

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

FINANCE - PAPER 14

TUESDAY, 18 DECEMBER 2001

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.

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SECTION A

Question 1

The following information was extracted from the records of Akana Juice Company as at 30 June 2001.

	Shs. 000s	Shs. 000s
Raw material stock (6600 kilos)		3,300
Finished goods stock (200 units)		1,800
Debtors less bad debt provision:		
1 month old	15,120	
2 months old	<u>3,360</u>	18,480
Creditors - for raw material	3,300	
- for variable overhead	<u>1,200</u>	4,500
Cash in Bank		2,000

The following information has been extracted from company's budgets for the next 4 months.

1. Budgeted sales (units)

July	1,000 units	Sept.	1,500 units
Aug	1,200 units	Oct	1,400 units

The budgeted selling price is Shs. 12,000 per unit.

2. Customers are on average expected to pay as follows:

In the month of sale	5%
In the month following the month of sale	70%
Two months following the month of sale	20%
Bad debts	5%

3. The stock of completed units at the end of each month is as follows:-

End of July	300 units	End of Sept.	500 units
End of Aug	400 units	End of Oct	500 units

4. Manufacturing costs are as follows:

Raw materials (6 kilos)	Shs 3,000 per unit
Direct Labour	Shs 2,000 per unit
Variable Overheads	Shs 1,000 per unit

In addition there are total manufacturing fixed overheads of Shs 4,200,000 per month, including Shs 200,000 for depreciation.

5. Other Information

- (i) The stock of raw materials at the end of each month should be sufficient for the following month's production. Raw material supplies and variable manufacturing overheads are paid for in the month following purchase.
- (ii) Administration expenses will be Shs 1,000,000 per month. Selling expenses are all variable at 10% of sales. Both expenses are paid in the month in which they are incurred.
- (iii) Other payments will be corporation tax of Shs 6,000,000 in respect of the year ended 31 March 1987 to be paid in June, and a replacement machine costing Shs, 5,000,000 to be purchased in May (the latter will not affect the depreciation charge).

Required:

- (a) Prepare a cash budget for **each** of the months from July to September 2001.

[15 marks]

- (b) Prepare a forecast Profit and Loss Account for the 3-month period ended 30 September 2001 (a monthly analysis is not required). Stocks of finished goods are valued for accounting purposes on the basis of a normal level of production of 1400 units per month.

[20 marks]

- (c) Explain to the proprietor of Akana why it is necessary to budget cash.

[5 marks]

[Total 40 marks]

SECTION B

Question 2

In your role as a director of BKK Ltd you have been closely reviewing the operating performance of one of your principal competitors, Shine Ltd. The following published accounts of Shine Ltd for 1999 and 2000 are available providing you with an opportunity to analyze your competitor.

Shine Ltd's Income Statement

	2000	1999
	Shs million	Shs million
Sales	1,514	1,487
Cost of sales	<u>760</u>	<u>813</u>
Gross margin	754	674
Operating costs	<u>571</u>	<u>465</u>
Profit on ordinary activities before taxation	183	209
Taxation	<u>(49)</u>	<u>(62)</u>
Profit on ordinary activities after taxation	134	147
Dividends	<u>(73)</u>	<u>(69)</u>
Profit retained for the year	<u><u>61</u></u>	<u><u>78</u></u>

Shine Ltd Balance Sheet

	2000	1999
	Shs million	Shs million
Non-current Assets	1,952	1,749
Current Assets		
Inventory	103	90
Accounts receivable	237	231
Cash at bank	<u>100</u>	<u>124</u>
	440	445
Accounts payable	<u>(638)</u>	<u>(543)</u>
Net Current liabilities	<u>(198)</u>	<u>(98)</u>
Total assets less current liabilities	1,754	1,651
Non-current liabilities	<u>(331)</u>	<u>(320)</u>
	<u><u>1,423</u></u>	<u><u>1,331</u></u>
Capital and Reserves		
Share capital	376	371
Revenue reserves	<u>1,047</u>	<u>960</u>
	<u><u>1,423</u></u>	<u><u>1,331</u></u>

Additional information is also available from published financial statements;

1. Operating costs include Shs 26 million interest payable in 2000 (in 1999 this figure was Shs 23 million).
2. Share capital comprises of wholly issued shares of Shs.500 each.
3. The market value of Shine's shares was Shs.800 at the end of 2000 as compared to Shs.600 in 1999.

The following 2000 average ratios for the industry in which BKK Ltd and Shine Ltd fall are available.

Current ratio	1.35:1
Quick ratio	0.95:1
Net profit margin	16%
Return on owners' equity	15%
Return on capital employed	10%
Debt/total assets	55%
Debt/equity	80%
Times interest earned	14.2 times
Inventory turnover	18.5 times
Average collection period	70 days
Earnings Per Share	Shs.60
Dividend yield	5%

Required:

- (a) Analyse the company's financial performance focusing on the following:-

- (i) Liquidity (short-run solvency)
- (ii) Profitability
- (iii) Long-run solvency and stability
- (iv) Efficiency
- (v) Stock market performance

[15 Marks]

- (b) What particular strengths in Shine Ltd should the director of BKK Ltd take into account when formulating strategies for his company?

[5 Marks]

(Total 20 marks)

Question 3

African Adventures, a company incorporated in the United States has been seriously considering investing a total of US \$ 2 million in leisure resorts in the Bwindi area and the Paraa Game Reserves which are all found in the great lakes region. The project has however been delayed on several occasions. These have included the massacre of tourists in Bwindi, the corporate failure of a leisure hotel, and the recent downing of the World Trade Centre, New York by terrorists. The board of the company are concerned about the following issues which are not clear to them.

- (a) Political Risk.
- (b) Inflation, Rates of Return and Economic Policy in Uganda.
- (c) Foreign Exchange Policy and Repatriation of profits.

They approach you an expert on Ugandan finance and request you to write a brief on these matters explaining what they mean and the country's economic outlook and policy stance.

Required:

Write a brief explaining these matters and where appropriate use examples.

[20 Marks]

Question 4

You have been approached by a potential investor in the shares of two companies, Company A is an operator of Casinos and other leisure resorts. Company Z is a manufacturer of alcoholic and related beverages. The investors provide you with the following information regarding the performance of the shares of the companies.

Market Condition	Probability	Share A	Share Z
Recession	0.3	2%	-5%
Normal	0.4	16%	18%
Boom	0.3	26%	20%

The investor requests you to advise him on how to proceed in determining how to invest.

Required:

- (a) Determine the expected return, variance and risk for each share.
[12 Marks]
- (b) Explain the relationship between the two shares and advise the investor using a brief memo.
[8 Marks]
(Total 20 marks)

SECTION C

Question 5

The Managing Director of your company, Mr. J Olwenyi has been meeting with executives of the Multi-national Company UBL who kept on referring to how Corporate Governance was a key concern for their proposed joint venture.

Mr. Olwenyi comes to you the Director of Finance and explains his difficulty with the concept and you propose to investigate and advise him.

Required:

Write a memo explaining to the Managing Director, the concept of Corporate Governance and what it means. Explain how your company can introduce the practices associated with good corporate governance.
[20 marks]

Question 6

“The main responsibility of a manager is to create, maintain and increase shareholder value. A manager who fails in this key task is a poor agent of the shareholders. A manager should always understand that failure to meet this key requirement will result in dismissal”.

Required:

Explain the concept of shareholder value within the context of a Stock Exchange and agency theory assumptions.
[20 marks]