NOVEMBER 2023 PROFESSIONAL EXAMINATIONS
FINANCIAL REPORTING (PAPER 2.1)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

EXAMINER'S GENERAL COMMENTS

The Financial Reporting syllabus assumes knowledge acquired in Financial Accounting, and develops and applies this further and in greater depth. The syllabus begins with the regulatory, conceptual and ethical framework of accounting. Other areas of the syllabus cover the reporting of financial information for single companies and for groups in accordance with relevant International Financial Reporting Standards. Finally, the syllabus covers the analysis and interpretation of information from financial reports.

STANDARD OF THE PAPER

The standard of the paper compares favourably with those of previous examination sessions. The syllabus coverage was good and the difficulty level was appropriate for the level of cognitive domain to be examined. The level of clarity of requirements of the respective questions was excellent. There was no ambiguity in the requirement of any of the questions in this diet.

PERFORMANCE OF CANDIDATES

Overall, performance of candidates was below expectation. The less than satisfactory performance may be because of short period for preparation and lack of appreciation of content and application of the relevant IFRSs. Candidates have still not appreciated the fact that passing the Financial Reporting Paper greatly depends on their comprehension and application of the IFRSs. Most candidates continue to show lack of understanding of the relevant IFRSs and so continue to perform very poorly in the paper.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

Most candidates scored good marks in Question 4 "Financial Statements Analysis''. That question was a 'low hanging fruit' for all the candidates. A greater number of the candidates demonstrated lack of understanding of how to present consolidated financial statements. Many could also hardly understand and apply the contents of the relevant International Financial Reporting Standards. As a result, the preparation of Single entity financial statements (Question 3) was a nightmare to most of the candidates. Question 5 (b) and (c) which were also based on the IFRSs were poorly attempted by a greater number of the candidates. Candidates must understand that a good knowledge in the relevant International Financial Reporting Standards (IFRSs) is what will ensure their success in this paper.

QUESTION ONE

Below are the financial statements of Monko Plc and its investee company, Danke Plc for the year ended 30 September 2023:

Statements of Profit or Loss and other Comprehensive Income for the year ended 30 September 2023

	Monko Plc	Danke Plc
	GH¢'000	GH¢'000
Revenue	110,000	66,000
Cost of sales	(88,000)	(67,200)
Gross profit (loss)	**22,000**	**(1,200)**
Distribution costs	(3,000)	(2,000)
Administrative expenses	(5,250)	(2,400)
Finance costs	(250)	-
Profit (loss) before tax	**13,500**	**(5,600)**
Income tax (expense)/relief	(3,500)	1,000
Profit (loss) for the year	**10,000**	**(4,600)**
Other Comprehensive Income: Revaluation surplus on property	1,000	-
Total Comprehensive income	**11,000**	**(4,600)**

Statements of Financial Position as at 30 September 2023

	Monko Plc	Danke Plc
	GH¢'000	GH¢'000
Assets		
Non-current assets		
Property, plant and equipment	41,000	21,000
Financial asset: equity investments	16,000	-
	57,000	21,000
Current assets	16,500	4,800
Total assets	**73,500**	**25,800**
Equity and liabilities		
Equity		
Equity shares (@ GH¢0.50 each)	30,000	6,000
Revaluation surplus	5,000	-
Retained earnings	23,500	12,000
	58,500	18,000
Current liabilities	15,000	7,800
Total equity and liabilities	**73,500**	**25,800**

Additional information:

i) On 1 April 2023, Monko Plc acquired 75% of the equity shares of Danke Plc. Danke Plc had been experiencing difficult trading conditions and making significant losses. Taking into consideration Danke Plc's difficulties, Monko Plc made an immediate cash payment of only GH¢1.50 per share. In addition, Monko Plc will pay a further amount in cash on 30 September 2024 if Danke Plc returns to profitability by that date. The value of this contingent consideration at the date of acquisition was estimated to be GH¢1,800,000 but in the light of continuing losses, its value was estimated at only GH¢1,500,000 as at 30 September 2023. The contingent consideration has not been recorded by Monko Plc. At the date of acquisition, shares in Danke Plc had a listed market price of GH¢1.20 each.

ii) On 1 April 2023, the fair values of Danke Plc's assets were equal to their carrying amounts with the exception of a leased property. This had a fair value of GH¢2,000,000 above its carrying amount and a remaining lease term of 10 years at that date. Depreciation is charged to cost of sales.

iii) Monko Plc transferred raw materials at their cost of GH¢4,000,000 to Danke Plc in June 2023. Danke Plc processed all of these materials incurring additional direct costs of GH¢1,400,000 and sold them back to Monko Plc in August 2023 for GH¢9,000,000. At 30 September 2023, Monko Plc had GH¢1,500,000 of these goods still in inventory.

iv) Monko Plc has recorded its investment in Danke Plc at the cost of the immediate cash payment. Other equity investments (included in the financial assets-equity investments) are carried at fair value through profit or loss as at 1 October 2022. The other equity investments have fallen in value by GH¢200,000 during the year ended 30 September 2023.

v) Monko Plc's policy is to value the non-controlling interest at fair value at the date of acquisition. Danke Plc's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.

vi) All items in the above statements of profit or loss are deemed to accrue evenly over the year unless otherwise indicated.

Required:

a) Compute the Goodwill on acquisition of Danke Plc. **(4 marks)**

b) Prepare the Consolidated Statement of Profit or Loss and other Comprehensive Income for Monko Plc Group for the year ended 30 September 2023. **(16 marks)**

(Total: 20 marks)

QUESTION TWO

a) Banda Ltd (Banda) incurred the following borrowing costs during the financial year-end 31 December 2022:

	GH¢
Overdraft interest	14,400
Foreign currency loan interest (correctly translated into GH¢)	100,800
Foreign currency exchange differences on equity	168,000

In addition, a three-year fixed rate GH¢2.4 million loan was borrowed on 1 January 2022 at 6.5%. A loan set-up fee (transaction costs) of GH¢24,000 was incurred. This increased the effective interest rate on the loan to 6.88%.

Required:
In accordance with ***IAS 23: Borrowing Costs***, calculate the maximum amount that could potentially be capitalised as borrowing costs for the year-end 31 December 2022 (assuming an asset was being financed using all available finance). **(5 marks)**

b) Fugu Ltd (Fugu) operates in the automobile industry. The following transaction relates to Fugu for the year-end 31 July 2023. On August 1, 2022, Fugu entered into a ten-year lease, agreeing to pay GH¢3 million annually in arrears in exchange for the use of a building. The present value of the minimum lease payments was GH¢20.13 million at 1 August 2022, and the useful economic life of the building was 50 years. Fugu's cost of capital is 8%.

Required:
In accordance with ***IFRS 16: Leases*** show the financial reporting treatment of the above transactions in the financial statements of Fugu for the year ended 31 July 2023.

(5 marks)

c) Wenchi Ltd (Wenchi) is a real estate development company which has been operating for several years. On January 1, 2022, the office building of Wenchi had a net carrying value of GH¢13.5 million. The cost model was used to value the property. No depreciation had been incurred because the expected residual value was more than the cost due to a buoyant real estate market.

The property became vacant as a result of relocating the company's operations, and on April 1, 2022, a third party (Dormaa Ltd) was given a six-month short lease to occupy it. The property's fair value at the time it was leased out was GH¢16.5 million.

Wenchi made the choice to add the property to its inventories of properties for sale in the regular course of business once the lease expired. The property was valued at GH¢15.75 million at 1 October, 2022. The property was sold in December 2022 for GH¢16 million. Wenchi uses the fair value model for its investment property.

Required:
In accordance with IFRS, determine the amounts to be recognised in profit or loss and in other comprehensive income in respect of the property for the year ended 31 December 2022.

(7 marks)

d) Taini Ltd (Taini) is a listed mining company which operates in the Bono Region with a ten-year term concession commencing on 1 April, 2022. After the expiry of the current mining term, Taini has a duty to rehabilitate the area. These rehabilitations are anticipated to cost GH¢12.09 million on April 1, 2032. On April 1, 2022, the present value of the restoration cost was calculated using the company's 8% cost of capital at GH¢5.6 million.

Required:
In accordance with ***IAS 37: Provisions, Contingent Liabilities and Contingent Assets***, explain the financial reporting treatment of the above transaction in the financial statements of Taini Ltd for the year ended 31 March 2023. **(3 marks)**

(Total: 20 marks)

QUESTION THREE

The following trial balance relates to Sompa Plc (Sompa) as at 30 June 2023:

	Note	GH¢'000	GH¢'000
Revenue	i)		966,500
Cost of sales		442,500	
Research and development costs	ii)	39,000	
Distribution costs		18,000	
Administrative expenses	iv)	34,000	
Loan note interest and dividends paid	iv) & vii)	25,000	
Investment income			1,500
Equity shares of GH¢1 each	vii)		196,500
5% Loan note	iv)		100,000
Retained earnings as at 1 July 2022			31,000
Revaluation surplus as at 1 July 2022			15,000
Property at valuation 1 July 2022	iii)	142,500	
Plant and equipment at cost	iii)	135,500	
Accumulated depreciation – plant and equipment 1 July 2022			45,500
Financial asset investments at fair value 1 July 2022	v)	44,000	
Deferred tax	vi)		3,750
Trade receivables		101,875	
Trade payables			241,250
Bank and cash		240,000	
Inventories		378,625	-
		1,601,000	**1,601,000**

Additional information:

i) Revenue includes a GH¢15 million sale made on 1 January 2023 of maturing goods, which are not biological assets. The cost of the goods at the date of sale was GH¢10 million. Sompa is still in possession of the goods (but they have not been included in the inventory count). Sompa has the option to repurchase the goods at any time within three years of the sale at a price of GH¢15 million plus interest of 10% per annum. On 30 June 2023, the option had not been exercised but it is likely that it will be exercised before the date it lapses.

ii) Sompa commenced a research and development project on 1 January 2023. It spent GH¢5 million per month on research until 31 March 2023. The project then passed on into the development stage with an GH¢8 million per month spending from 1 April 2023 to 30 June 2023, when the development of the project was completed. However, on 1 May 2023, the directors of Sompa were confident that the new product would be a commercial success. Expensed research and development costs should be charged to cost of sales.

iii) Non current assets:
Sompa's property is carried at fair value which at 30 June 2023 was GH¢145 million. The remaining life of the property at the beginning of the year (1 July 2022) was 15 years. Sompa does not make an annual transfer to retained earnings in respect of excess depreciation on revaluation. The company pays tax on profits at the rate of 25%.

Plant and equipment is depreciated at 15% per annum using the reducing balance method. No depreciation has yet been charged on any non current asset for the year ended 30 June 2023. All depreciation is charged to cost of sales.

iv) The 5% loan note was issued on 1 July 2022 at its nominal value of GH¢100 million incurring direct issue costs of GH¢2.5 million which have been charged to administrative expenses. The loan note will be redeemed after three years at a premium which gives the loan note an effective finance cost of 8% per annum. Annual interest was paid on 30 June 2023.

v) At 30 June 2023, the financial asset equity investments had a fair value of GH¢48 million. There were no acquisitions or disposals of these investments during the year.

vi) A provision of GH¢6 million for current tax for the year ended 30 June 2023 is required. Additionally, GH¢4 million increase in the deferred tax provision is to be charged to profit or loss.

vii) Sompa paid a dividend of GH¢0.20 per share on 30 March 2023, which was followed by an issue of 50 million equity shares at their full market value of GH¢1.70. At 1 July 2022, Sompa had in issue 100 million shares at full market value of GH¢1 each.

Required:
Prepare for Sompa Plc:

a) The Statement of Profit or Loss and other Comprehensive Income for the year ended 30 June 2023. **(10 marks)**
b) The Statement of Financial Position as at 30 June 2023. **(10 marks)**

(Total: 20 marks)

QUESTION FOUR

You are the Chief Finance Officer of LizOil Co. Ltd, a holding company with subsidiaries that have diversified interests. The company's Board of Directors are interested in acquiring a new subsidiary in the Downstream Petroleum Sector. Two companies have been identified as potentials for the acquisitions, Addin Petroleum & Gyan Petroleum. The following are the summaries of their respective financial statements:

Statement of Profit or Loss for the year ended 30 September 2022

	Addin Petroleum	**Gyan Petroleum**
	GH¢'000	**GH¢'000**
Turnover	39,400	22,400
Cost of Sales	(26,000)	(15,880)
Gross Profit	13,400	6,520
Distribution Costs	(4,960)	(3,000)
Profit before Interest & Tax	8,440	3,520
Finance Cost	(1,400)	(400)
Profit before Taxation	7,040	3,120
Taxation	(2,600)	(1,000)
Profit after Taxation	**4,440**	**2,120**

Statement of Financial Position as at 30 September 2022

	Addin Petroleum		**Gyan Petroleum**	
	GH¢'000	**GH¢'000**	**GH¢'000**	**GH¢'000**
Non-Current Assets				
Property Plant & Equipment		30,600		16,400
Current Assets				
Inventories	6,200		5,600	
Receivables	6,800		15,800	
Bank	2,000		1,800	
		15,000		23,200
Total Assets		**45,600**		**39,600**
Equity & Liabilities				
Equity				
Share Capital	18,000		17,600	
Retained Earnings	4,200	22,200	2,200	19,800
Current Liabilities				
Trade Payables		14,600		17,000
Non-Current Liabilities				
Debentures		8,800		2,800
		45,600		**39,600**

Required:

a) Calculate the following ratios for each of the two companies:

i) Net profit margin

ii) Return on year-end capital employed

iii) Quick ratio

iv) Trade receivables' collection period (in days)

v) Gearing (debt over debt plus equity)

vi) Interest cover **(9 marks)**

b) Write a report to the Chairperson of the board based on a comparable analysis of performance of both companies using the ratios computed in (a) above.

(9 marks)

c) State **TWO (2)** limitations of ratios. **(2 marks)**

(Total: 20 marks)

QUESTION FIVE

a) You are the Finance Manager of OJ Ltd, a manufacturing company in Ghana, which is beginning to feel the impact of the COVID-19 and the Russian-Ukraine war. As part of your duties, you prepare the quarterly management accounts to Evans, the Finance Director (FD), for his comment. A few months ago, you noted that the company was not in the position to honour the obligations of the company's long-term bank loan and you made Evans aware of this. He thanked you for your vigilance and for raising the issue but told you not to worry.

In the first quarter of 2022 ending 31 March, a set of quarterly management accounts were sent to the bank. You noted from the copy on file that the inventory figure on the financial position had been increased by GH¢1.55 million. Whilst you trust Evans and have a good working relationship with him, you found the inventory adjustment surprising as you had made all the usual checks to ensure that the cut-off and valuation procedures were properly adhered to.

At the end of the second quarter, similar inventory adjustment was made. The adjustment on this occasion had risen by GH¢2 million. This time you asked Evans why the inventory adjustment was made. He asserted that, at the quarter-end the company held inventory at external premises, which was not included in the inventory count. You found this strange as Evans had never mentioned this to you. However, you decided not to pursue this matter any further.

At the end of the third quarter, you noted that the set of accounts sent to the bank has again been altered to include a higher inventory figure. This time an additional GH¢3 million has been added to the inventory value you provided. This ensures that the company meets its obligation to the bank. You asked Evans to properly explain the inventory adjustments which have been made in recent months but he tells you to: "Mind your own business and get on with your own job". He also informs you that if you ever question his judgment again then: "You won't have a job to do!".

Required:

i) Explain how you could potentially act in order not to breach each of the **FIVE (5)** fundamental principles of the IFAC's code of ethics. **(5 marks)**

ii) Recommend **FIVE (5)** possible actions that you should take as a member of Institute of Chartered Accountants, Ghana in dealing with the situation. **(5 marks)**

b) Kaime Ltd (Kaime) deals in cosmetics and make-up manufacturing and with year-end 31 December 2022. Its date of authorization of financial statements for issue was 9 February 2023 and the annual general meeting is scheduled on 8 March 2023. The following event occurred:

A particular type of inventory held by Kaime at a different location was recorded at its cost of GH¢598,000 at 31 December 2022 in the statement of financial position. The entity sold 70% of this inventory for GH¢364,000 on 15 January 2023, incurring a commission expense of 15% of the selling price of the inventory. The remaining 30% of the inventory are estimated to be realised at cost.

Required:

In accordance with ***IAS 10: Events after the Reporting Period,*** explain the appropriate accounting treatment of the event in the financial statements of Kaime for the year ended 31 December 2022. **(5 marks)**

c) With reference to ***IFRS 10: Consolidated Financial Statements***, an entity that is a parent shall present consolidated financial statements. However, a parent need not present consolidated financial statements if it meets some conditions.

Required:

i) Define ***Consolidated Financial Statements***. **(1 mark)**

ii) Outline **FOUR (4)** conditions under which a parent may be exempted from presenting consolidated financial statements. **(4 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) **Computation of Goodwill on Acquisition of Danke Plc**

	GH¢'000
Investment at cost:	
Immediate cash consideration	
(6,000 x 2 (i.e. shares of 50p) x 75% x GH¢1.50)	13,500
Contingent consideration	1,800
Non-controlling interest (12,000 x 25% x GH¢1.20)	3,600
	18,900
Net assets (equity) of Danke at acquisition - 1 April 2023	(22,300)
Bargain purchase/negative goodwill – credited directly to profit or loss	**(3,400)**

Note: *IFRS 3* Business Combinations *says negative goodwill should be credited to the acquirer, thus none of it relates to the non-controlling interests*

(Marks are evenly spread using ticks = 4 marks)

b) **Monko Plc Group**
Consolidated statement of profit or loss and other comprehensive income for the year ended 30th September 2023

	GH¢'000
Revenue (110,000 + (66,000 x 6/12) – (4,000 + 9,000 intra-group sales))	130,000
Cost of sales (w (i))	(109,300)
Gross profit	20,700
Distribution costs (3,000 + (2,000 x 6/12))	(4,000)
Administrative expenses (5,250 + (2,400 x 6/12)	(6,450)
Fair valuation loss on equity investments	(200)
Gain on bargain purchase	3,400
Decrease in contingent consideration (1,800 – 1,500)	300
Finance costs	(250)
Profit before tax	**13,500**
Income tax expense (3,500 – (1,000 x 6/12))	(3,000)
Profit for the year	**10,500**
Other Comprehensive Income	1,000
Total Comprehensive income	**11,500**
Profit for year attributable to:	
Equity holders of the parent	11,250
Non-controlling interest losses (see below)	(750)
	10,500
Total comprehensive income attributable to:	
Equity holders of the parent	12,250
Non-controlling interest losses (see below)	(750)
	11,500

Workings in GH¢'000

1. Group structure

Monko	75%
NCI	25%
Date of acquisition	1 April 2023
Pre-acquisition period	6 months
Post-acquisition period	6 months

2. **Net Assets of Danke Plc**

	At acquisition date GH¢'000
Share capital	6,000
Retained earnings [12,000+6/12 (4,600 loss)]	14,300
Fair value adjustment for property	2,000
	22,300

3. **Cost of sales**

	GH¢'000
Monko	88,000
Danke (67,200 x 6/12)	33,600
Intra-group purchases (4,000 + 9,000)	(13,000)
URP in inventory (see below)	600
Additional depreciation on leased property (2,000/10 years x 6/12)	100
	109,300

The profit on the sale of the goods back to Monko is GH¢3·6 million (9,000.000 – (4,000,000 + 1,400,000)). Therefore the unrealized profit (URP) in the inventory of GH¢1·5 million at 30 September 2022 is GH¢600,000 (3,600,000 x 1,500,000/9,000,000).

4. **Profit for the year attributable to NCI**

Subsidiary's profit for the year (-4,600 x 6/12)	(2,300)
Less Depreciation	(100)
Less PURP	(600)
Adjusted profit for the year	(3,000)
X NCI%	x 25%
	(750)

5. **Total comprehensive income attributable to NCI**

Profit for the year attributable to NCI (as above)	(750)
Plus NCI% of Subsidiary's revaluation gain (25% x Nil)	-
	(750)

(Marks are evenly spread using ticks = 16 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The question required candidates to calculate goodwill on acquisition and prepare consolidated statement of profit or loss and other comprehensive income (involving a Parent and a Subsidiary). Unfortunately, this question was poorly answered by many candidates, with most of the candidates scoring less than 5 marks (out of 20 marks).

Students are therefore advised to ensure total coverage of IAS 27, IAS 28, IFRS 3, IFRS 10, IFRS 11, IFRS 12 and IFRS 13 in their preparation for Question One (Consolidated Financial Statements).

QUESTION TWO

a) Maximum amount to capitalise (IAS 23 para 6):

	GH¢'000
Overdraft	14.4
Foreign currency loan interest	100.8
Foreign currency exchange differences on equity	-
Effective interest on loan ((2,400 – 24) x 6.88%)	163.44
	278.64

(5 marks)

b) **Leases**

Fugu Ltd
Statement of financial position as at 31 July 2023

Right-of-use Asset	GH¢'000
Cost	20,130.0
Depreciation	(2,013.0)
Carrying amount	**18,117.0**
Liability (See working below):	
Non-current liability	17,239.6
Current liability	1,500.8
Total liability	**18,740.4**

Fugu Ltd
Statement of profit or loss for the year ended 31 July 2023

Operating costs:	GH¢'000
Depreciation	(2,013)
Finance costs:	
Interest on lease	(1,610.4)

Working: Lease schedule for payments in arrears

Year	Op. bal.	Int@8%	Payments	Cl. Bal.
2023	20,130.0	1,610.4	(3,000.0)	18,740.4
2024	18,740.4	1,499.2	(3,000.0)	17,239.6

(5 marks)

c)

	P&L	OCI
	GH¢million	**GH¢million**
Transfer from PPE to investment property (16.5 – 13.5)		3
Final fair value after revaluation becomes cost of inventories (15.75-16.5)	(0.75)	
Profit on sale of inventories (16 – 15.75)	0.25	
	(0.50)	**3**

Alternatively,

		GH¢'000	SP/L	OCI
1-Jan-22	Carrying amount of PPE	13,500		
	Revaluation gain - OCI	3,000		3,000
1-Apr-22	Fair Value - Investment property	16,500		
	Fair value loss - P/L	(750)	(750)	
1-Oct-22	Inventories	15,750		
	Gain on disposal - P/L	250	250	
31-Dec-22	Disposal proceeds	16,000		
	Amounts to be recognised		**(500)**	**3,000**

(7 marks)

d) Any amount recorded at the present value of future cash flows should be adjusted as time passes. The adjustment allows for the fact that the time to maturity is shorter. The adjustment is measured as the opening balance multiplied by the original discount rate.

Another method, which would give the same answer, would be to recalculate the discounted amount using the same discount rate but the shorter period.

Here GH¢5.6 million * 8% gives GH¢0.448 million.

This is charged (debited) to profit or loss (finance costs) and increases the present value of the provision (credit entry).
Debit profit or loss GH¢0.448m, Credit provision for restoration GH¢0.448m

Alternatively,

Accounting for decommissioning costs

DR	Non-current Asset	GH¢5.6 million	
CR	Provision for decommissioning cost		GH¢5.6 million

To initially recognise the asset and liability relating to decommissioning cost.

DR	Statement of profit or loss (dep'n)	GH¢0.56 million	
CR	Non-current asset (5.6 million/10)		GH¢0.56 million

To recognise depreciation charge for the year.

DR	Statement of profit or loss (Unwound discount) (5.6 million x 8%)	GH¢0.448 million	
CR	Provision for decommissioning cost		GH¢0.448 million

To recognise the unwound discount on the liability for the year.

(3 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Question 2 required candidates to demonstrate knowledge of contents and application of IAS 23, IFRS 16, IAS 40, and IAS 37. It was a straightforward question but regrettably, most candidates scored poor marks in this question. Question 2(a) was poorly answered by most candidates, scoring only 2 out of 5 marks available. Most candidates still do not understand the content of IFRS 16: Leases (Question 2(b)) in spite of the fact that this Standard was heavily tested in previous diets. Question 2(c) was well answered by candidates, scoring good marks (5 out of 7 marks). Most candidates poorly answered question 2(d).

QUESTION THREE

Sompa Plc

a) **Statement of Profit or Loss and Other Comprehensive Income for the year ended 30 June 2023**

	GH¢'000
Revenue (W1)	951,500
Cost of sales (W2)	(478,500)
Gross profit	473,000
Distribution costs	(18,000)
Administrative expenses (W4)	(31,500)
Operating profit	**423,500**
Investment income	1,500
Gain on financial assets equity investments (W5)	4,000
Finance costs (W6)	(8,550)
Profit before tax	**420,450**
Income tax expense (W7)	(10,000)
Profit for the year	**410,450**
Other comprehensive income:	
Net gain on property revaluation (W8)	9,000
Total comprehensive income for the year	**419,450**

b) **Statement of Financial Position as at 30 June 2023**

		GH¢'000
ASSETS		
Non-current assets		
Property, plant and equipment		221,500
Capitalised Development expenditure (8,000 x 2)		16,000
Financial asset equity investment at fair value		48,000
		285,500
Current assets		
Inventory (378,625 + 10,000)	388,625	
Trade receivables	101,875	
Bank and cash	240,000	730,500
Total assets		**1,016,000**
EQUITY AND LIABILITIES		
Equity		
Share capital (100,000 + 50,000)		150,000
Other components of equity (11,500 + 35,000)		46,500
Revaluation surplus (15,000 + 9,000)		24,000
Retained earnings (31,000 + 410,450 – 20,000)		421,450
		641,950
Non-current liabilities		

5% Loan notes (97,500 + 7,800 – 5,000)	100,300	
10% Loan	15,000	
Deferred tax	10,750	126,050

Current liabilities

Trade payables	241,250	
Income tax payable	6,000	
In-substance loan interest payable	750	248,000
		1,016,000

WORKINGS (IN GH¢'000)

1. **Revenue**

Per trial balance	966,500
Less Sale of maturing goods	(15,000)
	951,500

Note: The 'sale' of the maturing goods is in substance a loan of GH¢15 million carrying interest at 10% per annum. This is because the option is almost certain to be exercised because the expected value of the goods of GH¢25 million is considerably higher than the cost of buying them back.

2. **Cost of sales**

Per trial balance	442,500
Carrying value of maturing goods	(10,000)
Depreciation of property (142,500/15)	9,500
Depreciation of plant and equipment ((135,500 – 45,500) x 15%)	13,500
Research and development costs ((5,000 x 3) + 8,000))	23,000
	478,500

Administrative expenses	
Per trial balance	34,000
Less Direct issue costs	(2,500)
	31,500

3. **Gain on financial asset equity investments**

Carrying value	44,000
Fair value	48,000
Fair value gain	**4,000**

4. **Finance costs**

5% Loan note (100,000 – 2,500) x 8%	7,800
In-substance loan (15,000 x 10% x 6/12)	750
	8,550

5. **Income tax expense**

Provision for current tax	6,000
Increase in deferred tax	4,000
	10,000

6. **Gain on revaluation of property**

Carrying value at 30 June 2022 (142,500 – 9,500)	133,000
Valuation at 30 June 2022	145,000
Revaluation gain	12,000
Deferred tax @ 25%	(3,000)
Net gain on revaluation of property	**9,000**

7. **Deferred tax**

Opening deferred tax	3,750
Increase in deferred tax in P/L	4,000
Deferred tax on revaluation gain in OCI	3,000
Closing deferred tax	**10,750**

8. **Property, plant and equipment**

			Total
	GH¢'000	**GH¢'000**	**GH¢'000**
COST/VALUATION:			
At 1 July 2021	142,500	135,500	278,000
Revaluation gain	12,000		12,000
At 30 June 2022	154,500	135,500	290,000
ACCUM. DEPRECIATION:			
At 1 July 2022		45,500	45,500
Charge for the year	9,500	13,500	23,000
At 30 June 2022	9,500	59,000	68,500
CARRYING AMOUNT:			
At 30 June 2021	142,500	90,000	232,500
At 30 June 2022	145,000	76,500	**221,500**

(Maximum of 80 ticks @ 0.25 mark per tick = 20 marks)

EXAMINER'S COMMENTS

The question 3 required candidates to prepare statement of profit or loss and other comprehensive income, and statement of financial position. It was a straightforward question that required workings to determine the following items:

- Revenue
- Depreciation charge
- Revaluation surplus
- Profit on disposal of non-current asset with deferred tax consequences
- Research and development expenditure

- Share issue at full market price during the year
- Issue of loan notes
- Dividend paid to shareholders
- Financial asset equity investment at fair value through profit or loss
- Taxation – Current Tax and Deferred Tax

Unfortunately, only few of the candidates could obtain more than 10 marks (out of 20 marks).

QUESTION FOUR

a) Computation of ratios

Note: Figures used are in thousands of Ghana Cedis.

		Addin Petroleum	Gyan Petroleum
Net Profit Margin	Net Profit x 100 Revenue	4,440 x 100 39,400 **=11.27%**	2,120 x 100 22,400 **= 9.38%**
Return on Capital Employed	Profit Before Int & Tax x 100 Total Assets - Current Liabilities	8,440x100 31,000 **= 27.23%**	3,520 x100 22,600 **= 15.58%**
Quick Ratio	Current Assets – Inventories Current Liabilities	15,000-6,200 14,600 **= 0.60 times**	23,200-5,600 17,000 **= 1.04 times**
Receivables Collection Period	Receivables x 365 sales	6,800 x 365 39,400 **= 63 days**	15,800 x 365 22,400 **= 258 days**
Gearing Ratio	Debt x 100 Debt + Equity	8,800 x 100 31,000 **= 28.39%**	2,800 x 100 22,600 **= 12.39%**
Interest Cover	Profit Before Int & Tax x 100 Interest	8,440x100 1,400 **= 6.03 times**	3,520 x 100 400 **= 8.80 times**

(6 ratios @ 1.5 marks each = 9 marks)

b) Report

To: Vice President, Finance & Administration

From: Chief Finance Officer

Subject: Assessment of Financial Statement of Acquisition Targets

Introduction

The investigation on the financial statements of Addin Petroleum and Gyan Petroleum and should be viewed as preliminary in nature since a more detailed information about the two companies will be required before decision is finalized.

Assumptions

It is assumed that the two companies use similar accounting policies and that the statement of financial positions are representative of the companies' normal levels of trading.

Financial Performance

Analysis of the Statement of Profit of Loss of the two companies leads to the conclusion that Addin Petroleum has a better prospect on the basis of their performance for the year ended, September 2022. Its operating profit before tax was more than twice that of Gyan Petroleum. As provided in the attached appendices, Addin Petroleum has better in terms of profitability ratios in all measures used (Gross Profit margin, ROCE, & Net Profit Margin).

Working Capital Efficiency
Consistent with the Financial performance analysis, Addin has a better financial position outlook when the specific ratios are analysed together.
On Working Capital Efficiency, using the inventory turnover and receivables collection period ratios, Addin Petroleum's records indicate a better liquidity position as compared to Gyan Petroleum. Gyan Petroleum's receivables collection period shows signs of the non-existence of credit control policies and procedures. The acid test and current ratios of Gyan Petroleum are rather of a better position than Addin. The analysis will be better served if compared with the industry averages to confirm the true performance of these companies.

Gearing
Despite the comparatively good performance of Addin Petroleum on the basis of profitability, it is significantly more geared than Gyan Petroleum. Nonetheless, this risk is to some extent compensated by the better interest cover of six times as a result of investing in assets through debt financing.

Conclusion
The above analysis leads one to conclude that Addin Petroleum is stronger and more profitable company. Without any further material information from further investigations, and the projected cost of acquisition, Addin Petroleum may be considered the better option. Gyan Petroleum on the other hand has prospects if its internal controls on working capital management are strengthened. It may be prudent to also consider Gyan if its cost of acquisition is significantly lower than Addin Petroleum.

(6 ratios @ 1.5 marks each = 9 marks)

c) Limitations of ratios
- Ratios ignore qualitative aspects of the firm.
- Ratios ignore the price level changes due to inflation.
- There is no standard definitions of the ratios.
- Differences in accounting policies may make ratios difficult to compare from company to company.
- Creative accounting practices may make ratios meaningless.

(Any 2 points @ 1 mark each = 2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The question required candidates to compute some ratios and to use the results to analyse the performance of two entities, which have been identified as potential targets for acquisition. Candidates were also required to state two limitations of ratios. The question was very clear in meaning except that the calculation of the six ratios were quite time consuming. In spite of that, this question was the best-answered question. Almost all the candidates calculated the ratios correctly and gave good interpretation. However, some candidates could not recommend which of the companies is the best target for acquisition. Candidates were able to state the limitations of ratios.

QUESTION FIVE

a)

i) Implication on the ethical principles

Integrity

In order not to breach the fundamental principle of integrity, the Finance Manager (FM) must be open and honest about the situation with the Finance Director (FD). The FM needs to be straightforward with the FD since it will not be right to ignore the issue, without proper investigation.

The possibility exists that the FD has made the adjustments to include some stocks located at another company's premises or some errors identified with the stock count. However, if this is the case then why is the FD not providing evidence to justify his stock adjustments?

The FM should still try and resolve the issue with the FD. If the FM thinks he/she has already done enough by raising the issue with the FD, what will happen if the external auditors start to ask questions about the stock adjustments?

Objectivity

This is the ability to be able to question senior personnel when there is something that does not appear right, and not allowing self-interest or the undue influence of others override professional judgement. The FM should be objective and not allow the intimidation from the FD to override his professional judgement or his quest to seek clarification on the stock adjustment.

Professional Competence and Due Care

It is required of the FM to ensure that the quarterly management accounts are a fair representation of the company's financial performance and position. It is therefore necessary that he takes the required steps to know if the company has some stocks elsewhere or probably if there were errors in the stock count.

Confidentiality

It is expected of the FM to respect the confidentiality of information he is privy to, without disclosing such to any third party (such as the bank) unless the necessary permission has been sought from the company. He can only do so if he has the legal or professional right or duty to do so.

Professional Behaviour

There is the need on the part of the FM to display professional courage by getting to the bottom of the matter. He should make the necessary effort to satisfy himself of the reason for the stock adjustment.

(5 points @ 1 mark each = 5 marks)

ii) The Finance Manager could consider taking the following possible actions to help remedy the situation.

- If there is another director that the Finance Manager can speak to, the he should approach and raise the issue with that director. If the FD is falsifying the quarterly management accounts then he is bowing to the commercial pressure to ensure that OJ Ltd is satisfying the funding conditions placed on it by the bank, and all the directors might have agreed to this.
- It would be unprofessional to attempt to ignore the issue. However, simply resigning from your employment, may cause significant problems for you and the practice. The Finance Manager could consult ICAG for assistance.
- The Finance Manager should seek for legal advice. However, if the Finance Manager plans to seek advice from outside the practice, he should be mindful of the need for confidentiality as appropriate.
- The Finance Manager could consider resigning if all other options prove futile. Since it is necessary for the Finance Manager to disassociate himself from all dishonest information/act, it may become necessary to resign if he thinks there may be some dishonesty in connection with the stock adjustment.

(5 points @ 1 mark each = 5 marks)

b) This will be treated as adjusting event as sale of inventory after the reporting date reflects that the NRV of inventory is less than the cost.

The NRV of 70% inventory is GH¢309,400 calculated using the selling price of GH¢364,000 less commission expense of GH¢54,600 (GH¢364,000*15%), and it has a cost ofGH¢418,600 (GH¢598,000*70%).

NRV = 364,000-54,600 = 309,400

Value of Inventory = GH¢309,400 + (30% OF 598,000)
= GH¢309,400 + GH¢179,400
= GH¢488,800

Inventory write-down = GH¢598,000 – GH¢488,800 = GH¢109,200 (in SOP/L).

(5 marks)

c)

i) Consolidated financial statements are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity. **(1 mark)**

ii) A parent need not present consolidated financial statements if it meets all the following conditions:

- it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

- its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
- it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
- its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRSs.

(4 points @ 1 mark each = 5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The question required candidates to demonstrate knowledge in the content and application of the Code of Ethics for Accountants, IAS 10 and IFRS 10. Many candidates could not provide the right answers. Particularly, most candidates could not show the adjustment required in the financial statements for Adjusting events (IAS 10). When it comes to definitions in the IFRSs, most candidates demonstrated weak knowledge. Candidates must understand that when required to define an item per a Standard, only the correct verbatim definition from the Standard can be scored.

RECOMMENDATIONS

- Preparing for Financial Reporting examination requires working as many questions as possible. Read the concepts and solve more practical questions.
- In the examination room, try to allocate your time evenly over the questions, based on the marks allocation. Note that each mark requires 1.8 minutes so the maximum time to be allocated to a 20-mark question is 36 minutes. Try to attempt all questions. Most candidates scored 45 – 49 marks with only four (4) questions answered. They could have passed if they had attempted the fifth question.
- You must also provide the answers in direct response to the requirements of the respective questions. Try to avoid deviation.