

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

TUESDAY, 17 JUNE 2003

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **5 hours 30 minutes**
9.00 – 11.00 a.m. (2 hours): Planning
11.00 – 12.00 a.m. (1 hour): Break
12.00 – 3.30 pm (3 hours 30 minutes) Writing
2. The following pages contain a compulsory case study to be used for planning.
3. The questions to the case study will be issued in the next session.
4. The 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.
5. It is in your interest to hand in **ALL** written work you prepared during the examination.
6. Please read further instructions on the answer book.

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1.0 BACKGROUND

Rowan James & Co. is a firm of Certified Public Accountants. The firm and its sister consultancy arm *RJ Consult Limited* has been in practice since the 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 Securities Exchange. *RJ Consult Ltd* is now 60 % owned by the founding partners of Rowan James & Co. Certified Public Accountants and the remaining balance is owned by the public through buying shares listed on the Uganda Securities 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 Shs. 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 financial statements of *Okot Consult Ltd* revealed a turnover of Shs 860,000,000.

2.0 INFORMATION AVAILABLE

Upon receipt of the proposal, Mr Rowan Sonko commissioned Value-Consult Ltd to study the activities of both *Okot & Co. Certified Public Accountants* and *Okot Consult Ltd*. The consultants' terms of reference also included a review of the *Information and Communication Technology (ICT) systems, marketing plans and human resource management practices* of both *RJ Consult Ltd* and *Okot Consult Ltd*. The consultants' findings were as follows:

2.1 Sampled Audit Files

The consultants 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 was adhering to the Code of Ethics 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 consultants' 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:

1. 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 September 2000, for Shs 20,000,000 being the balance of audit fees.
- Invoice no. 01/247 dated 12, October 2001 for Shs 40,100,000 being the 2001 audit fee.
- No cash has been received from this client since August 2000.

2. Sekanyolya Systems Ltd – Partner responsible: BO

According to the correspondence file relating to this client in the year 2000, the company 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% - Shs 30,500,000.

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

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

4. Word-Wide Insurance Co Ltd: - Partner responsible: Alice

An employee of Okot & Co. Certified Public Accountants called Daniel Lule resigned from his post as Audit Manager in February this year to take up the job of Financial Controller at World-Wide.

5. COSTA Consult Ltd – Partner responsible: DO

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

	Shs
• Audit of 2001 financial statements	50,000,000
• Taxation advice re-2001	40,000,000
• Computer software advice	30,000,000
• Recruitment of senior managers	<u>20,500,000</u>
Total	<u>148,500,000</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 Consultants, Value 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 financial statements for submission to the bank. Martin attends all meetings of directors to report on the 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 do not 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 an 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 to our advantage to have a senior member of World-Wide's staff who has such a close understanding of our requirements and procedures.

COSTA-Consult:

On a personal note, I have to say I would 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 (Shs millions)

Year ended 31 December	2001	2000	1999	1998	1997	1996
Tangible Non-current Assets						
At cost	478	363	262	185	90	56
Less: Depreciation	230	143	76	36	15	6
	248	220	186	149	75	50
Current Assets						
Stationery inventory	10	20	11	5	2	0
Trade receivables	117	84	68	42	50	27
Other receivables	12	8	9	7	6	5
Cash & Bank	1	14	5	6	19	2
	140	126	93	60	77	34
Current Liabilities						
Trade payables	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
Net Current assets	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
Net assets	161	135	87	63	53	18
Share capital (share of 0.25/= each)	100	100	100	100	100	20
Accumulated Profits / Losses	61	35	(13)	(17)	(47)	(2)
	161	135	87	83	53	18
Turnover	860	684	547	421	281	175

Year ended 31 December	2001	2000	1999	1998	1997	1996
Operating Profit	55	68	16	38	(39)	1
Loan Interest	(20)	(14)	(12)	(8)	(6)	(3)
Taxation	(9)	(6)	-	-	-	-
Profit Retained	<u>26</u>	<u>48</u>	<u>4</u>	<u>30</u>	<u>(45)</u>	<u>(2)</u>
Remuneration of founding directors	25	20	20	20	18	15

Additional Information

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

Year ended 31 December	Shs millions
2002	29
2003	42
2004	55
2005	68

2.3 TAX AND ACCOUNTING MATTERS - OKOT CONSULT LIMITED

It was discovered that the financial statements of Okot Consult Ltd were not fully in compliance with International Financial Reporting Standards especially IAS 12. Details available indicate that the financial statements ought to have been adjusted for deferred tax for all the years from 1996. Proper computation of annual corporation tax payable were made after taking into account the appropriate allowable depreciation rates as per the Sixth Schedule of the Income Tax Act, 1997. The corporation tax rate has been constant at 30% since 1996.

The schedule below gives details of the non-current assets since 1996:

Tangible Non-current Assets (at cost)	2001	2000	1999	1998	1997	1996
Computers	70	60	50	40	30	20
Office furniture	116	96	76	56	36	16
Motor vehicles	<u>292</u>	<u>207</u>	<u>136</u>	<u>89</u>	<u>24</u>	<u>20</u>
Total	<u>478</u>	<u>363</u>	<u>262</u>	<u>185</u>	<u>90</u>	<u>56</u>

Over the years, the company has also not been preparing cash flow statements as required by International Financial Reporting Standards.

2.4 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 long run 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.

2.5 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 something needs to be done. The new thinking is that after the merger, the new firm will have to go out and market itself. In the new environment this means 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.

2.6 HUMAN RESOURCE MANAGEMENT

Well as both firms, Okot and Rowan, have been growing steadily over the years, their approach to staff development has not been done 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 consultants have recommended that the "Rowan Group" should study their findings critically before they can go ahead with the merger plans. You are Samuel Matovu, the best candidate at Level 5 of CPA (U) during the December 2001 Examinations diet, now working with the Rowan outfit. You are expected to study the available information and the consultants' report because all indications are that this afternoon Mr Rowan Sonko will be asking you to help him to make sense out of the information available to him.