THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

NOVEMBER 2011 EXAMINATIONS

(PROFESSIONAL)

PART 4

ADVANCED FINANCIAL REPORTING

(Paper 4.1)

Attempt ALL Questions

TIME ALLOWED:

Reading & Planning - 15 Minutes

Workings - 3 Hours

QUESTION 1

(a) The need to develop agreed set of accounting standards to enhance high quality corporate reporting cannot be over-emphasised.

You are required to:

(i) Explain why accounting standards are needed to help reporting entities and users of financial statements. (***4marks***)

(ii) Outline any **three (3)** costs associated with increased disclosure of information in the financial statements to the reporting entity. (***3 marks***)

(b) ABC Ltd issued a GHS5,000,000 18% convertible loan note at par on 1 January 2010 with interest payable annually in arrears. Three years later, on 31 December 2012, the loan note becomes convertible into equity shares on the basis of GHS100 of loan note for 50 equity shares or it may be redeemed at par in cash at the option of the loan note holder. The financial accountant of the company has observed that the use of a convertible loan note was preferable to a non-convertible loan note as the latter would have required an interest rate of 24% in order to make it attractive to investors. The present value of GHS1 receivable at the end of the year, based on discount rates of 18% and 24% can be taken as:

		18%	24%
		GHS	GHS
End of year	1	0·847	0· 806
	2	0·718	0· 650
	3	0·609	0·524

Required:

Show how the convertible loan note should be accounted for in ABC Ltd's income statement for the year ended 31 December 2010 and statement of financial position as at 31 December 2010.

(***8 marks***)

(c) Sika Ltd has been in business as a General Merchant for a number of years. During its accounting year ended 30th April 2011, the following transactions took place:

		GHS
(i)	Purchases: 1st July 2010	160,000
	1st January 2011	80,000
(ii)	Sales	320,000
(iii)	Sundry Expenses	38,000

The statement of Comprehensive Income for the year ended 30th April 2011 and the Statement of Financial Position as at 30th April 2011, prepared on the Historical Cost Accounting basis were on follows:

INCOME STATEMENT

	GHS	GHS
Revenue		320,000
Cost of sales		(260,000)
Gross profit		60,000
Operating expenses	38,000	
Depreciation	6,000	(44,000)
Operation profit		16,000

STATEMENT OF FINANCIAL POSITION

	GHS	GHS
Property, plant and equipment	64,000	
Depreciation	(24,000)	40,000
Inventories	18,000	
Net current monetary items	12,000	30,000
Net assets		70,000
Financed by:		49,000
Stated capital		21,000
Income surplus		70,000

Additional information:

(i) The inventories were valued using the FIFO method.
(ii) The Consumer Price Index (CPI) were:

	INDEX
Purchase of Non-current Assets and issue of equity share	120
30th April 2010	215
1st July 2010	223
1st January 2011	238
Average for the year	226
30th April 2011	240

Required:

(i) Prepare Current Purchasing Power Financial Statements (Income Statement for the year ended 30th April 2011 and Statement of Financial Position as at 30th April 2011).

(ii) A statement reconciling the Operating Profit of the two accounting systems – Historical cost and Current Purchasing Power.

(**15 marks**)

(**Total: 30 marks**)

QUESTION 2

(a) Countries and entities adopting International Financial Reporting Standards (IFRSs) for the first time should consider the possible conflict of some provisions of IFRS with local legislations. Such is the case in Ghana in respect of ***exclusion of subsidiary from consolidated financial statements***. IAS 27 "Consolidated and Separate Financial Statements" and Ghana Companies Code, 1963 (Act 179) (under review) are in conflict in respect of exclusion of subsidiary from consolidation.

Required:

Identify the conflicts between Section 127 of Ghana Companies Code 1963 (Act 179) and IAS 27, Consolidated Separate Financial Statements as regards exclusion of subsidiary companies from consolidation.

(***5 marks***)

(b) In its quest to dominate the textiles industry in Ghana, management of Tema Ltd decided to acquire shareholdings in two entities in the industry, Akosombo Ltd and Juapong Ltd.

Consequently, on 1 January 2010, Tema Ltd acquired the following non-current investments in the secondary market:

i) 15 million ordinary shares in Akosombo Ltd. The consideration was settled as follows:

- A share exchange (immediate) of one share in Tema Ltd for every two shares in Akosombo Ltd, (The market price of each Tema Ltd's share at the date of acquisition was GHS4) , plus
- A cash consideration of GHS2 per each acquired Akosombo Ltd share ***to be settled*** on 1st January 2011. The cost of capital for Tema Ltd approximates 20% per annum.

ii) 6 million of the ordinary shares of Juapong Ltd at a cost of GHS4.50 per share in cash. Payment was effected immediately. By this acquisition, Tema Ltd could exercise significant influence in the operating and financial policies of Juapong Ltd

The share exchange and the deferred considerations of the above investments have not been recorded by Tema Ltd.

The financial statements of Tema Ltd, Akosombo Ltd and Juapong Ltd for 2010 financial year are as follows:

Income statements for the year ended 31 December 2010

	Tema	Akosombo	Juapong
	GHS'000	GHS'000	GHS'000
Revenue	193,000	90,000	76,000
Cost of sales	(126,000)	(64,000)	(40,000)

Gross profit	67,000	26,000	36,000
Distribution and admin expenses	(22,000)	(10,400)	(6,000)
Finance costs	(1,000)	(600)	-
Other Income	6,000		
Profit before tax	50,000	15,000	30,000
Income tax expense	(10,000)	(3,000)	(6,000)
Profit for the year	40,000	12,000	24,000

Statements of financial position as at 31 December 2010:

	Tema	Akosombo	Juapong
	GHS'000	GHS'000	GHS'000
Assets			
Non-current assets			
Property, plant and equipment	95,000	52,000	90,000
Investments in shares	27,000		
Available-for-sale investments	32,500		
	154,500	52,000	90,000
Current assets			
Inventory	34,500	31,000	18,000
Trade receivables	16,000	7,500	12,000
Total assets	205,000	90,500	120,000
Equity and liabilities			
Ordinary shares (all issued at GHS1 each)	50,000	20,000	20,000
Retained earnings	90,000	44,000	80,000
	140,000	64,000	100,000
Non-current liabilities			
Loan notes	25,000	5,000	5,000
Current liabilities	40,000	21,500	15,000
Total equity and liabilities	205,000	90,500	120,000

The following information is relevant:

(i) At the date of acquisition, the fair values of Akosombo Ltd's assets were equal to their carrying amounts with the exception of a landed property which had a fair value of GHS2,000,000 below its carrying amount; This has not been reflected in the separate financial statements of Akosombo as at 31 December 2010. (Ignore depreciation implication)

(ii) On 1 January 2010, Tema Ltd transferred an item of plant to Akosombo Ltd at its agreed fair value of GHS13 million. Its carrying amount prior to the transfer was GHS10 million. The estimated remaining life of the plant at the date of transfer was five years (straight-line depreciation). Akosombo Ltd charges depreciation on plant to 'cost of sale'

(iii) In December 2010, Akosombo Ltd transferred some finished goods to Tema Ltd at a transfer price of GHS15 million. Akosombo Ltd had marked up these goods by 25% on cost. Tema Ltd had all of these goods still in its inventory at 31 December 2010. Also included in the inventory of Juapong Ltd at 31 December 2010 were some raw materials transferred from Tema Ltd at a transfer price of GHS5 million . Tema Ltd had also marked up these goods by 25% on cost. There were no intra-group payables/receivables at 31 December 2010.

(iv) The available-for-sale investments are included in Tema Ltd 's statement of financial position (above) at their fair value on 1 January 2010; they have a fair value of GHS36 million at 31st December 2010

(v) During the year ended 31 December 2010, the companies paid the following dividends and were charged to the statements of changes in equity (retained earnings column).

- Tema Ltd GHS25 million (dividend per share of GHS0.50)
- Akosombo Ltd Nil
- Juapong Ltd GHS10 million (dividend per share of GHS0.50)

The 'other income' in the separate income statement of Tema Ltd consists of the dividend received from Juapong and the gain on transfer of plant to Akosombo Ltd.

vi) It is the group's policy to value non-controlling interest at full fair value. The market price of a share of Akosombo Ltd immediately prior to the acquisition of controlling interest by Tema Ltd was GHS4.80.

(vii) Impairment tests on 31 December 2010 concluded that the value of the investments in both Akosombo and Juapong were not impaired.

Required:

Prepare the consolidated income statement for the year ended 31 December 2010 and a consolidated statement of financial position as at 31 December 2010.

(***20 marks***)

(**Total: 25 marks**)

QUESTION 3

Sweet Potato Limited operates a large-scale commercial farm. It now plans to off-load some of its shareholding to the public in order to raise funds to expand its operations.

Financial statements of Sweet Potato Limited are as follows:

Statement of Comprehensive Income for the year-ended 31st December, 2010

	GHS
Turnover	245,800
Cost of sales	117,300
Gross profit	128,500
Selling, general & administrative expenses	87,140
Earnings before interest & tax	41,360
Interest	3,360
Profit before taxation	38,000
Taxation at 25%	9,500
Profit after tax	28,500

Income Surplus Account for the year ended 31st December 2010

	GHS
Balance at 1/1/2010	95,940
Profit for the year	28,500
Dividends paid	(12,400)
Balance at 31/12/2010	112,040

Statement of Financial Position as at 31st December, 2010

	GHS	GHS
Property, plant & equipment		197,500
Patents		16,400
Development expenditure		26,100
		240,000
Current Assets		
Inventories	43,400	
Receivables	25,002	
Bank and cash	11,888	
	80,290	
Current Liabilities		
Payables	30,800	
Net Current assets		49,490
		289,490
14% Medium-term loan		(24,000)
Net assets		265,490

Financed By:	
Stated capital	100,000
Capital surplus	53,450
Income surplus	112,040
	265,490

Additional Information:

(i) Stated Capital is made up as follows:

	GHS
Ordinary shares (issued @ GHS0.20 each)	80,000
22% Irredeemable Preference Shares	20,000
	100,000

(ii) A review of the development expenditure revealed that 60% of it is worthless.

(iii) An independent valuer has placed values on some of the assets, detailed as follows:

	GHS
Property, plant & equipment	222,000
Inventories	32,400
Receivables	20,000

(iv) Profit forecasts for the next five years are as follows:

	Profit before Tax	Depreciation Charge
	GHS	GHS
2011	29,800	2,200
2012	32,000	2,450
2013	38,500	3,100
2014	39,600	4,050
2015	43,100	4,260

The estimated profit before tax figures are arrived at after charging the estimated depreciation.

(v) Yam Limited is a competitor listed on the Ghana Stock Exchange and data extracted from its recently published statements revealed the following:

- Market capitalisation = GHS2,000,000
- Number of ordinary shares = 800,000
- Earnings per share = GHS0.20 (20 pesewas)
- Dividend payout ratio = 80%

(vi) The patents represent a license to produce an improved variety of potatoes and is expected to generate a pre-tax profit of GHS20,000 per year for the next five years.

(vii) The cost of capital of Sweet Potato Limited is 18%.

Required:

(a) Determine the value to be placed on each share of Sweet Potato Limited using the following methods of valuation:

(i) Net assets
(ii) Prices-earnings ratio
(iii) Dividend yield
(iv) Discounted cash flow

(***12 marks***)

The discount factors and annuity at 18% for the relevant years are as follows:

Year	1	2	3	4	5
Discount factor	0.847	0.718	0.609	0.516	0.437
Annuity	0.847	1.565	2.174	2.690	3.127

(b) Outline any **three (3)** reasons why the dividend yield of Yam Ltd should be adjusted before it is used to value the shares of Sweet Potato Limited.

(***3 marks***)
(**Total: 15 marks**)

QUESTION 4

Malibu Limited, producers of telecommunication equipment has been making losses in recent times. The directors have proposed a scheme of reorganization, to take effect on 1st October 2011. The statement of financial position of the company at 30th September 2011 is as follows:

Statement of Financial Position as at 30 September, 2011

	COST GHS	ACCUM. DEPN. GHS	NET BOOK VALUE GHS
Fixed assets			
Property, plant & equipment	100,000	20,000	80,000
Plant and equipment	250,000	60,000	190,000
Vehicles	45,000	15,000	30,000
	395,000	95,000	300,000
Current assets			
Inventory		40,000	
Trade receivable		30,000	
Bank		10,000	
		80,000	
Less			
Current liabilities			
Trade payables		140,000	
			(60,000)
Net assets			240,000

Financed By:		
Stated capital		
Issued and fully paid		
100,000 7% preference shares of GHS1.00 per share	100,000	
400,000 ordinary share of GHS0.75 fully paid	300,000	
		400,000
Income surplus		(160,000)
Net assets		240,000

Additional information:

(i) The ordinary shares are to be written down to GHS0.25 per share and then to be converted into new ordinary shares of GHS1.00 per share fully paid.

(ii) The preference shareholders are to receive 40,000 ordinary shares of GHS1.00 per share, fully paid in exchange for their preference shares.

(iii) Dividends on 7% preference are two years in arrears. In consideration for waiving their rights to arrears of preference dividend, the preference shareholders have agreed to accept 10,000 new ordinary shares of GHS1.00 per share, fully paid in final settlement.

(iv) The creditors have agreed to take 100,000 new ordinary shares of GHS1.00 per share, fully paid in part settlement of the amounts due them.

(v) The balance on the income surplus account is to be written off.

(vi) Some assets of the company have been revalued and are to be incorporated in the accounts as follows:

	GHS
Freehold premises	100,000
Plant and equipment	125,000
Vehicles	25,000
Inventories	36,000

(vii) An allowance of GHS3,500 is to be made for doubtful debts.

(viii) The ordinary shareholders have agreed to inject additional GHS90,000 cash by acquiring 120,000 ordinary shares at GHS0.75 per share fully paid.

(ix) Reorganisation costs amounted to GHS7,500.

Required:

a. Prepare capital reduction account, stated capital account and bank account. (**7 marks**)

b. Prepare statement of financial position of Malibu Limited after the reorganization. (**5 *marks***)

c. Identify any **three (3)** reasons for which a company may opt to carry out a capital reduction scheme. (***3 marks***)

(**Total: 15 marks)**

QUESTION 5

(a) Drums Limited is engaged in the procurement of animal skins and tanning same for the production of church drums, hats, shoes and wallets. At the annual general meeting to consider the financial statements for the year ended 31st December 2010, some shareholders agitated over what they perceived to be the declining fortunes of the company.

The financial statements of drums Ltd for 2010 and 2009 are as follows:

Statement of financial Position as at 31st December,

	2010	2009
	GHS	GHS
Intangible assets	-	380,000
Non-current assets	1,224,000	1,204,000
	1,224,000	1,584,000
Current assets	288,400	300,250
Inventories	299,800	348,050
Receivables	-	36,500
Marketable securities	60,000	108,000
Cash and bank	648,200	792,800
Current liabilities	504,900	480,700
Trade payable	264,000	240,600
Other payables	768,900	721,300
	(120,700)	71,500
Net current (Liabilities)/Assets	1,103,300	1,655,500
	36,000	60,000
12% Medium-term loan	1,067,300	1,595,500
Net Assets		
Financed By:	500,000	500,000
Stated capital	227,500	154,800
Capital surplus	339,800	940,700
Income surplus	1,067,300	1,595,500

Statements of Comprehensive Income for the year ended 31st December:

	2010	2009
	GHS	GHS
Turnover	2,280,000	2,400,000
Cost of sales	1,920,000	1,884,000
Gross profit	360,000	516,000
Less: Selling, General & Admin. Expenses	240,000	252,000
Earnings before interest & tax	120,000	264,000
Less: Interest	4,320	7,200
Profit before tax	115,680	256,800
Taxation	28,980	64,200

Profit attributable to shareholders	86,760	192,600
Dividend	65,070	96,300
Retained profit	21,690	96,300

Statement of Cash Flows for the year ended 31st December,

	2010	2009
	GHS	GHS
Net cash inflow from operating activities	51,950	432,000
Investing activities	(84,750)	(2,150
Financing activities	(15,200)	25,400
Net (Decrease)/Increase in cash & cash equivalents	(48,000)	455,250
Cash & cash equivalents at beginning	108,000	(347,250
Cash & cash equivalents at 31st December	60,000	108,000

Additional information:

(i) Drums Ltd is registered with 500,000 ordinary shares of no par value out of which 200,000 shares were issued at GHS1.00 per share.

(ii) The company's shares are currently trading on the Ghana Stock Exchange at GHS2.50 per share as at 31st December, 2010 (2009: GHS1.50).

(iii) Cost of sales includes depreciation of GHS32,400 (2009: GHS27,600).

(iv) Inventories at 1st January, 2009 were valued at GHS260,500.

Required:

Review the performance of Drums Limited for the year 2010.

Your review should include comments on the appropriateness of the level of dividend paid.

(**15 marks**)