRINCIPLE 6

Good governance means engaging openly and comprehensively with all of the company's stakeholders.

SUPPORTING PRINCIPLES

- Providing clarity in relation to accountability relationships and organisational assurance, audit and scrutiny functions.
- Ensuring there is a process and mechanisms that deliver clear communication, effective stewardship and accountability to stakeholders.

There is not enough information in the case study in relation to this principle and supporting principles but if the company is striving for good corporate governance it is crucial that the above is achieved.

End of Paper