

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

MORNING SESSION MATERIAL

MONDAY, 15 DECEMBER 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 compulsory case study questions.
3. The appendices are also attached
4. The completed answer to the case study must 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.

For the purposes of this examination, you are Charles Kasule.

Introduction

After gaining an Electrical Engineering (EE) degree from the Makerere University, Charles joined a large Bank in Kampala as a trainee Accountant. During his first three years with the company he completed his CPA (U) examinations and, having worked on a variety of projects, was able to gain the experience necessary to become a full member of the Institute of Certified Public Accountants of Uganda (ICPAU).

Having qualified, Charles was keen to develop his experience of a wide range of businesses and so left the Bank to join a management consultancy, Skill Consulting Ltd, based in Kampala but with clients in all East African Community countries. His work centered on short projects in a variety of industries: he advised on improvements to planning and control processes and was often involved in the selection and implementation of new information-processing systems. One of these projects involved working for a small electrical manufacturing business – Musa Body & Sons Ltd (MBS) based in Katwe, Kampala

MBS, a private limited company, was established in 1959 by Musa Serwanga, an electrical engineer, who had spotted the opportunity to make voltage control equipment for businesses in his local area. Musa had no ambitions to extend the business, seeing it as a means of making enough money to enjoy his life with his children. When Musa retired, his son Musa Seruwagi Junior (MS Jr.) - who had been associated with the business since childhood - took over. MS Jr. has known most of the staff, suppliers and local customers for much of his life.

In the last five years, since MS Jr. took over, the business has grown. It still focuses on the provision of specialized electrical equipment but now supplies businesses across all the East African States. In recent years he appointed two other directors to help run the increasingly complex organization.

Ahmed Jooga, aged 38, took over as production director from MS Jr. when he became the Managing Director. He has worked for the business since joining as a sixteen-year-old and has excellent technical knowledge of the production processes used by MBS. He enjoys working with MS Jr., a childhood friend, and also the relaxed atmosphere of the small family company. He has been tempted with offers from bigger companies but has preferred to stay in his hometown, sticking to the business he knows so well.

Julius Kamulindwa, aged 36, joined as the first sales and marketing director of the business. He graduated with a degree in marketing from a leading University in Uganda. He has worked in a variety of marketing and sales roles in three companies prior to accepting the job from MS Jr. two years ago. He has been the main force behind the recent expansion of the customer base and has been arguing for some time that the company needs to focus more on selling and on customer management, rather than just the technical issues that seem currently to dominate board meetings.

MS Jr. is aware that the business world is changing rapidly around him and that he ought to be updating the culture, structure and technology used in the firm. His decision to recruit Julius two years ago has resulted in a different approach to business as well as a change in the culture of the firm. These changes have not always been popular with the more established members of staff.

MS Jr., Ahmed and Julius agreed at an earlier board meeting that some sort of strategic review and re-organization of the internal audit department as well as internal control systems was needed. Since none of them had any experience in how to structure such an exercise, they agreed to obtain some impartial and expert help from outside of the business. Skill Consulting Ltd agreed to send Charles Kasule into the company for two weeks to help with the business review.

Charles enjoyed the opportunity to work on a project that involved reviewing a whole business, rather than just one department's systems. During his time at MBS, he carried out a thorough review of the resources, business systems, past business performance and the business environment in which the company was operating. Recognizing that the strategy process ought to be oriented to the future rather than the past, he spent some time talking to MS Jr. and Ahmed about the future of the organization. Aware of the importance of a broad perspective, he took the opportunity of visiting a few of MBS's customers to try to understand the external image of the business. Charles presented his main findings and ideas to MS Jr. and Ahmed. (Notes to the presentation are shown in **Appendix 1**. MS Jr. was delighted with the results of the project and promised to go through it in more detail with Julius when he came back from a sales trip to Tanzania. The exercise made it clear to MS Jr. that, although his business had been built upon engineering knowledge, the future lay in harnessing specialist skills in the areas of finance, strategy and IT.

He noticed that Charles had enjoyed working on the project and had got on well with the staff and customers he had spoken to. During Charles's final day on the project, MS Jr. tentatively asked him if he would have an interest in becoming a full-time member of the MBS team. MS Jr. was not able to match his current salary initially, but could offer him some real responsibility and experience, with considerable challenge and interest. He also hinted at the possibility of lucrative performance bonuses tied into company profitability and a possible equity stake in the business later, if things were going well. Charles saw this as an excellent opportunity to improve his business experience and agreed to join the firm as soon as he had completed his contract at Skill Consulting Ltd.

A few months later Charles joined MBS as the Finance Manager, a role that involved supervising the administration of all financial transactions, and implementing many of the ideas from the strategic review. During the first few weeks of starting his new post Charles had to work hard to familiarize himself with the detailed financial situation at MBS. He studied a summary of its finances (**Appendix 2**) and also obtained an organization chart denoting the principal members of staff (**Appendix 3**).

APPENDICES

1. Skill Consulting Ltd – Strategic Review of MBS.
2. Financial Statements for the year ended 31 December 2002
3. MBS - Organization chart

APPENDIX 1

Skill Consulting Ltd – Strategic Review of MBS

NOTES TO THE PRESENTATION

Part A – What is the company trying to achieve?

1. A mission statement for MBS.

The company's aim is to maximize long-term profitability by manufacturing and selling high-quality electrical equipment to valued and loyal customers across the country.

Customer satisfaction will be achieved by working closely with established local suppliers to maintain and improve standards of reliability and technical innovation in the industry.

The directors expect staff to contribute by working hard to improve upon the company's loyal stakeholders and to ensure that the success of MBS is synonymous with success for staff, customers, suppliers and neighbours.

2. Suitable corporate objectives for the future

The long-term objectives are to increase profits before tax to U.shs 2,000,000,000 and sales to U.shs 25,000,000,000 within five years. Short-term objectives to support this are discussed in part C.

PART B – What is the current position of MBS ?

Human Resources

- MBS employs more than 200 people.
- The business has a high skills base in manufacturing but relatively limited experience in marketing, finance, IT and personnel management.
- Morale is high across the business. There are very few days lost through illness, absenteeism and none through labour disputes.
- There have never been redundancies at MBS. Staff turnover traditionally has been very low.

Financial Health (based upon the Financial Statements to 31 December 2001)

Profits before tax	3% up on last year	16% up over 3 years
Sales	8% up on last year	30% up over 3 years
Net current assets	2% down on last year	22% down over three years
Debt	23% up on last year	90% up over three years

The three directors of the business are also the majority shareholders. They are happy with current returns but would welcome higher long-term growth. Last year they showed their ambition for the company by turning down a U.shs 4,300,000,000 offer for the equity by UGMA Engineering Co. Ltd. The very large debt repayable in 2005 is a cause for concern. Any strategy undertaken will need to ensure that cash is available to meet the remaining interest payments and the capital sum. There has traditionally been a good relationship with the company's bankers, which has allowed the company to borrow extensively in recent years. Any future investment in the business is likely to have to come from retained earnings. This might require a reduction in the current level of dividend payments.

The supplier base

The company enjoys an excellent working relationship with long-standing suppliers. There are few squabbles over price or quality and several joint-venture projects are in progress to improve quality and reduce costs

The product range

The company produces a narrow range of electrical products for industrial clients. This range has maintained a strong leading market share in Uganda of 36 per cent.

Operations

Partly because of the good atmosphere, and partly because of the experience of the long-standing workforce, the operations department has an excellent record. Production has been the centre of the business for many years.

The customer base

Many of MBS's customers are still local to the area and have been associated with the company for many years. MTN (Uganda) Ltd a large foreign company acquired some of the customers of MBS, and it is increasingly introducing more formal purchasing controls into their routines.

Quotes from recent conversations with a few local customers have included:

'MBS are not the best value for money but we like to support small local firms.'

'I hope MS Jr. can keep the old firm going; it would seem a shame to see it close down with all this competition moving in.'

'I have said to MS Jr. for years that he needs to move with the times. We are friends but sooner or later I am going to have to start putting my shareholders first.'

Last year's survey showed big differences between the attitudes of established clients and those that the company has acquired more recently.

1. Customers who had been with MBS for more than ten years

How do you rate MBS for product quality and reliability?

Excellent 30% Good 50% Fair 20% Poor 0%

How do you rate MBS on price?

Excellent 5% Good 25% Fair 50% Poor 20%

How do you rate them on service?

Excellent 85% Good 15% Fair 0% Poor 0%

2. Customers who had been with the company less than ten years

How do you rate MBS for product quality and reliability?

Excellent 10% Good 40% Fair 40% Poor 10%

How do you rate MBS on price?

Excellent 0% Good 10% Fair 50% Poor 40%

How do you rate them on service?

Excellent 20% Good 20% Fair 40% Poor 20%

Distribution, logistics and customer service

This has been seen as a relatively less important area for the company in the past. Distribution costs and delivery times appear to lag behind the bigger and slicker suppliers that customers are accustomed to dealing with. Although customers appear to be impressed by the technical knowledge and helpfulness of staff, they increasingly see the company as a little out of date.

Support activities - finance, IT, strategic planning

In common with many small companies, the experience and resources in these specialist areas are limited. These areas are significant weaknesses within the company.

The industry environment

MBS operates in a specialized industry with few direct competitors. The electronics industry is increasingly consolidating into a small number of large organizations that are continually diversifying their products and markets.

The product technology in the industry is relatively mature, with few major innovations. Developments in information for administration, communication and logistics have been very extensive in recent years.

Environmental factors: Uganda

The country enjoys a stable political, legal and economic system. Recent attempts to improve the control of the economy have been successful, with inflation predicted to drop to 5 percent next year and as per table below and thereafter:

	Inflation %
Year 1	5
Year 2	4
Year 3	3
Year 4	3
Year 5	3

Business taxation is likely to stay at the uniform rate of 40 per cent, with payment remaining one year in arrears. Capital allowances are also likely to remain at 25 percent per year on a written-down basis.

Traditionally there has been relatively limited regulation of business (e.g. employment law, health and safety, pollution controls) but the law in each of the member states of the East African Community is forecast to be harmonized and brought into line with the World standard over the next three years.

Part C - Looking forward at strategic options for future development

What should be the company's source of competitive advantage?

MBS has traditionally competed as a focused niche-market business based on its long history and experience within the Industry. Given its small size, it is unlikely that the business should attempt to become a cost leader, but it might consider widening its market further by geographical expansion or by focusing on its existing loyal customers. Extending the services provided to include Internet support for products may provide an additional source of competitive advantage at a relatively low cost.

What should be the scope of business?

The organization has traded successfully off a narrow product and market range in the past. Natural growth opportunities might include expansion of the product range to existing customers, expansion of the

market for existing products by looking to overseas markets, or diversifying into other areas related to the existing business.

The most sensible of these would be to try to build on the company's existing strong customer relations and technical skills with a new and expanding product range.

What methods should be used for growth?

The board would need to consider the method by which this might be achieved - e.g. organic growth, acquisition or a joint venture. An acquisition would probably mean raising extra finance that might result in a dilution of control or an increase in finance risk. The long-standing autonomous culture of this business would perhaps make bringing in outsiders, or extensively enlarging operations, less appealing. Borrowing will be difficult and expensive given the high levels of gearing at present.

A joint venture would allow the business to share the initial costs and to increase the pool of skills available. It would also require compromises that may not be in the best interests of the business.

How should the company go about implementing the chosen strategy?

Having decided on a strategy, the board will have to be careful in the introduction of change. Experience has shown that change is often resisted by employees and other stakeholders. It will therefore be important to consult with them throughout the process, to communicate the reasons for change and to sell the benefits of the changes to be made.

It is also important to ensure that the company has the resources and the specialist knowledge required to complete the strategy. Any expansion by MBS may require more staff and more specialists, such as website designers, and more expertise in marketing and manufacturing. A particular resource problem will be the availability of cash.

How can the company effectively control the strategy?

Strategic control mechanisms are formal attempts to guide the organization towards its strategic aims. The most widely used control mechanism is to establish a range of short-term targets and to measure actual performance achieved against these. One commonly used framework for constructing suitable measures is the balanced scorecard, which builds measures around four key perspectives.

Proposed balanced scorecard for MBS.

- ***Financial perspective - what do the company's owners value?***

For MBS, the directors seem to be looking for long-term growth of the company.

Key short-term (in 2003) measures:

Profit before tax target U.shs 1, 100,000,000

Sales target Ushs 15,000,000,000

- ***Customer perspective - what do customers want?***

For MBS this seems to be high-quality, reliable supply.

Key short-term measures:

Customer complaints fewer than 100 in a year

Percentage rejects fewer than 2 per cent

- ***Internal business perspective - what internal activities does the company need to excel at to be successful as a business?***

For MBS this seems to centre on quality control, cost control and other Internal control systems.

Key short-term measures:

Product cost reduction Reduce by 5 per cent

Internal Audit and ICS For immediate review and reorganization

- ***Innovation and learning perspective - what does the company need to be good at now to excel in the long term?***

Technological innovation.

Key short-term measures:

Investment in R&D Ushs 200,000,000 in 2003

This sort of reporting system should be introduced to ensure that progress is being made in the key areas identified.

Appendix 2: Financial Statements for the year ended 31 December 2002

Income statement for the year ended December 2002 (Ushs' 000)

	2002		2001	
	Shs	Shs	Shs	Shs
<i>Sales</i>		12,995,430		12,847,680
<i>Direct expenses</i>				
Raw materials and components	4,903,690		4,909,430	
Direct salaries and wages	3,046,190		3,001,960	
Depreciation on plant, machinery, etc. including loss on disposal	746,540		709,130	
Factory rent and occupation costs	320,800		303,210	
Lighting and power	154,120		161,230	
Sundry expenses	130,330		152,610	
		<u>(9,301,670)</u>		<u>(9,237,570)</u>
		3,693,760		3,610,110
<i>Other expenses</i>				
Office salaries and wages	1,203,560		1,197,890	
Office rent and occupation costs	426,800		435,290	
Depreciation on motor vehicles including loss on disposal	203,440		175,920	
Motor vehicle expenses	91,940		93,470	
Travel and accommodation	74,580		83,670	
Telephone, fax and e-mail	44,600		36,740	
Postage and stationery	36,420		29,740	
Depreciation on office furniture and fittings	55,480		50,350	
Research and development*	110,200		85,300	
Professional fees	48,650		32,450	
Office lighting	13,610		13,460	
Sundry expenses	32,150		31,110	
Interest payable	486,540		384,020	
		<u>(2,827,970)</u>		<u>(2,649,410)</u>
Profit for the year		865,790		960,700
Taxation payable		<u>(320,340)</u>		<u>(355,400)</u>
		545,450		605,300
Dividends		<u>(500,000)</u>		<u>(435,000)</u>
Profit retained		45,450		170,300

* Includes outwork, materials used and salaries.

Balance sheet as at 31 December 2002 (Shs' 000)

		2002	2001
	Shs	Shs	Shs
<i>Tangible fixed assets</i> (note 1)		4,150,830	3,897,550
<i>Current Assets</i>			
<i>Inventories</i> (note 2)	3,125,640	2,578,910	
Trade receivables	3, 131,150	2,851,280	
Prepayments	24,560	34,120	
Cash in hand and at bank	13,640	52,890	
	<u>6,294,990</u>	<u>5,517,200</u>	
<i>Current liabilities</i>			
Trade receivables	1,201,340	1,101,230	
Dividends	332,000	275,000	
Accruals	33,670	21,560	
Taxation	320,340	355,400	
Bank overdraft	887,130	35,670	
	<u>2,774,480</u>	<u>1,788,860</u>	
Net current assets		3,520,510	3,728,340
Long-time loan from bank (repayable 2005)		<u>(4,500,000)</u>	<u>(4,500,000)</u>
		<u>3,171,340</u>	<u>3,125,890</u>
Called-up share capital		1,000,000	1,000,000
Reserves		<u>2,171,340</u>	<u>2,125,890</u>
		<u>3,171,340</u>	<u>3,125,890</u>

Notes' Shs 000*1. Tangible fixed assets*

	Office furniture and fittings	Motor vehicles	Plant, machinery & computer equipment	Total
	U.shs	U.shs	U.shs	U.shs
Cost				
At 1 January	503,450	803,670	7,091,230	8,398,350
Additions	51,300	250,100	992,340	1,293,740
Disposals	-	(261,490)	(939,800)	(1,201,290)
At 31 December	554,750	792,280	7,143,770	8,490,800
<i>Depreciation</i>				
At 1 January	245,600	425,940	3,829,260	4,500,800
Charge for year	55,480	198,070	714,380	967,930
Eliminated on disposals	-	(251,120)	(877,640)	(1,128,760)
At 31 December	301,080	372,890	3,666,000	4,339,970
<i>Net book value</i>				
At 31 December 2002	253,670	419,390	3,477,770	4,150,830
At 31 December 2001	257,850	377,730	3,261,970	3,897,550
Proceeds from sales of assets	-	5,000	30,000	35,000
Straight line depreciation rates	10%	25%	10%	

2. Stocks

	2002	2001
	U.shs	U.shs
Raw materials and components	1,211,340	1,001,030
Work-in-progress	1,367,650	1,235,670
Completed production	546,650	342,210
	3,125,640	2,578,910

3. For his presentation to the directors of MBS, made in August 2002, Charles Kasule used the financial statements for 2001, and for the half year to 30 June 2002. He took up his position with the company in time to contribute to the full year's financial statements for 2002. These are in draft form and are unaudited. **It is now early February 2003.**

Appendix 3

MBS – Organization Chart

