THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

MAY 2012 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) According to IAS 36 "***Impairment of Assets***", Impairment loss is "the amount by which the carrying amount of an asset or a cash generating unit exceeds its recoverable amount".

Guava Limited acquired a car renting business on 1st June 2011 for GHC450, 000. The values of the Net Assets acquired based on Net Selling Price were as follows:

	GHC'000
Property, plant and equipment	340
Intangible assets	70
Trade receivables	50
Trade payables	(40)
	420

On 1st August 2011, a rival car renting company commenced business in the same area. It is expected that the revenue of Guava Limited will drop by about 30%, leading to a decline in the Net Selling Price of the business, which is calculated at GHS405, 000.

The net selling price of the intangible assets has fallen to GHC60, 000 as a result of the rival car renting operator. The net selling price of the other assets remained the same since 1st June 2011.

Required:

(i) Outline the procedure for recognition and measurement of impairment loss in a Cash Generating Unit. (***2 marks***)

(ii) Calculate the impairment loss, if any, to be recognised in the statement of Comprehensive Income of Guava Limited. (***4 marks***)

(iii) What should be the Net Assets of Guava Limited as at 1st August 2011 after the recognition of the Impairment Loss. (***2 marks***)

b). On 1 January 2010, Asonaba Ltd issued 1,000 - 6% loan bonds at GHC100 each (the fair value at the date of issue). The bonds are quoted in an active market and are redeemable on 31 December 2013 at a premium of 4%. The interest on the bond is paid annually in arrears at 31 December. Issue costs were immaterial. The effective interest rate on the bonds is thus calculated as 6.9% per annum. The fair value of a bond at 31 December 2010 was GHC95. Oyoko Ltd subscribed for 250 of these bonds. Oyoko Ltd had not previously held any bond investments.

Required:

i) Prepare extracts from the financial statements (Income Statement, Statement of financial position and Statement of Cash Flows) of Asonaba Ltd for 2010 financial year in respect of the bonds **(4 marks)**

ii) Prepare extracts from the financial statements (Income Statement, Statement of financial position and Statement of Cash Flows) of Oyoko Ltd for 2010 financial year for each of the potential different classification options for the investment in Asonaba Ltd's Bonds [Held for Trading, Available for Sale, and Held to Maturity] **(6 marks)**

(**Total: 18 marks**)

QUESTION 2

Peace Limited acquired 2,100,000 ordinary shares in Love Limited, a Zambian Company on 1st January 2003. The Income surplus balance of Love Limited on that date was KA4,500,000 and the exchange rate was KA10 to GHC1. The currency of Zambia is Kwacha (KA).

The Income Statement of Peace Limited and Love Limited for the year ended 31st December, 2010 were as follows:

	Peace Limited	Love Limited
	GHC'000	KA'000
Turnover	27,675	283,500
Cost of sales	18,081	189,000
Gross profit	9,594	94,500
Distribution costs	3,870	22,659
Administratic3e expenses	4,407	7,560
Depreciation	573	6,300
	744	57,981
Investment income from subsidiary	945	-
	1,689	57,981
Tax	585	22,710
Profit after tax	1,104	35,271
Dividend paid	549	12,600
Transfer to income surplus	555	22,671

The Statement of Financial Position of the two companies as at 31st December, 2010 were as follows:

	Peace Limited GHS'000	Love Limited KA'000
ASSETS		
Property, plant & equipment	5,295	115,500
Investment in Love Ltd.	915	-
Inventories	6,735	11,025
Receivables	1,845	5,250
Cash & Bank	468	28,350
	15,258	160,125
EQUITY AND LIABILITIES		
Trade payables	6,735	13,125
Long-Term Loan	3,690	26,040
Ordinary share capital (GHS1.00 each)	1,800	-
Ordinary share capital (KA3.00 each)	-	10,500
Income surplus account	3,033	110,460
	15,258	160,125

Additional Information:

i. The property, plant and equipment of Love Ltd were acquired on 1st January 2003 and are stated at cost less accumulated depreciation.

ii. On 31st December 2009, the inventories held by Love Ltd amounted to KA14,280,000 and the exchange rate at the time they were purchased was KA10 to GHS1.

iii. Exchange rates have been as follows:

	KA to GHS1
1st January, 2003	10.00
30th June, 2009	10.50
30th September, 2009	10.00
31st December, 2009	9.50
Average for 2010	8.00
30th June, 2010	8.00
30th September, 2010	7.50
31st December, 2010	7.00

iv. The inventories of Love Limited as at 31st December, 2010 were purchased at the time the exchange rate was KA7.50 to GHS1.00.

v. In determining the appropriate method of currency translation, it has been established that the trade of Love Limited is more dependent on the economic environment of the investing company's currency than that of its own reporting currency.

Required:

(a) Prepare the Consolidated Statement of Comprehensive Income for the year ended 31st December 2010; and Consolidated Statement of Financial Position as at that 31st December, 2010 for Peace Limited. And its subsidiary.

(24 marks)

NOTE: Work to the nearest Ghana Cedi. (GHC1.00)

QUESTION 3

(a) Under the Current Cost Accounting system, four (4) adjustments are made in the Financial Statements. These adjustments are:

i. Cost of Sales Adjustment
ii. Depreciation Adjustment
iii. Monetary Working Capital Adjustment
iv. Gearing Adjustment

Required:
Briefly explain each of the **four (4)** adjustments above. **(8 marks)**

(b) The CEO of your company, Abokobi Limited, is attending a workshop on the theme "Multi-Variant Analysis – Importance and Computation" (Corporate failure prediction).

He has asked you to demonstrate how corporate failure is predicted using information relating to the company for the financial year ended 30th June, 2011.

Your CEO has heard of the Altman's Z-score prediction model and wants you to use that model for your analysis.

According to Professor Altman, the model has five variables which he defined as follows:

X_1 = Working Capital/Total Assets
X_2 = Retained Profit/Total Assets
X_3 = Earning before Interest and Tax/Total Assets
X_4 = Market Value of Equity/Carrying Amount of Debts
X_5 = Sales/Total Assets

Based on the model, the Z-score is calculated using the following formula:-

Z-score = $0.012X1 + 0.014X_2 + 0.033X_3 + 0.006X_4 + 0.999X_5$

The market value of Abokobi Limited equity shares is GHC2.00 per share.

The following Trial Balance was extracted from the books of Abokobi Limited as at 30th June 2011.

	DR GHC'000	CR GHC'000
Stated capital		7,700
Capital surplus		2,100
Income surplus (1st July 2012)		2,350
5% Debenture (2008 – 2015)		3,700
Creditors		6,300
Investment income	107	
Debenture interest paid	93	
Profit for the year	-	4,880
Plant and machinery	5,800	
Debtors	2,580	
Investments	1,400	
Freehold premises	8,100	
Stocks	5,600	
Bank	4,200	
Tax payable – 1st July, 2010	-	850
	27,880	27,880

Additional information

(i) A tax provision of GHC1,800,000 is to be made for the current year.

(ii) The equity shares were issued at GHC1.10 per share.

(iii) The company declared a dividend of GHC0.09 per share at its Annual General Meeting held on 30th September 2011. The dividend is to be treated in accordance with IAS 10 ***Events after the Reporting Period***.

(iv) Sales for the year amounted to GHC29,000,000

Required:

(i) Discuss any **three (3)** importance of Corporate Failure Prediction, and

(ii) Advice your CEO on the status of Abokobi Limited based on your computation.

(***10 marks***)

(**Total: 18 marks**)

QUESTION 4

Shoe Factory Limited has incurred losses for many years. However, the company is developing a new product, which is expected to generate profits of GHC400,000 per annum in anticipation of an immediate capital injection of GHC2,000,000. The company's Statement of Financial Position as at 31st December 2010 is as follows:

	GHC
ASSETS	
Property, plant and equipment	3,250,000
Inventories	1,000,000
Accounts receivables	500,000
	4,750,000
LIABILITIES & EQUITY	
Ordinary share capital (GHS1.00)	
10% Preference shares	2,000,000
15% Debentures (unsecured)	750,000
Accounts payables	1,000,000
Bank overdraft	1,000,000
Income surplus	750,000
	(750,000)
	4,750,000

The Bank overdraft is secured against the property, plant and equipment.

In the event of a forced sale the assets would probably raise the following amounts.

	GHC
Property, Plant and Equipment	1,500,000
Inventories	400,000
Accounts Receivables	350,000

The Directors are therefore proposing a capital re-organisation of the company on the following basis:

(i) The Ordinary share capital should be written down to 200,000 shares of GHC1.00 each.

(ii) The 10% preference shares are to be converted into 150,000 ordinary shares valued at GHC1 per share.

(iii) GHC650,000 of the 15% Debenture should be converted into ordinary shares at GHC1 per share and the remainder to be converted into GHC350,000 10% Debentures.

(iv) Trade creditors to accept a moratorium of six (6) months in payment of amounts currently due them. New supplies will be paid for on delivery.

(v) A two for-one rights issue will be made at a price of GHC1 per share for cash after the above conversions.

(vi) Property, plant and equipment are to be revalued at GHC2,250,000, inventories at GHC600,000 and Accounts Receivables at GHC450,000.

(vii) The accumulated losses are to be written off.

(viii) The corporate tax rate is 25%.

(ix) Liquidation expenses will amount to GHC10,000.

Required:

(a) Prepare a Statement of Financial Position after reconstruction on the assumption that the capital injection takes place. (***8 marks***)

(b) Compute the expected profit after tax and the earnings per share after the reconstruction. (***6 marks***)

(c) Prepare a statement of distribution if the company were to be liquidated now. (***6 marks***)
(**Total: 20 marks**)

QUESTION 5

Obuoba Ltd is a family controlled company that has grown over the years. The company is now considering listing on the Stock Market. The MD believes that as the company has assets with a book value of GHC46 million and shareholders fund GHC24 million, the company's value, when listed should be at least GHC70 million . He proposes that 500,000 new shares should be issued to the public to raise approximately GHC3.5 million for future expansion .
The company's financial performance for the last three years is summarized below:

Income statement for the years ended 31 December

	2009	2010	2011
	GHC'000	GHC'000	GHC'000
Sales	40,000	45,000	52,000
Cost of goods sold	25,000	26,000	29,000
Gross Profit	15,000	19,000	23,000
Admin expenses	3,000	4,000	4,500
Selling and general expenses	1,600	2,600	4,500
Interest payable	1,400	1,400	2,000
Net Profit before tax	9,000	11,000	12,000
Current Taxation @ 20%	1,800	2 200	2,400
Net profit after tax	7,200	8,800	9,600

Statement of Financial Position as at 31 December	2009	2010	2011
	GHC'000	GHC'000	GHC'000
Non-current assets			
Property, plant and equipment (Net):			
Land and buildings	15,000	16,000	16,000
Plant	5,000	6,000	7,000
Investment (FVTPL)		2,000	2,000
Current Assets			
Inventory	7,000	7,000	11,000
Trade Receivables	5,000	8,000	9,000
Cash	1,000	1,000	1000
	33,000	40,000	46,000
Financed by			
Stated Capital (Issued at GHC0.10 per share)	1,000	1,000	1,000
Retained earnings	18,000	19,000	23,000
Shareholders fund	19,000	20,000	24,000
Long term loans	7,000	7,000	11,000
Current liabilities			
Trade payables	5,000	10,800	8,600
Taxation	2,000	2,200	2,400
	33,000	40,000	46,000

Additional notes relating to the Income Statement for the year ended 31 December 2011 and the Statement of Financial Position as at 31 December 2011 is as follows:

(i) Obuoba's income statement includes GHC 8 million of revenue for credit sales made on a 'sale or return' basis. At 31 December 2011, customers who had not paid for the goods, had the right to return GHC 2·6 million of them. Obuoba applied a mark-up on cost of 30% on all these sales. In the past, Obuoba's customers have sometimes returned goods under this type of agreement.

(ii) The property, plant and equipment have not been depreciated for the year ended 31 December 2011. Obuoba has a policy of revaluing its land and buildings at the end of each accounting year. The values in the above statement of financial position are as at 1 January 2011 when the buildings had a remaining life of 20 years. A qualified surveyor has valued the land and buildings at 31 December 2011 at GHS 18 million. Additional plant was installed in January 2011. Plant is depreciated at 20% on the reducing balance basis.

(iii) The investments at fair value through profit and loss [FVTPL] are held in a fund whose value changes directly in proportion to a specified market index. At 1 January 2011 the relevant index was 150 and at 31 December 2011, it was 162.

(iv) In late December 2011, the directors of Obuoba discovered a material fraud perpetrated by the company's financial accountant that had been continuing for some time. Investigations revealed that a total of GHC 2 million of the trade receivables as shown in the statement of financial position at 31 December 2011 had in fact been paid and the money had been stolen by the Financial Accountant. An analysis revealed that GHC 1·5 million had been stolen in the year to 31 December 2010 with the rest being stolen in the current year. Obuoba is not insured for this loss and it cannot be recovered from the Financial Accountant.

(v) During the year taxable temporary differences of GHC 500,000 arose. The applicable income tax rate is 20%. This has not been included in the figures in the financial statements above.

vi) The long term loans consists of:

- 20% GHC 7 million debenture stocks issued on 1 January 2009 and redeemable at par on 31 December 2013; and
- 15% GHS 4 million loan notes issued on 1 January 2011 and redeemable on 31 December 2012 for GHC4,262,000 resulting in an effective interest rate of 18% per annum. This Financial liability is to be measured at amortised cost.

(vii) The only movements in the statement of changes in equity [retained earnings column] in 2011 were the reported draft profit and dividend payment.

Obuoba's management has obtained some financial information on a listed company in the same industry, which has the same number of listed equity shares as Sankofa.

	Dadeba Ltd
Market capitalization	GHC42 million
Number of shares	10 million
Earnings per share	GHC0.60
Dividend pay-out ratio	60%

Required

a) Assess the validity or otherwise of the Managing Director's statement (***5marks***)

b) Advise the directors of Obuoba Ltd the values to be placed on an ordinary share using the following methods

i) Price Earnings ratio

ii) Dividend yield

iii) Net Assets [fair values] (***15 marks***)

Note

The following assumptions and bases may be relevant:

i) The revised profit after tax for the current year may be a good representation of the earnings of the entity.

ii) Additional information (i) – (iv) above would necessitate a revision of the 2011 Income statement and statement of financial position profit. Dividend payment will however not be affected

iii) Investing in unlisted securities is about 25% more risky than investing in listed securities.

(**Total: 20 marks)**