MAY 2018 PROFESSIONAL EXAMINATIONS
FINANCIAL REPORTING (PAPER 2.1)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

EXAMINER'S GENERAL COMMENTS

The general performance of most of the candidates was as usual below average. It showed that most of the candidates were not prepared and ready for the examination. They showed lack of knowledge in the Accounting Standards and the double entry principles. Candidates with high understanding of the Accounting Standards scored high marks especially in questions two and five (b) and (c). The orderly and logical presentation of answers continued to be a challenge to most candidates. For instance, a candidate started a question on page one and then continued on page 18 with no reference on page one to the continuation on page 18.

STANDARD OF THE PAPER.

The standard of the questions was generally good and could be compared to those of the earlier years administered in terms of volume of adjustments required. The questions covered all the relevant sections of the syllabus. All the questions reflected the weighting of the topics in the syllabus, and the mark allocations followed a similar pattern in the previous exams.

Questions one, and three were too much loaded requiring more time and the marks allocated were not commensurate with the volume of work. Questions 2 and 5 (b) and (c) were on the Accounting Standards and the volumes of work required were commensurate with the allotted marks. Question 4 on ratios required the calculation of 12 ratios and a report on operational performance, gearing, investment and liquidity for 15 marks. The volume of work required for a 15 mark question was on the high side.

GENERAL PERFORMANCE OF CANDIDATES

The general performance of the candidates was far below average. About 57% of the candidates scored less than 40% of the total marks while a candidate scored as low as 2%. The poor performance could be attributed to inadequate preparation by candidates, or the low level of education achieved in their previous levels of studies. A few excellent candidates scored more than 66% of the total marks.

The high level of performance by candidates was concentrated in in Accra, Tema and Ho. The low performers were concentrated in the rest of the regional centres including a few in Accra.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

- Candidates who prepared adequately and were ready for the examinations scored above 50% and a few scored more than 70% of the total marks.
- The candidates' strengths were in the preparation of the Consolidated Statement of Financial Statement in question one, the standards in question two and 5 (b) and (c), and Ratio analysis in question four. These are areas which any serious candidate would not like to ignore while preparing for the exams.

- Suggested areas in which such strengths can be enhanced include the International Financial Reporting Standards.
- The general weaknesses shown were in respect of either lack of preparation or the background of most of the candidates entering the examinations at this level.
- The weaknesses were widespread as could be seen in the general performance.
- The reasons for the weaknesses shown were in respect of lack of preparation and the basic foundational knowledge for most of the candidates entering the examinations at this level.

QUESTION ONE

On 1 April 2017, Tamale Ltd acquired 60% of the 4 million ordinary shares of Navrongo Ltd in a share exchange of two shares in Tamale Ltd for three shares in Navrongo Ltd. The issue of shares has not yet been recorded by Tamale Ltd. At the date of acquisition, shares in Tamale Ltd had a market value of GH¢6 each. Below are the summarised draft financial statements of both companies.

Statements of Profit or Loss for the year ended 30 September 2017

	Tamale Ltd	**Navrongo Ltd**
	GH¢'000	**GH¢'000**
Revenue	85,000	42,000
Cost of Sales	(63,000)	(32,000)
Gross Profit	22,000	10,000
Distribution Cost	(2,000)	(2,000)
Administrative Expenses	(6,000)	(3,200)
Finance Cost	(300)	(400)
Profit Before Tax	13,700	4,400
Income Tax Expense	(4,700)	(1,400)
Profit for the Year	**9,000**	**3,000**

Statements of Financial Position as at 30 September 2017

	Tamale Ltd	**Navrongo Ltd**
	GH¢'000	**GH¢'000**
Assets		
Non-Current Assets		
Property, Plant and Equipment	40,600	12,600
Current Assets	16,000	6,600
Total Assets	**56,600**	**19,200**
Equity and Liabilities		
Ordinary shares	10,000	4,000
Retained Earnings	35,400	6,500
	45,400	10,500
Non-Current Liabilities		
10% Loan Notes	3,000	4,000
Current Liabilities	8,200	4,700
Total Equity and Liabilities	**56,600**	**19,200**

The following information is relevant:

i) At the date of acquisition, the fair values of Navrongo Ltd's assets were equal to their carrying amounts with the exception of an item of plant, which had a fair value of GH¢2 million in excess of its carrying amount. It had a remaining life of five years at that date (straight-line depreciation is used). Navrongo Ltd has not adjusted the carrying amount of its plant as a result of the fair value exercise.

ii) Sales from Navrongo Ltd to Tamale Ltd in the post-acquisition period were GH¢8 million. Navrongo Ltd made a markup on cost of 40% on these sales. Tamale Ltd had sold GH¢5.2 million (at cost) as at 30 September 2017.
iii) Other than where indicated, profit or loss items are deemed to accrue evenly on a time basis.
iv) Navrongo Ltd's trade receivables at 30 September 2017 include GH¢600,000 due from Tamale Ltd which did not agree with Tamale Ltd's corresponding trade payable. This was due to cash in transit of GH¢200,000 from Tamale Ltd to Navrongo Ltd. Both companies have positive bank balances.
v) Tamale Ltd has a policy of accounting for any non-controlling interest at fair value. The fair value of the non-controlling interest in Navrongo Ltd at the date of acquisition was estimated to be GH¢5.9 million. Consolidated goodwill was not impaired at 30 September 2017.

Required:

a) Prepare the consolidated statement of profit or loss for Tamale Ltd for the year ended 30 September 2017. **(8 marks)**

b) Prepare the consolidated statement of financial position for Tamale Ltd as at 30 September 2017. **(12 marks)**

. **(Total: 20 marks)**

QUESTION TWO

a) On 1 October 2016, the Government of Ghana awarded Sea Fishing Ltd one of six licences issued to operate a production facility for five years. A subsidised sum of GH¢1m was paid by Sea Fishing Ltd for the licence. The Government of Ghana considers the difference between the nominal value and its fair value which is GH¢3,000,000 as a grant to Sea Fishing Ltd.

Required:

Explain the **TWO** ways that the Directors of Sea Fishing Ltd can account for this transaction. (Apply the relevant accounting standards). **(4 marks)**

b) Devine Education Ltd acquired an item of plant at a cost of GH¢800,000 on 1 April 2016. The plant had an estimated residual value of GH¢50,000 and an estimated useful life of five years, neither of which has changed. Devine Education Ltd uses straight-line depreciation.

On 31 March 2018, Devine Education Ltd was informed by a major customer (who buys products produced by the plant) that it would no longer be placing orders with Devine Education Ltd. Even before this information was known, Devine Education Ltd had been having difficulty finding work for this plant. It now estimates that net cash inflows earned from the plant for the next three years will be:

	GH¢'000
Year ended:	
31 March 2019	220.00
31 March 2020	180.00
31 March 2021	170.00

Devine Education Ltd has confirmed that there is no market in which to sell the plant as at 31 March 2018, but is confident that it can still be sold for its original estimated realisable value on 31 March 2021. Devine Education Ltd's cost of capital is 10% and the following values should be used:

	GH¢
Value of GH¢1 at:	
End of year 1	0.91
End of year 2	0.83
End of year 3	0.75

Required:
In line with ***IAS 36: Impairment of Assets***, calculate the carrying amounts of the asset above as at 31 March 2018 after applying any impairment losses.
(Note: Calculations should be to the nearest GH¢1,000) **(6 marks)**

c) Abu Ltd had 100,000 shares in issue, but then makes a 1 for 5 rights issue on 1 October 2017 at a price of GH¢1. The market value on the last day of quotation with rights was GH¢1.60. Total earnings are GH¢50,000 in 2017, and GH¢40,000 in 2016.

Required:
Calculate the Earnings per Share for the year ended 31 December 2017 and the corresponding figure for 2016 in accordance with ***IAS 33: Earnings per Share***.**(4 marks)**

d) Delali Ltd adopts revaluation model for subsequent measurement of its intangible assets in accordance with ***IAS 38: Intangible assets***. The policy of Delali is to revalue its intangible asset at the end of each year. An intangible asset with an estimated useful life of 9 years was acquired on 1 January 2016 for GH¢45,000. It was revalued to GH¢54,400 on 31 December 2016 and the revaluation surplus was correctly recognized on that date. As at 31 December 2017, the asset was revalued at GH¢32,000.

Required:
Discuss the accounting treatment required in 2016 and 2017 financial statements.
(4 marks)

e) In accordance with ***IFRS 5*: *Non-Current Assets Held for Sale and Discontinued Operations,*** a non-current asset (disposal group) is classified as "held for sale" if it's carrying amount will be recovered principally through a sale transaction rather than through continuing use. However, to qualify to be classified as held for sale, a detailed criteria must be met.

Required:
Identify any **TWO** criteria to be met before an asset can be classified as held for sale.
(2 marks)
(Total: 20 marks)

QUESTION THREE

The following trial balance relates to Binkabi Ltd as at 30 September 2017:

	GH¢'000	GH¢'000
Revenue (Note (i))		380,000
Cost of sales	246,800	
Distribution costs	17,400	
Administrative expenses (Note (ii))	50,500	
Loan interest paid (Note (iii))	1,000	
Investment income		1,300
Profit on sale of investments (Note (iv))		2,200
Current tax (Note (v))	2,100	
Freehold property – at cost 1 October 2017 (note (vi))	63,000	
Plant and equipment – at cost (Note (vi))	42,200	
Brand – at cost 1 October 2013 (Note (vi))	30,000	
Accumulated depreciation – 1 October 2016 – building		8,000
– plant and equipment		19,700
Accumulated amortisation – 1 October 2016 – brand		9,000
Investments in equity instruments (Note (iv))	26,500	
Inventory at 30 September 2017	38,000	
Trade receivables	44,500	
Bank	8,000	
Trade payables		42,900
Ordinary shares		52,000
Retained Earnings at 1 October 2016		26,060
Other reserve at 1 October 2016 (Note (iv))		5,000
5% convertible loan note 2020 (Note (iii))		18,440
Deferred tax (Note (v))		5,400
	570,000	**570,000**

Additional Information:

i) Binkabi Ltd's revenue includes GH¢16 million for goods sold to Kofi on 1 October 2016. The terms of the sale are that Binkabi Ltd will incur ongoing service and support costs of GH¢1.2 million per annum for three years after the sale. Binkabi Ltd normally makes a gross profit of 40% on such servicing and support work. Ignore the time value of money.

ii) Administrative expenses include an equity dividend of ¢12 million paid during the year.

iii) The 5% convertible loan note was issued for proceeds of ¢20 million on 1 October 2015. It has an effective interest rate of 8% due to the value of its conversion option.

iv) During the year Binkabi Ltd sold an equity investment for GH¢11 million. At the date of sale it had a carrying amount of GH¢8.8 million and had originally cost GH¢7 million. Binkabi Ltd has recorded the disposal of the investment. The remaining equity investments (the GH¢26.5 million in the trial balance) have a fair value of GH¢29 million at 30 September 2017. The other reserve in the trial balance represents the net increase in the value of the equity investments as at 1 October 2016. Binkabi Ltd made an

irrevocable decision at initial recognition of these instruments to recognise all changes in fair value through other comprehensive income, and makes a transfer of realised profit from the other reserve to income surplus on disposal of the investments. Ignore deferred tax on these transactions.

v) The balance on current tax represents the under/over provision of the tax liability for the year ended 30 September 2016. The directors have estimated the provision for income tax for the year ended 30 September 2017 at GH¢16.2 million. At 30 September 2017 the carrying amounts of Binkabi Ltd's net assets were GH¢13 million in excess of their tax base. The income tax rate of Binkabi Ltd is 30%.

vi) **Non-current assets**
The freehold property has a land element of GH¢13 million. The building element is being depreciated on a straight-line basis. Plant and equipment is depreciated at 40% per annum using the reducing balance method. Binkabi Ltd's brand in the trial balance relates to a product line that received bad publicity during the year which led to falling sales revenues. An impairment review was conducted on 1 April 2017 which concluded that, based on estimated future sales, the brand had a value in use of GH¢12 million and a remaining life of only three years. However, on the same date as the impairment review, Binkabi Ltd received an offer to purchase the brand for GH¢15 million.

Prior to the impairment review, it was being depreciated using the straight-line method over a 10 year life. No depreciation/amortisation has yet been charged on any non-current asset for the year ended 30 September 2017. Depreciation, amortisation and impairment charges are all charged to cost of sales.

Required:

a) Prepare the statement of profit or loss and other comprehensive income for Binkabi Ltd for the year ended 30 September 2017. **(8 marks)**

b) Prepare the statement of financial position of Binkabi Ltd as at 30 September 2017. **(12 marks)**

(Total: 20 marks)

QUESTION FOUR

Obiya ltd assembles computer equipment from bought in components and distributes them to various wholesalers and retailers. It has recently subscribed to an inter-firm comparison service. Members submit accounting ratio as specified by the operator of the service, and in return, members receive the average figures for each of the specified ratios taken from all of the companies in the same sector that subscribe to the service. The specified ratios and the average figures for Obiya's sector are shown below.

Ratios of sector companies for the period to 30 September, 2017

Return on capital employed	22.1%
Net asset turnover	1.8 times
Gross profit margin	30%
Net profit (before tax) margin	12.50%
Current ratio	1.6:1
Quick ratio	0.9:1
Inventory holding period	46 days
Accounts receivable collection period	45 days
Accounts payable payment period	55 days
Debt to equity	40%
Dividend yield	6%
Dividend cover	3 times

Obiya's financial statements for the year to 30 September 2017 are set out below:

Statement of profit or loss for the year ended 30 September 2017.

	GH¢'000
Revenue	2,425
Cost of sales	(1,870)
Gross profit	555
Other operating expenses	(215)
Operating profit	340
Finance costs	(34)
Exceptional item (note (ii))	(120)
Profit before taxation	186
Income tax	(90)
Profit for the period	96

Statement of Changes in Equity (Extracts) for the year ended 30 September 2017

	GH¢'000
Retained earnings - 1 October 2016	179
Net profit for the period	96
Dividends paid (Interim GH¢60,000; final GH¢30,000)	(90)
Retained earnings - 30 September 2017	**185**

Statement of Financial Position as at 30 September, 2017

	GH¢000	GH¢000
Non-current assets (note (i)		540
Inventory	275	
Accounts receivable	320	
Bank	-	595
		1,135
Equity		
Ordinary shares (25 pesewas each)		150
Retained earnings		185
		335
Non-current liabilities		
8% loan notes		300
Current liabilities		
Bank overdraft	65	
Trade accounts payable	350	
Taxation	85	500
		1,135

Notes

i) The details of the non-current assets are:

	Cost	Accumulated depreciation	Net book value
	GH¢000	GH¢000	GH¢000
At 30 September 2017	3,600	3,060	540

ii) The exceptional item relates to losses on the sale of a batch of computers that had become worthless due to improvements in microchip design.

iii) The market price of Obiya's shares throughout the year averaged GH¢6.00 each.

Required:

a) Calculate the ratios for Obiya equivalent to those provided by the inter-firm comparison service. **(5 marks)**

b) Write a report analysing the ***operational performance, gearing, investment*** and ***liquidity*** of Obiya based on a comparison with the sector averages. **(10 marks)**

(Total: 15 marks)

QUESTION FIVE

a) The following trial balances for the year ended 31 December 2017 were obtained from the Head Office and Branch of Compassionate Grounds Ltd.

	Head Office		**Branch**	
	Debit	**Credit**	**Debit**	**Credit**
	GH¢'000	**GH¢'000**	**GH¢'000**	**GH¢'000**
Office equipment	18,000		3,500	
Motor vehicles	1,400		600	
Retained earnings		17,400		
Current accounts	16,500			4,100
Inventory (at cost or mark up at 1 Jan 2017)	21,200		7,200	
Purchases	38,000		18,600	
Sales		48,500		30,200
Stated capital		8,500		
Administrative expenses	10,500		4,400	
Provision for unrealised profit		2,600		
Goods sent to branch		28,600		
	105,600	**105,600**	**34,300**	**34,300**

Additional information was as follows:

i) The branch deposited GH¢800,000 on behalf of the head office in the bank on 31 December 2017. No record of this transaction had been made in head office books.

ii) All goods sold by the branch are supplied from the head office at cost plus 25%. At 31 December 2017 goods to the value of GH¢10 million were in transit to the branch.

iii) Inventories at 31 December 2017, excluding goods in transit were as follows:

	GH¢'000
Branch at mark up	8,000
Head office at cost	14,500

Required:

Prepare for the head office, branch and combined entity of Compassionate Grounds Limited: Statement of profit or loss for the year ended 31 December 2017 and Statement of financial position as at 31 December 2017. **(15 marks)**

b) According to the ***IASB Conceptual Framework***, the concept of capital maintenance is concerned with how an entity defines the capital it seeks to maintain. The concept of capital gives rise to ***financial capital maintenance*** and ***physical capital maintenance***. The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements.

Required:

Distinguish between ***financial capital maintenance*** and ***physical capital maintenance***.

(6 marks)

c) Once an entity has recognized an item of Property, Plant and Equipment as an asset in its books, the entity can choose between two models (or methods) to account for the asset in subsequent measurement periods, that is, the period(s) after the asset has been acquired and before its disposition. The two models are the ***cost model*** and the ***revaluation model***. The entity shall apply the same model to the entire class of property, plant and equipment to which that asset is of similar nature and use in the entity's operations.

Required:
Identify **TWO** differences between the ***cost*** and ***revaluation*** model for the measurement of Property, Plant and Equipment. **(4 marks)**

(Total: 25 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

(a)

TAMALE GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 30 SEPTEMBER 2017

	GH₵'000
Revenue (85,000 + (42,000 X 6/12) – 8,000 (W7))	98,000
Cost of sales (or W7)	
(63,000 + (32,000 x 6/12) – 8,000 intra-grp sales + 200(W2) + 800(W2))	(72,000)
Gross profit	26,000
Distribution costs (2,000 + (2,000 X 6/12))	(3,000)
Administrative expenses (6,000 + (3,200 X 6/12))	(7,600)
Finance costs (300 + (400 X 6/12))	(500)
Profit before tax	14,900
Income tax expense (4,700 + (1,400 X 6/12)	(5,400)
Profit for the year	9,500
Profit attributable to: Owners of the parent	9,300
Non-controlling interests (W4)	200
	9,500

(b)
TAMALE GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 30 SEPTEMBER 2017

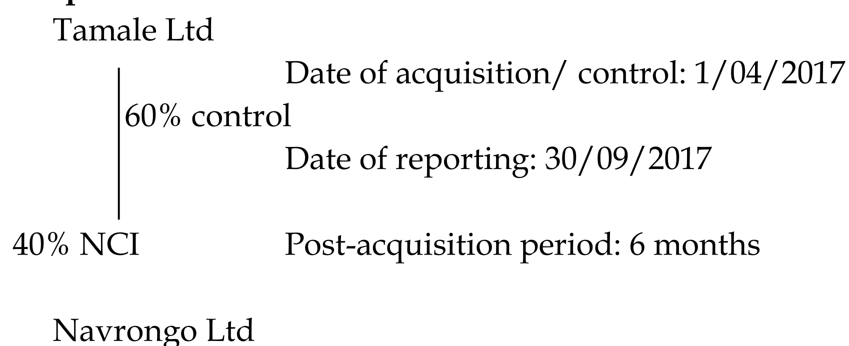
	GH₵'000
Non-current assets	
Property, plant and equip. (40,600+12,600+ 2,000 Fv adj. -200 Dep adj.)	55,000
Goodwill (W3)	4,500
	59,500
Current assets (16,000+6,600-800 pup-600 interco rec +200 CIT) Or W8)	21,400
Total assets	**80,900**
Equity attributable to parent Share capital (10,000 +9,600 share exch.)	19,600
Income surplus (W4)	35,700
	55,300
Non-controlling interests (W5)	6,100
	61,400
Non-current liabilities 10% loan notes (3,000 + 4,000)	7,000
Current liabilities (8,200 + 4,700 – 400 (W10))	12,500
	80,900

Workings

1 Group structure	%
Tamale Ltd in Navrongo	60
Non-controlling interest	40
	100

Date of acquisition: 1st April 2017
Dare of reporting: 30 September 2017
Mid-year acquisition, six months before year end.

Alternative presentation
1. **Group structure**



2. Net Assets of Navrongo

	Acquisition date 1/04/2017 GH¢'000	**Reporting date 30/09/2017 GH¢'000**	**Post acquisition movements GH¢'000**
Stated capital issued	4,000	4,000	_
Income surplus:			
(6500-(3000×6/12)	5000	6,500	1,500
Fair value adjustment: plant	2,000	2,000	—
Depreciation adjustment:			
Plant (2000/5×6/12)	—	(200)	(200)
PUP on inventory			
(40/140× (8000-5200)	—	(800)	(800)
	11,000	**11,500**	**500**

3. Goodwill computation

	GH¢'000
Cost of Investment (60% × 4,000 × 2/3 × 6)	9,600
Fair value of NCI at acquisition	5,900
	15,500
Less: Net Assets at acquisition (W2)	(11,000)
Total Goodwill at acquisition & consolidation	**4,500**

4. Consolidated income surplus

	GH¢'000
Tamale Ltd	
Balance at 30/09/2013	35,400
Navrongo Ltd	
Group share of post-acquisition profit (60%×500 W2)	300
At consolidation	**35,700**

5. Non-Controlling interest- Navrongo Ltd

	GH¢'000
Fair value of NCI at acquisition (W3)	5,900
Add: NCI's share of post-acquisition profit (40%×500)	200
At consolidation	**6,100**

6 Intragroup trading

	DR	CR
Cancel intragroup sales/purchases:	GH₵'000	GH₵'000
Sales	8,000	
Purchases		8,000
Eliminate unrealised profit:		
Cost of sales/ income surplus ((8,000 – 5,200) X 40/140)	800	
Inventories (SOFP)		800

7 Cost of sales

	GH₵'000
Tamale Ltd	63,000
Navrongo (32,000 X 6/12)	16,000
Movement on FV adjustment (W6)	200
Intragroup purchases (W7)	(8,000)
Unrealised profit (W7)	800
	72,000

8 Current assets

	GH₵'000
Tamale Ltd	16,000
Navrongo	6,600
Unrealised profit in inventory (W7)	(800)
Intercompany receivables (per question)	(600)
Cash in transit (W10)	200
	21,400

	DR GH₵'000	CR GH₵'000
10 Cash in transit		
Receivables		600
Payables	400	
Cash	200	

(20 marks evenly spread using ticks)

EXAMINER'S COMMENTS

- This was a question on consolidated statements of profit or loss and financial position. The general observations are as follows:
- Some of the candidates did not realise that the subsidiary was acquired during the year. Hence, the consolidation should be for six months instead of for a full year.
- Most candidates could not compute the NCI and Goodwill.
- The information for the computation of Goodwill was straight forward yet most candidates could not do it.

QUESTION TWO

(a) The licence is a purchased intangible asset, financed in part by a government grant. •Cost of asset is GH¢3 million and government grant is GH¢2 million

It can be accounted for in one of two ways:

The asset is recorded at the nominal price (cash paid) of GH₵1,000,000 and depreciated at GH₵200,000 per annum over its 5 year life; or

• The asset is recorded at its fair value of GH₵3,000,000 and a government grant is shown as deferred income at GH₵2,000,000. The asset is depreciated over 5 years at annual rate of GH₵600,000 per annum. The grant is amortised as income through profit or loss over the same period at a rate of GH₵400,000 per annum.

This results in the same net cost of GH₵200,000 in profit or loss per annum as the first method. The Relevant Standards are IAS 38 and IAS 20.

NB
Candidates may also prepare extracts of Statement of Profit or Loss and Statement of Financial Position to explain the treatment of the government grant.

(2 points for 4 marks)

b) Carrying amount of the plant at 31.3.18

			GH₵
1.4.16	Cost		800,000
	Depreciation	((800,000 – 50,000) / 5)	(150,000)
31.3.17	Balance		650,000
	Depreciation		(150,000)
31.3.18	Balance		**500,000**

As there is currently no market in which to sell the plant, its recoverable amount will be its value in use, calculated as:

	GH₵'000	GH₵'000	GH₵'000
Year Ended	**Cash Flow**	**Discount Factor 10%**	**PV**
31 March 2019	220	0.91	200
31 March 2020	180	0.83	149
31 March 2021	(170+50)	0.75	165
			514

As this is greater than the carrying amount, the plant is **NOT** impaired and will be left at its carrying amount of GH₵500,000.

c) **Calculation of theoretical ex-rights price:**

	GH₵
Before issue 5 shares, value × GH₵1.60	8.00
Rights issue 1 share, value × GH₵1.00	1.00
Theoretical value of 6 shares	9.00

Theoretical ex-rights price $= \frac{GHS9}{6} = GHS1.50$

EPS for 2016

EPS as calculated before taking into account the rights issue = 40p (GH₵40,000 divided by 100,000 shares).

$$EPS = \frac{1.50}{1.60} \times 40p = 37\frac{1}{2}p$$

(This is the corresponding value for 2016 which will be shown in the financial statements for B Co at the end of 2017)

(2 marks)

EPS for 2017

Number of shares before the rights issue was 100,000, 20,000 shares were issued

Stage 1: $100{,}000 \times 9/12 \times \frac{1.60}{1.50} = 80{,}000$

Stage 2: $100{,}000 \times 9/12 = 30{,}000$

110,000

$$EPS = \frac{GHS50,000}{110,000} = 45\frac{1}{2}\,p$$

The figure for total earnings is the actual earnings for the year. **(2 marks)**

d) **In 2016**

- The income statement for 2016 shows an amortization of GH₵5,000 [GH₵45,000/9years]
- The statement of financial position as at 31 December 2016 shows the following
- The asset at a carrying amount of GH₵54,400 [under non-current assets]
- A revaluation surplus of GH₵14,400 [GH₵54,400 - GH₵40,000] is shown under equity.

(2 marks)

In 2017

- Amortisation of GH₵6,800 [GH₵54,400/8 years (remaining useful life)] is charged to income statement
- A transfer should be made from revaluation surplus to retained earnings through the statement of changes in equity of the excess depreciation of GH₵1,800 [6,800 charged less 5,000 (45,000/9) based on the original cost], and thereby reducing the revaluation surplus to GH₵12,600.
- The carrying amount of the intangible asset as at 31 December 2017 is now GH₵47,600 [GH₵54,400 - GH₵6,800] but this should be reduced to GH₵32,000.
- The revaluation deficit is GH₵15,600 of which GH₵12,600 should be recognized in other comprehensive [reducing the revaluation surplus to *nil* and the GH₵3,000 remainder is recognized as an expense in the income statement).

(2 marks)

e) In general, the following conditions must be met for an asset (or 'disposal group') to be classified as held for sale:

- Management is committed to a plan to sell the asset. i.e. an active programme to locate a buyer is initiated and the asset is being actively marketed for sale.
- is available for immediate sale
- the sale is highly probable, within 12 months of classification as held for sale (subject to limited exceptions). The selling price is reasonable in relation to its fair value
- actions required to complete the plan indicate that it is unlikely that plan will be significantly changed or withdrawn.

(2 points for 2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

a) Most of the candidates could not apply their understanding of the issues raised in the various IFRS statements given. Over 70% of the candidates either did not understand the requirements or lack the basic knowledge of the Accounting

Standards. This resulted in the loss of vital marks. A few of the candidates never attempted the question.

b) This was a question in respect of the two ways of the treatment of Government Grants in accordance with IAS 20, Accounting for Government Grants and Disclosure of Government Assistance, which most candidates could not compute the amount to be allocated as the grant.
   Only a few candidates were able to score the maximum marks in calculating the carrying amount to be stated in the financial statement in accordance with IAS 36 on Impairment of Assets.
c) This question had a bit of ambiguity when it came to the computation of the earnings per share for 2017. Only a few candidates were able to compute the earnings per share for 2016.
d) Only a few candidates were able to analyse the revalued amount for the company's intangible assets for 2016 and 2017.
e) The approach to this sub question was above average. Most Candidates were able to identify the criteria to be met before an asset can be classified as held for sale.

QUESTION THREE

BINKABI LTD

a) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 2017

	GH₵'000
Revenue (380,000 – (W5) 4,000)	376,000
Cost of sales (W1)	(265,300)
Gross profit	**110,700**
Distribution costs	(17,400)
Administrative expenses (W1)	(38,500)
Investment income	1,300
Finance costs (W7)	(1,475)
Profit before tax	**54,625**
Income tax expense (16,200 + 2,100 – (W8) 1,500)	(16,800)
PROFIT FOR THE YEAR	**37,825**
Other comprehensive income: Investments in equity instruments ((W2) 2,200 + 2,500)	4,700
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**42,525**

b) **STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 2017**

	GH₵'000
Non-current assets	
Property, plant and equipment (W3)	67,500
Intangible asset (W4)	12,500
Investments in equity instruments (W2)	29,000
	109,000
Current assets	
Inventories	38,000
Receivables	44,500
Bank	8,000
	90,500
Total assets	**199,500**
Equity	
Share capital	50,000
Equity option	2,000
Income surplus (26,060 + 37,825 + (W2(c)) 4,000 – (W6) 12,000)	55,885
Other reserve (W2)	5,700
	113,585
Non-current liabilities	
Deferred tax (W8)	3,900
Deferred revenue (W5)	2,000
5% convertible loan note (W7)	18,915
	24,815
Current liabilities	
Trade payables	42,900
Deferred revenue (W5)	2,000
Tax payable	16,200
	61,100
Total equity and liabilities	**199,500**

Workings

1 Expenses

	Cost of sales GH₵'000	Distribution costs GH₵'000	Admin expenses GH₵'000
Per question	246,800	17,400	50,500
Depreciation (W3)	10,000	-	-
Amortisation (1,500 + 2,500 (W4))	4,000	-	-
Impairment loss (W4)	4,500	-	-
Dividend transferred (W6)	-	-	(12,000)
	265,300	**17,400**	**38,500**

2 Investments in equity instruments

(a) Investment disposed of:

	GH₵'000
Proceeds	11,000
Carrying amount	(8,800)
Gain on disposal – other comprehensive income	**2,200**

(b) Remaining investments:

FV at end of reporting period	29,000
Carrying amount in TB	(26,500)
Gain in year – other comprehensive income	**2,500**

(c) Other reserve:

Balance per TB	5,000
Gains in year (2,200 + 2,500)	4,700
Transfer of realised profit to income surplus (11,000 – 7,000) original cost)	(4,000)*
	5,700

* Entities are permitted to make this transfer and can choose whether or not to do so

3 Property, plant and equipment

Land Buildings Plant Total	**Land**	**Buildings**	**Plant**	**Total**
	GH₵'000	**GH₵'000**	**GH₵'000**	**GH₵'000**
Cost	13,000	50,000	42,200	105,200
Acc'd depreciation b/d		(8,000)	(19,700)	(27,700)
Carrying amount b/d	**13,000**	**42,000**	**22,500**	**77,500**
Depreciation: Building (50,000/50yrs)	-	(1,000)	-	(1,000)
Plant (22,500 × 40%)	-	-	(9,000)	(9,000)
Carrying amount c/d	**13,000**	**41,000**	**13,500**	**67,500**

* 8m depreciation since 20X0 = 8 years. Therefore 50-year life.

4 Intangible asset – brand

	GH₵'000
Cost	30,000
Accumulated amortisation b/d	(9,000)
	21,000
Amortisation to 1.4.2017 (30,000/10 × 6/12)	(1,500)
	19,500
Impairment loss	(4,500)
Recoverable amount (higher of FV less costs of disposal and VIU)	**15,000**
Amortisation to 30.9.2017 (15,000/3 × 6/12)	(2,500)
Carrying amount at 30.9.2017	**12,500**

5 Deferred revenue

Per IFRS 15 a proportion of the revenue from sales to Binkabi Ltd should be deferred to cover the ongoing service and support costs. The costs for the year to 30 September 2017 will already have been accounted for, but revenue must be deferred to cover the costs for the remaining two years. The total amount deferred should include the 40% profit, so will be calculated as:

((1,200 × 2) × 100/60) GH₵4,000,000

This will be deducted from revenue and split 50:50 between current and non-current liabilities.

6 Dividend

GH₵12m is added back to administrative expenses and deducted from income surplus.

7 Convertible loan note

	GH₵'000
Balance per TB	18,440
Interest paid to 30.9.20X9	(1,000)
Effective interest (18,440 × 8%)	1,475
Balance at 30.9.2017	**18,915**

Adjustment required: (1,475 – 1,000) = 475

DR Finance costs/CR Convertible loan note

8 Deferred tax

	GH₵'000
Balance b/f	5,400
Balance to c/f (13m × 30%)	(3,900)
Adjustment	**1,500**

DR Deferred tax (SOFP)/CR Income tax expense

(20 marks evenly spread using ticks)

EXAMINER'S COMMENTS

The approach to the preparation of statements of profit or loss and other comprehensive income and financial position were poorly handled. Since most of the candidates could not analyse the additional information provided to make the necessary adjustments.

QUESTION FOUR

	Obiya	Sector Average
Return on capital employed (186 + 34 loan interest/(335 + 300))	34.6%	22.10%
Net asset turnover (2,425/(335 + 300))	3.8 times	1.8 times
Gross profit margin (555/2,2425 x 100)	22.9%	30%
Net profit (before tax) margin (186/2,425 x 100)	7.7%	12.50%
Current ratio (595/500)	1.19:1	1.6:1
Quick ratio (320/500)	0.64:1	0.9:1
Inventory holding period (275/1,870 x 365)	54 days	46 days
Accounts receivable collection period (329/2,425 x 365)	48 days	45 days
Accounts payable payment period (350/1,870 x 365) (based on cost of sales)	68 days	55 days
Debt to equity (300/335 x 100)	90%	40%
Dividend yield (see below)	2.5%	6%
Dividend cover (96/90)	1.07 times	3 times

(5 marks evenly spread using ticks)

The workings are in GH₵'000 (unless otherwise stated) and are for Obiya's ratios.
The dividend yield is calculated from a dividend per share figure of 15p (GH₵90,000/150,000 × 4) and a share price of GH₵6.00.
Thus the yield is 2.5% (15p/GH₵6.00 × 100%).

REPORT
To:
From:
Subject: Analysis of Obiya's financial performance and financial position compared to sector average for the year to 30 September 2017.

Operation performance

- The return on capital employed of Obiya is impressive being more than 50% higher than the sector. The component of the return on capital employed are the asset turnover is much higher [nearly double] than the average, but the net profit margin after exceptionals are considerable below the sector average. However, if the exceptionals are treated as one off costs and excluded, Obiya's margins are very similar to the sector average.
- This short analysis seems to imply that Obiya's superior return on capital employed is due entirely to an efficient asset turnover i.e Obiya is making its assets work twice as efficiently as its competitors. A closer inspection of the underlying figures may explain why its asset turnover is so high. It can be seen from the note to the statement of financial position that Obiya's non-current asset appear quite old .Their net book value is only 15% of their original cost. This has at least two implications; they will need replacing in the near future and the company is already struggling for funding; and their low net book value gives a high figure for asset turnover. Unless Obiya has underestimated the life of its

asset in its depreciation calculation, its non-current asset will need replacing in the near future. When this occurs its asset turnover and return on capital employed figures will be much lower.

- This aspect of ratio analysis often causes problems and to counter this anomaly some companies calculate the asset turnover using the cost of non-current asset rather than their net book value as this gives a more reliable trend.it is also possible that Obiya is using asset that are not on its statement of financial position . It may be leasing asset that do not meet the definition of finance lease and thus the asset and corresponding obligation are not recognized on the statement of financial position.
- A further issue is which of the two calculation margin should be compared to the sector average (i.e. including or excluding the effect the exceptional losses). The gross profit margin of Obiyas is much lower than the sector average. If the exceptional losses were taken in at trading account level, which they should be as they relate to obsolete inventory, Obiya's gross margin would be even worse. As Obiya's net margin is similar to the sector average, it would appear that Obiya has better control over its operating cost .This is especially true as the other element of the net profit calculation is finance cost and as Obiya has much higher gearing than the sector average, one would except Obiya's interest to be higher than the sector average.

(2.5 marks)

Liquidity

- Here Obiya shows real cause for concern. Its current and quick ratio are much worse than the sector average, and indeed far below expected norms. Current liquidity problems appear due to high levels of accounts payable and a high bank overdraft .The high levels inventory contribute to the poor quick ratio and may be indicative of further obsolete inventory [the exceptional items is due to obsolete inventory]. The accounts receivable collection figure is reasonable, but at 68 days, Obiya takes longer to pay its accounts payable than do its competitors. Whilst this is a source of 'free' finance, its can damage relations with supplier and may lead to a curtailment of further credit.

(2.5 marks)

Gearing

As referred to above, gearing [as measured by debt/equity] is more than twice the level of the sector average. Whilst this may be an uncomfortable level, it is currently beneficial for shareholders. The company is making an overall return of 34.6%, but only paying 8% interest on its .loan notes. The gearing level may become a serious issues if Obiya becomes unable to maintain the finance costs. The company already has an overdraft and the ability to make further interest payment could be in doubt.

Investment ratio

Despite reasonable profitability figures, Obiya's dividend yield is poor compared to the sector average. From the extracts of the changes in equity it can be seen that total dividends are 90,000 out of available profit for the year of only 96,000 [hence the very low cover]. It is worthy of note that the interim dividend was 60,000 and the final dividend only 30,000. Perhaps this indicates a worsening performance during

the year, as normally final dividends are higher than interim dividends. Considering these factors, it is surprising the company's share price is holding up so well.

(2.5 marks)

(Total: 15 marks)

EXAMINER'S COMMENTS

This was a bonus question, since most candidates scored the maximum marks but as usual a few candidates messed up in computing ratios due to their inability to interpret the financial statements provided.

QUESTION FIVE

Alternative A

Compassionate Grounds Limited

Statement of comprehensive Income for the year to 31 December 2017

	Head Office	**Branch**	**Combined**
	GH¢	**GH¢**	**GH¢**
Sales	48,500	30,200	78,700
Goods sent branch	28,600		
	77,100		**78,700**
Cost of goods sold			
Opening Inventory	21,200	7,200	25,800
Goods from HO		18,600	
Purchases	38,000	0	38,000
	59,200	25,800	63,800
Closing Inventory	(14,500)	(8,000)	(28,900)
	44,700	**17,800**	**34,900**
Gross profit (A –B)	32,400	12,400	43,800
Expenses:			
Administration expenses	10,500	4,400	14,900
Increase in PUP(2,000 +1,600 +2,600)	1,000		
	11,500	**4,400**	**14,900**
Net profit (A – B – C)	20,900	8,000	28,900
Transfer to HO current account	8,000	(8,000)	
Profit balance b/d	28,900	-	28,900

Retained Earnings b/d	17,400		17,400
	46,300		46,300

Compassionate Grounds Limited
Statement of financial position as at 31 December 2017

	Head Office	**Branch**	**Combined**
	GH¢	**GH¢**	**GH¢**
Office equipment	18,000	3,500	21,500
Motor Vehicle	1,400	600	2,000
	19,400	**4,100**	**23,500**
Current Assets			
Stock	14,500	8,000	29,800
Branch Current account (13,700-1600)	12,100		
Goods in transit (10,000-2,000)	8,000		
Cash in transit	800		800
	35,400	8,000	29,700
Total Assets	**54,800**	**12,100**	**53,200**
Current liabilities			
Head Office current A/C	0	(12,100)	0
Net Assets	**54,800**	**0**	**53,200**
Stated Capital	8,500		8,500
Retained Earnings	46,300	-	46,300
	54,800		**54,800**

Workings

Combined opening stock			**GH¢**
Head office stock (always at cost)			21,200
Branch stock (at selling price)			7,200
Provision for unrealized profit			(2,600)
			4,600
			25,800

Combined closing tock			**GH¢**
Head office stock (always at cost)			14,500
Branch stock (at selling price)		8,000	
Provision for unrealized profit	(25/125X 8,000)	(1,600)	
			6,400
Goods in transit		10,000	
Provision for unrealized profit	(25/125 X10,000)	(2,000)	8,000
			28,900

a) **Alternative B**

b) **Compassionate Grounds Limited**

Statement of profit or loss for the year ended 31 December 2017

	Head Office GH₵'000	**Branch GH₵'000**	**Combined entity GH₵'000**
Sales	48,500	30,200	78,700
Transfers to branch	28,600		
Opening inventory	(21,200)	(7,200)	(28,400)
Purchases	(38,000)		(38,000)
Transfers from head office		(18,600)	
Closing inventory	14,500	8,000	22,500
Cost of sales	(16,100)	(17,800)	(43,900)
Gross profit	32,400	12,400	44,800
Administrative expenses	(10,500)	(4,400)	(14,900)
Increase in provision for unrealised profit	(1,000)		(1,000)
Net profit	20,900	8,000	28,900
Transfers to head office	8,000	(8,000)	-
	28,900	-	28,900

Compassionate Grounds Limited
Statement of financial position as at 31 December 2017

	Head Office GH₵'000	Branch GH₵'000	Combined entity GH₵'000
Non-current assets			
Office equipment	18,000	3,500	21,500
Motor vehicles	1,400	600	2,000
	19,400	4,100	23,500
Current assets			
Inventory	14,500	8,000	22,500
Goods in transit (10,000 (w (iii) - 2,000 (w (i))	8,000		8,000
Cash			-
Cash in transit	800		800
Current account (13,700 (w (iii) - 1,600 (w (i))	12,100		12,100
Current account		(12,100)	(12,100)
	35,400	(4,100)	31,300
Total assets	54,800	-	54,800
Equity			
Stated capital	8,500		8,500
Retained earnings (workings (ii))	46,300		46,300
	54,800	-	54,800

Workings

i) Provision for unrealised profit

	GH₵'000		GH₵'000
Balance c/d		Balance b/d	2,600
Goods in transit			
(10,000 x 25/125)	2,000	To Profit or loss	1,000
Inventory at branch			
(8,000 x 25/125)	1,600		
	3,600		3,600

ii) Retained earnings

Balance b/d	17,400
Profit for the year	28,900
	46,300

iii) **Head office books**

Current a/c with branch

	GH₵'000		GH₵'000
Balance b/d	16,500	Goods in transit	10,000
Profit	8,000	Cash in transit	800
		Balance c/d	13,700
	24,500		24,500

iv) **Branch books**

Current a/c with Head Office

	GH₵'000		GH₵'000
Balance c/d	12,100	Balance b/d	4,100
		Profit	8,000
	12,100		12,100

(15 marks evenly spread using ticks)

c) **Financial capital maintenance:** Under this concept, a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from owners during the period. Financial capital maintenance can be measured in either

nominal monetary units or units of constraint purchasing power. **(3 marks)**

Physical capital maintenance: Under this concept, a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from owners during the period.

(3 marks)

d) Cost Model Vs Revaluation Model

- According to IAS 16 Property, Plant and Equipment all purchased items of property, plant and equipment are initially recognised at cost, after this an entity may choose to apply the cost model, where PPE is carried at cost less accumulated depreciation, or the revaluation model, where an item of PPE is carried at re-valued amount.

- If the revaluation model is used the entire class of PPE to which that asset belongs must be re-valued. The frequency of revaluation depends on the movements in the fair value of the items being re-valued, but where there are significant movements in fair value, annual revaluations may be required.

- The cost model is more objective as a cost is definite but is providing out of date information. The revaluation model could be considered more subjective as it relies on expert valuers to provide reliable measures of fair value. These measures will be more up to date but may lead to large revaluation gains and losses in the event of a booming property market followed by a crash, as is the case here. The cost model will be cheaper to apply as no expert opinions are required.

- Allowing two models leads to a lack of comparability across reporting entities, not just in the statement of financial position but also in the statement of profit or loss as the depreciation charges will be adjusted for revaluation.

(Any 2 points for 4 marks)

(Total: 25 marks)

EXAMINER'S COMMENTS

a) The approach to the branch accounts question was above average. A few candidates failed to prepare the financial statements for the Head office, Branch and the Combined. A few also failed to show the presentation in columnar form thus wasting valuable time.

b) Most candidates were able to distinguish between financial capital maintenance and physical capital maintenance.

c) Only a few candidates could not distinguish between the cost and revaluation models for the measurement of Non-current assets.

CONCLUSION

There was enough evidence to show that candidates understood what was required, since there were no material deviations. Candidates presented wrong or contrary answers mainly because they did not know the expected answers, which reflected in their poor performance.

The level appreciation of candidates entering the exams at this level appears to be on the decline hence the poor performance in the subject. Candidates are therefore advised not to take the examinations for granted. They should ensure that they have completed the syllabus and worked through series of questions before registering for the examinations.