

# **THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD**

*A Committee of the Council of ICPAU*

## **CPA (U) EXAMINATIONS**

### **LEVEL FIVE**

#### **INTEGRATION OF KNOWLEDGE - PAPER 19**

#### **COMPREHENSIVE CASE STUDY**

**DECEMBER 2002**

#### **INSTRUCTIONS TO CANDIDATES**

1. Time Allowed : 4 Hours  
9.00 – 10.00 a.m (1 hour) Planning  
10.00 – 10.30 a.m (30 minutes): Break  
10.30 – 1.30 pm (3 hours) Writing
2. The following pages contain compulsory case study questions.
3. The appendices are also attached
4. The completed answer to the case study be handed in at the end of the examination
5. All answers to the case study and any working papers, clearly labeled as such, must be handed in at the end of the afternoon session. Where working papers and notes form part of your answer, ensure they are appropriately cross-referenced.
6. It is in your interest to hand in **ALL** written work you prepared during the examination.
7. Please read further instructions on the answer book.

## 1.0 BACKGROUND

*Rowan James & Co. Certified Public Accountants* is a firm of Certified Public Accountants. The firm and its sister consultancy arm *RJ Consult. Limited* has been in practice since 1950s. The firm has experienced remarkable growth and of recent (2001) its consultancy arm was given some independence and actually got listed on the Uganda Stock Exchange. *RJ Consult. Ltd* is now 60 % owned by the founding partners of Rowan James & Co. Certified Public Accountants and the remaining balance owned by the public through the Uganda Stock Exchange.

The managing partner of the audit firm, who also doubles as the Managing Director of *RJ Consult. Ltd* , Mr Rowan Sonko was approached by Mr David Okot of *Okot & Co. Certified Public Accountants / Okot Consult Ltd* for a possible merger of the two businesses – audit practice and consultancy.

*Okot & Co. Certified Public Accountants* is a medium sized operation with international connections. The Firm represents an International Audit firm, which analysts reckon could be the next in queue of becoming a 'Big 5' audit practice. The annual fee income of this firm is Ushs. 1,000,000,000/=. The consultancy arm, *Okot Consult Ltd* was established seven years ago, and the two founder directors (also partners of the audit firm) still provide the necessary technical and marketing skills. They also own 60% of the issued share capital, the balance plus the long-term loan capital having been subscribed by the International Consultancy firm associated with them. Records indicate that this International firm provided the capital as *venture capitalists*. The 2001 accounts of *Okot Consult Ltd* revealed a turnover of Ush. 860,000,000/=.

## **2.0 INFORMATION AVAILABLE**

Upon receipt of the proposal, Mr Rowan Sonko commissioned a consultant to study the activities of both *Okot & Co. Certified Public Accountants* and *Okot Consult. Ltd.* The consultant's terms of reference also included a review of the *ICT (Information Communication Technology) systems, marketing plans* and *Human Resource Management* practices of both *RJ consult Ltd* and *Okot Consult Ltd.* The consultant findings were as follows (The Consultants are known as Biz-Consult Ltd)

### **2.1 Sampled Audit Files**

The consultant sampled the following Audit files in order to assess the quality of work done by *Okot & Co. Certified Public Accountants* especially on matters of ethical standards and Auditor Independence in the wake of the *Enron and other scandals in America*. The consultant also wanted to confirm whether or not the firm is following the Uganda Code of ethics as issued by the Institute of Certified Public Accountants of Uganda.

#### Partners in Okot & Co. Certified Public Accountants.

- David Okot (DO) – Managing Partner / Managing Director – Okot Consult Ltd.
- Martin Leaves (ML)
- Betty Ongom (BO)
- James Male (JM)
- Alice Biribonwa (AB)
- Malick Kony (MK)

## Consultants' findings

The consultant's review of the audit files sampled for the partnership suggests that there are a number of clients, which may be *bordering on unethical practices* at *Okot & Co. Certified Public Accountants*. The files reviewed included the following:

**i. *Blue-Dog Security Ltd – Partner responsible: ML***

According to records on the file, the following invoices were still outstanding for payment by Blue-Dog:

- Invoice no. 00/202 dated 30<sup>th</sup> September 2000, for Ushs 20,000,000 being the balance of audit fees.
- Invoice no. 01/247 dated 12<sup>th</sup>, October 2001 for Ushs 40,100,000 being the 2001 audit fee.
- No cash has been received from this client since August 2000.

**ii. *Sekanyolya Systems Ltd – Partner responsible: BO***

According to the correspondence file relating to this client in the year 2000 it carried out work of installing anti-robbery razor wire at BO's housing estates. Comparison of the rates quoted in the correspondence with the data on the audit file suggests that the work was done at a discount of about 12% - 30,500,000.

**iii. *First Travel Limited [FTL]– Partner responsible: JM***

James's wife became a Manager of this company in 2001 and according to FTL's 2001 accounts; the wife now owns 20% of the share capital of the company.

**iv. *Word Wide Ins. Co Ltd: - Partner responsible: Alice***

An employ of *Okot & Co. Certified Public Accountants* in the names of *Daniel Lule* resigned from his post as audit manager in February this year to take up the job of Financial Controller at worldwide.

**v. ICPAU Consult. Ltd – Partner responsible: DO**

In the year 2001, the firm billed this client (their largest client), as follows:

• Audit of 2001 accounts	50,000,000
• Taxation advice re-2001	40,000,000
• Computer soft ware advise	30,000,000
• Recruitment of senior managers	<u>20,500,000</u>
<b>TOTAL</b>	<u><b>148,500,000</b></u>

The consultants were very concerned about the size of the fees charged in relation to the total fee income of the audit firm.

**Memo by Mr David Okot to the Consultant**

Reporting Consultant, Biz-Consult Ltd,

Thanks for your notes on the sampled audit files. I do appreciate it, but I think there is a need to balance your comments with the commercial facts of the situation. Indeed I do not want these findings to affect our planned merger with the Rowans. Perhaps my comments below will help to clarify matters.

**Blue-Dog:**

I am well aware that this client has been experiencing cash flow problems for some time, but we are able to monitor the situation closely, given that we are preparing Blue-dog's quarterly accounts for submission to the bank. Martin attends all meetings of directors to report on company's financial situation, and she is confident that it will be able to trade out of its difficulties, provided that the Bank's support is continued. On that basis, I am sure that we will be able to recover the outstanding fees.

**Sekanyolya systems:**

Well spotted – but I don't really think you could describe the discount given as material in relation to the income of this firm.

**First travel ltd**

I fully appreciate that this is a delicate situation. That is why I suggested that James should be replaced by Malick as engagement partner with effect from this year.

**World-wide**

Obviously it was a blow to us to lose Dan, especially at such short notice. He was a highly competent employee, and had been the mainstay of the World-wide Audit for several years, but our loss is clearly their gain, and I am sure it is our advantage to have a senior member of World-wide's staff who has such a close understanding of our requirements and procedures.

**ICPAU-Consult**

On a personal note I have to say I'd be very sorry to lose this client, having been associated with it since my training with this firm in 1970 ! Fortunately, I do not think that will be necessary. The guidelines on audit fees and other recurring work are very clear, and we fall within those limits.

Signed, David Okot.

**2.2 Data relating to *Okot Consult Limited* – extracts from annual reports by the consultants.(Ushs. Million)**

<i>Year ended 31st Dec</i>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>	<b>1996</b>
<i>Tangible Fixed Assets</i>						
At cost	224	174	133	113	58	44
Less: Depr	54	34	23	13	8	4
	170	140	110	100	50	40
<i>Development Costs</i>						
At cost	254	189	129	72	32	12
Less: Written off	176	109	53	23	7	2
	78	80	76	49	25	10
<i>Current Assets</i>						
Sationary stock	10	20	11	5	2	0
Trade debtors	117	84	68	42	50	27
Other debtors	12	8	9	7	6	5
Cash&Bank	1	14	5	6	19	2
	140	126	93	60	77	34
<i>Current Liabilites</i>						
Trade creditors	31	28	21	17	11	8
Taxation	12	6	0	0	0	0
Others	24	17	11	9	8	8
	67	51	32	26	19	16
<i>Net Current assets</i>	73	75	61	34	58	18
Total assets net of Current Liabilities	321	295	247	183	133	68
Long-term Loans	160	160	160	120	80	50
<b>Net assets</b>	<b>161</b>	<b>135</b>	<b>87</b>	<b>63</b>	<b>53</b>	<b>18</b>
<i>Share capital</i>						
(share of 0.25/= each)	100	100	100	100	100	20
Profit and loss account	61	35	(13)	(17)	(47)	(2)
	<b>161</b>	<b>135</b>	<b>87</b>	<b>83</b>	<b>53</b>	<b>18</b>
<i>Turnover</i>	<b>860</b>	<b>684</b>	<b>547</b>	<b>421</b>	<b>281</b>	<b>175</b>
Operating Profit	55	68	16	38	(39)	1
Loan Interest	(20)	(14)	(12)	(8)	(6)	(3)
Taxation	(9)	(6)	-	-	-	-
Profit Retained	<b>26</b>	<b>48</b>	<b>4</b>	<b>30</b>	<b>(45)</b>	<b>(2)</b>
Remuneration of founding directors	<b>25</b>	<b>20</b>	<b>20</b>	<b>20</b>	<b>18</b>	<b>15</b>

### **Supplementary Information**

The directors now forecast that profits after tax for the next four years will be as follows:

<b>Yr Ended 31st Dec</b>	<b>Ushs. Mill</b>
2002	29
2003	42
2004	55
2005	68

## **2.3 INFORMATION AND COMMUNICATION TECHNOLOGY (ICT)**

A study of the ICT systems at both Okot's place and at Rowan's place revealed that the systems at Rowan James & Co certified Public accountants and RJ consult Ltd are a totally integrated information system but will be inadequate to handle the volume of activities following the merger. The merger timetable means that Rowan has just a few months to set up a new computer system.

The requirement will be for a project management process, which can deal with tight timescales involving a complicated set of interrelated decisions and actions. Rowan must realize that effective project planning and control needs different management skills from those required to run a consultancy outfit.

This is the immediate requirement but in the longer term Rowan must put in place a strategy for managing information resources in ways, which enable it to achieve a competitive advantage or at least competitive parity with the BIG 4 international Audit and consultancy firms.



## **2.4 MARKETING SYSTEMS**

In the past Rowan audit practice and the consultancy had never actively sought out business and new clients had come in on the basis of recommendations and personal contacts. With the entry of the Big 4 in the Ugandan market, the firm may have to reconsider its approach to solicitation of new business. The managing partner agrees that some thing needs to be done. The new thinking is that after the merger, the new firm will have to go out and market its self. That it is not enough to be technically proficient. There is a need to get new and profitable business particularly in the envisaged competitive environment.

## **2.5 HUMAN RESOURCE MANAGEMENT**

Well as both firms, Okot and Rowan, have been growing steadily over the years, their approach to staff development was not in a coordinated manner. Audit staff is not well guided on the courses to follow in order to enhance their skill and professionalism.

## **3.0 FINAL THOUGHT**

The consultant have recommended that the "Rowan group" will require to study their findings critically before they can go ahead with the merger plans. You are Samuel Matovu the best CPA (U) student in the final papers for the December 2001 papers now working with the Rowan outfit. You are expected to study the available information and the consultant's report because all indications are that this afternoon Mr Rowan Sonko will be asking you to help him make sense out of the information available to him.

**ROWAN JAMES & COMPANY CERTIFIED PUBLIC  
ACCOUNTANTS**

**INTERNAL MEMORANDUM**

FROM : Rowan Sonko - Managing Partner

TO: Samuel Matovu.

DATE: 19<sup>th</sup> DECEMBER, 2002

**SUBJECT: PROPOSED MERGER AND MANAGEMENT  
ISSUES.**

Further to the information availed to you this morning, I am requesting you to analyze and interpret the issues raised by the consultant with a view of recommending a way forward for our business. In particular I would request you to address your self to the following matters.

- i. The consultant has raised a number of issues touching on auditor's independence globally and in Uganda, to which *Mr. Okot* has tried to respond. Please advise whether or not the responses are adequate. If not what further actions do we need to take should the merger go on, to improve on independence. (25)
- ii. Further to the above please indicate if there are any other factors that affect independence that were not raised by the consultants, which in your view we should consider. (5)
- iii. In order to sale this merger proposal to my colleagues they will need to be very clear of the benefits (financial or otherwise) that will accrue to the firm should the deal go on. Using the data provided and other considerations it will be necessary to point out the benefits or otherwise of the merger. (25)

- iv. Out of my discussions with Mr. Okot he would be comfortable with two alternative values for the total equity of *Okot consult Ltd – net assets & P/E ratio based on earnings*. Advise and discuss which basis should be used, having regard to the interests of the founder directors of *Okot consult Ltd* and of the venture capitalists (the international firm). It has been established that for Consultancy firms quoted on the Uganda Stock exchange (in the same field as *Okot Consult Ltd*) the range of P/E ratios is currently between 10 and 15%. This should give you an indication of what the P/E ratio would be for unquoted consultancies like Okot consult Ltd. (10).
- v. On the ICT side, the consultant is recommending adoption of new systems. These will have to be developed and implemented as a project. Please recommend appropriate range of project management tools and techniques, which we can use to help achieve an effective and efficient changeover to new ICT systems. (15 marks)
- vi. We need to have all our plans ready such that once the deal is given the blessing we immediately move into action. On the marketing side my understanding is that we need to change the way we have always got new business. We need to adopt a marketing oriented stance to the management of the business. Advise and suggest a possible approach to the development of a marketing plan for the “new merged business”. I would expect you to address your self to the differences that are likely to arise between the marketing of consumer products and the marketing of accountancy services, audit services and general management Consultancy services. Understanding these differences influence the way we should be marketing our selves. (10)
- vii. Changes come with a lot of issues that need to be managed. I understand we shall require having a formal, tailor made and focused training programme under the new merged business. Again picking on your brains, advise on how we could probably put up the require staff training plan. (10)

- viii. I must let you know that your performance evaluation for this year and possible promotion to a new rank in the new company, will be based on the strength of your advises in the above situation. The figures in the brackets indicate the maximum score (out of 100%) attributable to each area on the performance evaluation form.

I look forward to reading your recommendations.

***Rowan Sonko - Managing Partner***