NOVEMBER 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 more challenging than the previous diet. Although the questions were based on the syllabus and were largely straight forward and of the right level, some of the topics that were examined in this diet were not expected by most candidates. 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. Some candidates did not attempt the paper at all.

QUESTION ONE

Below are the statements of comprehensive income of Agingo Plc (Agingo), Telemo Plc (Telemo) and Zimbo Plc (Zimbo) for the year ended 31 March 2023:

	Agingo	Telemo	Zimbo
	GH¢000	**GH¢000**	**GH¢000**
Revenue	432,840	302,988	259,704
Cost of sales	(194,778)	(136,345)	(116,867)
Gross profit	**238,062**	**166,643**	**142,837**
Operating expenses	(83,322)	(58,325)	(49,993)
Other income	10,821	7,575	6,493
Finance cost	(5,952)	(4,166)	(3,571)
Profit before tax	**159,609**	**111,727**	**95,766**
Tax	(39,902)	(29,927)	(27,134)
Profit for the year	**119,707**	**81,800**	**68,632**
Other comprehensive income	6,493	5,843	-
Total comprehensive income	**126,200**	**87,643**	**68,632**

Additional information:

i) Agingo held 15% shareholding of the equity shares of Telemo before the start of the year ended 31 March 2023. This investment was acquired at a cost of GH¢35 million. The investment since the date of purchase is accounted for at fair value through other comprehensive income. On 1 December 2022, there was purchase of 45% of the equity shares and 10% of the loan stock of Telemo at the cost of GH¢156 million and GH¢19.2 million respectively. The loan stocks issued by Telemo pays a coupon of 12.5% per annum. The fair value of the existing 15% Shareholding at that date was also estimated at GH¢42 million. The 15% shares investment is carried in the statement of financial position at 31 March 2023 at GH¢40 million. The fair value of non-controlling interest at 1 December 2022, was however GH¢33 million.

ii) The carrying value of the net assets of Telemo approximated their fair values, except the company's production machinery whose fair value was lower than the carrying value by GH¢3 million. The remaining useful life of the machinery was four years. Telemo is yet to incorporate any fair value adjustment arising from the acquisition in its financial statements. Agingo deems any fair value adjustment as temporary difference which attracts tax at the rate of 25%. The carrying value of the net assets of Telemo at 1 December 2022 was GH¢221 million. The group charges depreciation to cost of sales.

iii) Agingo acquired 70% of Zimbo on 1 April 2016 at the cost of GH¢168 million. Zimbo recognises its assets and liabilities at fair values, and as result, there were no differences in the fair value of their net assets and the carrying amounts. The carrying value of the net assets at the acquisition date was GH¢170 million. The fair value of non-controlling interest at the acquisition date was GH¢30 million.

iv) In the course of the year to 31 March 2023, Telemo sold goods worth GH¢6 million to Agingo. 10% of the goods sold which related to the period after 1 December 2022 were yet to be sold by Agingo. Telemo's mark-up on all sales in the year was 25%.

v) On 1 January 2023, Agingo increased its shareholding in Zimbo by 10%, paying cash consideration of GH¢3.8 million. The fair value of non-controlling interest at this date was estimated at GH¢42 million.

vi) At 31 March 2023, goodwill in Telemo and Zimbo were tested for impairment. The fair values of the identifiable net assets of Telemo and Zimbo at 31 March 2023 (as appropriately adjusted by consolidation adjustments) were GH¢178 million and GH¢185 million respectively. The recoverable amounts of the net assets of Telemo and Zimbo at 31 March 2023 were also estimated at GH¢193.8 million and GH¢211 million respectively. Impairment losses are charged to operating expenses.

vii) All Income and expenses are assumed to accrue evenly throughout the year. Any intercompany interest income or interest expense is recognised in the above financial statements. There were no intercompany dividend payments in the year.

Required:

Prepare the **consolidated statement of profit or loss and other comprehensive income** of Agingo's group for the year ended 31 March 2023. (*All your workings are to be rounded to the nearest thousand).*

(Total: 20 marks)

QUESTION TWO

a) The following information were extracted from the financial statements of Tofiakwa Plc for the financial year-end 30 June 2023 to determine the year's basic earnings per share and diluted earnings per share:

	GH¢
Profit after tax from continuing operations	1,925,000
Non-controlling interests' profit	200,000
Ordinary shares, 150,000 issued at GH¢2	300,000
(this figure includes an additional 50,000 ordinary shares issued on 1/10/2022 for cash)	
5% non-cumulative preference shares, 500,000 issued at GH¢1	500,000
Average market price for one ordinary share during the year	15

Additional information:

- Tofiakwa Plc entered into a market transaction on 1 December 2022 to repurchase 12,000 ordinary shares at fair value.
- 20% convertible debentures: 4,000 debentures with an issue value of GH¢1000 per debenture. Each debenture is convertible to ten ordinary shares. Holders of 3,800 convertible debentures converted their holdings into ordinary shares on 1 May 2023.
- The tax rate is 30%.

Required:

For Tofiakwa Plc for the year ending 30 June 2023, calculate:

i) The basic earnings per share. **(5 marks)**

ii) The diluted earnings per share. **(5 marks)**

b) Odehyieba Plc owns a large manufacturing plant. In view of significant changes in technology, the entity has decided to reduce the remaining useful life of the plant by 5 years. For the current year ended 30 April 2023, no entry has been made for depreciation on the plant neither has there been any adjustments to decommissioning cost.

As at 1 May 2022, the plant had a carrying value of GH¢6,000,000 and a remaining useful life of 11 years. Further, in respect of this plant, revaluation surplus of GH¢960,000 and provision for decommissioning cost of GH¢1,600,000 were also appearing in the books as at that date. There is no change in expected decommissioning cost except for the timing due to change in useful life. Applicable discount rate is 11% per annum. It is the policy of Odehyieba to transfer revaluation surplus to retained earnings only upon disposal.

Required:

Advise on the appropriate financial reporting treatment for the above in the books of Odehyieba Plc in the 2023 financial statements for the year ended 30 April, 2023.

(6 marks)

c) Accra Investors Help (AIH), a large stock market data provider in Ghana, provides stock market data to investors across major markets in Africa.

On 1 June 2022, the data provider sold a client access to its real-time database for three (3) years at an invoiced price of GH¢3.6 million. The client has the right of access to AIH's database any time, 24 hours each day, to obtain the real-time data about stock prices around the African markets. On the same date, AIH sold to another client for GH¢800,000 access to 30 years of historical data for the next two (2) years. The client has the right to access the data, containing historical information from 1992-2021 (24 hours each day) and is also free to download the data and retain it after the two-year access to AIH's system has elapsed.

Required:
Advise on how much revenue AIH would recognise for the year ended 31 May 2023 on each of the two contracts. **(4 marks)**

(Total: 20 marks)

QUESTION THREE

a) On 1 January 2022, Avoka Grains Plantation Plc (Avoka) acquired a combined harvester from Awulley Farm Technologies for a lease term of 5 years with instalments payable annually in advance. The useful life of the harvester was estimated at 5 years. Avoka paid the first instalment of GH¢60 million on 1 January 2022.

However, subsequent lease payments are subject to increase/decrease in line with consumer price index (CPI). At the lease inception, Avoka estimated that CPI will increase by 10% annually. However, CPI increased by 14% in 2022 and consequently GH¢68.4 million was paid on 1 January 2023 as second instalment. At 31 December 2022, Avoka estimated that the annual increase in CPI will continue to be 14% in future years.

Avoka is also required to pay a usage fee of GH¢0.3 per acre of harvest in excess of 30 million units per annum from the machine. At the lease inception, Avoka planned to use the harvester to achieve 40 million acres of harvest each year during the lease term. During 2022, Avoka harvested 40 million acres of grains and accordingly an amount of GH¢3 million was also paid along with the second instalment. Avoka's incremental borrowing rate is 11% per annum.

Required:
Advise Avoka Plc on the financial reporting treatment for the above in the financial statements for the year ended 31 December 2022. **(10 marks)**

Note: *The single-period present value and annuity present value factors, based on GH¢1, are provided below for 11% discount rates.*

Year	***11%***	
	Single period present value factor	***Annuity present value factor***
1	*0.901*	*0.901*
2	*0.812*	*1.713*
3	*0.731*	*2.444*
4	*0.659*	*3.103*
5	*0.593*	*3.696*
6	*0.545*	*4.239*
7	*0.482*	*4.721*

b) The Directors of Okonko Ltd are considering acquiring shares in blue-chip companies domiciled in Asia, Europe and North America in the near future in order to diversify their operations and minimise systematic risk. Unfortunately, the entity is currently cash strapped and unable to exploit such opportunities. They would prefer to raise finance from shares on the Ghana Stock Exchange because it is currently highly geared and they do not wish to expose the company to further financial and liquidity risk. They are therefore keen to have a good amount as the balance on the retained earnings in order to remain attractive to prospective investors.

One proposal is that they sell non-controlling interest in one of its domestic subsidiaries (Afa-Alhaji Ltd) which has been recording persistent losses for the past five (5) years. The sale will improve the cash position but Okonko Ltd will continue to maintain control over Afa-Alhaji Ltd. In addition, the Directors are of the strong opinion that the shares can be sold profitably to boost its retained earnings. The Directors intend to transfer the relevant proportion of their share of the losses from the domestic subsidiary to the retained earnings, knowing that this is contrary to accounting standards.

Required:
Explain **FIVE (5)** ethical issues which may arise from the proposal of the directors of Okonko Ltd. **(10 marks)**

(Total: 20 marks)

QUESTION FOUR

a) The Directors of Odenkey Plc have decided to sell their business and have begun a search for organisations interested in the purchase. As a Consultant, you have been asked to determine the appropriate range of price per share suitable for the company. Relevant information is as follows:

Statement of financial position as at 31 December 2022

	GH¢000	GH¢000
Non-current assets		
Property Plant and Equipment		80,000
Investment Property		45,000
Deferred Development Expenditure		55,000
Patent		20,000
		200,000
Current assets		
Inventory	25,000	
Receivables	32,000	
Cash	8,000	
		65,000
Total Assets		**265,000**
Equities and liabilities		
Ordinary Shares (3,000,000)		100,000
Retained Earnings		30,000
		130,000
Non-current liabilities		
Long term loan	80,000	
Deferred tax	5,000	
		85,000
Current liabilities		
Payables	47,000	
Taxation	3,000	
		50,000
		265,000

Additional information:

1) The receivables include GH¢12,000,000 of revenue for credit sales made on a 'sale or return' basis. On 31 December 2022, customers who had not paid for the goods, had the right to return GH¢5,000,000 worth of them. Odenkey Plc applied a markup on cost of 25% on all these sales. Based on previous transactions, it is expected that 80% of the goods will be returned.

2) The property, plant and equipment includes a building that was originally acquired for GH¢20,000,000 five years ago with an initial estimated useful life of 20 years. The property was revalued to GH¢18,000,000 as at 31 December 2022, and the revaluation reserve is yet to be recognised in the financial statement. Due to degradation of the land on which the building stands, the company undertook an impairment review and it was found that, the fair value of the property as at 31 December 2022 is estimated to be GH¢17,000,000. The value in use of the property is calculated as being GH¢16,000,000.

3) The patent was originally acquired 2 years ago and the rights were set at 50 years from the date the patent was originally purchased. The patent was amortised by Odenkey Plc using straight line method over the remaining copyright period. However, recent legislative changes passed on 1 January 2022 have extended the patent period forever. The Research and Development departments projects net future cashflow of GH¢4,500,000 per year from the patent even though the prices of similar patents on the market are valued at GH¢ 18,500,000.

4) The company had a retained earnings balance of GH¢5,000,000 as at 31 December 2021. It has always practiced a dividend payout ratio of 35% when it makes profit during the year.

5) The following information relates to Odenkey Plc and a competitor Odafomtim Ltd:

	Odenkey Plc	**Odafomtim Ltd**
Number of Shares	3,000,000	500,000
5 years' average sales growth	8%	9%
5 years' average growth in EBIT	6%	10.5%
P/E ratio as at 31 December 2022	-	18.61
Estimated return on equity	9.5%	12%

6) The company's cost of capital is 25%.

7) Odafomtim Ltd is a listed firm and has a sizeable market share.

Required:

i) Use the information provided to suggest **FOUR (4)** valuations which prospective purchasers might make. **(12 marks)**

ii) Comment on the appropriateness of the range of price per share of Odenkey Plc that the Directors can offer. **(3 marks)**

b) Mmebusem Plc has been negotiating with Anansesem Plc for several months, and agreements have finally been reached for the two companies to combine. In considering the accounting for the combined entities, management realises that, in applying IFRS 3, an acquirer must be identified. However, there is a debate among the accounting staff as to which entity is the acquirer.

Required:

In accordance with ***IFRS 3: Business Combinations***, outline **FOUR (4)** factors that should be considered in determining which entity is the acquirer. **(5 marks)**

(Total: 20 marks)

QUESTION FIVE

You are a financial consultant of Synel Investments (SI). The Directors of SI have tasked you to evaluate the financial health of two wholesaling companies – Abodam Plc (Abodam) and Bossu Plc (Bossu) – to help them decide which entity to invest in. Assume that all other factors of the two companies have been considered except their current period's relative financial performance and position. The financial statements of Abodam and Bossu for the year ended 31 December 2022 are provided below:

Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2022

	Abodam	**Bossu**
	GH¢000	**GH¢000**
Revenue	23,000	18,000
Cost of sales	(10,800)	(8,100)
Gross profit	12,200	9,900
Operating expenses	(7,400)	(6,800)
Operating profit	4,800	3,100
Finance costs	(1,000)	(500)
Profit before tax	3,800	2,600
Tax	(1,740)	(1,380)
Profit for the year	2,060	1,220
Other comprehensive income:		
Revaluation – Land and buildings	800	300
Gain on cash flow hedge	-	100
Foreign exchange loss	(600)	-
Total comprehensive income	**2,260**	**1,620**

Statement of Financial Position as at 31 December 2022

	Abodam	**Bossu**
	GH¢000	**GH¢000**
Non-current assets		
Land and buildings	12,000	9,000
Plant and equipment	2,700	1,750
Goodwill	500	600
	15,200	11,350
Current assets		
Inventories	2,360	1,800
Trade receivables – unrelated parties	1,900	1,400
Trade receivables – related parties	400	200
Cash and cash equivalents	500	750
	5,160	4,150
Total assets	**20,360**	**15,500**

Liabilities and equity		
Trade payables	900	800
Deferred tax	200	100
Commercial loans (dated 2024)	2,500	1,900
Subsidised loans – (dated 2025)	1,000	-
Cash flow hedge	410	100
Share options	1,100	900
Foreign currency reserves	300	900
Retained earnings	5,750	3,100
Revaluation reserves	1,700	1,200
Share capital	6,500	6,500
Total equity and liabilities	**20,360**	**15,500**

Additional information:

1) The Directors of Bossu announced at the beginning of the current period to repurchase 20% of the company's issued shares in equal proportion over a three-year period. The purchase of the first tranche is expected to occur around February 2023. At the start of second quarter this year, the major commercial lender of Abodam triggered its covenant modification right to include stricter profit-based clauses in the loan agreement.

2) The following ratios were gleaned from the annual reports of the two entities:

	Abodam	**Bossu**
Gross margin	53.0%	55.0%
Operating margin	20.9%	17.2%
Current ratio	5.7	5.2
Inventory turnover	4.6 times	4.5 times
Trade payables	30 days	36 days
Basic earnings per share (GH¢)	0.76	0.80
Diluted earnings per share (GH¢)	0.76	0.67

3) During the year, Abodam and Bossu paid ordinary dividends of GH¢450,000 and GH¢315,000 respectively.

4) Average borrowing rate for the two companies has remained 11% during the period.

Required:

a) Compute the following additional ratios for the two companies:

i) Return on year-end equity

ii) Return on year-end capital employed *(where capital employed equals total assets less current liabilities)*

iii) Trade receivables days

iv) Debt-to-equity **(8 marks)**

b) Write a report to the board of SI to evaluate the relative financial performance and position of Abodam and Bossu, based on the following headings:

i) Profitability
ii) Working capital management
iii) Gearing
iv) Earnings per share
v) Bossu's repurchase plan
vi) Abodam's loan covenant

(12 marks)

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

Agingo
Consolidated statement of profit or loss and other comprehensive income for the year ended 31 March 2023

	GH¢000
Revenue (432,840+302,988 x 4/12 +259,704-6,000x4/12)	791,540
Cost of sales (194,778+136,345 x4/12+116,867- 6,000x4/12 -250(W4)+40(W9))	(354,883)
Gross profit	436,657
Operating expenses (83,322+58,325x4/12 +49,993+2,000(W8))	(154,757)
Other income (10,821+7,575x4/12+6,493-800(W6))	19,039
Finance cost (5,952+ (4,166-800(W6))x4/12 +3,571)	(10,645)
Profit before tax	**290,294**
Tax (39,902+29,927x4/12+27,134 +62.50 (W5))	(77,074)
Profit for the year	**213,220**
Other comprehensive income (6,493+5,843x4/12 +2,000(W3))	10,444
Total comprehensive income	**223,661**
Attributable to:	
Profit for the year:	
Non-controlling interest (W10)	29,226
Parent	183,994
	213,220
Total comprehensive income:	
Non-controlling interest (29,226+776(W10)	30,002
Parent	193,659
	223,661

Workings

1. **Group structure**

Agingo

1/12/22 – 31/3/23
60%
(15% + 45%)

70% +10% =80%
1/4/2016 – 31/3/23

Telemo
(4 months, subsidiary)

Zimbo
(7 years, subsidiary)

Summary of percentages

	Telemo	Zimbo	
		Before additional purchase	After additional purchase
P%	60%	70%	80%
NCI%	40%	30%	20%
Total	100%	100%	100%

2. **Goodwill in Telemo**

	GH¢000
Purchase consideration:	
Fair value of initial holding -15%	42,000
Additional purchase - 45%	156,000
	198,000
Fair value of NCI	33,000
	231,000
Fair value of net assets at acquisition (221,000 - 3,000+750(w))	(218,750)
Goodwill at acquisition	**12,250**

3. **Fair value change in the 15% shareholding in Telemo**

The fair value of the initial 15% held in Telemo was GH¢42 million at the date Agingo had control. However, since Agingo measures the investment at fair value through other comprehensive income, it is expected that the statement of financial position has the investment recognized at fair value at 31 March 2023 of GH¢40m. The fair value change to be recognized in the consolidated statement of comprehensive income is GH¢2m (GH¢42m – GH¢40m).

Debit Investment in Telemo GH¢2m
Credit Other comprehensive income GH¢2m

4. **Depreciation adjustment on the fair value difference**

   There was a downward valuation in the machinery of Telemo at the acquisition date of GH¢3 million. Excess depreciation recognized by Telemo is adjusted as follows:

   Depreciation = GH¢3m/4 = GH¢0.75m x 4/12
   = GH¢0.25m

Debit Machinery/PPE	GH¢0.25m
Credit Cost of sales	GH¢0.25m

5. **Deferred tax on fair value adjustment in Telemo**

	GH¢000
Deferred tax asset at reporting (3,000-250(W)) x25%)	687.5
Deferred tax asset at acquisition (3,000 x25%)	750
Increase in deferred tax expense (To P&L)	62.5

6. **Intercompany finance cost and income**

   Agingo purchased GH¢19.2 million of the 12.5% loan stock of Telemo at the acquisition date. This suggests that interest expense related to the four-months post-acquisition period is included in the finance cost of Telemo, and the same amount included in the other income of Agingo. These income and expense are cancelled upon consolidation.

   Interest expense/ income = 12.5% x GH¢19.2m = GH¢2.4m x 4/12
   = GH¢0.8m

Debit Other income	GH¢0.8m
Credit Finance cost	GH¢0.8m

7. **Goodwill in Zimbo**

	GH¢000
Purchase consideration	168,000
Fair value of NCI	30,000
	198,000
Fair value of net assets at acquisition	(170,000)
Goodwill at acquisition	**28,000**

8. **Impairment test of goodwill in Telemo and Zimbo**

	Telemo	**Zimbo**
	GH¢000	GH¢000
Fair value of identifiable assets	178,000	185,000
Goodwill	12,250	28,000
	190,250	213,000
Recoverable amount	193,800	211,000
Impairment loss	**NIL**	**2000**

9. Intercompany sales and Provision for unrealized profit (PUP)

Sales made by Zimbo to Agingo from the time they became group members (i.e 1 December 2022) is included in the revenue for the last four months being consolidated. Since it is intercompany sales, we remove it by debiting revenue and crediting cost of sales with the 4-months figure of the GH¢5 million intercompany sales. The unrealized profit on the 10% of this revenue yet to be sold is adjusted as follows:

Unsold stock = 10% x (GH¢6m x 4/12) = GH¢0.2m
PUP = 25/125 x GH¢0.2m = GH¢0.04m

Debit	Cost of sales	GH¢0.04m
Credit	Inventory	GH¢0.04m

10. Non-controlling Interest (NCI)'s share of profit

Telemo	GH¢000
Profit for the year	81,800
Finance cost	4,166
	85,966
Post-acquisition profit before interest ,but after tax (4/12 x 85,966)	28,655
Finance cost [(4,166-800) x4/12 + 800]	(1,922)
	26,733
Depreciation	250
PUP- Inventory	(40)
Increase in deferred tax	(62.50)
	26,880.50
NCI's share (26,880.50 x 40%)	**10,752**
Zimbo	
NCI's share of profit:	
Before- purchase (30%x 68,632 x 9/12)	15,442
After additional purchase (20% x68,632 x3/12)	3,432
Impairment of goodwill (2,000 x 20%)	(400)
	18,474
Total NCI	**29,226**
Other comprehensive income	
NCI-Telemo (5,843 x 4/12 x 40%)	779

(Marks should be evenly distributed at 100 ticks @ 0.20 per tick = 20 marks)

EXAMINER'S COMMENTS

Candidates had a poor performance in answering the question, which tested the candidates' understanding on preparing consolidated statement of profit or loss and other comprehensive income. Generally, candidates were able to identify the two acquisitions in Telemo and Zimbo by Agingo (the parent company).

Also, candidates were able to identify that Telemo was acquired in the course of the current year and hence income and expenses of the company to be consolidated have to relate to only the post-acquisition period of four months. The generality of candidates failed to determine or struggled to compute non-controlling interests (NCI) share of profit and total comprehensive income. Candidates who tried computing it were also computing NCI's share of net assets shown on the statement of financial position, and not the statement of profit or loss and other comprehensive income.

Candidates also had difficulty in showing the effect of the additional or further purchases made by the parent company in Zimbo on the consolidated statement of comprehensive income (SOCI). Whiles some candidates misunderstood that information to mean income and expenses in the SOCI are to be prorated, others did not consider it entirely. Candidates failed to realise that the additional purchase was to reflect in the apportionment of profit of the subsidiary (Zimbo) between the parent's shareholders and NCI. As a result, they were expected to apportion the adjusted profit of Zimbo into "profit before the additional purchase" and "profit after the additional purchase", and use the percentage *shareholdings before the purchase* and the *percentage shareholdings after the purchase* to apportion them respectively for Parent's shareholders and NCI in Zimbo.

Still on the additional purchase of shares in Zimbo by the Parent company, candidates also made attempt on computing gain or loss on the transaction and presenting it in the income statement, failing to recognise the fact that additional purchase of shares by the parent in a subsidiary is treated as a transaction between shareholders (i.e. Parent's shareholders and NCI). As a result, such transaction passes through the statement of changes in equity DIRECTLY. It is therefore neither recognised in the income statement nor other comprehensive income.

QUESTION TWO

a)

i) Basic earnings per share

The formula to calculate the basic earnings per share is as follows:

$$\frac{\text{Profit attributable to ordinary shareholders of the parent entity}}{\text{Weighted average number of ordinary shares outstanding during the period}}$$

First, we need to determine profit attributable to ordinary shareholders as follows.

	GH¢
Profit after tax from continuing operations	1,925,000
Non-controlling interests' profit	(200,000)
Preference dividends (5% x 500,000)	(25,000)
Profit attributable to ordinary shareholders of the parent	1,700,000

Next, we need to determine the weighted average number of ordinary shares outstanding during the period as follows.

		Issued shares	Treasury shares	Shares outstanding	No. of months	Weighted average
2022 July 1	Balance of ordinary shares at beginning of period	100,000		100,000		
Oct 1	Issue of new ordinary shares for cash	50,000		150,000	3	25,000
Dec 1	Repurchase of issued shares		12,000	138,000	2	25,000
2023 May 1	Conversion of debentures	38,000		176,000	5	57,600
June 30	Balance of ordinary shares at end of period	188,000	12,000	176,000	2 12	29,333 **136,833**

Weighted average number of shares is given by:

(100,000 x 3/12) + (150,000 x 2/12) + (138,000 x 5/12) + (176,000 x 2/12)

Or

(100,000 x 12/12) + (50,000 x 9/12) – (12,000 x 7/12) + (38,000 x 2/12) = **136,833**

Finally, the basic earnings per share for Tofiakwa Plc for the year ending 30 June 2023 can now be calculated:

$$\frac{\text{Profit attributable to parent's ordinary shareholders}}{\text{Weighted average number of ordinary shares outstanding}}$$

$$= \frac{GH¢1{,}700{,}000}{136{,}833}$$

$$= GH¢12.42$$

(1 mark for explanations and 4 marks for computations = 5 marks)

ii) Diluted earnings per share

The calculation for diluted earnings per share uses the weighted average number of ordinary shares that would be issued assuming the conversion or issue of any dilutive potential ordinary shares occurs during the financial year. For each group of dilutive potential ordinary shares, the increase in earnings attributable to ordinary shareholders needs to be considered along with their dilutive effect. In this example, only the convertible debentures need to be considered by Tofiakwa Plc for the financial year ending 30 June 2023.

The number of convertible debentures issued was 4,000. However, only 3,800 were converted to ordinary shares on a 1-for-10 basis into 38,000 ordinary shares two months before the year end. The effect of these converted bonds would be tested for dilution during the period when they remained unconverted (that is, the first ten months). Meanwhile the unconverted 200 bonds would be tested for dilution for the entire year.

The test for dilution would be based on the post-tax interest saved and the additional shares to have issued upon assumed conversion of the bonds.

Determine incremental earnings per share of the convertible to show whether it is dilutive (can reduce basic EPS or increase basic loss per share) or antidilutive.

	Increase in earnings	Increase in number	Incremental EPS	Remark
Convertible debenture: *Post-tax interest saved upon assumed conversion* (10/12 x 20% x 3,800 x GH¢1,000 x 70%) + (20% x 200 x GH¢1,000 x 70%) *Weighted number of shares from assumed conversion*	GH¢471,333	33,667	GH¢14.00	**Anti-dilutive**

[(10/12 x 38,000) + (12/12 x 200 x 10)]				

Confirmation

	Increase in earnings GH¢	Increase in number	Incremental EPS	Remark
Basic EPS	1,700,000	136,833	GH¢12.42	
Convertible debentures	471,333	33,667		**Anti-**
	2,171,333	170,500	GH¢12.74	**dilutive**

The convertible debentures are determined to be antidilutive as they have the effect of increasing the dilutive earnings per share from GH¢12.42 to GH¢12.74. Therefore, they are not included and the diluted EPS is calculated to be the same as the basic EPS. For the year ending 30 June 2023, the earnings per share for Tofiakwa Plc would be disclosed in the notes to the financial statements as follows.

	Basic EPS	Diluted EPS
Profit from continuing operations attributable to ordinary shareholders	GH¢12.42	GH¢12.42

(2 marks for explanations and 3 marks for computations = 5 marks)

b) This would be dealt with in line with IFRIC 1 ***Changes in existing decommissioning, restoration and similar liabilities,*** **IAS 37** ***Provisions, contingent liabilities and contingent assets***, **IAS 8** ***Accounting policies, changes in estimates and prior period errors*** and **IAS 16** ***Property, plant and equipment***.

In line with IAS 8, the change in the plant's useful life would be accounted for prospectively, effective the beginning of the current period. Post-change depreciation charges will be determined using the revised useful life.
IFRIC 1 requires changes in the measurement of an existing decommissioning, restoration and similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate to be accounted as follows if the related asset is a revalued asset.

Changes in the liability should alter the revaluation surplus or deficit previously recognised on that asset, so that:

- a decrease in the liability shall be recognised in other comprehensive income and increase the revaluation surplus within equity, except that it shall be recognised in profit or loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in profit or loss;

- an increase in the liability shall be recognised in profit or loss, except that it shall be recognised in other comprehensive income and reduce the revaluation surplus within equity to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Workings:

Manufacturing plant

	GH¢000
Carrying amount at 1 May 2022	6,000
Less: Depreciation (6,000/6 years)	(1,000)
Carrying amount at 30 April 2023	5,000

Decommissioning provision

	GH¢000
Carrying amount at 1 May 2022 before adjustment	1,600
Increase in provision (2,696 – 1,600)	1,096
Re-measured provision at 1 May 2022 (1,600 x $1.11^{11}/1.11^{6}$)	2,696
Add: unwound discount (2,696 x 11%)	297
Carrying amount at 30 April 2023	2,993

Write the revaluation surplus balance and take the remaining to profit or loss

	Dr	**Cr**
	GH¢000	GH¢000
Revaluation surplus	960	
Profit or loss (1,096 – 960)	136	
Provision for decommissioning		1,096

Odehyieba Plc
Statement of profit or loss (extract) for the year ended 30 April

	2023
	GH¢000
Finance cost	(297)
Depreciation	(1,000)
Increase in provision	(136)

Odehyieba Plc
Statements of financial position (extract) as at 30 April

	2023
	GH¢000
Non-current assets:	
Plant	5,000
Non-current liabilities:	
Provision for decommissioning costs	2,993

Any 2 valid points for explanations = 2 marks
25 ticks @ 0.16 ticks for the computations and extracts = 4 marks
6 marks

c) The case would be dealt with in accordance with rules set out under ***IFRS 15: Revenue from Contracts with Customers.***

IFRS 15 requires entities to apply a five-step model to recognize revenue in manner that depicts the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. More specifically to the scenario, it is important to determine when the promised data access would transfer to the clients as that shows when a performance obligation is satisfied by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer).

In the first situation, where Accra Investors Help (AIH) sold access to a real-time data base, AIH has granted the right to access its intellectual property as it exists at the time of access. Further, the content of that intellectual property is constantly updated. That allows the customer to simultaneously receive and consume benefit from AIH's performance of the obligation.

Therefore, AIH recognizes the revenue on that contract over time; i.e. GH¢1.2 million (i.e. GH¢3.6 million divided by 3 years). The remaining GH¢2.4 million would be presented as half current liability and half non-current liability.

In the second situation, where AIH sold historical data, it provided the customer with intellectual property as of a point in time. In this case, access over time does not seem to be a key aspect of performance obligation and AIH's performance obligation is satisfied at the time of sale.

Thus, AIH recognizes GH¢800,000 of revenue at the time of the sale (1 June 2022).

(Any 4 valid points for explanations for 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question on selected accounting standards (IFRS) was a difficult question for most candidates. Candidates understanding of the standards and their application to real situations were a bit weak and therefore found it difficult in solving the questions. Performance was low and below expectation. It seems candidates were unfamiliar with these standards. For instance, candidates could not calculate the Earning Per Shares and Diluted Earnings Per Share even though they had an idea of the formula. Candidates could not identify the relevant standards in the 'b' part and also did not know how to present the results in the extract financial statements. Candidates performed poorly in this question with few scoring average marks available. Overall, question 2 was partly attempted and answered. Some candidates did not attempt this question at all. ICAG should intensify revision on standards to enhance better appreciation by candidates.

QUESTION THREE

a) Avoka Plc would account for the lease by recognizing right-of-use asset and a corresponding lease obligation. IFRS 16 requires a lessee to recognise the asset initially at cost (including initial direct costs and lease liability). Subsequently, the asset would be depreciated over the lease term of five years.

The lease liability is recognised initially based on the present value of future lease payments discounted using the lease's implicit interest rate, or the lessee's incremental borrowing rate, if the former is not readily determinable. Subsequently, the lease liability is adjusted for finance charges, lease payments and any re-measurement of the liability.

The annual instalments are tied to general price increases, but since the variability of the payments is due to an index such payments are considered unavoidable and must form part of the lease payments. The usage-based payments however can be avoided and hence should be treated as executory costs (rather than lease payments) which would only be expensed once the attached condition is met.

At the end of year 1, new information shows that the instalments would be revised due to higher than expected inflation rate and hence, the lease liability would be re-estimated at that date using the original discount rate in line with IFRS 16.

Initial measurement and entries

Lease liability, given by the present value of future lease payments (as at the initial date) discounted @ 11%, is provided below:

Year	**Future lease Payments** ***(annual increment of 10%)***	**D.F.** (11%)	**Present value**
	GH¢m		GH¢m
0	60	1	60
1	66	0.901	59.47
2	72.6	0.812	53.07
3	79.86	0.731	58.38
4	87.85	0.659	57.89
Lease liability			**294.69**

	Dr	**Cr**
	GH¢m	**GH¢m**
Right-of-use asset	294.69	
Cash		60.00
Lease liability		234.69

(Initial recognition of the leased asset in Avoka's books)

Lease table for subsequent measurement of lease liability:

Year	Bal. at start GH¢m	Lease payments GH¢m	Interest (11%) GH¢m	Bal. at end GH¢m	Re-measurement GH¢m	Revised bal. GH¢m
2022	234.69	-	25.82	260.51	24.28	284.92
2023	284.92	(68.4)	23.82	240.34	-	240.34

Re-measured lease liability at 31 December 2022 is given by:

Year	Future lease payments *(annual increment of 14%)* GH¢m	D.F. (11%)	Present value GH¢m
0	68.4*	1.00	68.40
1	77.98	0.901	70.26
2	88.89	0.812	72.18
3	101.34	0.731	74.08
Re-measured liability			**284.92**

*At 31 December 2022, the payment is not yet made and so can be deemed as future rental.

The change in liability of GH¢24.28m (i.e. GH¢284.92m less GH¢260.51m) due to the re-measured liability is applied to revise both lease liability and right-of-use asset at 31 December 2022.

Right-of-use asset:

	GH¢m
Initial cost	294.69
Less: Dep (294.69/5)	(58.94)
Carrying value at 31 Dec 2022 (before revision)	235.75
Increase in lease liability	24.28
Carrying value at 31 Dec 2022 (after revision)	**260.03**

Avoka Plc

Statements of profit or loss (extract) for the years ended 31 December 2022

	GH¢m
Finance cost	(25.82)
Depreciation	(58.94)
Additional lease payment	(3)

Avoka Plc

Statements of financial position (extract) as at 31 December 2022

	GH¢m
Non-current assets:	
Right-of-use asset	260.03

Non-current liabilities:	
Lease liability (284.92 – 68.4)	216.52
Current liabilities	
Lease liability	68.4
Usage-based payment	3

Any 3 valid points for explanations for = 3 marks
40 ticks @ 0.175 for the computations and extracts = <u>7 marks</u>
10 marks

Alternative Solution (Question 3a)

This requires the application of IFRS 16, Leases Avoka has acquired the plant on a five-year lease arrangement, and hence Avoka is the lessee in the arrangement. Rental payments are made in advance but the payments are variable in nature. It is provided in this arrangement that the rental to be paid by Avoka in a year should be increased by inflation or changes in the CPI after the initial rental payment of GH¢60 million at 1 January 2022.

At commencement of lease (i.e start of year one), we measure the lease liability using five years lease term and a rental payment of GH¢60 million. The annual projected inflation for the subsequent years of 10% has uncertainty surrounding it because it is projection. IFRS 16 requires that the lessee at commencement of the lease should not anticipate the impact of future changes in the index on the lease liability. The lease liability is hence estimated at commencement of lease using annual rental payment of GH¢60m for the five years lease term.

At 31 December 2022, the actual inflation is known to be 14%. However, since the payments are in advance, a year of this arrangement will be 1 January 2023. So, rental payment increases by 14% to GH¢68.4m. The lease liability at 1 January 2023 is therefore revised using the original discount rate of 11%.

There is also performance-based variable payment contingent on excess capacity or production. Since this also has uncertainty surrounding it and contingent in nature, it is EXCLUDED in the determination of the lease liability. The lessee recognises it separately as expense when the performance target is satisfied. At 31 December 2022, the performance target (excess unit) was satisfied. Avoka therefore recognises expense of GH¢3 million related to this payment. A liability of this amount is also recognised at 31 December 2022 as the payment was made together with the second instalment (i.e 1 January 2023) suggesting that it was outstanding as at 31 December 2022.

Debit variable lease payment (P&L)	GH¢3m
Credit Variable lease payment payable	GH¢3m

Using annuity discounting factor for four years, the present value of lease liability will be:

PV = 3.103 x GH¢60m

=GH¢186.18m

Total value of lease payments before the payment for 2022 is GH¢246.18 (186.18+60).

Years	Cash flows	DCF@11%	PV
1	60	1	60
2	60	0.901	54.06
3	60	0.812	48.72
4	60	0.731	43.86
5	60	0.659	39.54
			246.18

At commencement of lease,

Debit right-of-use asset	GH¢246.18	
Credit Lease liability		GH¢186.18
Credit Bank		GH¢60m

At the end of year 1, subsequent recognition, measure the lease liability at amortised cost as follows:

Years	Opening balance (m)	Payment	Balance for the year(m)	Interest at 14%	Balance at end
2022	186.18	-	186.18	20.48	206.66
2023	206.66	(60)	146.66	16.13	162.79

The right-of-use asset is depreciated over the five-years lease term.

Depreciation = GH¢246.18/5

=GH¢49.24m

Income statement (extract) for the year ended 31 December 2022

	GH¢m
Depreciation	(49.24)
Finance cost	(20.48)
Usage fee	(3)

Statement of financial position- 31 December 2022

	GH¢m
Non-current asset	
Right-of-use asset (246.18-49.24)	196.94

Non-current liabilities:	
Lease liability	146.66
Current liabilities	
Lease liability (206.66 -146.66)	60
Usage fee payable	3

b) The proposal presented by the directors of Okonko Ltd raises several ethical concerns related to transparency, financial reporting, stakeholder interests, and proper corporate governance. Here are eight ethical issues that may arise from their proposal:

- **Misleading Financial Reporting:** The directors' intention to transfer the relevant proportion of their share of the domestic subsidiary's losses to retained earnings, knowing that this is contrary to accounting standards, raises concerns about the accuracy and transparency of the company's financial information. This action could mislead investors and other stakeholders about the company's true financial position. IFRS 9 outlines the criteria for recognizing and derecognizing financial assets and liabilities. Transferring losses from a subsidiary to retained earnings without proper justification and adherence to IFRS 9 criteria misrepresents the financial position.
  Addressing the Issue: Financial statements must be prepared in accordance with accounting standards and provide accurate and reliable information. Transferring losses to retained earnings to improve financial appearance is unethical and can mislead investors and stakeholders.

- **Manipulation of Retained Earnings:**
  The directors plan to transfer losses from the subsidiary to retained earnings to make the company more attractive to investors. This manipulative practice violates the principle of faithful representation which is a fundamental qualitative characteristics of the financial statement according to the conceptual framework. In addition, IAS 1 requires financial statements to provide a true and fair view. Misrepresenting financial information by transferring losses to retained earnings contradicts this principle.
  Addressing the Issue: Retained earnings should accurately reflect the company's cumulative profits and losses. Manipulating retained earnings misrepresents the company's true financial performance. The company should adhere to transparency and honesty in financial reporting.

- **Conflict of Interest**
  The directors' decision to sell minority interest in Afa-Alhaji Ltd to improve the cash position and boost retained earnings may be influenced by their personal interests rather than the best interests of the company and its shareholders. Selling

underperforming assets to manipulate financials and attract investors raises ethical concerns. This raises concerns about potential conflicts of interest and whether the directors are fulfilling their fiduciary duties. IAS 24 ″Related Parties Disclosure″ sets guidelines for disclosing related party transactions. If the directors' actions favor personal benefits over transparent decision-making, this could lead to a breach of these guidelines.
Addressing the Issue: Selling shares to boost earnings without addressing the underlying operational issues is a short-term solution that can harm investors in the long run. Ethical behavior requires addressing the root causes of losses rather than artificially boosting earnings.

- **Selective Disclosure to Attract Investors**
  The directors plan to sell the shares of a domestic subsidiary that has been consistently losing money. Disclosing only selective information that may attract investors while concealing negative aspects of the subsidiary's performance is unethical. Selling shares of the loss-making subsidiary to boost earnings selectively highlights positive aspects and omits crucial negative information. IAS 1 "Presentation of Financial Statements" requires the presentation of financial statements that fairly represent the financial performance and position of the company. Selective reporting that masks negative information violates this requirement.
  Addressing the Issue: The company should provide complete and accurate information to potential investors, including both positive and negative aspects of the subsidiary's performance. Selective disclosure undermines investor trust.

- **Maintaining Control Over Loss-Making Subsidiary**
  The directors' proposal to sell a minority interest in the loss-making subsidiary while maintaining control contradicts ethical corporate governance practices. Selling underperforming assets should involve relinquishing control.
  Addressing the Issue: Maintaining control over an underperforming subsidiary to profit from its assets while shifting losses elsewhere goes against transparency and accountability. A more ethical approach would be to address the losses or divest fully.

- **Lack of due diligence**
  The proposal to sell minority interest in Afa-Alhaji Ltd without conducting proper due diligence on the potential risks and benefits of such a transaction raises concerns about the directors' decision-making process and whether they are acting in a responsible and prudent manner. Selling a minority interest in the subsidiary without full disclosure of its consistent losses and financial challenges disregards the interests of minority shareholders who may not have complete information.
  Addressing the Issue: The directors should prioritize the interests of all shareholders, providing them with transparent and accurate information about the subsidiary's performance and financial situation before making any decisions.

- **Lack of Accountability for Losses**
  The lack of transparency surrounding the proposal to sell minority interest in Afa-Alhaji Ltd and transfer the relevant proportion of their share of the domestic subsidiary to the retained earnings raises concerns about whether the directors are being open and honest with shareholders and other stakeholders about their actions and intentions. Transferring losses from the subsidiary to retained earnings allows Okonko Ltd to avoid accountability for the poor performance of the subsidiary. IFRS 10 Consolidated Financial Statements outlines the principles of consolidated financial statements. Transferring losses to avoid proper consolidation or to manipulate financial reporting disregards the intent of this standard.
  Addressing the Issue: Companies should be transparent about their performance, addressing losses instead of transferring them to other areas. This accountability fosters ethical behavior and proper corporate governance.

(Any 5 points @ 2 marks each = 10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The question examined candidates on IFRS 16 *Leases* as well as on the principles of ethics. The question was of the appropriate standard but the issue of the effect of the 10% price index on the annual payment posed a problem for most candidates. Candidates performed above average on the principles of ethics. However, a few of them wasted time explaining the principles of ethics instead of focusing on the context of the question. A greater percentage of the marks earned by candidates came from the ethics part of the question.

QUESTION FOUR

a. **Adjustments Workings**

Inventory Adjustment	**GH¢000**
Balance per Statement of financial Position (30,000-5,000)	25,000
Cost of Inventories returned (100/125× 80%×GH¢5,000,000)	3,200
Adjusted Inventory	28,200

(4 ticks * 0.125= 0.5 mark)

Receivables Adjustment	**GH¢000**
Balance per Statement of financial Position	32,000
Value of Good returned. (80%×5,000,000)	(4,000)
Adjusted Receivables	28,000

(3 ticks * 0.167= 0.5 mark)

Property, Plant and Equipment	**GH¢000**
Balance per Statement of financial Position	80,000
Fair Valuation Surplus (GH¢17,000,000- GH¢15,000,000)	2,000
Adjusted PPE value	82,000

Impairment Test

Impairment loss = Carrying value greater than recoverable amount

Carrying Value asset = GH¢20,000,000- (GH¢20,000,000/20 years* 5yr)
= GH¢15,000,000

Recoverable amount = higher of value in use and fair value

Recoverable amount = GH¢17,000,000

Since carrying value is less than recoverable amount, the asset is not impaired.

(8 ticks * 0.1875= 1.5 mark)

i)

Adjusted Net Profit or Earnings	GH¢000
Balance per December 2022 SOFP	30,000
Opening Balance	(5,000)
Retained Profit for the year	25,000
Therefore, Net Profit for the year (25,000/0.65)	38,462
Unrealized Profit of Inventories return (25/125× 80%×GH¢5,000,000)	(800)
Adjusted Net Profit	37,662

(6 ticks * 0.083= 0.5 mark)

1. **Assets Based Valuation Method**

Value of firm = Total Asset – Total liabilities

Total Assets	**GH¢'000**
Property, Plant and Equipment (80,000 + 3,000 – 1,000)	82,000

Investment Property	45,000
Patent (Higher of 18,500 and 18,000)	18,500
Inventory	28,200
Receivables	28,000
Cash	8,000
	209,700
Total liabilities	
Long term liabilities	80,000
Deferred tax	5,000
Payables	47,000
Taxation	3,000
	135,000

Value of firm = GH¢209,700,000– GH¢135,000,000 = GH¢74,700,000

Value Per Share $=\frac{\text{GH¢}74{,}700{,}000}{3{,}000{,}000}$ = GH¢24.9

(15 ticks * 0.2= 3 marks)

Note: The value of Patent is the recoverable amount of GH¢18.5million which is the NRV higher than the value in use of GH¢18million.

2. Earning Method – P/E ratio method

Price Per Share = Earnings per shares (E.P.S)× P/E ratio

Earnings Per Share = $\frac{\text{GH¢}37{,}662{,}000}{3{,}000{,}000}$ = GH¢12.554

Price Per Share = GH¢12.554 × 3.35 = GH¢42.06

Because Odafomtim Ltd is 25% greater than Odenkey Ltd, discount by 25%

Price per share = 75%× GH¢42.06 = GH¢31.55

Value of Firm = GH¢31.55×3,000,000 = GH¢94,650,000

(5 ticks * 0.6= 3 marks)

3. Dividend Based Method – Dividend Growth Method

$P = \frac{D(1+g)}{Ke-g}$

Dividend Paid = 35%× GH¢37,662,000 = GH¢13,181,700

Dividend Per Share (D.P.S) = $\frac{\text{GH¢}13{,}181{,}700}{3{,}000{,}000}$ = GH¢4.39; g = 6%; Ke =19.5%

Price per share = $\frac{\text{GH¢}4.39(1+0.06)}{0.195-0.06}$ =4.6534/0.135

Price per share = GH¢34.47

(5 ticks * 0.6= 3 marks)

b.

i) Factors that should be considered in determining which entity is the acquirer:

- Relative voting rights in the combined entity after combination: Acquirer is usually the entity whose owners as a group entity after the combination. retain or receive the largest portion of the combined voting rights, after considering the existence of any unusual or special voting arrangements and options, warrants or convertible notes.
- No majority interest in the combined entity but single large minority interest: Acquirer is usually the entity whose single owner or group. or organised voters holds the largest minority voting interest in the combined entity
- Composition of the governing body of the combined entity: Acquirer is usually the entity whose owners have the ability to elect or appoint a majority of the members of the governing body.
- Senior management of the combined entity: Acquirer is usually the entity whose (former) management entity dominates the combined management.
- Terms of the exchange of equity interests: Acquirer is usually the entity that pays a premium over pre-combination fair value of the other entity or entities.
- Acquirer is usually the entity that transfers the cash or other assets, or incurs the liabilities.
- Acquirer is usually the entity that issues its equity interests. However, in a reverse acquisition, the acquiree may issue equity interests
- Acquirer is usually the entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entities.

(Any 5 points @ 1 mark each = 5 marks)

(Total: 20 marks)

ii) Appropriateness of the range of price per share of Odenkey PLC depends on the following factors:

- Whether or not Odenkey PLC is a going concern. If not, only a break-up valuation is required
- The percentage of shareholding to be disposed
- The marketability of the shares of Odenkey Plc.

EXAMINER'S COMMENTS

This question on business valuation was not answered well by almost all the candidates. Many candidates scored below the average mark. The poor performance could be due to inappropriate treatments of valuation adjustments. In the second part of the question, most candidates were not able to provide reasonable factors that should be considered in determining which entity is the acquirer in accordance with IFRS 3.

QUESTION FIVE

a) Computations of ratios

Ratios	**Formula**	**Abodam**	**Bossu**
Return on year end equity *(see workings below)*	PAT x 100 / Year end equity	2,060 x 100 / 15,760 **= 13.07%**	1,220 x 100 / 12,700 **= 9.6%**
Return on year end capital employed	PBIT x 100 / Year end capital employed	4,800 x 100 / 20,360 – 900 **= 24.7%**	3,100 x 100 / 15,500 – 800 **= 21.1%**
Trade receivables days	Trade receivables x 365 / Revenue	1,900+400 x 365 / 23,000 **= 37 days**	1,400+200 x 365 / 18,000 **= 32 days**
Debt-to-equity *(see workings below)*	Debt x 100 / Equity	3,500 x 100 / 15,760 **= 22.2%**	1,900 x 100 / 12,700 **= 14.96%**

(2 marks for each ratio computed = 8 marks)

b) **Report**

To: Board of Directors, Synel Investments
From: Financial Consultant
Date: 01/11/2023
Subject: Analysis of the relative financial performance and position of Abodam and Bossu

This report provides a detailed evaluation of the financial performance and position of two "investment target" entities – Abodam and Bossu for the year ended 31 December 2022. The analysis seeks to provide insight into the financial health of the two shortlisted entities to help your company decide which of them to invest in. The evaluation covers relative profitability, working capital, gearing, and earnings per share of the two entities. This report, which also reserves a space for discussing the effects of the announced repurchase plan and the modified covenants, should be read along with the attached appendix.

Profitability

Profitability has to do with how well an entity deploys its resources to generate and maximize revenues in an efficient and cost-effective manner. If done well, the entity is expected to earn positive returns. In this section, I would use four metrics to gauge which of the two have been more profitable and how. The measures include gross margin, operating margin, return on capital employed, and return on equity.

Abodam's reported gross margin of 53% sits two percentage points below that of Bossu. This seems to suggest that Bossu has better control over cost of sales. Nothing however stops any supposition from being stretched as far as to suggest that this could as well result from different pricing strategies or different classification of expenses between cost of sales and other operational expenses. This last reasoning could so soon have sufficed by the fact the operating margin takes an opposite turn; Abodam's operating margin is noticeably higher than Bossu's margin. Could it be that Abodam keeps more within cost of sales than within the other lines of operational costs? Whatever the answer may be, it does not prevent the fact that Abodam has better control over overall operational costs than Bossu. The former requires around 81% of revenues to attend to operational costs in entirety whereas the latter needs around 83%.

Abodam's better margins feed seamlessly into the returns for long-term investors as well as for only equity holders. With the return on capital employed of Abodam at 24.7% against Bossu's 21.1%, Abodam has generated more profit for providers of long-term funds, including lenders and shareholders. Equally, Abodam's 13.07% return on equity is higher and better than Bossu's 9.6%, and this implies that from shareholders' perspective only, Abodam has earned more profits per every cedi of capital invested.

Working capital management

Managing working capital is one activity which is very key in helping entities to not only ensure that they have appropriate level of liquidity but to also keep their operations running efficiently without sacrificing profitability. If well managed, arranging the constituents of current assets and current liabilities should lead to a good balance between liquidity and profitability. I conduct this analysis using four ratios: current ratio, inventory turnover, trade receivables days, and trade payables days.

The current ratio of Abodam compares more favourably than Bossu's. But with both entities covering their current liabilities with current assets by more than five times, it does not make much difference that one is more liquid than the other. A look at the individual working capital items provides interesting revelations. Abodam appears to be managing inventory better but tends to be sluggish in dealing with suppliers and customers. Abodam has a slightly faster inventory turnover rate; it turns inventory over 4.6 times in a year compared to Bossu's 4.5 times. These figures also seem to lend credence to the initial thoughts that perhaps Abodam may have employed a lower product pricing strategy to increase turnover rate. Bossu's receivables days of 32 days against Abodam's 37 days means that the former takes five (5) fewer calendar days to collect its debts from credit customers.

In terms of managing credits received from suppliers, Bossu takes six (6) more days than Abodam before making payment to credit suppliers. These decent working capital management efforts by using fewer days to collect debts and more days to pay suppliers may be the cause of Bossu's lower current ratio.

Gearing

Gearing shows how an entity blends equity and debt in its capital structure. This relationship reveals the amount of financial risk investors will bear to create or keep financial contracts with the entity. Bossu maintains a debt-to-equity ratio of 14.96%, which is about seven (7) percentage points less than Abodam's. Bossu's lower gearing ratio makes it less financially risky and safer to keep investments with. But given that the operating margins of both entities edge above the average borrowing rate of 11%, it seems questionable for Bossu to have kept debt levels that low. Since debt tends to be cheaper than equity, it is prudent to use more of it especially if profit levels provide sufficient cushion to help service the legal interest payments.

Earnings per share

This measures the cedi amount of profit earned on each number of issued ordinary share. It gauges an entity's profitability from shareholders' perspective based on number of shares held, rather than the monetary value of shareholders' investments. In this analysis, I use two related measures: basic earnings per share and diluted earnings per share. Basic earnings per share denotes how much actual earnings is attributable to each one weighted ordinary share outstanding while diluted earnings per share refers to earnings (both actual and notional) attributable to each one weighted ordinary share, after considering both issued and dilutive potential shares.

With Abodam reporting same basic and diluted earnings per share, it simply suggests that Abodam does not have any dilutive potential shares even though it has issued some share options. What this means is that these outstanding options are not in the money; the fair value of shares is lower than the exercise price. Bossu however reports different figures for the two types, meaning that Bossu's options are in the money and dilutive.

Based on the basic earnings per share, Bossu is considered to be more profitable than Abodam as it earns 4 pesewas more on each issued share. However, the more predictive and more useful diluted earnings per share figures put Abodam above Bossu. The higher diluted earnings per share indicates that if dilutive potential shares were assumed to have been issued at the beginning of the period or the date of issue, whichever comes later, Abodam would earn 9 pesewas more on each weighted ordinary share than Bossu. Considering possible dilution of the earnings per share helps investors to have a better view of the company's future.

Bossu's repurchase plan
Share repurchase plans represent one popular way, often more tax-efficient than cash dividend alternative from shareholders' point of view, used by corporate entities to return monies to shareholders while helping the buying entities to reduce the number of shares in circulation. From the company's perspective, it may be preferable to buy back shares where management believes or ensures that the company's shares trade at a price lower than their true value. Accounting gimmicks could play a role in ensuring that this is the case. For instance, motivated by the desire to cause share under-pricing, management could cause negative market reaction by choosing techniques, often sophisticated earnings management mechanisms, to paint less healthy financials by cutting incomes, overstating expenses, understating assets, and inflating liabilities. Bossu's general poor show could therefore have been driven by this desire to keep share prices down and minimize the cost of the share repurchase.

Modification of Abodam's loan covenant
Debt covenant violations can be very costly for borrowing entities as failure to keep to the covenant requirements could trigger early repayment, unfavourable renegotiations, and lost credibility for future debt contracting. These covenants could be based on either accounting numbers or non-accounting numbers. Those which are related to accounting numbers broadly require the borrower to achieve and maintain strong financial performance and healthy financial position. Thus, entities have a large incentive to put measures in place to ensure that they meet these requirements in order not to invite the wrath of their lending counterparts.
With the lender putting stricter clauses into the existing covenant, Abodam would be motivated to do all it can put up a good show of financial performance. While Abodam's good performance which I have laid bare from the above analyses may be the outcome of prudent decisions, these urges to resort to biased reporting in order to meet the new covenants at all costs cannot be discounted.

Conclusion
From the assessment above, I would like to suggest that Abodam is a better entity and target to proceed with as it has generally been more profitable, more liquid, and kept debts at sustainable and more prudent level. Its diluted earnings per share figure, which is more predictive and relevant, is better than that of Bossu. However, there are concerns that the good numbers could have been induced by motivation to meet the stricter covenants. Yet, until concrete evidence to that effect is tended it would be far too unjustifiable to be assuming any wrongdoing. In terms of short-term efficiency, Abodam seems to be lagging behind Bossu. But this deficiency with Abodam pales into insignificance when compared to its overall good showing.

(Signed)
Financial Consultant

(2 marks for each explanation = 12 marks)

(Total: 20 marks)

Workings

		Abodam	Bossu
1.	**Equity:**	**GH¢000**	**GH¢000**
	Cash flow hedge	410	100
	Share options	1,100	900
	Foreign currency reserves	300	900
	Retained earnings	5,750	3,100
	Revaluation reserves	1,700	1,200
	Share capital	6,500	6,500
		15,760	12,700
2.	**Debt:**		
	Commercial loans	2,500	1,900
	Subsidised loans	1,000	-
		3,500	1,900

Summary

	Abodam	Bossu
Gross margin	53.0%	55.0%
Operating margin	20.9%	17.2%
Current ratio	5.7	5.2
Inventory turnover	4.6 times	4.5 times
Trade payables	30 days	36 days
Basic earnings per share (GH¢)	0.76	0.80
Diluted earnings per share (GH¢)	0.76	0.67
Return on equity	13.07%	9.6%
Return on capital employed	24.7%	21.1%
Trade receivables days	37 days	32 days
Debt-to-equity ratio	22.2%	14.96%

EXAMINER'S COMMENTS

This question on analysis of the financial statements was of the appropriate standard. Most candidates could not however compute the ratios required. The interpretation of the ratios also posed a challenge for most candidates. The report required specific discussion of certain issues but candidates were unable to discuss these issues.

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. This ultimately has implication for the overall pass rate for the corporate reporting exams.