



PROFESSIONAL LEVEL EXAMINATION

2024-2029 Syllabus

Mock Exam

CORPORATE REPORTING

Paper 3.1

QUESTION ONE

The following statements of financial position are as at 31 March 2024:

	Herd Plc GH¢m	Swarm Ltd GH¢m	Army Ltd GH¢m
Assets			
Tangible non-current assets	1,280	440	280
Investment in Swarm Ltd	400		
Investment in Army Ltd	60		
Current assets	544	190	130
Total assets	2,284	630	410
Equity and liabilities			
Share capital	950	260	230
Revaluation reserve	90		
Retained earnings	390	210	94
Total equity	1,430	470	324
Non-current liabilities	640	30	16
Current liabilities	214	130	70
Total equity and liabilities	2,284	630	410

Herd Plc acquired the following shareholdings in Swarm Ltd and Army Ltd.

	Date of acquisition	Holding acquired	Fair value of net assets	Purchase consideration
			GH¢m	GH¢m
Swarm Ltd	1 April 2021	10%	325	30
	1 April 2023	70%	460	370
Army Ltd	1 April 2023	25%	200	60

You are also provided with the following information which will be relevant to the consolidated financial statements of Herd Plc.

- At 1 April 2021, the carrying amount of the net assets of Swarm Ltd was the same as their fair value, GH¢325 million.
- The estimated fair value of the initial investment in 10% of the shares of Swarm Ltd was GH¢40 million at 31 March 2023.
- Herd Plc wishes to use the full fair value method of accounting for the acquisition of Swarm Ltd. At 1 April 2023 the estimated fair value of the non-controlling interests was GH¢95 million.
- The difference between the carrying amount of Swarm Ltd's net assets and their fair value at the date of acquisition was due to land measured at cost which on 1 April 2023 had a fair value of GH¢25 million in excess of its carrying amount. There has been no subsequent significant change in that value.
- At 1 April 2022 the fair value of Army Ltd's land was GH¢16 million in excess of its carrying amount. There has been no subsequent significant change in that fair value.

- vi) Goodwill arising on acquisition is tested for impairment at each year end as part of the cash-generating unit to which it belongs. Goodwill in Swarm Ltd at 31 March 2024 was found to be impaired by one-third.
- vii) There has been no impairment of the investment in Army Ltd.
- viii) During the year the directors of Herd Plc decided to form a defined benefit pension scheme for its employees. The company contributed cash to it of GH¢250 million but the only accounting entry for this has been to include it in receivables at 31 March 2024.

At 31 March 2024 the following details relate to the pension scheme:

	GH¢m
Present value of obligation	317
Fair value of plan assets	302

Required:

Prepare the consolidated statement of financial position of the Herd Plc group as at 31 March 2024. **(20 marks)**

QUESTION TWO

Waters plc operates in the pharmaceuticals industry as a manufacturer of drugs and medical equipment, which it supplies to customers throughout the world. Its treasury department acquired the following financial assets and liabilities in 2024.

- i) On 1 September, Waters acquired 2,000 GH¢100 nominal units of 7% treasury (Y5) stock for GH¢104.10 per unit. The gross redemption yield at the date of purchase was 6.30%. Waters does not intend to hold the treasury stock until maturity, as the cash may be required in the meantime. Interest is paid annually in arrears.
- ii) Waters buys and sells medical products in Constantia, a country whose currency is the Prif (PR) and expects to receive PR500,000 on 30 April (Y0). On 3 December Waters enters into a forward contract to sell PR500,000 on 30 April at an agreed price of GH¢3/PR1. This contract is not part of a designated hedge. The cost of entering into the contract was GH¢750.
- iii) On 5 February Waters acquired 250,000 ordinary shares in Gilmour plc at GH¢4.85 per share incurring GH¢35,000 attributable transaction costs.
- iv) On 30 April Waters acquired 1,000 GH¢100 nominal units of 8.5% treasury stock (Y1) at GH¢107.10 per unit. The gross redemption yield is 5.9%. Waters intends to hold the investment to maturity. Interest is paid annually in arrears.
- v) On 26 December Waters purchased GH¢25,000 of quoted company loan notes. This asset has been designated as being held for short-term trading purposes.

On 31 December 2024, the values are as follows:

- GH¢100 nominal units of 7% treasury stock (Y5) are trading at GH¢98.07 per unit at 31 December 2024. The gross redemption yield at that date is 7.3%.
- The forward rate for a Prif contract with a delivery date of 30 April is GH¢2.9/PR1.
- The shares in Gilmour are now trading at GH¢5.20 – GH¢5.25 per share, having an average of GH¢5.05 during the year. Disposal costs would be 2% of the sale proceeds.
- The 8.5% treasury stock Y1 is now trading at GH¢101.50 per unit and the gross redemption yield is currently quoted at 7.48%.
- The loan notes are now worth GH¢25,500 due to the market being more confident that the interest will be paid in full and on time.

Required:

Explain and calculate the impact of the above transactions on the financial statements of Waters plc for the year ended 31 December 2024.

(20 marks)

QUESTION THREE

- a) Medina Power Plc a pharmaceutical company which supplies to customers overseas has carried out the certain transactions denominated in foreign currency during its financial year ended 31 October 2024 and has also conducted foreign operations through a foreign entity. Medina Power Plc's functional and presentation currency is the cedi. The foreign currency activities are summarised below:

On 31 July 2024 Medina Power Plc purchased goods from a foreign supplier for 16 million dinars. At 31 October 2024, the supplier had not yet been paid and the goods were still held in inventory by Medina Power Plc.

On 31 July 2024 Medina Power Plc sold goods to a foreign customer for 8 million dinars and it received payment for the goods in dinars on 31 October 2024.

Medina Power Plc had also purchased an investment property on 1 November 2023 for 56 million dinars. At 31 October 2024, the investment property had a fair value of 48 million dinars. The company uses the fair value model to measure investment properties.

Medina Power Plc wants advice on how to treat these transactions in the financial statements for the year ended 31 October 2024. **(10 marks)**

Exchange rate (direct quotes)	GH¢/1	Average rate for year to:
1 November 2022	GH¢0.9091/1 dinar	
31 October 2023	GH¢0.7143/1 dinar	1 GH¢0.8333/1 dinar
1 November 2023	GH¢0.7143/1 dinar	
31 July 2024	GH¢0.6250/1 dinar	
31 October 2024	GH¢0.7692/1 dinar	GH¢0.6667/1 dinar

Required

Discuss the accounting treatment of the above transactions in accordance with the advice required by the directors.

(You should show detailed workings as well as a discussion of the accounting treatment used.)

- b) Identify the impacts that Medina Power plc is likely to disclose in its sustainability report. **(5 marks)**
- c) The Shareholders of vMedina Power Plc are keen that the organisation adopts integrated reporting in order to create a focus on short, mid and long-term value creation. Briefly explain the concept of value creation referred to in the Integrated Reporting Framework. **(5 marks)**

(Total: 20 marks)

QUESTION FOUR

- a) Foso Automation Limited was incorporated some years ago through the issue of 6 million ordinary shares for GH¢1 per share. The company traded profitably until the 2017s. During early 2017 the entry of new competitors into the market led to a fall in demand for its product. Consequently, the company started making losses and no dividend has been paid to its equity shareholders since 2019. A significant failure to co-ordinate production and sales, and a breakdown in credit control following staff illness, has led to an increase in inventory and receivables. This, in turn, has led to an increase in the bank overdraft beyond the current limit of GH¢1.3 million. Discussions with the bank have revealed a reluctance to increase the overdraft limit beyond the current level. The loan notes, all of which are held by the bank, are due for repayment on 31 December 2024. Both the loan notes and the overdraft are secured by a fixed charge over the premises. The bank has threatened to put the company into receivership so as to recover the amounts owed to it. The costs of a receivership and likely subsequent liquidation are estimated at GH¢150,000.

The directors of the company approached a venture capitalist with the idea of using a new design to produce an alternative product. With an investment of GH¢1.2 million, production could begin to yield an annual operating profit before loan note interest and taxation of GH¢600,000 which would result in a cash inflow of a roughly equal amount. However, the venture capitalist was reluctant to invest in the company unless a scheme of capital reorganisation was agreed, and did not wish to gain a controlling interest in the company.

The statement of financial position of the company at 31 March 2024, before the implementation of the capital reorganisation scheme (see below), was as follows:

	GH¢'000	GH¢'000
Non-current assets:		
Premises	3,000	
Plant	<u>2,000</u>	5,000
Current assets:		
Inventories	2,000	
Receivables	1,500	
		<u>3,500</u>
		8,500
Capital and reserves:		
Equity share capital		6,000
Retained losses		<u>(3,300)</u>
		2,700
Current liabilities:		
Trade payables	1,800	
Bank overdraft	1,500	
8% loan notes	2,500	
		<u>5,800</u>
		8,500

The directors have obtained the following estimates for the value of the assets of the company as a going concern, and in a liquidation, at 31 March 2024.

Asset	Going concern value GH¢'000	Liquidation value GH¢'000
Premises	3,500	3,500
Plant	1,600	400
Inventory	1,500	500
Receivables	1,300	900

A scheme of capital reorganisation has been agreed with all interested parties and implemented by the directors. Details of the scheme are as follows:

- i) The equity shares of GH¢1 were written down to a value of GH¢0.3 per share.
- ii) The assets of the company were stated at their going concern values.
- iii) The repayment date for the loan notes was deferred to 31 December 2019 with the interest rate increased to 10% per annum.
- iv) The bank was issued with 1 million equity shares at an agreed value of GH¢0.3 per share in return for its willingness to accept a deferred repayment of the loan notes.
- v) The venture capitalist subscribed for 4 million equity shares at GH¢0.3 per share.
- vi) The retained losses were written off.

Required:

- a) Prepare the statement of financial position of the company at 31 March 2024 which incorporates the scheme which has been implemented. **(11 marks)**
- b) Briefly assess the effect of the scheme from the point of view of EACH of
 - the equity shareholders;
 - the bank.**(4 marks)**
- c) Explain the consolidation implication of a *change in group structure* that does not result in *loss of control*. **(5 marks)**

(Total: 20 marks)

QUESTION FIVE

The following table shows key financial ratios for Galtron (Ghana) Ltd and industry averages. Galtron (Ghana) Ltd has compiled this information to better understand their financial position and performance within their industry in advance of seeking additional loan finance.

	Galtron (Ghana) Ltd	Industry average
Return on capital employed ((312,000 + 65,000)/1,159,000)	32.5%	24.0%
Net asset turnover (4,365,000/1,159,000)	3.8 times	2 times
Gross profit margin (823,000/4,365,000 × 100)	18.9%	28%
Net profit (before tax) margin (312,000/4,365,000 × 100)	7.1%	12.0%
Current ratio (1,080,000/896,000)	1.2:1	1.8 : 1
Quick ratio (600,000 /896,000)	0.67:1	1.5 : 1
Inventory days (480,000/3,542,000 × 365)	49 days	35 days
Receivables days (600,000/4,365,000 × 365)	50 days	49 days
Payables days (624,000/3,542,000 × 365) (based on cost of sales)	64 days	48 days
Gearing ratio (500,000/1,159,000 × 100)	43%	22%

Galtron (Ghana) Ltd's draft financial statements for the year to 31 December 2024 (used to calculate the above figures) are set out below:

Statement of financial position	GH¢000	GH¢000
Non-current assets (Cost = GH¢4,710,000)		975
Current assets		
Inventory	480	
Accounts receivable	600	
Bank	-	
		<u>1080</u>
		2,055
Equity		
Ordinary shares		100
Retained earnings		<u>559</u>
		659
Non-current liabilities		
Bank loan		<u>500</u>
		1,159
Current liabilities		
Bank overdraft	117	
Trade accounts payable	624	
Taxation	<u>155</u>	
		<u>896</u>
		2,055

Statement of profit or loss	GH¢000
Revenue	4,365
Cost of sales	<u>(3,542)</u>
Gross profit	823
Other operating expenses	(246)
Exceptional item (note)	(200)
Finance costs	<u>(65)</u>
Profit before taxation	312
Income tax	<u>(180)</u>
Profit for the period	132

Notes

The exceptional item relates to inventory that became obsolete when the new customer for whom it was made fell into financial difficulties before delivery. The company could not find an alternative use for the inventory. The loss has been measured correctly in accordance with IFRS Accounting Standards and presented as a separate line item as required by IAS 1 when such an item is relevant to an understanding of an entity's financial performance.

Non-current assets are depreciated over 10 years on a straight line basis.

Required:

Analyse the financial performance and position of Galtron (Ghana) Ltd (so far as the information allows) in comparison to the industry averages. **(15 marks)**

- b) Michael is a newly qualified member of ICAG and now works for Galtron (Ghana) Ltd with responsibility for the preparation of financial information for use by the board. In fact, he was heavily involved in the preparation of the draft financial statements above and the company's statistics derived from them.

The managing director dropped in to talk to Michael. He said *“The gearing level shown by our analysis is too high. We are looking to borrow more from the bank later this year and we need to fix this. I need you reverse the inventory write off. We both know that this inventory is worthless but we need to boost the figures. Also, I want you to revalue the non-current assets up to GH¢2,000,000. I have no idea what they are really worth but this will make the figures look a lot better. The auditors arrive next week and we need to prepare adjusted figures before they arrive. Make the necessary changes in our system and make sure that there is nothing that they might find to alert them to the changes as you know how fussy they can be. Once we get through the audit and arrange the new borrowing we need to talk about a pay increase for you”*.

Required:

Identify and explain any ethical issues arising for Michael. **(5 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

Consolidated statement of financial position as at 31 March 2024

	GH¢m
Assets	
Tangible non-current assets (W4)	1,745
Intangible non-current assets (W3)	30
Investment in associate (W3)	95
Current assets (544 + 190 - 250)	484
	<hr/> 2,354
Equity and liabilities	
Share capital	950
Revaluation reserve	90
Retained earnings (W7)	186
	<hr/> 1,226
Non-controlling interest (W8)	99
	<hr/> 1,325
Non-current liabilities (640 + 30)	670
Current liabilities (214 + 130)	344
Pension liability (W6)	15
	<hr/> 2,354

Workings

(W1) Net assets summaries

Swarm Ltd

	31 March 2024	1 April 2023
	GH¢m	GH¢m
Share capital	260	260
Retained earnings		
Given	210	
Balancing figure		175
FV adjustment	25	25
FV (given)	<hr/> NA	<hr/> 460

Army Ltd

	31 March 2024	1 April 2023
	GH¢m	GH¢m
Share capital	230	230
Retained earnings		
Given	94	
Balancing figure		(46)
FV adjustment	16	16
FV	NA	200

(W2) Gain or loss on acquiring control of Swarm Ltd

1 April 2023	GH¢m
Fair value of initial investment in Swarm Ltd at 1 April 20X8	40
Initial cost of investment	30
Gain recognised on gaining control of Swarm Ltd	10

This gain has not yet been recognised in the individual financial statements of Herd Plc; it must therefore be included in the calculation of group reserves (see Working 8).

(W3) Goodwill in Swarm Ltd at acquisition

	GH¢m
Consideration transferred to achieve control	370
Fair value of initial investment at acquisition	40
Non-controlling interest at acquisition (at fair value)	95
	505
Fair value of net assets acquired	460
Total goodwill at acquisition date	45
Impairment (1/3 x 45m)	(15)
Goodwill at date of consolidation	30

The goodwill impairment of GH¢15 million is apportioned between the interests of the equity owners of Herd Plc and NCI in the ratio 80:20.

Impairment of goodwill attributable to parent = GH¢15m × 80% = GH¢12m

Impairment of goodwill attributable to NCI = GH¢15m × 20% = GH¢3m.

(W4) **Tangible non-current assets**

	GH¢m
Herd Plc	1,280
Swarm Ltd	440
Fair value adjustment	25
	<hr/> 1,745

(W5) **Investment in associate – Army Ltd**

	GH¢m
Cost	60
Group share of post-acquisition profit (94 – (46)) × 25%	35
	<hr/> 95

(W6) **Pension**

The amount paid to set up the pension must be removed from receivables, and the net pension liability must be recognised in the statement of financial position.

The double entry to achieve this is as follows:

	Dr (GH¢m)	Cr (GH¢m)
Retained earnings (balancing figure)	265	
Receivables		250
Pension scheme liability (317 – 302)		15

Tutorial note: The amount recognised in retained earnings is made up of the return on plan assets, interest, current service cost and actuarial gain or loss. If the answer required the preparation of a consolidated statement of profit or loss and other comprehensive income, these amounts would have to be identified separately. This would not be needed when preparing a statement of financial position (and in any case, the necessary information was not provided in the question).

(W7) **Consolidated retained earnings**

	GH¢m
Herd Plc (given)	390
Swarm Ltd post-acquisition retained earnings (210 – 175 (W1)) × 80%	28
Gain on acquiring control (W2)	10
Goodwill impairment attributable to parent (W3)	(12)
Share of post-acquisition profits of associate (W5)	35

Pension adjustment (W6)	(265)
	<u>186</u>
W8) Non-controlling interest in Swarm Ltd	GH¢m
FV at date of acquisition	95
NCI share of post-acquisition retained earnings (210 – 175 (W1)) × 20%	7
Goodwill impairment (W3)	(3)
	<u>99</u>
Alternative approach	GH¢m
Book value (20% × 470)	94
Fair value adjustment (20% × 25)	5
Goodwill (3 – impairment 3) (W3)	0
	<u>99</u>
(20 marks evenly spread using ticks)	

QUESTION TWO

1) Investment in 7% treasury stock Y5

Financial assets are classified based on an assessment of the business model followed for holding the financial asset and the cash flow characteristics of the asset.

This assessment is not on an asset by asset basis. Thus, an entity might hold different portfolios for different purposes resulting in the entity using more than one business model in turn resulting in financial assets being measured using different methods.

Cash flow characteristics of the asset

The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Business model

This is unclear. It could be argued that the asset is held within a business model whose objective is achieved by both holding and collecting contractual cash flows and selling the financial assets. On the other hand, it could also be argued that the asset is held for trading.

If held to collect contractual cash flows and sell:

The investment would be classified as at fair value through other comprehensive income.

At initial recognition it would be measured at fair value which is the consideration given of GH¢208,200.

Finance income would be recognised in the statement of profit or loss at $6.3\% \times 208,200 \times 4/12 = \text{GH¢}4,372$.

The financial asset would then have a carrying amount of GH¢212,572 ($208,200 + 4,372$) prior to remeasuring to the fair value. The fair value of the stocks at the reporting date is GH¢196,140 and the revaluation loss of GH¢16,432 would be recognised in other comprehensive income.

If held for trading:

The investment would be classified as at fair value through profit or loss.

At initial recognition it would be measured at fair value which is the consideration given of GH¢208,200.

Finance income would be recognised in the statement of profit or loss at $6.3\% \times 208,200 \times 4/12 = \text{GH¢}4,372$.

The fair value of the stocks at the reporting date is GH¢196,140 and the revaluation loss of GH¢16,432 would be recognised in profit or loss.

(6 marks)

2) Forward contract

The forward contract is a derivative and is therefore measured at fair value through profit or loss at an initial amount of nil.

Initial transaction costs cannot be included as part of the carrying amount and therefore the fee of GH¢750 will be immediately charged to profit or loss.

At 31 December 2024 the forward rate for delivery on 30 April (Y0) has changed and the forward contract therefore has a value. A gain on the contract is as follows:

	GH¢
Forward contract: PR 500,000 × GH¢	
	1,500,000
Best available contract as at 31 December	
PR 500,000 × GH¢2.9	1,450,000
Gain on contract	50,000

At the reporting date the contract is measured at the fair value of GH¢50,000 with a gain of GH¢50,000 included in profit or loss and as an asset on the statement of financial position.

		GH¢	GH¢
Dr	Financial asset (FVPL)	50,000	
Cr	Statement of profit or loss		50,000
			(5 marks)

3 Investment in Gilmour plc

Equity investments are normally measured at fair value through profit or loss.

On initial recognition it should be measured at fair value which is the cost of GH¢1,212,500. The directly attributable transaction costs (GH¢35,000) should be expensed to profit or loss.

At the reporting date the shares are remeasured to fair value (GH¢5.20 per share) ignoring selling costs = GH¢1,300,000.

The revaluation gain of GH¢87,500 should be recognised in profit or loss.

Alternative:

Waters Plc could have made an irrevocable election at initial recognition to recognise gains and losses in other comprehensive income if the intention was not to hold the shares for trading. If this election had been made the shares would have been measured on initial recognition at the cost of GH¢1,212,500 plus directly attributable transaction costs GH¢35,000 = GH¢1,247,500.

At the reporting date the shares would then have been measured at fair value with the revaluation gain of GH¢52,500 recognised in other comprehensive income.

(3 marks)

4 Investment in 8.5% treasury stock Y1

This investment should be classified as measured at amortised cost.

On initial recognition, it should be recorded at fair value, the cost of GH¢107,100.

Finance income will be credited to profit or loss using the gross redemption yield of 5.9%. The amount recognised in profit or loss will be GH¢4,213 ($\text{GH¢}107,100 \times 5.9\% \times 8/12$).

The investment in the statement of financial position at 31 December 20X9 will be measured at GH¢107,100 plus GH¢4,213 = GH¢111,313. (No interest will have been received to date as it is paid annually in arrears).

The fair value is not reflected in the statement of financial position at 31 December 2024 but should be disclosed in accordance with IFRS 7.

(4 marks)

5 Investment in loan notes

The investment has been classified as held for trading so it is accounted for as a financial asset measured at fair value through profit or loss.

On acquisition it should be recognised at its cost of GH¢25,000. At the reporting date the investment should be revalued to the fair value of GH¢25,500 with the GH¢500 gain being recognised in profit or loss.

(2 marks)

(Total: 20 marks)

QUESTION THREE

a) Inventory, sale of goods and investment property Inventory and payable

The inventory and trade payable would be recorded initially at GH¢10 million (16 million dinars \times GH¢0.6250).

At the year-end on 31 October 2024, the amount payable is still outstanding. It should be re-translated at the closing rate to GH¢12.3 million (16 million dinars \times GH¢0.7692).

This creates an exchange loss of GH¢2.3 million which should be recognised in profit or loss.

Unless it has been impaired, the inventory (a non-monetary asset) should be recorded at GH¢10 million at the year end.

Sale of goods

The sale of goods should be recorded at GH¢5 million (8 million dinars \times GH¢0.6250) million as revenue and as a trade receivable.

Payment in dinars was received on 31 October 2024 and the actual cedi value of the dinars received was GH¢6.2 million (8 million dinars \times GH¢0.7692). This creates a gain on exchange of GH¢1.2 million which should be recognised in profit or loss.

Investment property

The investment property should be recognised on 1 November 2023 at GH¢40 million (56 million dinars \times GH¢0.7143). At the year-end on 31 October 2024 the property should be recognised at its fair value of GH¢36.9 million (48 million dinars \times GH¢0.7692). The fall in fair value should be recognised in profit and loss as a loss on investment property. The property is a non-monetary asset and when a gain or loss on a non-monetary item is

recognised in profit or loss, the element of the gain or loss relating to exchange rates is also recognised in profit or loss.

(10 marks)

b) Sustainability impacts

Medina Power plc operates in the pharmaceuticals industry, manufacturing drugs and medical equipment. As such it is likely to disclose significant impacts in its sustainability report. These may be both positive and negative.

Positive impacts include the effect of medicines on society. For example, medicines extend life expectancies and contribute to the eradication of diseases. They allow individuals to manage chronic illnesses and may also result in higher birth rates and less pressure on health services. These societal impacts in turn create economic impacts as individuals can work for longer and so contribute to economic and industrial development. Waters plc is also likely to have a positive impact through creating employment opportunities directly and indirectly across its global network. If it provides training and development support to employees its positive impact is enhanced.

Negative impacts are likely to be primarily environmental. The pharmaceutical manufacturing sector creates very high levels of emissions and uses significant amounts of water. It also relies on the natural world for continued research and development and some raw materials and the extraction of these can have detrimental effects on ecosystems. Waters plc is likely to have a complex global supply chain and sells its products throughout the world. The extensive logistics operations are likely to involve air and sea freight plus land transport and so create high levels of emissions.

(5 marks)

- c) The Integrated Reporting Framework explains that an organisation creates value when there is an increase in capitals between the start and end of a financial period. It may also deplete value if capitals decrease over a period. It identifies six different capitals:

- financial;
- manufactured (human-created assets used by a business);
- natural (resources used by a business such as water, land and minerals);
- intellectual (knowledge-based intangible assets);
- human (employees and their knowledge, experience and skills); and
- social and relationship (relationships between a business and its stakeholders).

An organisation's business model relies on these capitals as inputs and uses them to develop outputs. In doing so, it affects each of the capitals, in a positive or negative sense. For example human capital is an input to a business, as is financial capital. Providing training for employees increases human capital but, at least in the short term, decreases financial capital due

to the cost involved. However, in the longer term better educated and skilled employees are likely to contribute to higher profits and so increase financial capital.

Value creation therefore involves understanding interdependencies between an organisation's performance and the stakeholders, communities and natural environment that it both affects and utilises.

(5 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Statement of financial position at 31 March 2024 (after reorganisation)

	GH¢'000	GH¢'000
Non-current assets		
Premises	3,500	
Plant	1,600	
		5,100
Current assets		
Inventory	1,500	
Receivables	1,300	
		2,800
		7,900
Capital and reserves		
Equity share capital (W2)	3,300	
Retained profits	-	
		3,300
Non-current liabilities		
8% loan notes		2,500
Current liabilities		
Trade payables	1,800	
Bank overdraft (1,500 – 1,200)	300	
		2,100
		7,900

(b) The effect of the scheme

Equity shareholders

The alternative to re-organisation is liquidation. If the company is liquidated, there will be an overall deficit of GH¢650,000 (W3). This means that the existing shareholders will receive nothing if the bank carries out its threat.

The re-organisation will generate profits after tax of approximately GH¢224,000 (W4). Accumulated losses have been written off. Therefore it will be possible to pay dividends as soon as the company becomes profitable. Alternatively, the profits will be available for re-investment.

The existing shareholders will hold 54% of the equity shares (W4), meaning that they will retain control of the company. The return on their new nominal investment will be approximately 7% ($220 \times 54\% \div 1,800$). In addition to this, there is the possibility of capital growth in the future.

Bank

If the bank carries out its threat to liquidate the company, it will incur a loss of GH¢141,000 (W3).

If the re-organisation goes ahead, the overdraft is reduced to GH¢300,000. The current ratio becomes greater than one (1.33:1). The bank will not receive its loan repayment of GH¢2,500,000 for another ten years, but in the meantime it will receive an additional

GH¢50,000 in interest each year. If the projections are accurate, interest cover will be 2.1 times, which is likely to be acceptable. As the value of the security is increased, the bank's cover is greatly improved (1.25 times the value of the loan). It is possible that the level of cover will be affected by changes in the market value of the premises.

The bank will gain a shareholding of 9% (W4), which is not enough to give it significant influence over the company. It is not known whether the bank will be represented on the board of directors. However, the shareholding should result in dividends of up to GH¢20,000 each year, a return of 7% on its investment.

Workings

(W1)		Reorganisation account	
	GH¢'000		GH¢'000
Premises	3,000	Premises	3,500
Plant	2,000	Plant	1,600
Inventory	2,000	Inventory	1,500
Receivables	1,500	Receivables	1,300
Issue of share capital		Reduction of share capital	
Bank (1,000 × GH¢0.3)	300	(6,000 × GH¢0.7)	4,200
Venture capitalist		Cash (issue proceeds	
(4,000 × GH¢0.3)	1,200	(4,000 × GH¢0.3))	1,200
Retained losses	3,300		
	<u>13,300</u>		<u>13,300</u>

(W2)		Equity share capital	
	GH¢'000		GH¢'000
Reduction in share capital	4,200	Balance b/d	6,000
		Bank (1,000 × GH¢0.3)	300
Balance c/d	3,300	Venture capitalist (4,000 × GH¢0.3)	1,200
	<u>7,500</u>		<u>7,500</u>

(W3) Effect of liquidation

	GH¢'000	GH¢'000
Premises		3,500
Less: Loan notes (security)	(2,500)	
Overdraft	<u>(1,500)</u>	
		(4,000)
		<u>(500)</u>
Asset values		

Plant	400	
Inventory	500	
Receivables	900	
		1,800
Less: Costs		(150)
		1,150
Less: payables		(1,800)
Total deficit		(650)

This deficit is shared between the bank and the creditors. The loss to the bank is GH¢141,000 ($650 \times 500/2,300$).

(W4) Effect of re-organisation

	GH¢'000
Annual profit	600
Less: Interest on loan notes (10%)	(250)
Interest on overdraft (say 10%)	(30)
	(280)
	320
Less: Tax at 30%, say	(96)
Profit available for dividends or re-investment	224

(W5) Shareholdings after the re-organisation

	Number of shares	% holding
Original equity shareholders	6,000,000	54.5%
Bank	1,000,000	9.1%
Venture capitalist	4,000,000	36.4%
	11,000,000	100%

c) The following accounting implications should be noted when an NCI in a subsidiary changes but the same parent retains control:

- no gain or loss is recognised when the parent sells shares (so increasing NCI)
- a parent's purchase of additional shares in the subsidiary (so reducing NCI) does not result in additional goodwill or other adjustments to the initial accounting for the business combination
- in both situations, the carrying amount of the parent's equity and NCI's share of equity is adjusted to reflect changes in their relative ownership interest in the subsidiary. Any difference between the amount of NCI adjustment and the fair

value of the consideration received or paid is recognised in equity, attributed to the parent.

(5 marks)

(Total: 20 marks)

QUESTION FIVE

(a) **Analysis of Galtron (Ghana) Ltd's financial performance compared to industry average**

Operating performance

Galtron (Ghana) Ltd's return on capital employed is 32.5% which compares very favourably to the industry average.

Return on capital employed is a function of asset turnover and profit margins.

Asset turnover

Galtron (Ghana) Ltd's asset turnover (3.8 times) is almost twice the industry average (2 times)

At first sight, this might imply that Galtron (Ghana) Ltd's superior return on capital employed is due to an efficient asset turnover i.e. Galtron (Ghana) Ltd is making its assets work twice as efficiently as its competitors.

However, the carrying amount of Galtron (Ghana) Ltd's non-current assets at GH¢975,000 is only 21% of their original cost (GH¢4,710,000). This implies that the non-current assets are quite old with a remaining useful life of 2 years out of the original 10 years. Their low value within the calculation of asset turnover (and in turn ROCE) tends to make those statistics look stronger than they actually are in comparison to other companies with non-current assets purchased more recently.

These assets will need to be replaced in the near future. When the assets are replaced, asset turnover and return on capital employed figures will fall.

It is also worth noting that the non-current assets will need to be replaced at a time when the company is struggling for funding. This could be a serious problem.

Net profit margin

The profit figure includes a large charge for inventory obsolescence. The measurement of the charge and its separate presentation are appropriate and in accordance with IFRS Accounting Standards (given in the question).

The question arises about whether the net profit margin should be calculated to include or exclude the effects of the inventory obsolescence.

The net profit margin as calculated includes the charge. This results in a net profit margin (7.1%) which is considerably below the industry average (12%). However, if the inventory obsolescence is treated as a one off cost and excluded, Galtron (Ghana) Ltd's net profit margin changes to 11.7% $((312,000 + 200,000)/4,365,000)$ which is much closer to the industry average. This indicates that the company's underlying performance is in line with the industry.

However, stronger management might have avoided this contract in the first place if the new customer had been subjected to a more rigorous credit appraisal before the contract was agreed.

Comment on the gross margin

The gross profit margin of Galtron (Ghana) Ltd (18.9%) is much lower than the industry average (28%). There is a strong argument that the inventory obsolescence should be recognised at trading account level (thus impacting gross profit). This would make Galtron (Ghana) Ltd's gross margin even worse (14.3 %). The relocation would not affect the net profit margin.

Liquidity

Galtron (Ghana) Ltd's current ratio (1.2) and quick ratio (0.67) are both worse than the industry averages (at 1.8 and 1.5 respectively). Current liquidity problems are reflected in high levels of accounts payable and a high bank overdraft. This may have been caused in part, by the production of the inventory that has been written off.

Even after a large write off there are still high levels of inventory and this results in a weak quick ratio (0.67) compared to the industry average (1.5). This may be indicative of further obsolete inventory.

Galtron (Ghana) Ltd's inventory days (49 days) is higher than the industry average (35 days). Indications are that Galtron (Ghana) Ltd's inventory control is weak compared other members of its industry.

The receivables days (50 days) is in line with the industry average (49 days). However, Galtron (Ghana) Ltd takes longer to pay its accounts payable (64 days) than its competitors (48 days). Whilst this is a source of 'free' finance, it can damage relations with suppliers and may lead to a curtailment of further credit. It might indicate cash flow problems within the company.

Gearing

Gearing at 43% is nearly twice the industry average (22%). Whilst this may be an uncomfortable level, it is currently beneficial for shareholders. The company has a ROCE of 32.5% but is only paying 10% on its bank loan.

The gearing level may become a serious issue if Galtron (Ghana) Ltd becomes unable to maintain the finance costs. The company already has an overdraft and the ability to make further interest payments could be in doubt. Also note that the apparent age and consequent low carrying amount of the non-current assets means that the company will not be able to offer lenders a fixed charge as security against future borrowing.

(15 marks)

b) Ethical issues

The managing director is asking Michael to make adjustments that should not be made. The inventory obsolescence has been properly recognised in accordance with IFRS Accounting Standards and the revaluation cannot be supported by objective evidence.

His instruction that Michael take steps to conceal the adjustments from the auditors is particularly troubling. Clearly, the managing director realises that the adjustments he is asking for would result in misleading information being presented in the financial statements with the intention of using that information in order to influence the decisions of a user (the lender).

The managing director is asking Michael to do things that are dishonest and unethical.

Michael is a member of ICAG. As such, he has a professional responsibility to always abide by the spirit of the five fundamental ethical principles set out in the IESBA Code of Ethics. These are:

- integrity;
- objectivity;
- professional competence and due care;
- confidentiality; and
- professional behaviour

The code points out that compliance with the fundamental principles may potentially be threatened by a broad range of circumstances.

The code provides further guidance for accountants in business:

Accountants in business need to ensure that they do not prepare financial information in a way that is misleading or that does not show a true and fair view of the entity's operations.

Accountants who are responsible for the preparation of financial information must ensure that the information they prepare is technically correct, reports the substance of the transaction and is adequately disclosed.

Information must be prepared and presented fairly, honestly and in accordance with relevant professional standards

The managing director of the company has asked Michael to act in a way that breaches the code and linking his cooperation to a possible future pay increase.

Michael faces a self-interest threat that might compromise his professional integrity and objectivity. ICAG members should not allow bias, conflicts of interest or undue influence of others to override their professional or business judgements.

Michael must set his personal considerations aside and explain to the managing director that he cannot be party to the preparation of information that he knows to be contrary to the accounting rules and regulations and, in this case, possible false.

(5 marks)

(Total: 20 marks)