



Institute of Certified Management Accountants of Sri Lanka

Level 5 – November 2015 Examination

Examination Date : 22nd November 2015 Number of Pages : 11
 Examination Time: 1.30 p:m. – 4.30 p:m. Number of Questions: 07

Instructions to candidates:

1. Time allowed is **three (3) hours**.
2. Attached to the question are **Scenario I** given in advance and **Scenario II**
3. The answers should be given in **English language**.

<u>Subject</u>	<u>Subject Code</u>
Integrative Case Study	(ICS – 501)

Question (100 Marks) - Colombo Port City Project (CPCP) and its Implications

You are required to:

1. **Briefly discuss** merits and demerits of CCCC to undertake this project. **(04 Marks)**
2. **Discuss** possible strategies that, CCCC could adopt to generate revenue in future if the project would continue as planned. **(06 Marks)**
3. **Prepare a Consultant** report assuming that you have been appointed as a consultant to critically analyze the current situation and advise the new government as to how it could deal with prevailing alternatives for CPCP and the implications of Megapolis city development project proposed with a view to develop the economy while minimizing the negative consequences. **(20 Marks)**
4. **Critically analyze** socio and economic implications of the project if the government decides to stop it due to the pressures arising from several corners. **(10 Marks)**
5. **Suggest** strategies that could be implemented to mitigate the environmental impacts highlighted in the case including the impact of waste materials and possible heat increase after the real city would be constructed and business operations are carried out. **(10 Marks)**
6. **Discuss** the benefits that the government of Sri Lanka can gain from the reclaimed land of 125 hectares if the project would be completed **(10 Marks)**
7. **Explain** socio economic and political consequences if the land areas as planned is given to CCCC after the completion of the project. **(15 Marks)**
8. **Discuss** two possible financing strategies that CCCC could propose to finance the required amount of USD 15bn by highlighting the cost and benefits of each strategy. **(10 Marks)**

9. **Compute** the perpetual annual net cash inflow required for CCCC to breakeven if the project will be completed after 15 years from now and the intended investment of US\$ 15 billion will be spent as follows.
- (a) US\$ 2 billion at present
 - (b) US\$ 5 billion after 2 years from now
 - (c) US\$ 3 billion after 5 years from now
 - (d) US\$ 5 billion after 12 years from now

(10 Marks)

10. **Explain** the ways in which Sri Lanka Port Authority could be benefited from this project.

(05 Marks)

(Total 100 Marks)

(Assume the exchange rates of one Chinese Yuan (RMB) is equivalent to Rs. 22 for any calculation needed)

Colombo Port City Project (CPCP) and its Implications

Scenario I

Introduction

Sri Lanka has been experiencing many socio economic and political changes over time but yet to discover the real path of economic development. After the civil war that waged for about 3 decades and ended in 2009, it literally created a peaceful environment in the country and an opportunity for national reconciliation and economic development.

At the economic development front, Sri Lanka chose to promote tourism industry as the main strategic priority of development with the main objective of making Sri Lanka, a competitive and preferred maritime and logistic hub in the Asian region. Government took initiatives of constructing roads, highways, bridges, ports and other required infrastructure facilities with an intention of boosting investment mainly in the tourism sector on the belief that these strategies would create forward-looking conducive investment climate for the private sector to play a vital role of value creating in the economic development.

The Colombo Port City Project (CPCP) is the ever largest single development project in the country that the government contracted with a Chinese public company, “China Communications Construction Company” (CCCC) and it began the construction work following the signing of an agreement with the Government of Sri Lanka on 16th September 2014. The estimated investment of the CPCP is US\$ 15 billion.

However, the history of this project dates back to even 1990s. In 1998, a draft proposal had been submitted to the government by a Singaporean Company called CESMA despite the fact that it was not given a serious consideration. Subsequently, in 2004, the UNP government which was in power unveiled a plan of constructing a leisure center with a harbour front in Colombo in the name of Western Megapolis plan but the proposal went in vain. The birth of CPCP really took place with a new identity in 2011, when initial discussions took place between CCCC and the government of Sri Lanka. This bid was then reviewed by a Standing Cabinet Appointed Review Committee (SCARC). The rest of the time line of the project can be highlighted as follows.

- A detailed proposal submitted to Sri Lanka Freedom Party in 2012.
- Environmental Impact Assessment (EIA) was done by Moratuwa University, it was not made available to public.
- Cabinet Appointed Review Committee approved the project and the contract was signed between parties in 2014.
- Contraction works began in September 2014.

An area of 233 hectares of land will be reclaimed under this project. The reclamation process called rainbow dredging excavates sand from the sea and dumps it directly onto the seabed. Media highlighted that, after the completion of the construction of CPCP, the Government of Sri Lanka, will be entitled to get 125 hectares of reclaimed land on freehold basis whereas, CCCC will have 108 hectares. Out of 108 hectares of land, 20 hectares will be owned by CCCC on a freehold basis and the balance 88 hectares will be used by CCCC on a 99-year lease under the condition that the ownership will be transferred back to the Government of Sri Lanka at the end of 99 years. Since the reclaimed land is going to be owned by two countries, some doubts may arise as to under what laws and regulations it would be administered. Comments of one of the officials of CCCC had been cited in news as follows.

“We are not only spending 15 billion dollars for land, but also giving more than half of it to your government to keep for free. We are not even buying land, we are making land. We own part of this land. We will sell it to investors to come build here, and we will make a profit. Do you think if we were not doing this under the laws of your country, we would suspend this project? No, we would not. We are not doing this because we are charitable people, or because we want to occupy part of the country. No company is going to spend 15 billion dollars for nothing. We come for business and profit. Some people were arguing that there were tax breaks. Of course. To make this project commercially viable there must be some incentive. If you don't do the project, nobody generates profit, nobody makes anything. If you do the project, people set up businesses here, businesses make profit and that means more tax money”.

The development of the port city will really happen after the successful land reclamation process. It would take another 15 years as per experts' opinions and judgments. Accordingly, CPCP will be developed with roads, water, electricity, communication facilities to help facilitate shopping areas, water sports area, mini golf course, hotels, apartments, recreation areas, marinas and other related businesses in a modern city with the state of art of technology. Apart from other benefits of the project, CPCP employs approximately 1,000 direct employees and about 4,000 indirect employees. Most of these employees are Sri Lankans.

Many partnering organizations involve in the project by providing their specific expertise to CPCP. internationally reputed firms such as AECOM (America's premier fully integrated infrastructure and support services firm), ATKINS (globally recognized UK based design engineering and project management consultancy), SWECO (Nordic region's leading consulting engineering company in sustainable engineering and design), JLL (US and India's professional services and investment management company specializing in real estate services), Pinsent Masons (UK) and PWC (US) have been identified as major partners to the project in addition to Sri Lanka ports Authority which oversees and coordinates the entire project work. Sri Lanka Ports Authority has already invested over US\$ 3 billion on other port development projects including Colombo Port Expansion Project, Magam Ruhunupura Mahinda Rajapaksa Port in Hambantota, Galle Port Development, Oluvil Port Project, Trincomalee and KKS Port Development Project.

Similar projects of this nature where land has been reclaimed from sea can be seen in the Hong Kong airport development project, Singapore Changi airport and property development initiative, and the Palm City project in Dubai. The Dubai Palm City project, which carried high financial risks nearly, went in to recession but later on is back in business. Singaporean reclaimed land city is an ongoing project that comprises many investment projects including Changi International Airport and Sentosa Island as well. In addition to the protest being developed within the country, India has also opposed to this decision of giving the freehold ownership of 20 hectares of land to a Chinese state-owned company, next to Colombo port which primarily serves India for trans-shipment.

Profile of the Main Contractor

China Communications Construction Company (CCCC) was established in 2006, with a total capital of 10,800 million shares fully owned by China Communications Construction Group (CCCCG) under the approval of the State Council. CCCC was listed on the Hong Kong Stock Exchange in the same year and it became the first super-large state-owned infrastructure construction company entering to the overseas capital market. Subsequently, the company launched its IPO in china and was listed on Shanghai Stock Exchange in 2012. CCCC now holds about 64% of the total share capital of CCCC.

At present, CCCC is the largest port construction, city development and Design Company in China and has more than 30 subsidiaries. One of the subsidiaries, China Harbour Engineering Co. Limited (CHEC) which has business experience in marine construction and development and in Sri Lanka, has undertaken the works of land reclamation and infrastructure works of CPCP.

In addition, it engages in business operations as a substantial real estate developer and an urban complex operator. CCCC has been carrying out its operations over 100 countries and regions in Asia, Africa, Middle East and South America. It has been maintaining its position since 1992 being a large constructor among top 225 international contractors in the 'Engineering News Records' (ENR) list with the latest reports ranking it at 10th position. In terms of revenue from overseas projects, CCCC holds the first position among the Chinese enterprises in ENR. Further, it proudly claims that it constructed 5 out of 10 of the world's largest container terminals and cross-sea bridges.

Before, winning the contract for CPCP, CCCC had been the principal contractor in Sri Lanka since 1998 for some other big constructions. Southern Highway, Outer Circular Highway, Magampura Mahinda Rajapaksa Port, Mattala Rajapaksa International Airport and Colombo South Container Terminal are the major constructions where CCCC involved as the major contractor. Some financial information of CCCC is given in the following tables.

The Statements of Financial Position as at 31st December

	2014 (RMB Mn)	2013 (RMB Mn)
Non-Current Assets		
Property Plant and Equipment	52	50
Investment in Subsidiaries	100,977	91,875
Investments in Associates	2,094	2,094
Available for sale Financial Assets	13,903	7,957
Other Assets	4,390	1,558
	121,416	103,534
Current Assets		
Inventories	341	336
Other current Assets	51,157	36,488
Cash and cash equivalent	18,708	25,226
	70,206	62,050
Total Assets	191,622	165,584
Equity		
Share Capital	16,175	16,175
Share Premium	19,656	19,656
Financial Instruments classified as Equity	4,986	
Other reserves	46,409	35,230
Proposed final dividend	2,778	3,035
	90,004	74,096
Non-Current Liabilities	27,495	23,467
Current Liabilities	74,123	68,021
Total Equity and Liabilities	191,622	165,584

Borrowings included in the Liabilities

	2014 (RMB Mn)	2013 (RMB Mn)
Long Term Bank Borrowings at Interest	1,984	1,298
Corporate Bonds	19,846	19,834
Other Non-Current Borrowings	<u>129</u>	<u>138</u>
	21,959	21,270
Current Portion of Long term Borrowings	1,306	108
Short Term Bank Borrowings	10,557	10,601
Other Short term Borrowings	<u>13,373</u>	<u>9,671</u>
Total Borrowings	<u>47,195</u>	<u>41,650</u>

Age Analysis and the functional currencies of the borrowing

	2014 (RMB Mn)	2013 (RMB Mn)
<u>Age of Borrowings</u>		
6 Months or Less	14,995	16,103
6 – 12 Months	8,924	2,059
1 – 5 years	17,137	8,149
Over 5 years	<u>6,139</u>	<u>15,339</u>
	<u>47,195</u>	<u>41,650</u>

	2014 (RMB Mn)	2013 (RMB Mn)
<u>Currency</u>		
RMB	44,241	40,096
USD	2,885	1,368
EUR		55
JPY	<u>69</u>	<u>131</u>
	<u>47,195</u>	<u>41,650</u>

Borrowing facilities obtained by CCCC at the floating rates

	2014 (RMB Mn)	2013 (RMB Mn)
Expiring within 1year	37,100	37,100
Expiring after 1year	216,556	198,243

Financial performance of the company over last 5 years (RMB mn)

	2014	2013	2012	2011	2010
Revenue	366,042	331,798	295,321	294,281	272,734
Gross Profit	39,272	33,938	32,598	27,907	23,247
Operating Profit	23,785	19,575	19,189	16,218	13,753
Profit For the year	13,883	12,272	11,732	11,983	9,901
EPS (RMB)	0.86	0.78	0.77	0.79	0.67

Environmental Concerns

CPCP is mainly criticized for bad environmental consequences. The impact of adding to the land mass of the island, sand mining from the ocean, inundation of water to the peripheral areas and negative impact of biodiversity were highlighted by opposition political parties, NGOs and environmental pressure groups. Public were not made available of adequate information or do not have knowledge about environmental impact of CPCP. As a result, general sentiments which were influenced by different corners are spreading. Environmental Impact Assessment (EIA) done by the Moratuwa University and commissioned by the Ports Authority but was never made available to general public.

The Sunday Times in 2010 cited that the CEO of Lanka Hydraulic Institute (LHI) Limited has mentioned that it was unlikely to have major impact on the environment such as beach and land erosion without ruling out the fact that there would be a long term impact on marine resources. However, LHI or any other institute too had not carried out an in depth analysis. This situation created a huge uncertainty on the environmental impact.

Environmentalists argue that the creation of an artificial city on a reclaimed maritime land affects sea species including endangered ones and the water quality. Further, the possibility of having the earthquakes have also been discussed despite the fact that such treats have not yet been explained with adequate evidence. It has been estimated by the SLPA that 5 million cubic meters of granite will be used by CPCP and around 20 quarries would be fully consumed to supply this required amount of granite.

Excavation of large amount of sand from the sea is believed to cause sea erosion and destabilization of coastal area. Accordingly, the livelihood of fishermen especially those who engage in shallow sea fishing are most likely to be negatively affected.

On the other hand, no details or plans were seen to have been discussed with respect to the ways of dealing with waste materials when the project would establish a real city. Would they be simply dumped in to sea or what? How could be an assessment done, if it is unknown what would be done with these wastes? Further, no information was found with respect to any assessment on the additional heat that would be generated as a result of operations of new city.

A writer to the Colombo telegraph argued that most of the people who argue for the project are simply dismissing the warnings from scientist and environmentalists and it is more like that that the project has the potential of becoming one of Sri Lanka's biggest environmental nightmares.

Change in the Government

Immediately after the presidential election held on 8th January 2015, the new government decided to review the project on many charges. A cabinet subcommittee was appointed subsequently. New Prime Minister also charged that this project has led to a luxury real estate deal with China and it was signed without cabinet approval and had not followed proper procedures. In addition to corruption charges, the new government mentioned that it wanted to mainly scrutinize the feasibility study, environmental impact assessment (EIA), tax concessions given and land ownership issues as well.

On 6th March 2015, it was announced, that the project was suspended temporarily with immediate effect by issuing a statement with the signature of the Secretary to the Ministry of Ports, Shipping & Aviation. Subsequently, Chinese government expressed its displeasure over it and mentioned that the project was initiated in compliance with local laws and regulations and the charges on bribes and corruption are baseless. Further, CCCC mentioned that the sudden suspension of CPCP incurs a loss of US\$ 380,000 per day.

There were several arguments for and against this mega project even under the new government. After several months, the new government came out with different explanations and claimed that there is no evidence of giving bribes or significant corruption taken place and therefore, by considering the importance of economic development and national interest and mentioned that CPCP will continue as planned subject to close monitoring in a transparent manner. In support of the project, the government further claims that an Environment Impact Assessment (EIA) that the University of Moratuwa prepared has declared that the CPCP would not have a negative impact on marine life. However, rumours spread that the repost has very limited scope and it has mentioned only about the impact of a landfill on the sea front.

Some Allegations

There was a lot of criticism for most of the infrastructure projects carried out by the then government, mainly on the grounds of corruption, transparency and waste of public funds despite the fact that those allegations have not been proven before the law. Critics say the details of the deal of CPCP were not revealed to the public.

Colombo International Container Terminal that won a contract award to build a part of the CPCP was later accused of transferring US\$ 150,000 to the account of a Foundation initiated by an individual who has close relationship with high rank politicians. However, the main contractor, the Chinese company denied all the allegations and said that they did not pay any commission or bribes to politicians in this connection.

Among many charges and allegations level against CPCP, there were no much concrete evidence to prove that. However, the announcement that had been made by the World Bank in 2011 by imposing debarment of CCCC, and its subsidiaries to engage in any road and bridge projects financed by the World Bank Group until 12th January 2017 on charges that CCCC has engaged in fraudulent practices in connection with a Philippines National Roads Improvement and Management Project, created a some overcast about the ethical business conduct of CCCC in large projects.

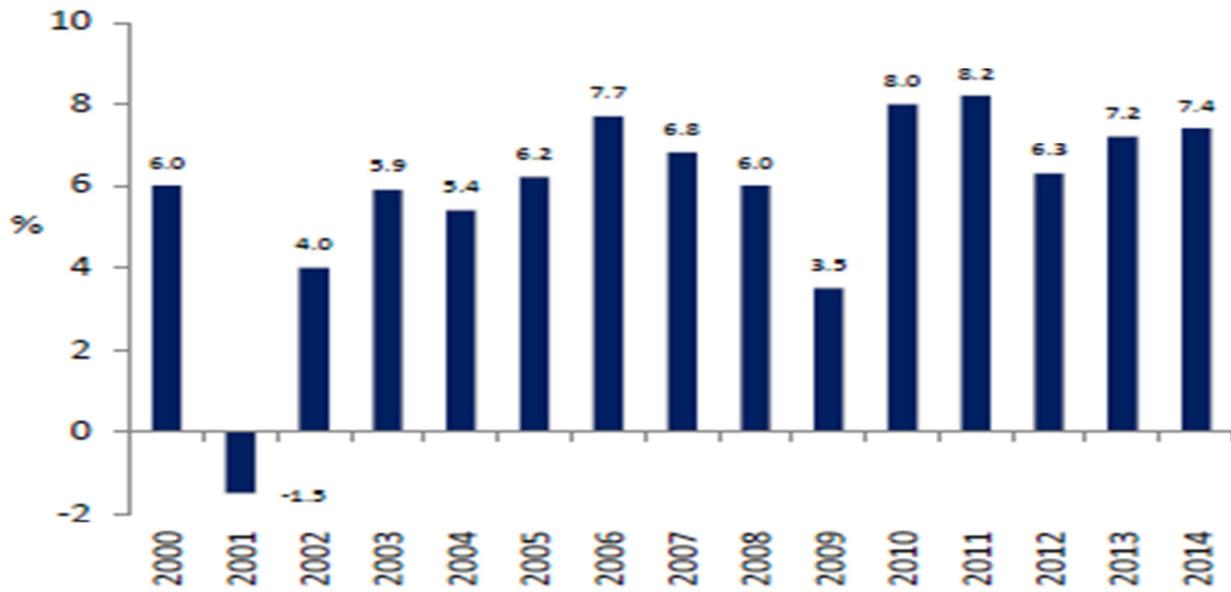
Figures 1 to 3 depict selected Economic Statistics

Figure 1: A summary of Economic Statistic with forecasts by World Bank

TABLE: Sri Lanka

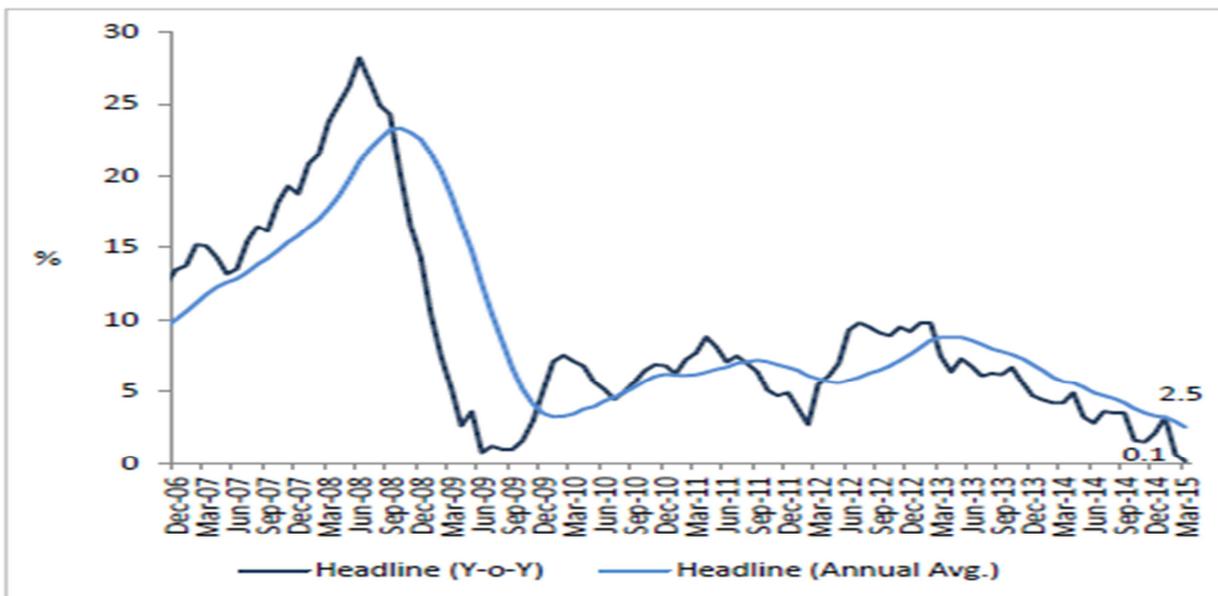
	2012	2013	2014	2015	2016 f	2017 f
Real GDP growth, at constant market prices	9.1	3.4	4.5	5.3	5.6	6.0
Private Consumption	9.3	0.6	4.5	5.3	5.6	6.0
Government Consumption	1.8	-1.5	9.8	13.0	-1.9	4.7
Gross Fixed Capital Investment	10.7	6.4	5.6	5.8	5.2	5.7
Exports, Goods and Services	2.6	2.8	2.7	3.7	4.7	3.4
Imports, Goods and Services	2.9	-3.2	7.2	8.7	0.5	3.2
Real GDP growth, at constant factor prices	9.1	3.4	4.5	5.3	5.6	6.0
Agriculture	3.9	3.2	-2.2	1.7	1.7	2.0
Industry	9.0	4.1	1.2	3.6	5.0	5.8
Services	11.2	3.8	6.5	6.0	6.4	6.6
Prices						
Inflation (GDP price deflator)	10.8	6.2	2.7	2.2	3.2	3.1
Inflation (Consumer Price Index)	7.5	6.9	3.3	0.9	3.0	2.9
Current Account Balance (% of GDP)	-5.8	-3.4	-2.6	-3.2	-2.2	-1.9
Fiscal Balance (% of GDP)	-5.6	-5.4	-5.7	-5.8	-6.2	-6.0
Sources: CBSL, DCS, World Bank staff forecasts				Source - World Bank		
Notes: e = estimate, f = forecast; 1/ In annual percentage change percent, unless otherwise noted						

Figure 2: GDP Growth over last 15 years



Source: Department of census and statistics

Figure 3: Inflation from 2006 to 2015



Source: Central Bank of Sri Lanka

End of Scenario I

Scenario II – A continuation of Scenario I

Despite the fact the green light has been shown by the new government on the continuation of the CPCP, it has not been formally informed through government agencies. Meantime, the new government has shown its interest of carrying out a Megapolis city development project. Accordingly, major cities in the western province have been identified in development plan. It was learnt from government sources that, the initiative of Megapolis development project would start by mid-2016. For example, Katunayake will be developed as an airplane city and Malabe will be developed as a technology city under the Western Province Development Programme.

CCCC has already structured its plans for financing the project. Accordingly, initial plans are underway to raise fund roughly 30% from equity and 70% from loans at an interest rates ranging 4% to 7% per annum. CCCC is confident that the project would be reviewed as the Sri Lankan government has been maintaining good relations with China through diplomatic practices and bilateral agreement signed even somewhere in the 1970's. However, CCCC has not ignored the uncertainties prevailing at present. It has raised lot of concerns such as the protection of the work already done on the site to date and the restrictions on taking adequate measures to safeguard this work, including the breakwater and landfill. Currently, the company is only performing quantity surveys at the site. This uncertainty further shatters future big investment plans of CCCC which have been already explored, such as promotion of fishing with high tech equipment and techniques by using the legal rights and provisions included in the contract agreement.

On the other hand lots of differences have developed within and outside of the government. Those who support the project mainly argue on the positive impacts on economic success without undertaking any debt burden as the entire investment comes from CCCC. The main argument of the parties those who argue against the project is that the project would have significant negative social, environmental and political impacts on the country. Amidst these uncertainties, one critique said that the new government has several options to deal with CPCP. They are given as follows.

- Continue with the project as planned and allow the current operations to proceed on the understanding that any corrective actions, where necessary, will be taken by CCCC to improve the final outcome of the project.
- Cancel the project and restore the Colombo water front disregarding the enormous direct and indirect costs and international litigations which are likely to be proceeded in future.
- Cancel the project and reconsider the possibilities of reviving the project with another investment which could mitigate the political differences in principle and address socio economic concerns raised.

End of Scenario II

**CMA INTEGRATIVE CASE STUDY – (ICS – 405)
November 2015 Examination – Marking Grid**

	Marks	A	B	C	D	E
1. Management Accounting Sound technical knowledge in Management Accounting	20	High level of Management Accounting awareness relating to world examples 17-20	Good Management Accounting awareness relating to case study examples 11-16	Some level of Management Accounting awareness relating to few case study examples 10-14	Low level Management Accounting awareness 5-9	Lack of Management Accounting awareness 0-4
2. Application of theories Diverse knowledge clearly applied in an analytical and practical manner in solving the problems in the case study.	20	High level of application of theory in an analytical manner in solving problems in the case study 17-20	Good level of application of theory in an analytical manner solving problems in the case study. 11-16	Some level of application of theory in an analytical manner solving problems in the case study. 10-14	Low level of application of theory in solving problems in the case study 5-9	Lack of application of theory in solving problems 0-4
3. Identifying key issues Issues to be identified and prioritized in a logical manner with a clear rationale.	10	High level of recognition of key issues and these being prioritized logically with a clear rationale. 8-10	Good level of recognition of issues and these being prioritized logically 5-7	Some level of recognition of issues and these being prioritized 3-4	Low level of recognition of issues 1-2	Lack of recognition of issues 0
4. Decision making skills Ability to recognize and present appropriate alternate solutions and make effective judgment in a logical & rational manner.	20	High level of ability to recognize and present appropriate alternate solutions and make effective judgment in a logical and rational manner 17-20	Good level of ability to recognize and present alternate solutions and make effective judgment in a logical and rational manner. 11-16	Some level of ability to recognize and present alternate solutions in a logical and rational manner 10-14	Low level of ability to recognize alternate solutions 5-9	Lack of ability to recognize alternate solutions 0-4
5. Logical arguments Ability to communicate effectively with realistic recommendations in a concise and logical manner.	20	High level of ability to communicate effectively with realistic recommendations in a concise and logical manner 17-20	Good level of ability to communicate effectively with realistic recommendations in a concise manner 11-16	Some level of ability to communicate effectively with realistic recommendations in a concise manner 10-14	Low level of ability to communicate effectively 5-9	Lack of ability to communicate effectively 0-4
6. Communication skills Style and synthesis in evaluation of a good report to higher management.	10	High level of combining ideas and experiences in a professional manner using relevant appendixes 8-10	Good style in writing a Management Report encompassing ideas and recommendations with some appendixes 5-7	Some style in writing a Management Report encompassing ideas and recommendations 3-4	Poor style in writing a Management Report 1-2	Lack of knowledge in writing a Management Report 0
TOTAL	100					

End of Question Paper