

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, 15 DECEMBER 2005

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 p.m. (3 hours 30 Minutes): Writing.
2. The following pages contain case study materials.
3. The case study questions are contained in a separate paper marked Afternoon Session Material.
4. The completed answers and any working papers, clearly labelled working papers must be handed in at the end of the afternoon session. Where working papers form part of your answer, ensure that they are appropriately cross referenced.
5. It is in your interest that you hand in all written materials prepared during the examination.
6. Please read further instructions on the answer book.

GLOBAL COMMERCIAL BANK UGANDA

Global Commercial Bank Uganda (GCBU) was set up in 1923 as the financial services arm of the Imperial British East Africa Company (IBEAC) and the Royal Dutch East Africa Company (RDEAC) to assist in the finance of various trades in coffee, tea, cotton and copper. At the time of set up, the main areas of operation centred around what was euphemistically known as the 'Great Steel Snake' route, in reference to the Kampala-Mombasa railway line. Indeed part of GCBU's remit had been to finance the colonial government's infrastructure expansion plans to western Uganda and Northern Uganda.

Having achieved this objective, the company had now established an unblemished reputation as one of the most reliable trade banks for import / export trade. The bank financed traders in several types of markets. The primary market was mainly populated by Indian tradesmen who sold tinker and house wares to the 'natives' and also acted as a conduit for the purchase of the Africans' cash crops. Thus they could sell goods on credit to the local farmers and thereby lock in a price for the season's harvest of whatever crop would be harvested. In turn the Africans had access to non-seasonal products besides obtaining some cash to pay school fees for their children.

In the secondary market, the bank financed auction trades for the cooperatives and big trading houses, which exported the cash crops and mineral ores. This market involved more merchant banking activities and thus more sophistication, even if there were fewer players than in the primary market. Volumes were also huge, and the profits more attractively conformed to the 80-20 rule of business.

Thus at the time of independence, GCBU Limited was a nationally recognised symbol of growth and pride to the nation. The years following independence were heady years and the bank recognised unprecedented growth as the African intelligentsia grew into a budding middle class, with a taste for modern goods, mortgages for homes, cars and the like. The feeling of emancipation created a bigger market and therefore a demand for new products such as house mortgages, lease financing and salary loans. The bank prospered and grew in size from 7 branches at independence, to 23 branches countrywide by 1967 with over 330 employees nationwide.

In 1969, the President of Uganda, in what became known as the Nakivubo Pronouncements' decided to nationalise the bank as part of indigenisation of the economy. The bank's assets were seized and management was placed in the hands of an African manager. The Government also injected more money and increased the number of branches to 46, for each of the district capitals. This did not however stall the bank's business, which continued to grow from strength to strength despite several years of turmoil between 1972 and 1985.

As part of the Government's drive to support indigenisation, the bank in 1983 introduced a Rural Farmer's Scheme (RFS), which started off with an investment of US \$ 4.5 million. It was argued that the rural economy had always formed the core area of the bank's business. This particular pro-people investment was also responsible for the expansion and growth of the business. The cash crop economy,

which had been in decline for the last 10 years, coupled with the collapse of Co-operative Unions was on the mend. It was thus necessary to jump start production by financing farmers especially in the post war period. However, others argued that while this reasoning was acceptable, it was more suited to macro management issues rather than corporate strategy for a bank. However, in its nationalised state, the bank could not ignore government policy interventions. Since the bank was now a national bank, it had to also channel resources in such a manner as would best enhance a trickle down of economic benefits and spur growth.

Despite the noble objectives of the bank and its officers, the RFS was a disaster. It, along with several loans to large enterprises, crippled the banks ability to create new business. Furthermore, several political decisions had changed the composition of the Board unfavourably away from a business focus. Politicians were also taking loans from the bank and not paying. By 1987, the bank had grown to 89 branches countrywide with over 4,650 employees. The bank's organisational structure had over 15 hierarchical levels (see exhibit 1), which made decision making almost impossible.

The bank's position was not unique. Poor management, political interference and lack of capital had hobbled most public enterprises at the time. The government of the day, which adopted structural adjustment programmes, identified the bank as one of the public enterprises to be privatised. However, due to its historical linkages, to the IBEAC and RDEAC, these companies were given first call to purchase the bank. Actually, the privatisation was nothing more than a repossession of the bank. The bank was repossessed by the owners in 1988

On re-acquisition, the owners decided to radically restructure the bank, which despite the poor business decisions was still a profitable institution (exhibit II). It was decided that the following strategic interventions be undertaken immediately as part of a modernisation process to make the bank portray its international image of old and also fit into 21st Century banking.

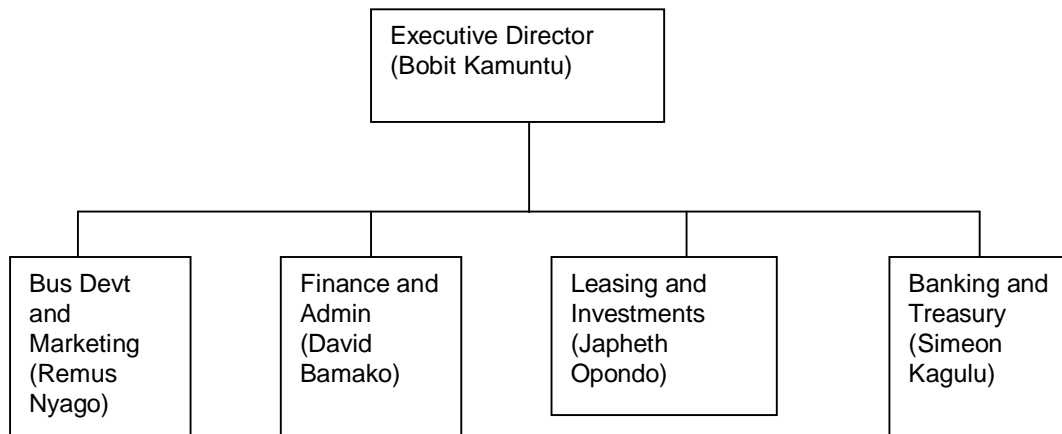
- Recapitalisation of the operations.
- Organizational structure and HR Competence profiling.
- Systems Redesign and ICT development.
- Sale of non-core assets/businesses.
- Re-branding and rehabilitation/redesign of premises.

Details relating to the above strategic interventions are set out in exhibit III that is attached at the end of the case study.

GCBU embarked on a serious market penetration drive and also attempted to change its work culture by changing norms in the work place. While it was recognised that banking required a very formal and confidence building approach to clients, it was necessary to break down barriers among staff so as to raise productivity. Amongst the work place innovations that were introduced, several were well received and staff productivity improved. Many of the older staff were phased out and younger managers given more responsibility for day-to-day management.

By 2001, the face of GCBU had radically changed. A new and recognisable amber colour theme brand was in use and the oldest manager was Bobit Kamuntu aged 38 years old. Directly under him were four energetic young managers whose average age was 34 years. They were all highly qualified in their respective fields and had a proven track record in the banking industry, having worked in several banks. The top two levels of the bank looked as shown in the chart below after the organisational review and attendant restructuring. There were only four business units left under which all bank activities were now organised.

GLOBAL COMMERCIAL BANK UGANDA 'TOP TEAM'



Bobit Kamuntu was an easygoing chap, who did a good days work and always assisted his colleagues overcome any difficulties they may have faced. The industry was however a very competitive business and it was always necessary to attract new business using commission plans. The system seemed to work well and the business grew incredibly as a result of handling these huge accounts. He gave his colleagues full authority to run their units and he always delegated a lot. His background was accounting and he had graduated with the ICPAU as one of its first graduands.

Remus Nyago, the Business Development Manager had been able to attract several new customers to the bank, including several donor projects, which had banked huge foreign currency sums with the bank. Besides this feat, he had also introduced several 'smart' products, which suited working class executives for example salary loans, 'credit-on-the-go' cards and the like. Currently he was asking management to consider investing in a new rural based insurance product, details of which are included in the afternoon session material.

Remus was always immaculately attired and never seemed to disagree with anybody. He however had his eye on the top job and was always doing his best to catch the eye of the bank's chairman. He also had a habit of spying on his colleagues and seemed to keep a scorecard on their mistakes. Besides his marketing role, he was responsible for all Corporate Social Responsibility work. In other words, he was the face of the bank. He was always seen in the Press,

helping this orphanage here, building low cost housing there and closing a sports gala at one of the up-market clubs. The bank believed that it had a duty to give back to the community and had pledged to spend 0.1% of its annual net profit on community activities.

David Bamako (CPA) the finance man was a reserved and bureaucratic type. He liked to play by the rules and he was not one to play along with the fudging of rules to get customers. He was reluctant to play the commission game but what could he do in this competitive industry? Profits, profits and profits. That was the way the cookie crumbled. You played or you were out.

Still he was concerned with the ethical issues arising from the way some accounts were handled in which third parties not directly connected with the business earned huge commissions for dubious connections. He had once intimated to Bobit that 'this pay for connections thing makes me uneasy... one day we are going to answer for these unexplained commissions to dubious agents. We need to clean our act and improve the corporate governance standard.' Bobit told him 'Take it easy. I have already discussed with the Chief Executive though the Board Chairman doesn't know this matter. I don't see how the Audit Committee guys are going to come asking questions.' David was not satisfied but he had a wife and two young children. He was not going to turn whistle blower or rock the boat. He would just do his job. However, as a fully qualified CPA, he was still not so comfortable for the accounting methods used in recording the secondary transactions that were a spin off the large accounts. He felt that his independence and objectivity had been compromised by the set up and the hands-off attitude of the Board.

Simeon however was a different kettle of fish. Given his law background he was always aware of the grey areas and given his extroverted nature, he always warned that 'the cocks would come home to roost one day'. He was however responsible for banking, credit and investment (treasury) and he was making a lot of money for the bank, besides making a handsome package on the side for the 'top team'. He was going to play with the team. He was in the middle of appraising an investment project whose income statement and projected cash flow is shown in exhibit IV and V respectively. He was one of those who believed that 'cash is king' and did not need any other analysis to make a decision on the viability of the project. This approach had created serious animosity between him and Japeth Opondo who was also responsible for investments and was supposed to be his co-support in decision-making.

The bank's re-branding and business re-engineering policies were so successful that by 2003 its profits were three times its core capital. The government also decided to sell its residual interest to the public through the stock exchange and accordingly contracted MBAWE Stock Brokers to prepare a prospectus and identify an underwriting house for the issue. The public offer was extremely successful and the IPO was oversubscribed. It proved to be a very popular issue with the public and the capital gains reaped by several buyers of the shares in the first six months were threefold.

For the 'top team', life went on as usual with the bank making more and more profits, and the commission agents making a killing on the side, especially with the

foreign accounts. In 2004, the bank received one especially large account for the 'Fight against Water Hyacinth'. The water hyacinth had become a menace and worldwide efforts to eliminate the weed were being supported by several governments, which had created a Worldwide Fund for giving grants to poor countries to fight the hyacinth and protect the world's water reservoirs. Complications set in immediately as the account for the Worldwide Fund was opened. On opening, a contract was signed with an 'introducing agent' from the firm S&H Associates which claimed a fee for 'introducing' the multi million dollar account.

The firm S&H Associates did not have any known connection with the eradication of water hyacinth, and its appearance in the business world was also a surprise since it had no track record in the area of finance. The 'introduction fee was also based on the number of transactions conducted on the account and had no predetermined rate or limit. In December 2004, one particular transaction involving the sale of US \$ 4.5 million was conducted at a selling rate way below Bank of Uganda's mid rate for the day. Moreover the sale involved an intermediary account such that the money sold appeared to have been sold by the project to another party, which then sold it to GCBU. The commission on this particular transaction was Ugx 395 million and was accordingly paid by the bank to S&H Associates.

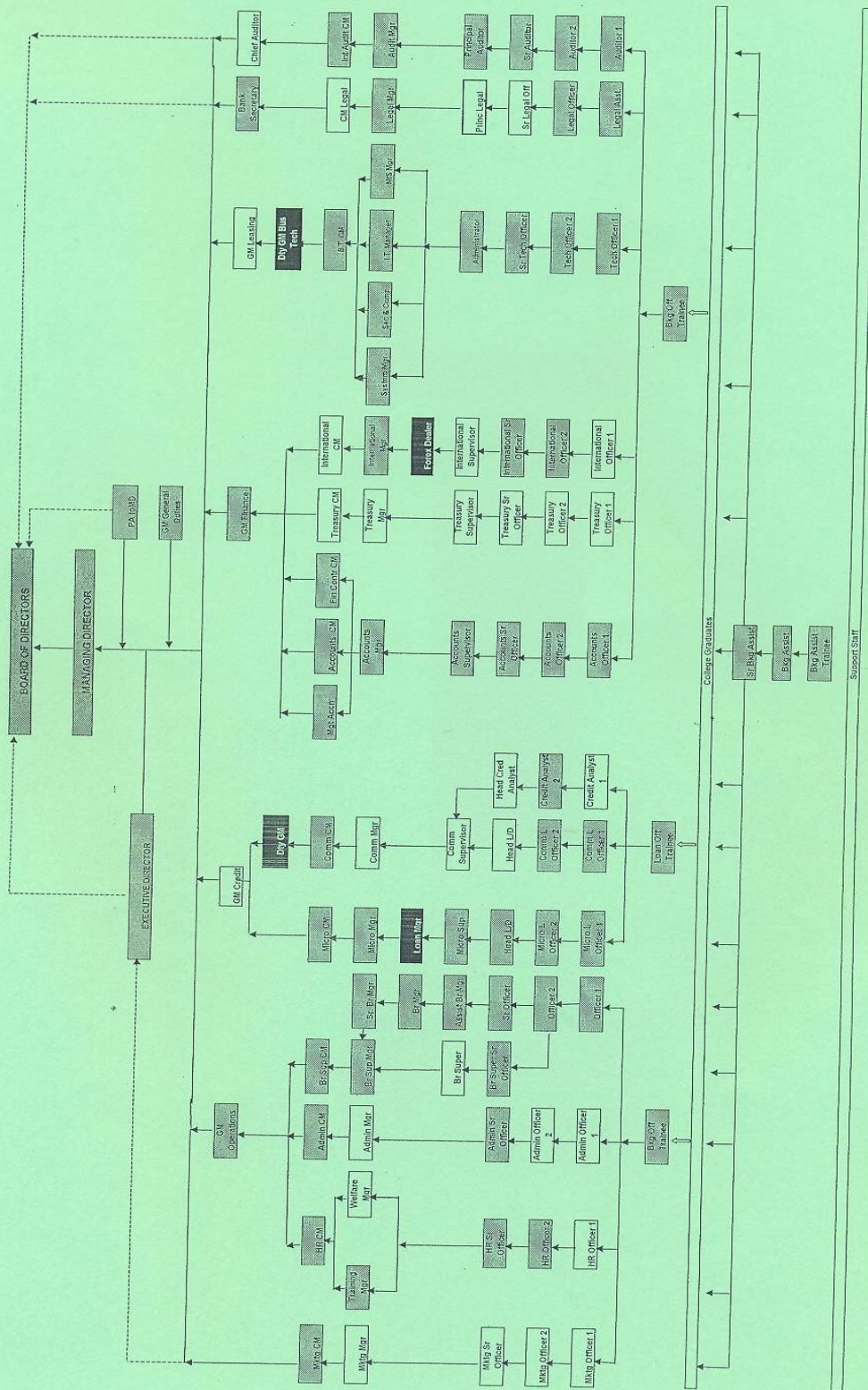
The external auditors, whilst carrying out the 2004 audit, noted the abnormality of this transaction and raised it as part of their management letter.

Their audit query was as follows:

"In the course of our review of the bank's foreign exchange transactions, we noted that sales of foreign exchange from the 'Fight against Water Hyacinth' Account no GCBU/FAWHA/001 were conducted at rates well below the bank board rate. Furthermore on December 13, 2004 the sale of US \$ 4.5 million occasioned a loss of Ugx 405,000,000 to the client, which is not in tandem with the banks working policy of maximising client benefits. The sale was also conducted through a third party who in our opinion was not necessary given the banks experience in such business. This loss was material in all respects and we seek your comment on the matter".

The response of management was found unsatisfactory and the matter was carried as a qualification in the auditors report. The Board, which considered the issue of Corporate Governance to be one of the cornerstones of the banks business activities was very displeased by this type of transactions and decided to constitute an internal inquiry into the activities of its managers.

Exhibit I Organogram



December 2005

**Exhibit II: Pre Reacquisition Performance
Global Commercial Bank Uganda**

Income Statement For The Year Ended 31 December 1987

| | 1987 | 1986 |
|---|---------------------|---------------------|
| | Ugx 000 | Ugx 000 |
| Interest Income | 51,208,776 | 39,669,609 |
| Interest Expense | <u>(2,897,757)</u> | <u>(2,814,495)</u> |
| Net Interest Income | 48,311,019 | 36,855,114 |
| Bad and Doubtful Debts Expense | <u>(2,144,517)</u> | <u>(1,933,704)</u> |
| Net Interest Income | 46,166,502 | 34,921,410 |
| Non Interest Income | 18,576,630 | 24,187,467 |
| Non Interest Expenses | <u>(38,547,764)</u> | <u>(33,240,436)</u> |
| Profit Before Taxation | 26,195,368 | 25,868,441 |
| Taxation Expense | <u>(1,916,896)</u> | <u>(186,103)</u> |
| Net Profit From Ordinary Activities | 24,278,272 | 25,682,338 |
| Extra Ordinary Item – Payment To Seller | <u>(8,493,486)</u> | : |
| Retained Profit For The Year/Period After Extraordinary Item | <u>15,784,986</u> | <u>25,682,338</u> |
| Diluted Earnings Per Share Before Extraordinary Item (Shs) | 1.21 | 1.29 |
| Diluted Earnings Per Share After Extraordinary Item (Shs) | 0.79 | 1.29 |

BALANCE SHEET AT 31 DECEMBER 1987

| ASSETS | 1987 Ugx 000 | 1986 Ugx 000 |
|---|---------------------------|---------------------------|
| Cash and bank balances and balances with Bank of Uganda | 83,987,687 | 70,937,373 |
| Investment in Government securities | 225,341,263 | 229,205,125 |
| Placement with other banks and financial institutions | 50,657,400 | 41,176,252 |
| Loans and advances to customers | 31,674,266 | 32,328,464 |
| Investment securities | 207,720 | 213,660 |
| Other assets | 31,137,414 | 25,285,045 |
| Deferred expenditure | 4,196,396 | 2,897,924 |
| Deferred tax asset | 19,557,404 | 21,474,300 |
| Property and equipment | <u>26,533,770</u> | <u>30,492,000</u> |
| Total Assets | <u>473,293,320</u> | <u>454,010,143</u> |
| LIABILITIES AND SHAREHOLDER EQUITY | | |
| Liabilities: | | |
| Customers deposits | 369,578,865 | 344,723,618 |
| Bank of Uganda balance | 8,493,486 | - |
| Other liabilities | 45,032,092 | 73,858,432 |
| Government liabilities | <u>438,693</u> | <u>1,462,895</u> |
| | <u>423,543,136</u> | <u>420,044,945</u> |
| Shareholders' funds: | | |
| Share capital | 2,000,000 | 1,500,000 |
| Share premium | 5,705,000 | 5,705,000 |
| Revenue reserves | <u>42,045,184</u> | <u>26,760,198</u> |
| Shareholders' funds | <u>49,750,184</u> | <u>33,965,198</u> |
| Total Liabilities and Shareholders Equity | <u>473,293,320</u> | <u>454,010,143</u> |

Exhibit III: Strategic Interventions to Revamp GBCU

Recapitalisation of the operations

In order to conform to the requirements of FIS 1993, the bank would have to increase its core capital to Ugx 4,000 million and also reassess its asset portfolio. All non-performing assets were to be transferred to a Special Purpose Vehicle so as to improve the net assets position of the bank and also conform to Bank of Uganda's Capital, Asset Quality, Management, Equity and CAMEL requirements.

Organizational structure and HR Competence profiling

- The bank's organisational structure was to be reduced to seven hierarchical levels only from Board to support staff and several redundant positions without defined competencies were to be eliminated. A total of 900 staff would be retired as a result of the restructuring.
- The use of first name was encouraged and Friday was designated as corporate day on which every member of staff dressed the same in a company colour coded attire.
- Staff-appraisal was to be carried out continuously and not once a year. All staff were required to participate in the self-appraisal process.

Systems Redesign and ICT development

- At the time of privatisation each bank client could only carry out transactions in their specific branches. The bank invested in an integrated client database package known as Bank Master and also linked up all its branches using the MTN fibre optic cable network. In addition Automatic Teller Machines, which could dispense or receive cash were introduced. As a result queues shortened and customers could use any of the branches in the banks network to carry out transactions.

Sale of non-core assets/businesses

- GCBU prided for its focus on core business. Since the bank was not in the business of owning buildings and motor vehicles, it was agreed that all buildings and land owned by the company should be sold. All vehicles, except the Chief Executive's official transport were sold to current users.

Re-branding and rehabilitation/redesign of premises

- GCBU decided to rehabilitate its premises and make them more user-friendly. All bank branches were given a facelift and painted in the banks new brand colours.
- Introduction of an open office plan based on the open office concept. Under this approach all staff, including the top managers had their offices redesigned with glass and all staff generally sat in an open office arrangement.

Exhibit IV: Banjo Limited Income Statement

| | 1987 (Ugx 'millions) | 1986 (Ugx 'millions) |
|--|---------------------------------------|---------------------------------------|
| Turnover | | |
| Banjo Brothers Limited | 201.7 | 193.2 |
| Tooke Distribution Ltd | 13.0 | 10.8 |
| Non-group | <u>16.5</u> | <u>15.1</u> |
| Total Banjo group | 231.2 | 219.1 |
| Investments | <u>76.7</u> | <u>73.0</u> |
| Total group revenues | 307.9 | 292.1 |
| Direct Costs | <u>(168.8)</u> | <u>(164.5)</u> |
| Gross Profit | 139.1 | 127.6 |
| Distribution costs | (80.0) | (76.2) |
| Administration costs | (47.9) | (42.9) |
| Other operating income (loss) | <u>(1.2)</u> | <u>0.6</u> |
| | 10.0 | 9.1 |
| Banjo group Operating profit (loss) | | |
| Banjo Brothers Limited | 17.9 | 12.8 |
| Tooke Distribution Ltd | (1.1) | (.8) |
| Non-group | <u>(2.0)</u> | <u>(1.7)</u> |
| Total Banjo group | 14.8 | 10.3 |
| Investments | <u>4.8</u> | <u>(1.2)</u> |
| Total operating profit (loss) | 10.0 | 9.1 |
| Exceptional gains (costs) | (18.4) | (5.2) |
| Net interest paid | <u>(13.0)</u> | <u>(6.5)</u> |
| Profit (loss) before taxes | (21.4) | (2.6) |
| Taxes | (5.7) | (2.5) |
| Extraordinary items | <u>(1.1)</u> | <u>-</u> |
| Net profit/(loss) | <u>(28.2)</u> | <u>(5.1)</u> |
| Earnings (loss) per share (Shs) | (4.29) | (0.73) |

EXHIBIT V:PROJECTED CASHFLOW ANALYSIS FOR BANJO LTD.

| Financial Year End | VALUE (Ugx millionss) | | | | | | | |
|---------------------------|-----------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 |
| CASH IN: | | | | | | | | |
| Equity | 1,177 | - | - | - | - | - | - | - |
| Overdraft | - | 268 | 258 | 267 | 269 | 363 | 363 | - |
| Loan | 6,667 | - | - | - | - | - | - | - |
| Sales | 0 | 16,621 | 18,699 | 19,945 | 21,815 | 23,269 | 23,269 | 23,269 |
| Total Cash In | 7,844 | 16,889 | 18,957 | 20,212 | 22,084 | 23,632 | 23,632 | 23,269 |
| CASH OUT: | | | | | | | | |
| Pre-operational expenses | 53 | | | | | | | |
| Capital Expenditure | 5,171 | - | - | - | - | - | - | - |
| Working Capital | 2,620 | | | | | | | |
| Direct Production costs | | 13,682 | 13,877 | 13,187 | 13,540 | 13,500 | 19,154 | 19,154 |
| Indirect Production costs | - | 1,660 | 1,525 | 1,530 | 1,552 | 1,571 | 1,584 | 1,597 |
| Debt servicing | - | 545 | 696 | 1,638 | 1,590 | 1,535 | 1,582 | 1,525 |
| Tax payments | - | 260 | 747 | 1,340 | 1,816 | 2,285 | 607 | 627 |
| | - | | | | | | | |
| Dividends paid | - | 60 | 175 | 313 | 425 | 533 | 142 | 147 |
| Total Cash Out | 7,844 | 16,207 | 17,020 | 18,008 | 18,923 | 19,424 | 23,069 | 23,050 |
| NET CASH FLOW | | 682 | 1,937 | 2,204 | 3,161 | 4,208 | 563 | 219 |
| ACC. CASH BALANCE | 0 | 682 | 2,619 | 4,823 | 7,984 | 12,192 | 12,755 | 12,974 |

