

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

FINANCE - PAPER 14

DECEMBER 2000

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Attempt question **one** in Section **A**. It is a 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

Basaba Suppliers Limited are a manufacturing concern in the hides and skins industry. The company has currently been experiencing a boom in its activities due to increasing export demand. Despite the boom the company seems to be facing a serious cash shortage. Its overseas clients take about a month to remit funds due, while it must pay cash for all raw materials it purchases locally. They have consulted with a leading financial analyst who has advised them that they must review their working capital management. "It appears like you are overtrading and your working capital cycle is really out of sync. This will create problems for you in the future if you do not address the problem. You need to manage your current assets better".

The manager of the company approaches you for help and provides the following information about their operations:

	Shs' millions / per year
Material Costs	
Raw Materials	248.00
Less By-Products	<u>68.80</u>
Net Material Costs	179.20
Manufacturing Costs	
Labour	171.20
Maintenance	160.00
Utilities	57.60
Overheads	240.00
Depreciation	<u>788.00</u>
Total Product Cost	1,596.00
Annual Sales	2,076.00
EBIT	480.00
Investment	1,600.00
Expenditure Period	1 year
Plan Life	10 years

The manager also informs you of their working capital assumptions which are based on one month, that is the period taken to receive remittances. They need to be able to have an inventory of one month's supply of raw materials, semi finished goods and finished goods. They also need to maintain receivables at only one month's sales and operating cash. They should be able to meet one month's total cost in order to operate smoothly.

Required:

- a) Explain to the manager the determinants of working capital.
(15 Marks)
 - b) Calculate for Basaba Limited the working capital requirement based on the information provided by the manager.
(10 Marks)
 - c) Write a memo to the manager explaining the meaning of the term working capital cycle and overtrading. In your memo point out the problems that would arise as a result of poor working capital management.
(10 Marks)
 - d) What are the other methods that could have been used by Basaba Limited to determine its working capital requirements?
(5 Marks)
- (Total 40 Marks)**

SECTION B**Question 2**

John Kazi Wasi, is the Managing Director of Waka Waka Investments which is a newly formed venture company. After taking out an advertisement in the papers and reviewing several business plans for prospective investments he has narrowed down on three projects as follows.

Cash flows for years				
Shs' millions				
Project Name	C₀	C₁	C₂	C₃
Entertainers Ltd	(400)	241	293	311
Croppers Ltd	(200)	131	172	212
Constructors Ltd	(250)	181	205	141

The opportunity cost of capital is 16%.

- a) Carry out an analysis of the viability of the project using at least two comparable methods to determine the most viable project.

(14 Marks)

- b) Explain to the MD in a memo which project is most viable and why you have arrived at this position given the alternative methods of analysis.

(6 Marks)

(Total 20 Marks)

Question 3

The following are the Financial Statements of Sses Paper and Timbers Ltd for the years 1998 and 1999. Sses Paper and Timbers Ltd's shares are traded on Uganda Stock Exchange.

INCOME STATEMENT

	(Shs' million)	
	1999	1998
Net Turnover	11,378	9,587
Cost of Sales	<u>7,918</u>	<u>6,717</u>
Gross Income	3,460	2,870
Operating Expenses	1,291	1,033
Depreciation	<u>559</u>	<u>474</u>
	<u>1,850</u>	<u>1,507</u>
Profit before Interest & Tax	1,610	1,363
Interest	205	165
Taxation	<u>541</u>	<u>444</u>
Profit after tax	864	754
Referred Stock Dividend	<u>19</u>	<u>21</u>
Profits applicable to Ordinary Shares	<u>845</u>	<u>733</u>

BALANCE SHEET

	(Shs' million)	
	1999	1998
Non-Current Assets		
Land and Buildings	5,011	4,504
Plant and Equipment	2,091	1,724
Other Assets	<u>1,384</u>	<u>891</u>
	<u>8,486</u>	<u>7,119</u>
Current Assets		
Stocks	1,355	971
Trade Debtors	1,517	1,153
Prepayments	122	97
Cash and Cash Equivalents	<u>102</u>	<u>122</u>
	<u>3,096</u>	<u>2,343</u>
Total Assets	<u>11,582</u>	<u>9,462</u>
Equity and Liabilities		
Equity	5,147	4,557
Ordinary Share Capital	<u>2</u>	<u>322</u>
Referred Stock	5,149	4,879
Liabilities		
Non-Current Liabilities		
Term Loan and Capital Leases	2,324	1,853
Debenture	<u>1,379</u>	<u>3,368</u>
	<u>3,703</u>	<u>3,021</u>
Current Liabilities		
Term Loans Due	1,017	252
Trade Creditors	934	672
Accruals	<u>779</u>	<u>638</u>
	<u>2,730</u>	<u>1,562</u>
Total Equity and Liabilities	<u>11,582</u>	<u>9,462</u>

Required:

- a) Assess the performance of the company on the basis of profitability, liquidity, leverage and market ratios. **(18 Marks)**
 - b) What are the limitations of your analysis. **(2 Marks)**
- (Total 20 marks)**

Question 4

Ponders Ltd is a private company which is involved in open cast gold mining and prospecting. The company's prospecting activities indicate that it may have discovered one of the largest mines in Sokolo Hills. Alfred Kabushesha (AK) is the Prospecting Director and a member of the Board. He is the only one who knows the prospecting findings and a possible Initial Public Offer (IPO) on the Stock Exchange.

As a result of his privileged position, he has convinced the board of Ponders Ltd. to sell shares to Ratchet Ltd in which he has a controlling interest. The proposed sale of shares is supposed to boost financing for Ponders' activities and will result in Ratchet Ltd owning 20% of Ponders' Shares, besides the 15% that AK already owns directly. AK has not revealed his interest in Ratchet to his fellow directors nor the discovery of the mines.

An announcement of the mine discovery, which he plans to do after buying the Ponders' shares and the IPO, is projected by a privately hired investment advisor to be able to yield a 50% share price increase. In the process, AK is set to cream off Shs.540,000,000/= as a result of the discovery of the mine field and purchase of shares by Ratchet Ltd before the floatation. The investment advisor hired by AK will receive Shs.108,000,000/= after the IPO as payment for services.

Required:

- a) Explain the significance of AKs actions and their impact on Ponders Limited if they are known.

(12 Marks)

- b) The Investment Advisor hired by AK, in order to make an analysis of AKs scheme must become privy to all information. What are the ethical problems raised by this position of privileged information and the expected pay off.

(8 Marks)

(Total 20 Marks)

SECTION C

Question 5

Mr. Phil Parkes of Moores Investments UK is visiting Uganda in search of strategic partnerships. At a dinner hosted by Uganda Manufacturers Association, Mr. Parkes explains what he is trying to achieve. “We are trying to create synergy in our international business by acquiring local Partners. Your expertise will exponentially increase our knowledge of the local market and its coverage. You gain from our technology and we gain from your experience. We all win”.

Required:

- a) Explain what Mr. Parkes means by creating business synergy and give an example to illustrate.

(6 Marks)

- b) Write memo to Mr. Parkes explaining how the strategic partnership could be consummated. In your memo expound the difficulties that may be created by a business merger and why mergers sometimes fail.

(14 Marks)

(Total 20 Marks)

Question 6

- a) “Most of the financial institutions that failed last year had huge off-balance sheet finance items. We did not know about this and could not stop it in time,” explained an official of the Bank of Uganda.

Required:

In your own words and using an appropriate example, explain off-balance sheet finance.

(10 Marks)

- b) “These financial institutions assets were also non-performing thereby impairing their capital. The institutions were heavily indebted to the central bank, thereby increasing their gearing”.

- i) Explain the meaning of the phrase “... assets were also non-performing thereby impairing their capital.”

(5 Marks)

- ii) What does financial gearing as referred to above mean?

(5 Marks)

(Total 20 Marks)