

# 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*

Thursday, 24 June 2004

#### INSTRUCTIONS TO CANDIDATES

1. Time allowed : **6 hours**.  
9.00 – 11.00 a.m. (2 hours): **Planning**  
11.00 – 12.00 a.m. (1 hour): **Break**  
12.00 – 4.00 pm (4 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 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.

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## Introduction

United Supermarkets Ltd (**USL**) was formed three years ago when the owner-managers of five independent small supermarkets came together, and decided that they should combine their businesses.

Prior to the merger all five supermarkets had been independently managed by their owners. They had not significantly competed with each other, although they were all within a ten-mile radius of a large industrial city. They served distinct local communities.

They were all, to varying extents, affected by competition from very large supermarket chains. These had invested in much larger stores (superstores) which had a much greater product range, a more spacious and attractive selling area to encourage customers to look around and make additional impulse purchases, and good car parking facilities. These had superior buying power because of their operating on a large. They had also invested in modern systems and information technology.

The basic strategy that **USL** has adopted to meet this challenge is one of providing customer convenience at existing stores in established shopping areas. The customer convenience is emphasized by being open from 7.00 a.m. to 11.00 p.m. all seven days of the week, even though this involves high staffing costs.

The original aims of **USL** had been to try to combine and take advantage of some economies of scale, and to modernize in order to be more competitive. There was also the important question of planning for retirement for some of the owner-managers. They considered that shares in a successful small chain of supermarkets would be worth more than the value of the individual shops.

Unfortunately, progress made in the three years to date had been very limited, and it was decided after the disappointing 2003 results had been considered to rethink the strategy.

You are **Paul Byaruhanga**, a Certified Public Accountant employed by one of the leading local accountancy firms. You have been assigned to **USL** to assist the company with the development of its financial and general management function. It is now early 2004.

## Information Data (ID) AVAILABLE TO YOU – United Supermarkets Ltd

### ID NO.

1. United Supermarkets Ltd. – Stores.
2. Industry background.
3. Directors' agreement.
4. Premises and resources
5. United Supermarkets Ltd. – Summary of income statements for three years.
6. United Supermarkets Ltd. – Budget for 2004.
7. United Supermarkets Ltd. – Directors, managers, administrative staff and consultants.
8. United Supermarkets Ltd. – Draft balance sheet as at 31 December 2003.
9. Extract from the management letter on the draft balance sheet as at 31 December 2003 and financial management.
10. Summary of the market forecast.

**ID NO . 1****United Supermarkets Ltd. – Stores****Kawempe Township Store**

This is situated in a mini-industrial area. It has not been subject to significant competition from the major supermarkets. However, this is a semi-urban area with relatively low family incomes and there is considerable concern about pricing. If a major supermarket chain managed to get a suitable site in the area it could have a considerable effect on the Kawempe Store.

**Bugolobi Store**

This is in a similar, but slightly more prosperous area than the Kawempe Store. It is the largest store in the group, and has been quite successful. It has not been subject to competition from a major supermarket chain. However, it is known that at least one such chain is looking for a suitable site in the area, and that, if they succeed in finding such a site, it could have a major impact on sales and profits.

**Makerere Store**

This is in the university area, and the premises are leased from the university. A significant part of the trade is selling to the students a wide range of convenience foods. While there is some competition from stores on the campus and within the nearby Wandegaya township, this has not been too important. Major supermarket competition has not been very important, as few students are willing and able to take a taxi to the mega-supermarket. However trade is very poor during University semester holidays, and some staff are only employed during semester-time.

**Old Taxi Park Store**

This store is in a very poor area. The store premises are leased from the organization that runs the taxi park. There is high local unemployment, and many families are living on one meal a day with very low disposable income. Competition from the near by Shoprite Supermarket is acute. Shoprite has very many products at low prices. Sales volumes and selling prices are under pressure.

**Kampala-Kikuubo Store**

Located in a congested but busy area of the city. It sells a different range of products, regarded as better quality, compared with those sold in the other stores within the same locality. However, trade is difficult as parking space is a problem, and many would be shoppers prefer to go by car some five Kilometers away where competing stores sell similar goods but have adequate parking space. Customers buy only relatively few specialised items from **Kampala-Kikuubo Store**.

## ID. NO. 2

### Industry Background

#### Introduction

**USL** is in both the dry foods retailing and domestic appliances Industry. There are a wide variety of organisations in similar line of business. These range from very small shops which are individually owned and managed, offering limited choice and often rather limited opening hours. Such businesses make modest profits by charging relatively high prices and rely on customers purchasing locally for convenience. However, very few such customers would purchase their main requirements from such stores.

On the other hand, there are large International supermarkets with a significant purchasing power with suppliers. USL, with its five supermarkets, falls in-between these two extremes. Other forms of retailing organisations are in the form of “markets” licenced by the city authorities and other unregistered shops that are not known to the tax authorities shops.

#### Competition

USL's is in a very competitive characterised by:

- Typically low growth in volume terms;
- Being influenced by the constant introduction of new product lines;
- The increasing dominance of a few but well organized international supermarket chains;
- Growth in 'own-brand' label products offered by the large chains;
- Increasing use of “special-offer” deals by the large chains;
- The very many unregistered and un-known to the tax authorities shops and markets.

Some recent comments from the “*The Market-Place*”, a monthly magazine published by Uganda Traders Association (UGATA) on behalf of the grocery, food retail and domestic appliances traders include the following:

- Widespread prediction that discount stores are due to make inroads into grocery and domestic appliances retailing after the first opening of a 'Cut-Price' store in Bugolobi by a large overseas retailer.
- Commentators in this trade are warning that the industry is moving into its most confrontational stage for a decade.
- Growth in the market is likely to be insufficient to sustain the expansion of the leading supermarket chains.
- Consumers' sensitivity to price is increasing.
- “**SHOPRITE**” one of the leading International supermarket chains, included a statement from the Chairman in its annual report to shareholders that ***‘we intend to increase our selling space by 50 percent over the next five years.’***

**Industry statistics**

Some statistics relating to the structure of the dry food retailing and domestic appliances industry are as follows:

	<b>1992</b>	<b>1997</b>	<b>2002</b>
Number of outlets	47,000	41,000	39,000
Market share of International. Supermarkets (%)	73	76	80
Average store size of large retailer (square metres)	1,117	1,295	1,500
Own-label brands: share of market (%)	29	32	36
Number of stores with scanning devices	470	2,300	12,000
Press and television advertising (Ug Shs Million)	63	98	125

**ID NO # 3****Directors' Agreement****Background**

When **USL** was formed three years ago, the then owner-managers of the five independent small supermarket stores agreed the net worth of the businesses at a total of U.Shs 500,000,000.

The U.Shs 500,000,000 was determined on the basis of the book value of the existing businesses. The existing owners did not wish to revalue the assets, as they were not sure of the provisions of the Income Tax Act (1997) with regards to capital gains tax liabilities. The company's bank (Century International Bank) received valuations of the various properties as part of their assessment of the creditworthiness of the new business. The bank's loan to the company effectively replaced separate loans by both Century International and other banks to the previous owners.

The book value of U.Shs 500,000,000 was converted into shares in USL with a nominal value of Shs 10,000 per share. The previous owners of the five supermarket stores were issued with shares in the new company in proportion to the agreed book values of their respective businesses at close of business at 31 December 2000.

The personal guarantees required by the banks of the previous owners are still required of those who are now directors in the new company.

The share capital of **USL** at 1 January 2001 is as below, and there have been no changes to date:

Store	Director	Share capital Shs	Number of shares
Kawempe	Bagenda	100,000,000	10,000
Bugolobi	Sentamu	150,000,000	15,000
Makerere	Winfred Acan	80,000,000	8,000
Old Park	Katongole	70,000,000	7,000
Kampala -Kikubo	Rutaro	<u>100,000,000</u>	<u>10,000</u>
		<u>500,000,000</u>	<u>50,000</u>

If a director wishes to retire, and gives a formal twelve months' notice, the auditors will be asked to value the business and the retiring director's shares. These shares will be offered to the remaining directors at this valuation, in proportion to their existing shareholdings.

**Directors' agreement**

An agreement was drawn up between the five directors when the company was formed, an extract of which is shown below.

- All directors are entitled to receive an annual fee. This is initially to be U Shs 5,000,000 each, but can be reviewed annually.
- Any director who actively works in the business is entitled to be paid a salary commensurate with the duties involved. The salary is to be determined by all directors, with a majority vote if required.
- All directors have equal voting rights irrespective of their shareholdings.

- (d) An annual dividend per share is normally expected to be paid, dependent upon the profitability of the company.
- (e) No shares in the company can be sold without the agreement of all other directors.
- (f) Any director wishing to retire from the company is required to give a minimum of twelve months' notice.

The intention of this agreement is that directors should be fairly rewarded for duties undertaken and be recompensated according to their investment in the company.

It was agreed when the company was formed in 2001 that any investment by the previous owners carried a risk. The value of their investment could fall as well as rise; accordingly the return of capital was not guaranteed.

By forming the company the ex-owners no longer benefit, or suffer from, any gains or losses arising from the sale of any USL store. Such gains or losses now belong to the company as a whole.

#### **ID NO # 4**

##### **Premises and resources**

Three supermarket stores – Kawempe (KPE), Bugolobi (BUG) and Kampala-Kikuubo (KK) – are freehold premises. The other two stores – Old Park (OP) and Makerere (MUK) – are on long-term leases.

The following statistics have been compiled from the financial statements for the year ending 31 December 2003:

	<b>KPE</b>	<b>BUG</b>	<b>MUK</b>	<b>OP</b>	<b>KK</b>	<b>TOTAL</b>
Store area in square metres	800	900	240	500	340	2,780
Annual sales @ square metres ('000)	3,178	3,744	5,079	3,246	4,365	3,683
Number of staff (note 1)	33	36	20	27	27	143
Gross profit % of sales	28.3	31.1	34.1	27.4	36.2	30.9
Stock in days (note 2)	43	43.4	44.5	46.1	52.8	45.1
Number of product lines stocked	3,000	3,000	2,500	2,000	4,000	
Average expense per customer visit	40,000	50,000	20,000	25,000	15,000	29,000

##### **Notes:**

1. The number of staff relates to shop assistants only, excluding management. The numbers are calculated on a 'full-time equivalent' basis. For example, two assistants working half a week each become the equivalent of one full-time assistant.
2. The stock in days is the number of days' stock in relation to the cost of goods sold in the year.

**ID No # 5****USL – Summary of Income Statements for three years ( U.Shs million)**

<b>2001</b>	<b>KPE</b>	<b>BUG</b>	<b>MUK</b>	<b>OP</b>	<b>KK</b>	<b>GROUP TOTAL</b>
Sales, excl. VAT	<u>2,367</u>	<u>3,137</u>	<u>1,123</u>	<u>1,757</u>	<u>1,425</u>	<u>9,809</u>
Gross Profit	<u>689</u>	<u>988</u>	<u>382</u>	<u>516</u>	<u>519</u>	<u>3,094</u>
Personnel costs	<u>367</u>	<u>387</u>	<u>194</u>	<u>277</u>	<u>320</u>	<u>1,545</u>
Other costs	<u>283</u>	<u>423</u>	<u>137</u>	<u>170</u>	<u>168</u>	<u>1,181</u>
	<u>650</u>	<u>810</u>	<u>331</u>	<u>447</u>	<u>488</u>	<u>2,726</u>
Store profit	<u>39</u>	<u>178</u>	<u>51</u>	<u>69</u>	<u>31</u>	<u>368</u>
Central costs						86
Interest						<u>90</u>
						<u>176</u>
Profit before tax						<u>192</u>
<b>2002</b>						
Sales, excl. VAT	<u>2,440</u>	<u>3,201</u>	<u>1,182</u>	<u>1,673</u>	<u>1,454</u>	<u>9,950</u>
Gross Profit	<u>695</u>	<u>1,005</u>	<u>404</u>	<u>495</u>	<u>525</u>	<u>3,124</u>
Personnel costs	<u>383</u>	<u>402</u>	<u>202</u>	<u>285</u>	<u>335</u>	<u>1,607</u>
Other costs	<u>298</u>	<u>445</u>	<u>140</u>	<u>176</u>	<u>180</u>	<u>1,239</u>
	<u>681</u>	<u>847</u>	<u>342</u>	<u>461</u>	<u>515</u>	<u>2,846</u>
Store profit	<u>14</u>	<u>158</u>	<u>62</u>	<u>34</u>	<u>10</u>	<u>278</u>
Central costs						64
Interest						<u>90</u>
						<u>154</u>
Profit before tax						<u>124</u>
<b>Draft 2003</b>						
Sales, excl. VAT	<u>2,542</u>	<u>3,370</u>	<u>1,219</u>	<u>1,623</u>	<u>1,484</u>	<u>10,238</u>
Gross Profit	<u>719</u>	<u>1,048</u>	<u>416</u>	<u>445</u>	<u>537</u>	<u>3,165</u>
Personnel costs	<u>395</u>	<u>483</u>	<u>208</u>	<u>290</u>	<u>351</u>	<u>1,727</u>
Other costs	<u>312</u>	<u>468</u>	<u>144</u>	<u>180</u>	<u>187</u>	<u>1,291</u>
	<u>707</u>	<u>951</u>	<u>352</u>	<u>470</u>	<u>538</u>	<u>3,018</u>
Store profit / (loss)	<u>12</u>	<u>97</u>	<u>64</u>	<u>(25)</u>	<u>(1)</u>	<u>147</u>
Central costs						72
Interest						<u>83</u>
						<u>155</u>
Profit / (loss) before tax						<u>(8)</u>



**ID NO # 6****USL – budget for 2004 ( Shs 000,000)***Memorandum:*

	KPE	BUG	MUK	OP	KK	GROUP TOTAL
Sales						
% change	+3	+3	+3	-4	+3	
GP %	28.1	30.9	33.9	27.0	36.0	
Sales excl. VAT	<u>2,618</u>	<u>3,471</u>	<u>1,256</u>	<u>1,558</u>	<u>1,529</u>	<u>10,432</u>
GP	<u>736</u>	<u>1,073</u>	<u>426</u>	<u>421</u>	<u>550</u>	<u>3,206</u>
Stores costs:						
Personnel	394	444	226	315	324	1,703
Other	318	477	146	183	190	1,703
Other costs:						
Group staff, MD, etc.						99
Central costs						125
Interest	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>83</u>
Total costs	<u>712</u>	<u>921</u>	<u>372</u>	<u>498</u>	<u>514</u>	<u>3,324</u>
Profit/(loss) before tax	<u>24</u>	152	<u>54</u>	<u>(77)</u>	<u>36</u>	<u>(118)</u>

**Notes**

1. These costs were allocated to the individual stores on the basis of sales excluding VAT in the summary income statement.
2. Interest has not been recalculated on the basis of expected borrowings for 2004; the figure shown is the 2003 charge.

**ID No # 7****USL- Directors, managers, administrative staff and consultants****KAWEMPE**

This was formerly owned by **Mr Bagenda**, who sold the business to USL. He is now a director of USL and has continued to manage the Kawempe store. He is over 60 years of age and wishes to retire, and would be quite happy to make way for a new store manager, or a new management structure. Because he has always been reluctant to agree to change, or to authorise any expenditure, the store looks old-fashioned and in need of redecoration.

Bagenda's salary (including related costs) for 2003 was Shs 27,000,000. For 2004. Shs 14,000,000 has been budgeted for six months, to allow time to train a new store manager, and hand over responsibility to him. A new manager, **Ken Lubega**, was appointed, commencing on 1 January 2004 at a cost of Shs 20,000,000 per annum.

Bagenda will continue to be a non-executive director, receiving a fee of Shs 5,000,000 per annum. in addition to his salary. This is included in central costs.

## Bugolobi

This was formerly owned by **Mr Sentamu**, who sold the business to USL. He is now Managing Director of USL, but has continued to spend some time on the management of the Bugolobi store. While he has been criticised by the other directors for the time thus spend, and the consequent delay in implementing plans for achieving group savings, he has considered it unavoidable because of problems regarding past employment of casual workers. His salary is not charged to the Bugolobi store; it is shared between all five stores in proportion to sales, as are the salaries of the very small central staff, who together with Mr. Sentamu work from offices above the Bugolobi store.

There had been considerable difficulties several years ago in recruiting staff to work part-time in the evenings and weekends, at what Sentamu regarded as reasonable wage rates. He had engaged staff on 'unofficial' terms; they were paid cash, no PAYE or NSSF was deducted, and no official returns showed their existence. This had been discovered by the authorities in due course and followed by a prolonged investigation. This eventually led to payments to the authorities in 2003 of Ushs 28,000,000 to cover past liabilities. All employment terms at the store have now been regularized.

Mr Sentamu had duties beyond the Bugolobi store as managing director. An assistant store manager, **Alice Lakweno**, was appointed two years ago, with the intention that she should become manager if satisfactory. It is now agreed that she could be promoted to manager. A 10 percent salary increase for Alice has been budgeted, increasing her cost from U.Shs 20,000,000 in 2003 to U.Shs 22,000,000 in 2004. She has been promised that some form of bonus on profits will be introduced for store managers.

## Makerere

**Winfred Acan** inherited this business on the death of her husband several years ago. She carried on managing it until it was sold to USL, but since then she has been a very inactive non-executive director. Her fee as a director of U.Shs 5,000,000 per annum is included in central costs. She is concerned about the long-term value of her shares, and the falling income, but does not wish to take a more active part in the business.

The store is managed by **David Gava**. His salary and related costs amounted to U.Shs 22,000,000 in 2003 and are budgeted at U.Shs 23,000,000 in 2004. He is regarded as competent, but unhappy that there is no scheme to provide any sort of bonus or profit share, though it has often been said that some such scheme will be introduced.

## Old Park

This was originally the "staff shop" for the Taxi-Drivers Association, managed by **Male Katongole** until it closed. He then took over the premises and restarted the business. Three years ago he sold the business to USL, and agreed to continue to manage it for three years, after which he expressed his intention to retire.

He now wishes to retire from being a store manager, but nothing has yet been done to recruit and train a successor. His salary and related costs were U.Shs 25,000,000 in 2003. The budget for 2004 provides his salary for six months of U.Shs 13,000,000 to train a new

manager. U.Shs 20,000, 000 has been provided in the budget for the salary of a new manager. Katongole will continue to be a director at a fee of U.Shs 5,000,000 per annum.

### **Kampala-Kikuubo**

This store is managed by **Susan Batuwa**, who was appointed six months ago. She replaced a previous assistant manager who did not prove capable of managing the store. The costs in 2003, relating to Susan and the assistant manager she replaced, were U. Shs 21,000,000. The same amount is budgeted for in 2004 for Susan. Now that she is fully in charge, the previous owner, **Abas Rutaro**, now a director of USL, can devote his time to group responsibilities. **Abas Rutaro's** 2003 salary costs of Shs 27,000,000 were charged to the Kampala-Kikuubo store; in 2004 his salary is budgeted to be shared between all stores.

### **Group staff**

In 2004 the group staff, working from offices above the Bugolobi store comprised:

- **Mr. Sentamu**, Managing Director of USL. His salary and related costs were U.Shs 42,000,000 in 2003, and will remain unchanged in 2004. He is under pressure from his co-directors to spend more time on the business as a whole, and to take actions to improve the recent poor results.
- **Patrick Kandole** is the Purchasing Officer. His salary and related costs were U.Shs 14,000,000 in 2003, budgeted to increase to U.Shs 15,000,000 in 2004. Since he was appointed, he has been able to achieve relatively little in negotiating new prices with suppliers as his time has been taken up establishing the extent to which common suppliers are used by the stores, and resolving day-to-day problems.
- **Charles Lule**, the part time Accountant,; received a salary of U.Shs 15,000,000 in 2003 and the same amount is budgeted for 2004. When he was appointed it was envisaged that he would be able to provide some management information, and have some time to do some limited internal audit. Until now he has been largely engaged in sorting out the problems of Bugolobi's failure to deduct PAYE and NSSF from employees, and establishing that similar, but smaller, problems exist at Old Park and Makerere. These matters will have to be resolved. He has provided budget figures for 2004 for all stores for non-managerial personnel, taking account of these problems and making the necessary adjustments.
- **Abas Rutaro**, formerly the manager of the Kampala-Kikuubo store, as well as its former owner, and a director of USL, will from January 2004 be a full-time member of the group staff, and will concentrate on purchasing matters. His salary and related costs have been budgeted to remain at U.Shs 27,000,000 per annum

The costs of the above central staff have been shared between the stores on the basis of sales, as shown in the analysis of 2003 personnel costs.

### Costs included in central costs and not charged to stores

All five directors (Sentamu, Bagenda, Winfred Acan, Katongole and Rutaro) receive directors' fees of U.Shs 5,000,000 per annum. each, in addition to any salary received for duties undertaken. These are charged to central costs.

Central costs also include legal, consultancy and audit fees.

In 2004 fees of U.Shs 15,000,000 have been budgeted for **Paul Byaruhanga**, a Certified Public Accountant employed by one of the leading local accountancy firm, to provide assistance with financial accounting and management matters. It is anticipated that this service will be required as a continuing service, for a similar fee, each subsequent year.

Fees of U.Shs 40,000,000 have been budgeted to be paid in 2004 to Forward Marketing Consultants, for providing sales forecasts for the stores and for providing advice on potential competition from the major international supermarkets. It is assumed that there will be no need to provide for a similar fee in 2005.

### Analysis of central costs in U.Shs million (not charged to individual stores)

	2001	2002	2003	2004	2005
				Budget	Forecast
Directors' fees	25	25	25	25	25
Audit	30	32	35	38	40
Accounting & Management fees	-	-	-	15	15
Marketing consultancy	-	-	-	40	-
Other legal and consultancy	31	7	12	7	20
Total	86	64	72	125	100

**Analysis of personnel costs charged to stores (U.Shs million)**

<b>2003</b>	<b>KPE</b>	<b>BUG</b>	<b>MUK</b>	<b>OP</b>	<b>KK</b>	<b>Group</b>	<b>Total</b>
Shop staff excl. managers	350	412	177	254	293		1,486
Exceptional costs (tax etc.)		28					28
<b>Directors</b>						42	
Sentamu							
Bagenda	27						
Katongole				25			
Rutaro					27		121
<b>Managers:</b>							
Alice Lakweno		20					
David Gava			22				
Susan Batuwa					21		63
Patrick Kandole						14	
Charles Lule						15	29
Allocate central staff (sales basis)	<u>18</u>	<u>23</u>	<u>9</u>	<u>11</u>	<u>10</u>	<u>(71)</u>	
<b>Total</b>	<b><u>395</u></b>	<b><u>483</u></b>	<b><u>208</u></b>	<b><u>290</u></b>	<b><u>351</u></b>	<b><u>-</u></b>	<b><u>1,727</u></b>
<b>2004</b>							
Staff excl. managers	360	422	203	282	303	-	1,570
<b>Directors:</b>							
Sentamu						42	
Bagenda	14						
Katongole				13			
Rutaro						27	96
<b>Managers:</b>							
Ken Lubega	20						
Alice Lakweno		22					
David Gava			23				
New				20			
Susan Batuwa					21		106
Patrick Kandole						15	
Charles Lule						15	30
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<b><u>394</u></b>	<b><u>444</u></b>	<b><u>226</u></b>	<b><u>315</u></b>	<b><u>324</u></b>	<b><u>99</u></b>	<b><u>1,802</u></b>
(Central staff not allocated)							

**ID NO. 8****UNITED SUPERMARKETS LIMITED****Draft balance sheet as at 31 December 2003 (U.Shs' million)**

	KPE	BUG	MUK	OP	KK	TOTAL
<b>Non-current assets</b>						
Freehold Premises <b>1</b>	260	420			230	<b>910</b>
Leasehold Premises <b>2</b>						
• Cost			168	222		
• Amortisation			<u>(40)</u>	<u>(12)</u>		
• Written-down value			128	210		<b>338</b>
<b>Equipment <b>3</b></b>						
• Cost	290	350	180	200	200	
• Depreciation	<u>(204)</u>	<u>(165)</u>	<u>(90)</u>	<u>(80)</u>	<u>(40)</u>	
• Written-down value	<u>86</u>	<u>185</u>	<u>90</u>	<u>120</u>	<u>160</u>	<b>641</b>
<b>Total non-current assets</b>	<b>346</b>	<b>605</b>	<b>218</b>	<b>330</b>	<b>390</b>	<b>1,889</b>
Inventories	<u>215</u>	<u>276</u>	<u>98</u>	<u>149</u>	<u>137</u>	<b>875</b>
<b>Total assets</b>	<b><u>561</u></b>	<b><u>881</u></b>	<b><u>316</u></b>	<b><u>479</u></b>	<b><u>527</u></b>	<b><u>2,764</u></b>
<b>Equity and Liabilities</b>						
Trade creditors (not allocated) <b>4</b>						<b>1,461</b>
<b>Liabilities</b>						
Shareholder funds						<b>553</b>
Bank loan						<b>700</b>
Trade payables (not allocated) <b>4</b>						<b>1,461</b>
Bank overdraft <b>5</b>						<b><u>50</u></b>
<b>Total Equity and Liabilities</b>						<b>2,764</b>

**Notes**

- Freehold premises are as valued in 2001. They are not depreciated.
- Leasehold premises are amortised over the lives of the leases. Makerere store is a 21-year lease from 1 January 1999 with rent reviews after seven and fourteen years. The rental is U.Shs20,000,000 per annum. Old Park store is on a 70-year lease from 1 January 2000, with rent reviews every seven years. The rental is U.Shs10,000,000 per annum.
- Equipment, largely shop fittings, is depreciated over ten years.
- Trade payables are all creditors of USL, not the individual stores. On average, payment is made in 75 days.
- The bank overdraft and loan are secured by a charge on all the assets of the company.

**ID NO. 9*****Extracts from the Auditors Management Letter on the draft balance sheet as at 31 December 2003 and financial management***

**Leasehold premises:** A rent review is due on the Makerere store after seven years, i.e. at the end of 2005. Professional advice is that the rent could double at this time, as the store is obviously profitable. A rent review will be due on the Old Park store at the end of 2006; in view of the trading problems, and the general condition of the surrounding neighborhood, there is unlikely to be a rent increase, and there may be a case for a decrease. Management has to take into account the above issues during budget sessions.

**Bank loan and overdraft:** These are secured by a charge on all assets of USL and by the personal guarantees of all five directors, and charges on all the individual directors' assets, which are mainly their houses. The directors consented to the arrangements but the Board minutes are not yet signed.

**Inventories** are valued at cost. Considerable efforts have been made to reduce stockholdings, with little effect. It has been decided not to allow stocks to rise above the present (end-2003) cash value. The inventory valuation method is not the "bench mark" method allowed under IAS 2: Inventories.

**Dividends:** After the 2002 results, the maximum possible dividend was paid on the profits of that year to enable the directors to resolve personal financial problems. No dividend will be payable on the results of 2003, and it has been decided not to pay any further dividend until all questions of possible modernisation, and the retirement of various directors, have been resolved. Directors have agreed to the arrangement but it is yet to be adopted in a formal annual general meeting.

**Taxation** is payable on profits at the rate of 30 percent in the following year. In theory there should be a small payment of tax in 2004, based on the loss in 2003; this has been ignored in the calculations, as there could be considerable delays.

**Turnover** excludes VAT (value added tax). Cash-flow effects of the collection and payment of this tax can be ignored.

**ID NO # 10****Summary of the Marketing Forecast**

This was provided by Forward Marketing Consultants (Managing Director- **Ben Sekabira**)

**General assumptions**

- Inflation : 3 percent per annum for the foreseeable future (approximately five years)
- Sales will generally rise by 3 percent per annum. – in line with inflation; there will be real growth to reflect rising living standards, effectively a slow loss of market share. This is to apply to all stores except "Old Park".
- "Old Park": because of intense competition from the major supermarket chains, a loss of sales volume of 4 percent per annum should be assumed.

- Gross profit margins will fall slowly under competitive pressures, by approximately 0.2 percent per annum. for all stores except Old Park, which will fall by 0.4 percent per annum.

**Paul Byaruhanga** was consulted on the original inflation forecast, and agreed that, in line with that forecast, it would be consistent to assume a 3 percent per annum. increase in all personnel costs, managerial and non-managerial. This would not provide for any real increase in living standards, but that this was realistic in a very competitive industry. This 3 percent would only apply for 2005 and thereafter; specific forecasts had already been made for 2004 for directors, managers and administrative staff, and for store staff, adjusting for the taxation problems.

Some other costs were known to be fixed, and not going to change in the absence of policy decisions. Others could be assumed on average to rise by 2 percent per annum.

Group central costs could also be assumed to rise by 2 percent beyond the period for which a specific forecast had been made.

### Specific Store Problems

**“Kawempe” and “Bugolobi”:** competitive risks

Either or both of these stores would be very badly affected if a major international supermarket obtained a site for a superstore near them. It is not easy to estimate any probabilities for such an event, but at least one major supermarket is known to be searching for a suitable site.

Without knowing which supermarket could obtain a suitable site, or quite how near to either the Kawempe or Bugolobi store sites this would be, any estimate of the potential effect is very approximate, and subject to a wide margin of error. However, there will be a significant and unfavorable impact. An initial estimate of the potential impact on either store is:

- Sales would fall immediately by 15 percent. Thereafter sales would be stable in money terms. They would not show the normal increase of 3 percent in line with inflation, effectively a slow fall in real terms.
- Gross profit margins would immediately fall 3.0 percent, as a result of price competition. There after there would be a continuing fall of 0.2 percent per annum, as with other stores.
- Costs of non-managerial personnel could be reduced, as these are relatively large stores, in line with the reduced volume. A simple, probably reasonable, assumption is that costs could be controlled to the same percentage of turnover as in the 2004 budget.
- Other costs would be unlikely to show any significant change with the fall in sales volume, and any projections should regard them as fixed in relation to short-term volume fluctuations.