

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

THURSDAY 20 JUNE 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 p.m. (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.

CASE STUDY

In answering this case study you will assume the name of John Mukasa, B.Com, CPA(U) a newly recruited Finance and Administration Manager.

ALBERT, LAWRENCE & Co. (The Company)

Albert Okumu and Lawrence Okello are two shareholders of “Albert, Lawrence & Co. Limited (The Company) which acts as agents for the sale of commercial and residential premises. ALC also manages properties on behalf of clients many of which are former Custodian Board Properties for Departed Asians.

The Company was started in 1972 by the two shareholders who are also brothers. The Company has experienced remarkable growth in business. It now employs a total of 100 employees country wide. Mr. Albert Okumu is the Chairman / Managing Director while Lawrence Okello is not involved in the day-to-day management of the Company.

In order to streamline the operations of the company you are recruited as the Finance and Administration Manager. You started work yesterday and the whole day was taken up with introductions and tours to some of the prime properties the company is managing.

When you arrive at work this morning you find a file in your in-tray with a Long Memorandum (reproduced below) from Mr. Albert Okumu. As this seems to be your only piece of work for the day you decide to get a cup of coffee and start reading.

ALBERT, LAWRENCE & Co. (ALC)

MEMORANDUM

TO: JOHN MUKASA – Finance & Administration Manager

FROM: Albert Okumu – Managing Director

DATE: 19 June 2002

**RE: OUR FINANCIAL STAND AND THE ACQUISITION OF
KAMPALA PLASTICS LIMITED**

Welcome to Albert, Lawrence & Co.!

I am sorry we couldn't get much time together yesterday, but I am really busy at the moment. This long memo should be able to explain to you our plans. We are preparing for the next directors' meeting due in 3 weeks time, and the main item on the agenda is the proposal to acquire KAMPALA PLASTICS LIMITED (KPL) – our financial position permitting and if we can obtain support from our bankers – Paradise Commercial Bank Limited (PCB), and from the motor vehicles spray business we started this year. As things stand now we are not sure of the future given our past and current position.

This morning we received our audited financial statements for the year ended 31 December 2000, and the draft financial statements for the year ended 31 December 2001 and we have also obtained the attached information about KPL. I would request that you familiarise yourself with the attached data and comments / remarks made on both sets of information.

SITUATION 1

As your first assignment at ALC we would require you to use this afternoon to prepare a report for our meeting. We believe that you will be in a better position to appraise us on our financial position in light of our request for an increase in our overdraft limit at PCB from Ushs 30,000,000 to Ushs 35,000,000 for a further period of six months. As you will note our overdraft shown in the balance sheet is far below our assets of Ushs.181,000,000. It is important that we are clear

about our solvency , liquidity; profitability and gearing position, and also consider other financial options that could improve our performance.

Our profit position is disappointing and we trust you can assist with developing a future strategy for getting us out of poor profitability. We carried out an internal review of the results for the year ended 31 December 2000 and concluded that marketing was the problem, and we implemented the following measures during the year ended 31 December 2001 to improve on the situation:

- i) engaged marketing consultants and incurred up to Uganda shillings 12,000,000 in a marketing campaign. On the advice of our auditors whom we have just noted are not members of ICPAU, we recorded 50% of the marketing campaign costs as a current asset in the year 2002, since the benefits are expected over a long period of time.
- ii) The advertising material carried a “PRICE-SWEETNER” to under cut any other property managers in Uganda.
- iii) We won a very competitive tender to manage Nambole National Stadium with all attached hotel facilities.
- iv) We extended the credit period allowed to customers from 2 to 3 months.

It is against the above background that we reviewed the financial statements for the year 2001 which indicated a deterioration of our performance. We are not even sure whether PCB will renew and extend the overdraft facility because the maximum agreed level of Ushs.30,000,000 is already exceeded.

As a professional accountant we would require you to prepare a report on our performance over the last two (2) years in light of the above measures we had taken to improve on the situation. In your report, suggest ways of how the situation can be improved.

We also believe that if we improve on the motivation of the staff, the company will record substantial improvements in profitability and liquidity in the near future. Suggest ways and means of improving profitability and liquidity of the company.

SITUATION II

We are intending to buy a motor vehicle spray equipment on 1 January 2003 worth Ushs.10,000,000 which we trust will last for five years. Our projections are that from this line of business we anticipate the operating profit to be Ushs.6,000,000 per year for five years before deducting depreciation of the equipment. We are to depreciate this equipment on a straight-line basis over its useful life. Uganda Revenue Authority have informed us that for tax purposes, the equipment is to be depreciated at 25% per annum on a reducing balance basis. The Corporation Tax rate may be increased from 30% to 40% for the years 2003 – 2006.

We are informed that such equipment can be acquired on lease hire arrangement. The monthly charges are Ushs 300,000. The Board would appreciate your advice on this alternative.

We are worried of the deferred income tax implications of this equipment for the next five years in light of IAS 12. It is, therefore, important that in your paper you include calculations of the deferred tax at the end of each of the five years and show the projected income statement of this motor vehicle spray business for the next five years.

SITUATION III – Proposed acquisition of Kampala Plastics Limited

We have been offered an opportunity to quote for 100% shares of KPL which is on offer. Our interest is to be equipped with all the relevant values to be placed on one “Shs.10/= Ordinary share” in KPL based on company financial statements and notes provided. We are not willing to be caught off guard by the owners’ of KPL. Therefore, we would appreciate if you can provide the value per share using at least four bases.

The Managing Director will appreciate if, in your report, you can discuss the meaning and significance of each of the four valuations and also comment on their relevance in the light of our proposal to takeover the company.

Please state whether Shs 10 per share is good for us and if or not this price should be adjusted if we are not taking the majority ownership of the business.

As you will appreciate our minds are “mixed up” about which way to go, but we believe that after a clear understanding of our current position; the deferred tax implications of the motor spray business and the valuations of KPL we shall be able to make a decision. Your input is required on the technical analysis of the situation

Signed by:

Albert Okumu
Managing Director

APPENDIX I
ALBERT & LAWRENCE & Co. LIMITED
SUMMARISED INCOME STATEMENT FOR
THE PERIODS ENDED 31 DECEMBER 2001

	2000		2001	
	(Ushs million)		(Ushs million)	
<u>REVENUE:</u>				
Commissions Revenue		120		300
Direct Costs	83		261	
Depreciation	<u>7</u>	<u>(90)</u>	<u>9</u>	<u>(270)</u>
Gross Profit		30		30
<u>EXPENDITURE</u>				
Other Expenses	10		28	
Interest	<u>2</u>	<u>(12)</u>	<u>10</u>	<u>(38)</u>
Profit (Loss) before Tax		18		(8)
Tax		<u>(6)</u>		<u>(4)</u>
Profit (Loss) after Tax		12		(12)
Dividends Paid	-	<u>(8)</u>		<u>(8)</u>
		<u>4</u>		<u>(20)</u>

ALBERT, LAWRENCE & Co. LIMITED
SUMMARISED BALANCE SHEET AS AT 31ST DECEMBER 2001

	2000 (Ushs millions)	2001 (Ushs millions)
<u>NON CURRENT ASSETS:</u>		
Land & Buildings	5	5
Plant & Equipment	<u>38</u>	<u>58</u>
	43	63
<u>CURRENT ASSETS</u>		
Inventory	12	18
Receivables	25	94
Deferred Expenditure	0	6
Bank	<u>8</u>	<u>0</u>
	45	118
TOTAL	<u>88</u>	<u>181</u>
<u>CAPITAL AND RESERVES</u>		
Ordinary Shares	25	25
<u>Reserves</u>		
Capital Reserves	11	10
Accumulated Profits	<u>8</u>	<u>(12)</u>
	44	23
<u>NON-CURRENT LIABILITIES</u>	19	32
Current Liabilities		
Trade Payables	15	80
Others	10	12
Bank	=	<u>34</u>
	25	126
TOTAL EQUITY AND LIABILITIES	<u>88</u>	<u>181</u>

Notes:

a) Plant and Equipment is made up as follows.

	As at 31 December	
	2000 (Millions)	2001 (Millions)
Owned Plant	10	18
Leased Plant	28	40

b) Non Current Liabilities are leasing obligations due to DFCU Leasing Ltd.

APPENDIX II

ACQUISITION

The following information relates to Kampala Plastics Limited for the year ended 2001.

1.0 Profit and Loss Appropriation Account for year ended 2001

	<u>(Ushs '000)</u>
Net profit	72,000
<u>Less: dividends</u>	<u>18,000</u>
	<u>54,000</u>

2.0 Balance Sheet as at 31 December 2001

	<u>(Ushs '000)</u>
Freehold property at cost less depreciation	29,000
Machinery at cost less depreciation	125,000
Inventories	63,000
Net Monetary Assets	<u>17,000</u>
	<u>234,000</u>
<u>Financed By:</u>	
Share Capital (Ushs 10, Ordinary Shares)	100,000
Reserves	<u>134,000</u>
	<u>234,000</u>

Notes

- i) M/s Bagaine & Co. Property Valuers have estimated the following to be the current valuations

▪ Freehold Property	Ushs. 150,000,000
▪ Machinery (Forced sales value)	Ushs. 50,000,000
▪ Inventory	Ushs. 52,000,000

Replacement costs have been estimated per asset as

▪ Machinery	Ushs. 180,000,000
▪ Inventories	Ushs. 75,000,000

- ii) Shares of AK Plastics Limited a company quoted on the Uganda Securities Exchange and also operating in the same plastics industry as KPL have a price/earnings ratio of 10 and a dividend yield of 6%.