

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

FINANCE - PAPER 14

June 2000

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Attempt question one in **Section A**. It is compulsory and carries **40 marks**
3. Section **B** has **three** questions and only **two** questions are to be attempted. Each question carries **20 marks**.
4. Section **C** has **two** questions and only **one** question is to be attempted. Each question carries 20 marks.
5. Please read further instructions on the answer book.

SECTION A

Question 1

Mr. Theodore Katimbo is the chairman of a large industrial concern, Trading Venture Partners Limited. His nephew Peter Omaswa is the Managing Director (MD) of the Company. The shares of the Company are held by him (11%), his wife Maria (4%), his son James a minor (82%) and the MD 3%. The board of directors consists of seven members including himself, his son Peter and five other non-executive directors. Board meetings were not held regularly. While the day to day activities of the Company are managed by Peter, Theodore Katimbo is prone to assuming executive powers which include giving credit, authorising expenditure, debt collection, hiring and firing. These powers were sometimes exercised autocratically. Management consists of a Financial Controller (formerly a clerk with a manufacturing concern), a newly recruited Credit Control Manager, an Internal Auditor an Administration and Personnel Manager, and a Corporation Secretary. The Company had 21 staff members. The equity of the Company consists of actual cash contributions of Shs.200 million, capitalised retained earnings of Shs.181 million and capitalised asset revaluations Shs.125 million.

The venture portfolio of the Company was by December 31, 1999 valued at over Shs. 12bn/= of which 57% was considered insider lending. The company had provided venture capital to 3 sister companies as follows

	Amount (m)
a) Credit Transactions Limited	95
b) Media Limited	417
c) International Printers Limited	<u>182</u>
TOTAL	<u>684</u>

out of the total venture portfolio.

Many of the ventures were not properly documented or secured and were performing poorly. While interest was charged on the loans and credited to the Profit and Loss Account, in many instances it was not collected.

Turn Over

The Company had several small creditors and a few large institutional lenders and largely depended on big institutional depositors. The latter group held a claim of about 76% on all trade creditors of the institution. The Company was running a huge overdraft with their bankers which attracted interest rate of 26% p.a. The information system (IS) of the company was computerized but applications were not interactive and the IS was not networked. It was thus very difficult to reconcile large accounts especially in the case of foreign transactions.

The balance sheet and profit of the Company was as follows as at December 31, 1999.

Balance Sheet as at December 31, 1999

Non Current Assets	
Fixed Assets	3,719
Other Assets	<u>10</u>
	3,709
Current Assets	
Cash	254
Stocks	394
Prepayments	534
Venture Debtors	12,031
Items in Transit	<u>1,040</u>
	14,253
TOTAL ASSETS	<u>17,962</u>
Equity and Liabilities	
Share Capital	1,012
Retained Profits	(17,132)
Revaluation Reserves	<u>1,130</u>
	(14,990)
Liabilities	
Trade Creditors	15,359
Accruals	2,872
14% Bills Payable	2,736
Overdrafts	1,607
Other Liabilities	<u>10,378</u>
	32,952
TOTAL EQUITY & LIABILITIES	<u>17,962</u>

Required:

- a) Comment on the characteristics of management and corporate governance of the Company vis-à-vis the risks of failure.

(10 Marks)

- b) Based on the narration and financial statements, provide specific analysis of the following

- i) Capital
- ii) Assets
- iii) Management
- iv) Equity
- v) Liabilities

(10 Marks)

- c) You have been hired as a consultant to help bail out the Company. Using your expertise in finance draw out an appropriate restructuring plan and write a report to the Board which shall be used as a basis for negotiating resuscitation of the Company.

(20 Marks)

SECTION B**Question 2**

No Change Limited is an unlisted company which has been operating in Uganda for the last 14 years. Due to the increasing popularity of its products and its ever improving technology the company is seeking methods of raising new capital. The company's Director of Finance, Mr. Danze claims that a stock listing would be very appropriate on the Uganda Stock Exchange.

- a) Write a memo to the Board explaining the advantages of a stock exchange listing.

(8 Marks)

- b) The Board, after reading your memo thinks that the idea is worthwhile and requests you to provide them with calculations of a share value for purposes of making out a prospectus and subsequent floatation. The following information is provided.

	1999	1998	1997
	Shs.million		
1. Profit after tax	230	190	210
2. No. Of Ordinary Shares	10		
3. Price/Earnings rate for comparable companies	7		

(4 Marks)

- c) The realizable value of the assets of No Change Limited are given as follows.

	Shs(m)
Land and Buildings	1,150
Plant and Machinery	150
Stock	400
Debtors	390
Cash	40
	<u>2,130</u>
Creditors	350
Net Assets	<u>1,780</u>

What is the value of the company's shares on the basis of liquidation?
Liquidation costs would be Shs.50m/=.

(4 Marks)

- d) Explain to the Board which of the two methods of valuation for shares is considered the most realistic.

(4 Marks)

Question 3

The accounts of Cosmos International Limited, a property holding company are set out below for the years 1999 and 1998.

	<u>1999</u>	<u>1998</u>
	(Shs million)	
Balance Sheet		
Non Current Assets		
Property, Plant & Equipment	1,224	1,244
Current Assets		
Advances	67	-
Debtors	313	78
Prepayments	56	(20)
Cash Balances	16	154
	452	212
TOTAL ASSETS	1,676	1,456
Equity and Liabilities		
Capital and Reserves		
Share Capital	200	200
Retained Profits	1,279	1,048
Revaluation Reserves	39	39
	1,518	1,287
Current Liabilities		
Deposits	1	98
Accruals	24	-
Creditors	34	71
Tax Payable	99	-
	158	169
TOTAL EQUITY & LIABILITIES	1,676	1,456

Profit and Loss Accounts

	1999	1998
	(Shs million)	
Turnover	<u>636</u>	<u>613</u>
Profit before Tax	330	271
Taxation	<u>99</u>	<u>72</u>
Profit after Tax	<u>231</u>	<u>199</u>

Statement of Retained Earnings

Balance c/f	1,047	848
Profit for the Year	<u>231</u>	<u>199</u>
	<u>1,278</u>	<u>1,047</u>

Required:

- a) Write a report to the directors explaining the general condition of the company and performance over the two years.

(16 Marks)

- b) Explain the limitations of your analysis of the company's records.

(4 Marks)

Question 4

Paraa Tours Limited is a company involved in the tourist industry. Because of the seasonality of the industry, the company has been experiencing cashflow difficulties in the off-peak season.

Management is trying to stabilize its cashflow and has zeroed on 6 projects. The projects can not be replicated but they can be rejected or accepted on a partial basis.

The cost of capital is 12.5% and the company has Shillings 215m/= for investment. The expected outflows from the projects are as follows.

Year	Projects (Shillings Million)					
	1	2	3	4	5	6
0	-25m	-60m	-90m	-100m	-120m	-35m
1	7.5	17.5	25	0	75	40,000
2	7.5	17.5	25	0	75	0
3	7.5	17.5	25	50	0	0
4	7.5	17.5	25	50	0	0
5	7.5	17.5	25	50	0	0

Required:

- a) How should Paraa Tours invest in the projects with the objective of maximizing?

(16 Marks)

- b) Explain the meaning of the term profitability index.

(4 Marks)

SECTION C

Question 5

Mrs. Tammy Othieno, the Managing Director of Little Rock Limited is interested in acquiring a new stone crushing machine through Uganda Leasing Company. She has learnt from a friend that there are various methods of raising finance for small business that she can consider including commercial Company loans, leases and venture capital. Due to the confusion created in her mind by the array of instruments on the market, she approaches you the new financial analyst at Skill Consulting for assistance.

Required:

Write a report to Mrs. Othieno, your new client explaining the differences between the instruments referred to above. In your report you should differentiate types of commercial banks loans and leases, and also recommend to her whether she should go ahead and acquire the machine from Uganda Leasing Company.

(20 Marks)

Question 6

There are two major explanations for mergers. These are synergy and the belief that the shares of the company being acquired are under valued.

a) Explain what you understand by synergy in a merger.

(5 Marks)

b) What are the economic theories and business situations that would indicate the situations in which gains from mergers and takeovers would occur?

(15 Marks)