MARCH 2023 PROFESSIONAL EXAMINATIONS
CORPORATE REPORTING (PAPER 3.1)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

STANDARD OF THE PAPER

The standard of the paper was moderate. The questions were based on the syllabus and were largely straight forward and of the right level. The mark allocation followed the weightings in the syllabus and was fairly allocated to each sub-question. Most questions were clearly stated and followed higher order learning outcomes. Questions that required considerable amount of work were commensurate with the allotted time and marks.

PERFORMANCE OF CANDIDATES

The general performance of candidates in this exams diet was worse than previous diets. Candidates who performed well demonstrated a clear understanding of the subject matter. Some candidates also showed abysmal performance. The poor level of preparedness of some candidates reflected in their poor performance.

QUESTION ONE

Below are statements of financial position of three companies: Abuakwa, Tanoso and Kwadaso as at 31 December 2021:

Statements of financial position as at 31 December 2021

	Abuakwa GH¢ million	**Tanoso GH¢ million**	**Kwadaso GH¢ million**
Non-current assets			
Tangible assets	358.0	169.5	120.0
Investments	170.0	6.5	-
	528.0	176.0	120.0
Current assets	264.0	172.0	116.0
Total assets	**792.0**	**348.0**	**236.0**
Equity and liabilities			
Share capital:			
Ordinary shares at GH¢2 each	180.0	50.0	30.0
Preference shares at GH¢2 each	-	40.0	13.0
Retained earnings	330.0	66.0	56.0
Other reserves	50.0	23.0	8.0
	560.0	179.0	107.0
Current liabilities	232.0	169.0	129.0
Total equity and liabilities	**792.0**	**348.0**	**236.0**

Additional information:

i) Abuakwa acquired 20 million shares in Tanoso on 1 January 2019, when retained earnings and other reserve balances of Tanoso were GH¢12 million and GH¢8 million respectively. The consideration, which has been correctly accounted for, was settled by Abuakwa issuing its own ordinary shares of 7.5 million. Abuakwa's share price was GH¢8 at 1 January 2019. The fair value of non-controlling interest of Tanoso at the date of acquisition was GH¢25 million.

ii) On 1 January 2019, the fair value of the identifiable net assets of Tanoso was equal to their book value except a brand name with a fair value of GH¢2 million which was not validly recognised. The brand was determined to have a useful economic life of five years. At 31 December 2021, an impairment review carried out on the brand showed that its recoverable amount was GH¢1.1 million. No previous impairment losses had been recognised.

iii) Abuakwa acquired 10.5 million shares in Kwadaso on 31 December 2019, when retained earnings and other reserve balances of Kwadaso were GH¢11 million and GH¢10 million respectively. Abuakwa satisfied this consideration by deferring the cash payment for a year. The amount which was eventually paid to the former shareholders of Kwadaso amounted to GH¢49.5 million, but the discounted present value of this payment at acquisition was estimated at GH¢45 million. Abuakwa has correctly recorded these figures.

iv) Other than a fair value uplift of GH¢3 million on a non-depreciable land, no fair value adjustment in respect of Kwadaso's net assets was considered necessary at acquisition. The land's fair value has not been reassessed since acquisition. The fair value of non-controlling interests in Kwadaso at acquisition was GH¢11 million.

v) On 31 December 2020, Tanoso acquired 1.5 million shares of Kwadaso for immediate cash consideration of GH¢6.5 million. Kwadaso's identifiable net assets (as appropriately adjusted for consolidation purposes) on this date was estimated at GH¢72 million.

vi) On 1 January 2021, Tanoso sold a piece of machinery to Abuakwa. The carrying amount of this machinery at the date of sale was GH¢5 million and its original cost was GH¢7 million. Tanoso had originally attributed the machinery with a useful economic life of seven years. Tanoso made a profit of 20% on cost. Abuakwa depreciates this type of machinery at 10% on cost per annum.

vii) Goodwill in Tanoso was impaired by 10% but goodwill in Kwadaso remained unimpaired. Abuakwa does not hold any preference shares in both Tanoso and Kwadaso.

viii) Abuakwa's trade payables include GH¢7 million due to its foreign suppliers. This amount has not yet been updated with related exchange loss of GH¢2 million.

Required:
Prepare the consolidated statement of financial position as at 31 December 2021 for the Abuakwa Group. ***(All figures should be stated in nearest GH¢0.1 million)***

(Total: 20 marks)

QUESTION TWO

a) On 31 December 2022, Hamza Ltd purchased GH¢10 million 5% bonds in Jins Ltd at par value. The bonds are repayable on 31 December 2025 and the effective rate of interest is 8%. Hamza Ltd's business model is to collect the contractual cash flows over the life of the asset. At 31 December 2022, the bonds were considered to be low risk and as a result, the 12-month expected credit losses are expected to be GH¢10,000. On 31 December 2023, Jins Ltd paid the coupon interest, however, at that date the risks associated with the bonds were deemed to have increased significantly.

The present value of the cash shortfall for the year ended 31 December 2024 were estimated to be GH¢462,963 and the probability of default is 3%. On 31 December 2023, it is also anticipated that no further coupon payments would be received during the year ended 31 December 2025 and only a portion of the nominal value of the bonds would be repaid. The present value of the bonds was assessed to be GH¢6,858,710 with a 5% likelihood of default in the year ended 31 December 2025.

Required:
With reference to IFRSs, calculate and discuss the financial reporting treatment of the bonds in the financial statements of Hamza Ltd as of 31 December 2022 and for the year ended 31 December 2023, including any impairment losses. **(10 marks)**

b) Sanda Ltd is a consumer electronics company in Accra, Ghana which has faced a challenging year due to increased competition and the impact of COVID 19. Sanda Ltd has a year end of 31 December 2021 and the unaudited draft financial statements reported an operating loss. Additionally, debt covenant limits based on gearing are close to being breached by Sanda Ltd and the company has reached its overdraft limit. The following occurred during the year:

i) On 1 January 2021, the Finance Director and the CEO paid GH¢3 million cash each in exchange for preference shares from Sanda Ltd which provide cumulative dividends of 7% per annum in line with the Companies Act, 2019 (Act 992). These preference shares can be either converted into a fixed number of ordinary shares in three years' time, or redeemed at par on the same date, at the choice of the preference shareholders. The Finance Director has suggested to the Accountant that the preference shares should be classified as equity because the conversion is into a fixed number of ordinary shares on a fixed date ('fixed for fixed') and conversion is certain (given the current market value of the ordinary shares). **(5 marks)**

ii) Sanda Ltd has included a deferred tax asset in its statement of financial position, based on losses incurred in the previous two years. The Finance Director has asked the Accountant to include the deferred tax asset in full. The Finance Director has suggested this on the basis that Sanda Ltd will return to profitability once its funding issues are resolved. **(5 marks)**

Required:
With reference to International Financial Reporting Standards:
Discuss appropriate accounting treatments which Sanda Ltd should adopt for the issues identified in i) and ii) and their impact on gearing as at 31 December 2021.
(Total: 20 marks)

QUESTION THREE

a) Dajanso Plc (Dajanso) owns a number of printing shops across the country. On 1 January 2021 the carrying amount of Dajanso's largest printing machine was GH¢65 million. The machine had a remaining useful life of five years and a residual value of GH¢7 million using the cost model. Demand for printed books fell during the early quarters of the current year due to the increased popularity of e-Book readers. As a result, Management conducted an impairment review of the printing machine on 30 June 2021.

At this date the printing machine had an estimated selling price of GH¢55 million (including GH¢4 million which would only be received after an expected reconditioning work has been carried out on the asset) with agent fees being 5% of the appropriate fair price. If the machine is kept in use, it is estimated to generate cash flows (in real terms) of GH¢20 million a year over its remaining life which was now estimated to be three years, with the original residual value revised to GH¢6 million. Dajanso has the following discount rates:

Pre-tax nominal discount rate	**Pre-tax real discount rate**	**Post-tax nominal discount rate**	**Post-tax real discount rate**
11.9% p.a.	8.3% p.a.	10.5% p.a.	6.6% p.a.

Required:
In line with **IAS 16** ***Property, Plant and Equipment*** and **IAS 36** ***Impairment of Assets***, recommend how Dajanso would account for the plant in its financial statements for the year ended 31 December 2021. Show appropriate computations where necessary. **(5 marks)**

b) Sadio Plc (Sadio) imports wheat from Ukraine for wholesale distribution to local groceries shops in Ghana. It prepares its financial statements to 31 October each year. Sadio purchased goods for €7.2 million cash when the exchange rate was GH¢1: €0.12. Sadio had not sold any of the goods at 31 October 2022 and the net realisable value was estimated to be €7.0 million at 31 October 2022. The exchange rate at this date was GH¢1: €0.14. The only entries made by directors of Sadio were to include the inventory at its purchase cost (in cedis) in Sadio's financial statements for the year ended 31 October 2022.

Sadio only receives tax relief for any inventory loss when the related item is sold. The company's tax rate at 31 October 2022 was 20%, but a revised rate of 25% was substantially introduced on 18 November 2022. Assume that Sadio has sufficient taxable future profit.

Required:
Recommend, with brief explanations, the correct financial reporting treatment of the above in Sadio's financial statements for the year ended 31 October 2022. **(5 marks)**

c) BYF Health Facility offers varied medical services; It is known for its high-quality laboratory services. In 2021, the company added to its laboratory services, testing of Covid-19 following the increased demand by Airlines that, travelers have to be certified to have negative Covid-19 status either through PCR or Antigen tests. Consequently, the company recruited additional workers in the year to work in the new Covid-19 Lab on a part-time basis. All part-time employees (Locum staff) are paid based on hours worked, either on an 8-hour or 12-hour cycle.

As a precondition, part-time workers are to log in and also log out on every working day, for hours worked to be computed by the log-in device.

Bismark Appau (Bismark), a brother of the Director of Health Services of BYF Health Facility, is one of the employees who was employed on part-time basis at the Covid-19 Lab on an 8-hour cycle. Bismark has permanent employment with KBT hospital and hardly gets time to work at the Covid-19 Lab of BYF Health Facility. However, in preparing payroll of Locum staff, the Director of Health Services, continuously insists that in the case of Bismark, the full hours for the total working days in the month on the 8-hour cycle should be used, regardless of the hours he worked. Colleague workers are aware of this special treatment to Bismark, and are unhappy about this preferential treatment.

Required:

i) Based on the scenario above, justify the possible ethical principles that might have been breached and its effect on productivity. **(6 marks)**

ii) Recommend the possible actions to be taken in dealing with this ethical dilemma. **(4 marks)**

(Total: 20 marks)

QUESTION FOUR

a) For some years now, Adonten has been reporting operating losses, principally due to competition from better models. Adonten is now considering reorganising its operations and financial structure to allow it to obtain new funding required to develop and launch its new product. This product is tipped by technical experts to fare strongly on the market once launched.

The Statement of Financial Position as at 31 December 2021 is available:

	GH¢ million	GH¢ million
Non-current assets		
Tangible assets		5,000
Financial instruments		1,000
Current assets		4,125
		10,125
Equity and liabilities		
Ordinary shares of GH¢1 each		4,000
20% Cumulative preference shares of GH¢1 each		1,500
Retained earnings		(2,918)
		2,582
Non-current liabilities		
20% Bonds		750
Current liabilities		
Trade payables	1,968	
Bank overdraft (secured on properties)	3,900	
Loan from Venture Capital Fund	925	6,793
		10,125

Additional information

i) Preference dividends have been in arrears for three years.
ii) Retained earnings balance is to be eliminated.
iii) The following details relate to the assets:

- Tangible assets: 15% of the book value is to be transferred to the bondholders for an agreed value of GH¢720 million as full settlement of the debt, and the remaining book value of these assets marked up to 110%;
- Inventories include obsolete items worth GH¢540 million below their book value of GH¢680 million;
- A bond investment (having 10 months to maturity date) is to be revised to GH¢280 million from its carrying value of GH¢370 million.
- Receivables with carrying amount of GH¢1,200 million to be factored out for 70% advance under terms that will allow for refund of any difference between actual collections and the upfront payment from the factor.
- One customer who owes GH¢828 million is in serious financial difficulty. Only 50% is expected to be received from this customer in one year's time.

iv) The bank has demanded repayment of the bank overdraft, while Venture Capital Fund (VCF) has accepted to receive 92% of their existing loan in new ordinary shares as full settlement. Upon successful completion of the reorganisation process however, VCF is ready to immediately buy 15% GH¢900 million debentures in the reconstructed entity's debts provided the directors will attach right to convert the debt into shares at maturity. VCF will also require 10% discount on the convertible debt at issue and repayment period of three years. The effective rate of interest on this convertible debt, if the discount is granted, is estimated to be 18.7% and the effective rate of interest on an equivalent non-convertible instrument will be 22.5%.

v) Existing ordinary shareholders are prepared to inject GH¢4,200 million for 840 million new ordinary shares, while preference shareholders have pledged to finance a new production equipment whose estimated fair value is GH¢1,350 million in exchange for 250 million ordinary shares. Each of these shares currently has a value of GH¢5.

vi) Half of the trade payables (suppliers) are satisfied to receive ordinary shares in the reconstructed firm.

vii) The directors are projecting annual profit before interest and tax in the reconstructed entity to be GH¢650 million.

viii) A firm order has been received from Amanten, a competitor to buy all the business assets for GH¢7,200 million. 60% of these proceeds relate to properties. Closure costs are estimated at GH¢50 million.

ix) Assume a discount rate of 15%, unless a different rate is more appropriate.

Required:
Suggest a scheme of capital reorganisation that would be acceptable to all stakeholders, including a revised statement of financial position.

Note
The present value of GH¢1 receivable at the end of the year, based on discount rates of 10%, 15%, 18.7% and 22.5% can be taken as:

Year	**10%**	**15%**	**18.7%**	**22.5%**
1	0.91	0.87	0.84	0.82
2	0.83	0.76	0.71	0.67
3	0.75	0.66	0.60	0.54

(15 marks)

b) Whether an investor's rights in an entity are voting or contractual under ***IFRS 10: Consolidated financial statements***, these rights should be carefully evaluated to find out whether they are mere protective or actually confer power over investee.

Required:
Explain ***protective rights***, providing **FOUR (4)** instances where voting or contractual rights could be regarded as protective. **(5 marks)**

(Total: 20 marks)

QUESTION FIVE

Atiku Ltd operates in the same business sector as Obi Ltd. The directors of Atiku Ltd would like to understand the firm's strengths and weaknesses relative to Obi Ltd from the latest financial statements of the two entities as set out below:

Summerised Statements of profit or loss for the year ended 30 June 2022

	Atiku Ltd	Obi Ltd
	GH¢'000	**GH¢'000**
Revenue	25,600	21,900
Net Profit	1,500	1,260
Net Profit figures were arrived at after considering among others, the following items:		
Depreciation and amortisation	3,110	2,850
Employee benefits	7,200	6,050
Finance cost	1,050	880
Provision for current tax - 2022	1,004	925
Deferred tax (decrease in provision) – 2022	116	55
Current tax under-provision (2021)	-	32

Statements of financial position as at 30 June 2022

	Atiku Ltd	Obi Ltd
Non-current assets	**GH¢'000**	**GH¢'000**
Tangible assets	18,300	16,770
Receivables	2,500	3,020
	20,800	19,790
Current assets		
Inventory	4,600	4,200
Receivables	6,300	5,000
Cash	2,000	1,500
	12,900	10,700
Total assets	**33,700**	**30,490**
Equity		
Share capital (@ GH¢0.50 per ordinary share)	1,500	2,100
Retained earnings	8,800	10,150
12% Convertible loans	3,100	2,450
	13,400	14,700
Non-current liabilities		
8% Redeemable preference shares	3,000	1,800
12% Convertible loans	7,510	8,337
	10,510	10,137
Current Liabilities		
15% Debenture	5,600	-
Trade payables	3,940	5,123
Others	250	530
	9,790	5,653
Total equity and liabilities	**33,700**	**30,490**

Additional information

The following ratios have been extracted from the Directors' Report accompanying the financial statements:

	Atiku Ltd	**Obi Ltd**
Gross profit margin	22%	25%
Dividend coverage	4	5
Current share price (GH¢)	2.10	1.55

Required:

a) Compute the following ratios for both entities for the year ended 30 June 2022:

i) Operating profit margin **(1.5 marks)**

ii) Return on capital employed (capital employed defined as all interest-bearing liabilities and equity) **(1.5 marks)**

iii) Inventory turnover period **(1.5 marks)**

iv) Current ratio **(1.5 marks)**

v) Capital (long-term) gearing **(1.5 marks)**

vi) Dividend yield **(2.5 marks)**

b) Write a report to the Chief Executive Officer analysing Atiku Ltd's financial performance and position relative to Obi Ltd, for the year ended 30 June 2022. For the report writing, use only the following ratios: ***operating profit margin, return on capital employed, capital gearing and dividend yield.*** **(10 marks)**

(Total: 20 marks)

SUGGESTED SOLUTION

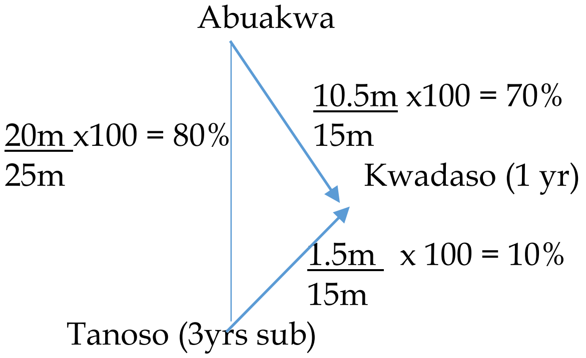
QUESTION ONE

Abuakwa Group
Consolidated statement of financial position as at 31 December 2021

	GH¢'million
Assets:	
Non-current assets:	
Tangible assets (358.0 + 169.5 + 120.0 – 1.0(W2) – 0.4(W2) + 3(W2))	649.1
Investments (170.0 + 6.5 – 60.0(W3) – 45.0(W3) – 6.5(W7))	65.0
Goodwill (11.7 + 2.0) W3	13.7
Brand (2.0 – 1.2 (W2))	0.8
	728.6
Current assets (264.0 + 172.0 + 116.0)	552.0
Total assets	**1,280.6**
Equity and liabilities	
Ordinary shares	180.0
Retained earnings (W5)	400.2
Other reserves (W6)	61.2
Total equity attributable to shareholders of parent	642.9
Non-controlling interest (76.7 + 30.5) W4	107.2
	750.6
Current liabilities (232 + 169 + 129 + 2 exchange loss)	532.0
Total equity and liabilities	**1,280.6**

Workings

1. **Group structure**



Summary of percentages

		Tanoso	Kwadaso	
			Before change	*After change*
Parent% -	Direct	80%	70%	70%
	Indirect	-	-	8% (80%x10%)
				78%
NCI%		20%	30%	22%
		100%	100%	100%

2. **Net assets schedule**

Tanoso	**Acq. Date GH¢ million**	**Rep. date GH¢ million**	**Post-acq GH¢ Million**
Ordinary shares	50.0	50.0	-
Retained earnings	12.0	66.0	54.0
Other reserves	8.0	23.0	15.0
Brand	2.0	2.0	-
Amortisation (2 x 3/5)	-	(1.2)	(1.2)
PUP on equipment (20% x 5)	-	(1.0)	(1.0)
Additional depn on equipment [(7/7) – (10% x (5 + 1))]	-	(0.4)	(0.4)
	72.0	**138.4**	**66.4**

Kwadaso			
Ordinary shares	30.0	30.0	-
Retained earnings	11.0	56.0	45.0
Other reserves	10.0	8.0	(2.0)
Land	3.0	3.0	-
	54.0	**97.0**	**43.0**

Further analysis of net assets and post-acquisition movements

	GH¢ million
Net assets at reporting	97.0
Movements after step-acquisition	(25.0)
Net assets at step-acquisition date	72.0
Movements before step-acquisition	(18.0)
Net assets at acquisition	**54.0**

3. **Goodwill**

Tanoso	**GH¢ million**
Cost of investment (7.5 x 8)	60.0
Fair value of NCI at acquisition	25.0
Fair value of identifiable net assets acquired (W2)	(72.0)
Goodwill at acquisition	13.0
Impairment (10% x 13)	(1.3)

Goodwill at reporting	**<u>11.7</u>**

Kwadaso	**GH¢ million**
Cost of investment	45.0
Fair value of NCI at acquisition	11.0
Fair value of identifiable net assets acquired (W2)	<u>(54.0)</u>
Goodwill at acquisition and reporting	**<u>2.0</u>**

4. Non-controlling interest

	GH¢ million
Tanoso	
Fair value of NCI at acquisition	25.0
Add: NCI % of post –acquisition (20% x 66.4)	13.3
Less: Indirect holding adjustment (20% x 6.5)	(1.3)
Impairment (20% x 1.3)	(0.3)
Add: Preference shares	<u>40.0</u>
	<u>76.7</u>
Kwadaso	
Fair value of NCI at acquisition	11.0
Add: NCI % of post-acq before step-acquisition (30% x 18 (W2))	<u>5.4</u>
NCI at step acquisition	16.4
Less: Transfer to group (8/30 * 16.4)	(4.4)
Add: NCI% of post-acq. from step-acquisition to reporting (22% x 25 (W2))	5.5
Add: Preference share capital	<u>13.0</u>
	<u>30.5</u>

5. Retained earnings

	GH¢ million
Abuakwa	
Balance b/d	330.0
Exchange loss	<u>(2.0)</u>
	328.0
Tanoso	
Parent's share of post-acq earnings (80% x (66.4 – 15 other res.))	41.1
Impairment charge (80% x 1.3 (W3))	(1.0)
Kwadaso	
Parent's share of post-acquisition earnings (W2):	
From acquisition to step-acquisition (70% x 18)	12.6
From step-acquisition to reporting (78% x 25)	<u>19.5</u>
At reporting	**<u>400.2</u>**

6. Other reserves

	GH¢ million
Abuakwa	
Balance b/d	50.0
Control-to-control adjustment (see W7)	(0.8)
Tanoso	
Parent's share of post-acquisition (80% x 15)	12.0
At reporting	**61.2**

7. Control-to-control adjustment

	GH¢ million
Cost of additional shares acquired	(6.5)
Less: Indirect holding adjustment (W4)	1.3
Transfer from NCI (W4)	4.4
Excess payment to other reserves	**(0.8)**

(Total: 20 marks)

EXAMINER'S COMMENTS

Candidates generally had a satisfactory performance in answering the question, which tested the candidates' understanding on preparing consolidated statement of financial position. Notwithstanding the satisfactory performance candidates had in their responses to the question, the following observations were made. This is to guide candidates of ICAG who will be sitting for the paper in the future:

- Candidates had difficulty in the treatment of preference shares held by the subsidiaries. The generality of candidates failed to identify that preference shareholder's capital should be added to the non-controlling interest so far as they are not held by the parent company. They rather recorded it separately under the equity side of the statement of financial position.
- Computation of the net assets at the acquisition date by candidates also captured the preference share capital of the subsidiaries. Candidates failed to realise that the fair value of the subsidiaries at the date of acquisition is determined from the perspective of only equity shareholders and hence included in the preference share capital.
- Candidates also failed to realise that any subsequent purchase after the date control is gained is not considered in computing goodwill. The further purchase by Tanoso in Kwadaso was considered by most candidates in their goodwill computation in Kwadaso.

QUESTION TWO

a) The business model of Hamza Ltd is to collect the contractual cash flows of the bonds over the life of the asset, the bonds should be measured at amortised cost. All financial assets including amortised cost assets should initially be recognised at fair value. This would be equal to the GH¢10 million paid on acquisition of the bonds. **IFRS 9 Financial Instruments** requires entities to adopt an expected value approach to the consideration of impairment losses on financial assets.

On acquisition, the bonds are considered low risk and are not credit impaired. The bonds would be classified as a **stage one** financial asset as of 31 December 2022. This implies that Hamza Ltd should create an expected credit loss equal to *12 months expected credit los*ses. It is important to appreciate that the 12-month expected credit loss is not the lifetime expected credit loss which an entity will incur which it predicts will default in the next 12 months. The 12-month expected credit loss is defined as a portion of the lifetime expected credit losses which represent the expected credit losses which result from a default within the next 12 months. In effect, the proportion of the lifetime expected credit losses which are expected should a default occur within 12 months are weighted by the probability of a default occurring.

Hamza Ltd should therefore recognise a default allowance of GH¢10,000 as at 31 December 2022. This will be expensed **to profit or loss** and a separate allowance created rather than offset against the GH¢10,000,000 bonds. The allowance is, however, netted off the GH¢10,000,000 bond in the statement of financial position of Hamza Ltd as at 31 December 2022. The carrying amount of the bonds in the statement of financial position at 31 December 2022 will be GH¢9·99 million (GH¢10 million – GH¢10,000). As the bonds are to be measured at amortised cost, the effective rate of interest of 8% will be included in profit or loss and added to the bonds. This is calculated on the initial GH¢10,000,000 and is not affected by the loss allowance of GH¢10,000. The coupon interest of GH¢500,000 (GH¢10,000,000 x 5%) is deducted from the carrying amount of the bonds. This implies that the bonds would have a carrying amount of GH¢10,300,000 at 31 December 2023 before considering the impairment allowance.

Amortised cost table 31 December 2023

Bal b/fwd	**Interest rate 8%**	**Coupon rate 5%**	**Bal c/fwd**
GH¢10,000,000	GH¢800,000	GH¢500,000	GH¢10,300,000

At 31 December 2023, there has been a significant increase in credit risk. As no actual default has yet occurred, the bonds should be classified as a **stage two financial asset.** This implies that Hamza Ltd should make an allowance to recognise ***the lifetime expected credit losses.*** This is defined as the expected credit losses (cash shortfalls) which result from all possible default events over the expected life of the bonds. An allowance is required equal to the present value of

the expected loss in contractual cash flows as weighted by the probability of default. The expected default losses are discounted using the original effective rate of interest of 8%.

Date	Calculation of Cash flow loss	Present value of default
31 December 2024	3% x GH¢462,963	GH¢13,889
31 December 2025	5% x GH¢6,858,710	GH¢342,936
		GH¢356,825

The expected loss allowance should be increased to GH¢356,825 with an expense recorded in profit or loss of GH¢346,825 (GH¢356,825 – GH¢10,000). The loss allowance is deducted directly from the bonds with future interest income recorded on the gross position. The carrying amount of the bonds on 31 December 2023 would be GH¢9,943,175 (GH¢10,300,000 – GH¢356,825).

Marks allocation	**marks**
Identification of IFRS 9	1
Classification of financial assets	1
Determination of allowance to P&L	2
Amortised cost table	3
Present value of expected default losses	2
Determining carrying amount of the bond	1
	10

b)

i) **IAS 32** defines an equity instrument as any contract which evidences a residual interest in the assets of an entity after deducting all of its liabilities. An equity instrument has no contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities under potentially unfavourable conditions. If settled by the issuer's own equity instruments, an equity instrument has no contractual obligation to deliver a variable number or is settled only by exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. Preference shares which are required to be converted into a fixed number of ordinary shares on a fixed date should be ***classified as equity*** (this is known as the 'fixed for fixed' requirement to which the finance director refers).

However, a critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of the issuer either to deliver cash or another financial asset to the holder, or to exchange financial assets or financial liabilities with the holder, under conditions which are potentially unfavourable to the issuer. In this case, Sanda Ltd has issued convertible redeemable preference shares – which makes little commercial sense from the company's perspective, as they offer the holder the benefit of conversion into ordinary shares if share prices rise, and the security of redemption (at the choice of the holder) if share prices fall.

IAS 32 notes that the substance of a financial instrument, rather than its legal form, governs its classification in the entity's statement of financial position. A preference share which provides for mandatory redemption for a fixed or determinable amount at a fixed or determinable future date or gives the holder the right to require the issuer to redeem the instrument at a particular date for a fixed or determinable amount **is a financial liability.** Since the preference shares offer the holder the choice of conversion into ordinary shares as well as redemption in two years' time, the terms of the financial instrument should be evaluated to determine whether it contains **both a liability and an equity component.** Such components are classified separately as compound financial instruments, recognising separately the components of a financial instrument which creates both a financial liability of the entity (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity).

Per IFRS 9 Financial Instruments, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. Sanda ltd would measure the fair value of the consideration in respect of the liability component based on the fair value of a similar liability without any associated equity conversion option. The equity component is assigned the residual amount. ***Gearing would decrease if the draft financial statements had included the preference shares within equity: the correction would increase non-current debt (the present value of the future obligations) and decrease equity.***

ii) In accordance with ***IAS 12: Income Taxes***, a deferred tax asset shall be recognised for the carry-forward of unused tax losses to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilised. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses only to the extent that it has convincing evidence that sufficient taxable profit will be available against which the unused tax losses can be utilised. In such circumstances, the amount of the deferred tax asset and the nature of the evidence supporting its recognition must be disclosed.

The directors of Sanda Ltd should consider whether it is probable that Sanda Ltd will have taxable profits before the unused tax losses or unused tax credits expire, whether the unused tax losses result from identifiable causes which are unlikely to recur; and whether tax planning opportunities are available to the entity which will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised. To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset should not be recognised. However, the impact on the financial statements is that the removal of a deferred tax asset would reduce net assets, and equity and increase gearing.

Marks allocation	**marks**
i)	
Identification of IAS 32: Financial Instrument -Presentation	1
Recognition and classification as compound instrument	1
Splitting compound instruments into equity and debt	1
Financial liability measured at amortised cost	1
Impact on gearing and equity	1
	5
ii)	
Identification of IAS 12	1
The use of future profit to support tax losses	4
	5

(Total: 10 marks)

EXAMINER'S COMMENTS

This question on selected accounting standards (IFRS) was a difficult question for most candidates. It was generally not well answered though the questions were straight forward. The question was on precisely IFRS 9, IAS 32 and IAS 12. Candidates performed poorly in this question with few scoring average marks.

Some candidates did not attempt this question at all. It seems most candidates were not familiar with IFRS provisions on financial instruments, particularly the issues regarding impairment arising from expected credit losses. Deferred tax arising from carry-forward of unused tax losses was also a problem to most candidates. Most candidates just defined deferred tax but were not able to speak to the issues raised in the question. In general, the performance was below average.

QUESTION THREE

a) Whenever impairment indicators are present, IAS 36 requires the relevant asset to be assessed for impairment loss which is the amount by which the asset's or the group's carrying amount exceeds its recoverable amount. The recoverable amount is given by the higher of fair value less cost of disposal and value-in-use of the asset or the unit. **(0.5 marks)**

The carrying amount of the machine at 30 June 2021 would be GH¢59.2 million [GH¢65 million less depreciation charge of GH¢5.8 million, i.e. ((GH¢65 million - GH¢7 million) x 1/5 x 6/12)]. **(0.5 marks)**

The fair value is estimated in line with ***IFRS 13: Fair value measurement*** and hence, the amount should reflect the perspective of market participants. The GH¢4 million would therefore not be deducted before arriving at the fair value as market players would consider such required reworking before agreeing on the price to pay for asset. Hence, the fair value less cost of disposal would be GH¢52.25 million (i.e. GH¢55 million less agent fees of GH¢2.75 million). **(1 mark)**

Whereas the machine's value in use would be computed by discounting the projected real cash flows using pre-tax real discount rate. The value-in-use based on annual cash flows of GH¢20 million over the next three years using 8.3% would be GH¢51.26 million (i.e. GH¢20 million x 3-year annuity of 2.563), plus present value of residual value of GH¢6 million x 3-year discount factor of 0.787, amounting to GH¢4.72 million. The total value in use will be GH¢55.98 million. **(1.5 marks)**

The recoverable amount is therefore GH¢55.98 million, and the impairment required is GH¢3.22 million (i.e. GH¢59.2 million less GH¢55.98 million) which is a charge against profit. **(0.5 marks)**
Subsequent depreciation charge for the current period would be GH¢8.33 million ((GH¢55.98 million - GH¢6 million) x 1/3 x 6/12), reducing the revised carrying amount further to GH¢47.65 million (GH¢55.98 million less GH¢8.33 million) at current yearend. Total current depreciation charge would be GH¢14.13 million (GH¢5.8 million plus GH¢8.33 million). **(1 marks)**

b) The recommendation for dealing with the above issues requires the application of IAS 2, IAS 12 and IAS 21.

- IAS 2 requires inventories to be measured initially at cost and later at the lower of cost or net realizable value.
- At the transaction date, IAS 21 requires any foreign-denominated transaction to be translated into the entity's functional currency, and at each date of any re-measurement of the non-monetary item, the item is retranslated into the entity's functional currency as though the item is reacquired for its revised amount. Any resultant retranslation gain or loss is treated along with any required write-down within profit or loss.

- IAS 12 requires provision to be made for deferred tax due to deductible temporary difference created as a result of asset write-down.

At transaction date:
Initial recognition

Purchases (7.2 million/0.12)	GH¢60 million	
Bank		GH¢60 million

At 31 October 2021:
Inventory write-down and retranslation of inventory:

Cost of sales (GH¢60 million – (7 million/0.14))	GH¢10 million	
Inventory		GH¢10 million

At 31 October 2022:
Deferred tax asset provision computed based on the temporary difference and existing tax rate as the new rate is a non-adjusting event:

Deferred tax asset (20% x GH¢10 million)	GH¢2 million	
Profit or loss		GH¢2 million

(2 marks for explanations and 3 marks for computations and entries)

c) **BYF Health facility**

i) The following fundamental principles of the IFAC code of ethics might have been breached:

Integrity
An Accountant is encouraged to be honest and straightforward in carrying out his duties. The Locum staff members are paid based on hours worked. Thus, under no circumstance is a locum staff member expected to be paid for hours he did not work in the month. By complying with the directive of the Director of Health Services to pay Bismark the full allocated hours for the month, when he actually did not work, only suggests dishonesty in the work of the Accountant.

Objectivity
The IFAC code of ethics expects Accountants to be unbiased in their work and not succumb to any undue influence. The use of full hours allotted to Bismark in computing his salary when other Locum staff members are paid strictly on the hours they work, suggests only one thing, "bias" on the part of the Accountant. The objectivity of the Accountant might be impaired by the influence of the Director of Health Services.

Professional behaviour
The conduct of Accountants at their work place, in carrying out their duty or wherever they find themselves, is expected to maintain the good reputation of the Accountancy profession, and not to soil it. The "inconsistent" treatment given to

the Locum staff which has become known to other Locum staff does not speak well of the Accountant, and could put the Accountancy profession in a bad image.

(3 principles @ 2 marks each = 6 marks)

ii) Possible actions that the Finance Director should take include:

- The Finance Director should engage the Human Resource Director and the Laboratory manager, if any or whoever Bismark reports to on the issue of Bismark's continuous absence from work. The Human Resource Director should be encouraged to bring the matter to rest by ensuring that Bismark reports to work during the allotted hours or lose it to a willing and ready Lab professional.
- There is the need to engage the Director of Health services also on why an exception cannot be made for Bismark regarding the determination of his earned salary in a month.
- Also, the Finance Director should engage Bismark to reiterate the point that he is only paid on his hours worked and not on the allotted hours, and hence will not be paid for any hours not indicated by the device.
- Where there is a designated person in charge of payroll of the Locum staff and not the Finance Director, the Finance Director should communicate to the officer or the manager to pay all Locum staff including Bismark using only the output of the clock-in device, and nothing else.
- Where the Director of Health Services insists that Bismark should be given that special treatment, the Finance Director can draw the attention of the Board of Directors to the matter.
- The Finance Director can always seek advice from the Professional body on the matter if it lingers.

(Any 4 points @ 1 mark each= 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question was in two parts: accounting standards and ethics. As usual, the accounting standards part of the question was poorly answered by most candidates. The accounting standards aspect related to IAS 36, IFRS 13, IAS 2, IAS 12 and IAS 21. Candidates could not demonstrate sufficient understanding of the accounting treatments relating to these standards. A greater percentage of the marks earned by candidates came from the ethics part of the questions. Candidates provided reasonable responses regarding the fundamental ethical principles that apply and the possible courses of action to be taken to deal with the ethical dilemma.

QUESTION FOUR

a) The following steps are followed to propose a scheme of capital reorganisation:

Step 1: ***Show liquidation option***

	GH¢ million	GH¢ million
Expected proceeds:		
Properties (60% x 7,200)		4,320
Other assets		2,880
		7,200
Distributed as follows:		
Closure costs		(50)
Bank overdraft		(3,900)
Amount available to creditors		3,250
Unsecured creditors:		
Bond	750	
Trade payables	1,968	
Loan from venture capital fund	925	
	3,643	
		(3,250)
Available to shareholders		-

Recovery rates:

Unsecured creditors: 3,250/3,643 = GH¢0.89 in GH¢1

Shareholders: nil

Step 2: ***Estimate the maximum loss***

	GH¢ million
Retained earnings	2,918
Preference div (20% x 1,500 x 3)	900
Tangible assets (to be taken over) (750 – 720)	30
Other tangible assets (85%x5,000x10%)	(425)
Bondholders (750 – 720)	(30)
Inventories	540
Bond investment (370 – 280)	90
Irrecoverable debts [828 – (50%x828/1.15%)]	468
Loan from venture capital fund (8% x 925)	(74)
Maximum loss	**4,417**

Step 3: ***Allocate the maximum loss to stakeholders (Show the sacrifice table)***

Since ordinary shareholders and preference shareholders are the only losing stakeholder groups, it may be appropriate to ask them to dear the available reorganization loss of GH¢4,417 million in the proportion of their capital balances. Hence, it is proposed that GH¢3,212 million (GH¢4,417 million x 4,000/5,500) of the loss be allocated to ordinary shareholders and the remaining GH¢1,205 million (GH¢4,417 million less GH¢3,212 million) allocated to the preference shareholders.

Other proposed changes

- In exchange of the sacrifice by the ordinary shareholders, they are to subscribe for new ordinary shares in order to benefit from the projected good years.
- The remaining preference share capital and preference dividends in arrears to be converted into ordinary shares.
- Deficient retained earnings account to be cancelled
- Asset values to be restated to reflect their true worth

Note: Other capital changes are permissible, if reasonable.

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Revised statement of financial position (immediately after reorganization)

	GH¢ million	GH¢ million
Tangible assets ((85%x5,000x110%) + 1,350)		6,025
Financial instruments		1,000
Other current assets (4,125-540-90-468)		3,027
Bank (W1)		1,950
Total assets		**12,002**
Equity & liabilities		9,368
Ordinary share capital (W2)		50
Equity option (15% convertible debenture) – W3		9,418
Non-current liabilities:		
15% Convertible debenture (W3)		760
Current liabilities:	984	
Trade payables (50%x1,968)	840	
Advance from factor(W1)		1,824
Total equity & liabilities		**12,002**

Workings

1. **Bank Account**

	GH¢ million		GH¢ million
Factoring (70%x1,200)	840	Bank overdraft	3,900
Venture capital fund (90%x900)	810		
Ordinary shares	4,200	Balance c/d	1,950
	5,850		5,850

2. **Ordinary share capital**

	GH¢ million		GH¢ million
Capital reduction	3,212	Balance b/d	4,000
		Loan (92%x925)	851
		Creditors (50%x1,968)	984
		Preference shares	1,195

		(1,500-1,205+900)	
		Cash	4,200
Balance c/d	9,368	Equipment	1,350
	12,580		12,580

3. **Convertible debentures**

Split the proceeds between liability and equity at the initial date. Liability is given by the present value of the expected interest payments and principal repayments, discounted at the rate (**22.5%)** carried by equivalent non-convertible debentures.

Year	**Future cash flows GH¢ million**	**Df@22.5%**	**PV of Cash flow GH¢ million**
1	135	0.82	111
2	135	0.67	90
3	135	0.54	73
3	900	0.54	486
Liability component			760
Proceeds (90%x900)			810
Equity component (residual amount)			50

(15 marks)

b) Protective rights are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective. Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to which those rights relate, an investor that holds only protective rights cannot have power or prevent another party from having power over an investee.

(1 mark)

Some examples of the types of rights that might be protective include:

- Rights held by a lender that can be used to prevent borrower from undertaking activities that could significantly change the credit risk of the borrower.
- Rights held by a lender to seize assets in the event of default.
- The right of a party holding a non-controlling interest in an investee to approve capital expenditure above set limits or to approve the issue of equity or debt instruments.
- Blocking rights over matters such as foreign takeovers or changes to an investee's founding charter held by a governments or founding party via a 'golden share'.
- Rights held by a franchisor to protect the franchise brand against adverse actions by a franchisee.

(Any 4 points @ 1 mark each = 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question on capital reduction/reorganization was expected to be one of the simplest for candidates. Unfortunately, some candidates could not answer this question appropriately. Most candidates could not determine the maximum loss and how to distribute the loss to the respective stakeholders. The second part of the question on protective rights was poorly answered by almost all the candidates.

QUESTION FIVE

a) Computation of relevant ratios

i) Operating profit margin =

$\frac{\text{PBIT}}{\text{Revenue}} \times 100$

PBIT is given by:

	Atiku Ltd	Obi Ltd
	GH¢ 000	**GH¢ 000**
Profit after tax	1,500	1,260
Finance cost	1,050	880
Provision for current tax	1,004	925
Decrease in deferred tax	(116)	(55)
Under provision of 2021 tax		32
	3,438	**3,042**

	Atiku Ltd	Obi Ltd
Operating profit margin =	$\frac{3,438 \times 100}{25,600}$	$\frac{3,042 \times 100}{21,900}$
	=13.43%	**= 13.89%**
		(1.5 marks)

ii) Return on capital employed

	Atiku Ltd	Obi Ltd
$= \frac{\text{PBIT}}{\text{Capital employed}} \times 100$	$\frac{3,438 \times 100}{13,400+10,510+5,600}$	$\frac{3,042 \times 100}{14,700+10,317}$
	=11.65%	**= 12.24%**
		(1.5 marks)

iii) Inventory turnover period

$= \frac{\text{Inventory}}{\text{Cost of sales}} \times 365$

Cost of sales is given by:

	Atiku Ltd	Obi_Ltd
Cost of sales	19,968	16,425
Atiku (25,600 × (100%-22%))		
Obi (21,900 × (100%-25%))		
Inventory period =	4,600 x 365 / 19,968	4,200 × 365 / 16,425
	= 84 days	**= 93days**
		(1.5 marks)

iv) Current ratio

=Current assets / Current liabilities	**Atiku Ltd**	**Obi Ltd**
	12,900 / 9,790	10,700 / 5,653
	= 1.32:1	**= 1.89:1**
		(1.5 marks)

v) Capital (long-term) gearing

	Atiku Ltd	**Obi Ltd**
Long-term debts x100 / Long-term debts + Equity	10,510 x100 / (10,510+13,400)	10,137 x100) / (10,137+14,700)
	= 43.96%	**= 40.81 %**
		(1.5 marks)

vi) Dividend yield

	Atiku Ltd	**Obi Ltd**
Dividend per share x 100 / Share price	0.125 x 100 / 2.10	0.06 x 100 / 1.55
	=5.95%	**=3.87%**

Dividend per share was found using the coverage ratio. Dividend coverage indicates how many times earnings cover dividends or how many times dividends go into earnings. So if earnings per share is available, we can easily determine dividend per share. Earnings per share is calculated as follows:

Earnings per share

	Atiku Ltd	**Obi Ltd**
PAT – Pref. Div / No. of ordinary shares	1,500 / 1500/0.5	1,260 / 2,100/0.5
	= 0.50	= 0.30
Dividend per share	0.50 / 4	0.30 / 5
	=0.125	**=0.06**
		(2.5 marks)

Summary

	Atiku Ltd	**Obi Ltd**
Gross profit margin	22%	25%
Operating profit margin	13.43%	13.89%
Return on long-term capital employed	11.65%	12.24%
Inventory turnover period	84 days	93 days
Current ratio	1.32:1	1.89:1
Capital gearing	43.96%	40.81%
Dividend yield	5.95%	3.87%
Dividend coverage	4.0	5.0

b) **Report to the Board**
To: Board
From: Accountant
Date: 1 July 2022
Subject: Analysis of financial performance and position of Atiku Ltd

This report provides an assessment of the financial performance and position of Atiku Ltd, relative to its competitor, Obi Ltd, for the year ended 30 June 2022. Four ratios: operating margin, ROCE, capital gearing and dividend yield have been used for this analysis, and hence the report should be read with reference to the ratios computed.

Operating profit margin
Operating margin is a key profitability measure and provides an indication of how well cost of operations has been controlled. It shows how much an entity earns as profit after covering all of its operational expenses. Atiku reports an operating margin of 13.43% which is slightly lower than that of Obi (13.89%). This signifies that Atiku is operating a bit less efficiently in managing overall operational costs incurred to earn revenue.

Return on capital employed
ROCE is a popular indicator of management efficiency and for strategic planning. A comparison of the operating profit generated by an entity with the book value of the non-current and working capital indicates how many cedis of profit are obtained from every cedi of resource under management's control. It throws light on how profitable the entity appears to providers of long-term capital. On ROCE of 11.65% compared Obi's 12.24%, Atiku looks not as good in terms of how much profit is generated for long-term financiers. A critical look is required to find out whether this picture is as a result of only the lower margins Atiku earns as poor asset utilisation could play part role.

Gearing
Capital gearing ratio is measure of financial risk and expresses the amount of a company's debt relative to its equity. The capital gearing of Atiku Ltd and Obi Ltd are 43.96% and 40.81% respectively. Since both companies' capital gearing is below

50%, it means that the companies are lowly geared. This indicates that they use less debt in financing the businesses. Therefore, it would not be difficult for the entities to borrow more when there is the need to raise new capital. There is also low risk that the entity will be unable to meet its payment obligations to lenders when these obligations are due for payment.

Dividend Yield
Dividend yield measures how much income has been received relative to share price. A higher dividend yield is more attractive while a lower yield can make a stock less competitive relative to its industry. The dividend yield for Atiku Ltd and Obi Ltd are 5.95% and 3.87%. This indicates that the stock of Atiku Ltd is more attractive and competitive as compared to Obi Ltd.

Conclusion
The overall performance and position of both companies are very similar. Per the ratios calculated, there is only a slight difference in the companies' performance. Even though the financial performance and position of both companies are okay, Obi Ltd is performing a bit better than Atiku Ltd.

(10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
This question on analysis of the financial statements was of the appropriate standard. Most candidates could not however compute operating profit from the data given. This led to them getting operating profit margin and ROCE ratios wrong. Some could not also derive dividend per share from the data given, hence, their inability to correctly compute dividend yield. Few candidates also devoted separate headings analysing current ratio and inventory holding period in the report even though that was not a requirement.

CONCLUSION
As indicated earlier, overall, candidates performed poorly than previous diets. The results provide some indication of ill preparation and lack of appreciation of accounting standards. It seems that the exemptions granted to most candidates is a factor of poor performance given that candidates lack the pre-requisite knowledge and competence for corporate reporting. It is suggested that candidates preparing for corporate reporting paper should thoroughly revise on the financial reporting paper even when they are exempted from taking the financial reporting paper. The exemptions criteria or policy must be re-looked at. Some candidates just register and sit the paper without the aim of passing but because he/she must register for all subjects. So, they prepare for other subject(s) they have interest in.