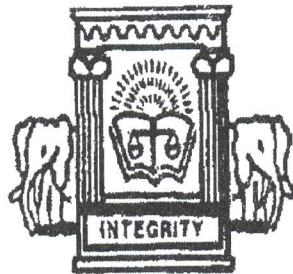


# **INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)**



**MAY 2011 EXAMINATIONS  
(PROFESSIONAL)**

**PART 4**

**ADVANCED FINANCIAL REPORTING  
(Paper 4.1)**

**Attempt ALL Questions**

**TIME ALLOWED:**

Reading & Planning	-	15 Minutes
Workings	-	3 Hours

QUESTION 1

The Handbook of International Financial Reporting Standards (IFRSs) states, in part, that “many entities also present outside the Financial Statements, the Value Added Statement, particularly in industries where the employees are regarded as an important user group”.

The following balances were included in the Corporate Report of Armour Ltd, a company incorporated in Ghana on 1<sup>st</sup> January 2009.

	<u>31<sup>st</sup> Dec. 2010</u>	<u>31<sup>st</sup> Dec. 2009</u>
	GHS'000	GHS'000
Non-current asset (net)	3,750	3,594
Accounts receivable	870	769
Accounts payable	530	448
10% Debenture	1,200	1,080
Ordinary shares:		
(issued at GHS1.00 each)	3,200	3,200
Sales	5,124	4,604
Materials consumed	2,934	2,452
Wages	607	598
Depreciation for the year	115	114
Fuel consumed	290	242
Hire of plant & equipment	41	38
Salaries	203	198
Auditor's remuneration	10	8
Corporate tax	<u>402</u>	<u>393</u>
Dividend per share	GHS0.09	GHS0.08
Number of employees	40,000	42,000

*Required:*

- a) Identify the major stakeholders of Value Added Statements. (2 marks)
- b) Suggest any **three (3)** limitations in the use of Value Added Statement as a measure of performance. (3 marks)
- c) Prepare a Value Added Statement to be included in the Corporate Report of Armour Ltd for the year ended 31<sup>st</sup> December 2010, including the comparative figures for 2009. (10 marks)

(Total: 15 marks)

## QUESTION 2

The statements of financial position for R Ltd, B Ltd and C Ltd as at 30 September 2010 are provided below:

	R Ltd GHS000	B Ltd GHS000	C Ltd GHS000
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	30,000	55,000	45,000
Available for sale investment	<u>42,000</u>	<u>-</u>	<u>-</u>
	<u>72,000</u>	<u>55,000</u>	<u>45,000</u>
<b>Current assets</b>			
Inventories	15,200	18,000	25,000
Receivables	16,600	22,000	22,000
Cash and cash equivalents	<u>11,200</u>	<u>13,000</u>	<u>15,000</u>
	<u>43,000</u>	<u>53,000</u>	<u>62,000</u>
<b>Total assets</b>	<u>115,000</u>	<u>108,000</u>	<u>107,000</u>
<b>Equity and liabilities</b>			
<b>Equity</b>			
Stated capital (GHS1 ordinary shares)	30,000	20,000	30,000
Income surplus	15,500	22,000	23,000
Capital surplus	<u>1,500</u>	<u>-</u>	<u>-</u>
<b>Total equity</b>	<u>47,000</u>	<u>42,000</u>	<u>53,000</u>
<b>Non-current liabilities</b>			
5% Bonds (2009 – 2015)	13,900	-	-
<b>Current liabilities</b>			
Trade payables	15,100	22,000	20,000
Corporate tax	20,000	15,000	16,000
Sundry payables	<u>19,000</u>	<u>29,000</u>	<u>18,000</u>
<b>Total liabilities</b>	<u>68,000</u>	<u>66,000</u>	<u>54,000</u>
<b>Total equity and liabilities</b>	<u>115,000</u>	<u>108,000</u>	<u>107,000</u>

Additional information:

- R Ltd acquired 15% ordinary shares in B Ltd in May 2008 for GHS5,000,000. The investment was classified as available for sale and the gains earned on it have been recorded in equity of R Ltd's individual financial statements. The fair value of the 15% investment at April 2010 was GHS6,000,000.

On 1 April 2010, R Ltd acquired an additional 60% of the ordinary shares of B Ltd for GHS29,000,000. In its own financial statements, R Ltd has kept its investment in B Ltd as an available for sale assets recorded at its fair value of GHS37,000,000 as at 30 September 2010.



- ii. R Ltd issued 14,000,000 GHS1.00 5% Redeemable Bonds on 1 October 2009 at par. The associated costs of issue were GHS100,000 and the net proceeds of GHS13,900,000 have been recorded within non-current liabilities. The bonds are redeemable at GHS14,500,000 on 30 September 2015. The interest on the bonds is payable annually in arrears and the amount due has been paid in the year to 30 September 2010 and charged to the income statement.
- iii. R Ltd acquired 90% of the ordinary shares in C Ltd at the beginning of the current financial year and offered the following consideration for the acquisition of C Ltd:
  - a. Cash of GHS5,000,000.
  - b. Issue of 1,000,000 ordinary shares at GHS35 per share.
  - c. GHS2,000,000 to be paid after 2 years of acquisition.
  - d. GHS5,000,000 to be paid at the end of the fifth year of acquisition if C Ltd earns a return of 25% on its equity.

No entries have been made in the financial statements except the cash offer.

- iv. The cost of capital of R Ltd is 10%.
- v. An impairment review conducted at the year end revealed that the goodwill on the acquisition of B Ltd has suffered an impairment loss. There was no impairment loss in the goodwill of C Ltd.
- vi. It is the group's policy to value non-controlling interest at fair value at the date of acquisition. The fair values of the non-controlling interest were GHS10,250,000 and GHS6,500,000 for B Ltd and C Ltd respectively.
- vii. The profit for the year of B Ltd was GHS12,000,000, and that of C Ltd was GHS9,000,000. Profits are assumed to accrue evenly throughout the year.
- viii. B Ltd received arbitration award against a supplier amounting to GHS2,050,000. This award resulted from an action pending against the supplier since 2009. No records have been made in respect of this award.
- ix. B Ltd sold goods to R Ltd for GHS400,000. Half of these goods remained unsold at 30 September 2010. B Ltd makes a margin of 20% on all sales.
- x. No dividends were paid by any of the entities in the year to 30 September 2010.
- xi. In April 2010 C Ltd received plant costing GHS4,000,000 from Ministry of trade and Industry as capital grant. It was immediately installed and became operational. No entry was made in respect of the plant. C Ltd depreciates plant at 20% on cost per annum in full at the year of acquisition.

**Required:**

- a. Determine the fair value of the consideration that R Ltd will give for acquiring the shares in C Ltd. (4 marks)
- b. Prepare the consolidated statement of financial position for R Ltd and its subsidiaries as at 30 September 2010. (21 marks)

**(Total: 25 marks)**

**Note** The discount factors at 10% per annum are as follows:

Year	1	2	3	4	5
Discount factor	0.909	0.826	0.751	0.683	0.621

**QUESTION 3**

Investors are concerned with maintaining the value of their capital. Profit is a residue available for distribution once provision has been made for maintaining the value of capital intact. What then is the meaning of capital maintenance (ie maintaining the value of capital intact)?

**Required:**

- (a) Identify and clearly explain any **three (3)** concepts of capital maintenance. (9 marks)
- (b) Briefly explain the following:
- i. Current entry price
  - ii. Current purchasing power accounting
  - iii. Current cost accounting
- (6 marks)
- (c) One of the disclosure requirements of IAS 12, 'Income Taxes' is an explanation of the relationship between tax expense charged in the statement of comprehensive income and the product of accounting profit multiplied by the applicable corporate tax rate.

Kokosekye Limited recorded profit before tax of GHS15,650,000 for the year ended 31<sup>st</sup> December 2009. Income tax expense charged in the statement of comprehensive income for 2009 differed from the sum of GHS3,912,500 being the product of accounting profit multiplied by the applicable corporate tax rate due to the following:

			GHS
i.	Capital allowance	-	2,202,448
ii.	Penalty for non payment of SSNIT deductions	-	992,400
iii.	Provision for depreciation	-	410,600
iv.	Increase in deferred tax expense	-	126,000
v.	Gain on disposal of fixed assets	-	2,928,000

The corporate tax rate was reviewed downwards from 28% in 2008 to 25% in 2009.

**Required:**

Prepare, in a form suitable for inclusion in the financial statements for the year ended 31<sup>st</sup> December 2009, a statement showing the numerical reconciliation between the income tax expense and the sum of GHS3,912,500 and compute the effective tax rate.

**(5 marks)**

**(Total: 20 marks)**

#### QUESTION 4

- (a) For the purpose of subsequent measurement of financial instruments after initial recognition, IAS 39 “Financial Instruments: Recognition and Measurement” categorises financial assets into four categories.

**Required:**

Identify and explain the **four (4)** categories of financial assets.

**(6 marks)**

- (b) An asset is said to be impaired when its carrying amount exceeds its recoverable amount (IAS 36: Impairment of Assets).

**Required:**

State **four (4)** events and changes in circumstances that indicate that impairment has occurred.

**(4 marks)**

- c) Adepa Ltd has been in operation for many years as a private company. In January 2011, the directors decided to go public by making available for public subscription 60% of the existing shares. The un-audited financial statements for 2010 and the comparatives for 2009 (audited and published) are as follows:

**Statement of Comprehensive Income for the year ended 31 December 2010**

	2010 GHS'000	2009 GHS'000
Turnover	200,000	180,000
Cost of Sales	<u>(120,000)</u>	<u>(110,000)</u>
Gross Profit	80,000	70,000
Selling and administration expenses	<u>48,500</u>	<u>43,500</u>
Profit before interest and tax	31,500	26,500
Interest on debentures	<u>(1,500)</u>	<u>(1,500)</u>
Profit before Tax	30,000	25,000
Tax (@ 20%)	<u>(6,000)</u>	<u>(5,000)</u>
Profit for the period	24,000	20,000
Other Comprehensive Income	-	-
Total Comprehensive Income	<u>24,000</u>	<u>20,000</u>

**Statement of Financial Position as at 31 December 2010**

	2010 GHS'000	2009 GHS'000
Property, plant and equipment (note iii)	70,000	65,000
Investment Property (note iv)	20,000	20,000
Financial Assets	10,000	10,000
Current assets (note v)	<u>8,000</u>	<u>5,000</u>
	<u>108,000</u>	<u>100,000</u>
Equity and liabilities		
Stated Capital (note ii)	20,000	20,000
Retained Profit (note i)	<u>62,000</u>	<u>53,000</u>
	82,000	73,000
Non-Current Liabilities (note vi)	20,000	15,000
Current Liabilities	<u>6,000</u>	<u>12,000</u>
	<u>108,000</u>	<u>100,000</u>

During the examination of the 2010 financial statements, the following issues emerged

- The only movement in the draft statement of changes in equity was dividend paid.
- The stated capital of Adepa Ltd is made up of 20 million ordinary shares issued at GHS1.00 per share. The company is not listed.
- Included in the property, plant and equipment are the following items that require adjustments: Ignore depreciation implications.



- A piece of land whose fair value is GHS2,000,000 in excess of its carrying value
  - A plant with a carrying value GHS10,000,000 but has a fair value of GHS8,000,000 and value in use of GHS7,000,000
- iv) The Investment property is fair valued at GHS21,000,000. The company adopts fair valuation model in accounting for investment property.
- v) Current assets include obsolete inventory of GHS1,100,000 and irrecoverable debts of GH¢2,300,000.
- vi) The non-current liability consists of 10% GHS15,000,000 debenture stocks and GHS 5,000,000 'deep discount' bond. The bond was issued for GHS5,000,000 on 1 January 2010 . No interest is payable on the bond but it will be held to maturity and redeemed on 31 December 2011 for GHS6,272,000. The effective interest rate is 12% per annum. The bond has not been designated as fair value through profit or loss. The financial liability is to be measured at amortised cost.

*Other relevant information*

The retention policy of the company is expected to achieve 5% dividend growth each year. Bredi Ltd, a comparable listed company in the same industry as Adepa Ltd, assumes equity beta of 1.2, earning per share of GHS0.40 (40 pesewas) and market price per share of GHS3.20. The current Treasury bill yield (risk-free investment) is 15% per annum. The average market return is estimated to be 25%.

***Required:***

Advise the directors on the range of prices at which a share of Adepa Ltd may be offered for the public subscription using the following methods of valuation:

- a) Net Assets
- b) Earnings based
- c) Dividend growth model

***(15marks)***

***Note***

***The following assumptions and bases may be relevant:***

- i) The weighted average profit of the two years (as appropriately revised) may be a good representation of the earnings of the entity.
- ii) Adjustments (iii), (iv), (v) and (vi) above would necessitate a revision of the 2010 draft profit before tax and the taxation expense. Dividend payment will however not be affected.
- iii) Investing in unlisted securities is about 25% more risky than investing in listed securities.

***(Total: 25 marks)***



## QUESTION 5

Adomfa Ltd has been trading at a loss for a number of years. The board of directors of the company is now considering the option to liquidate the company or reconstruct it. The following statement of financial position is available as at 31<sup>st</sup> December, 2010.

	Cost GHS	Depreciation GHS	NBV GHS
Non-current Assets:			
Goodwill	50,000	20,000	30,000
Development expenditure	30,000		30,000
Land and building	80,000		80,000
Fixtures and fittings	20,000	5,000	15,000
Plant	45,000	12,000	33,000
Investments	<u>55,000</u>		<u>55,000</u>
	<u>280,000</u>	<u>37,000</u>	243,000
Current Assets:			
Inventory		50,000	
Account receivable		<u>120,000</u>	
		<u>170,000</u>	
Less Current Liabilities:			
Bank overdraft		20,000	
Trade payables		60,000	
Directors' loans		15,000	
Accrued interest on debenture		<u>4,000</u>	
		<u>99,000</u>	<u>71,000</u>
			<u>314,000</u>
Financed by:			
Stated capital			
200,000 Ordinary shares			200,000
300,000 20% Preference shares			<u>100,000</u>
			300,000
Income surplus			(45,000)
Capital surplus			8,000
22% Debentures			<u>51,000</u>
			<u>314,000</u>

Additional information:

- Preference dividend is 5 years in arrears.
- The debentures are held by Adoma Bank Ltd and are secured on the land and building. The bank has requested that the arrears of debenture interest be paid and have intimated that they might lend the company a further GHS50,000 on condition that the company increases the collateral and the shareholders inject additional capital.
- The bank has demanded the overdraft to be paid immediately.

- iv. The directors have agreed to waive their loan if they are guaranteed employment. The ordinary shareholders have promised to introduce additional capital of GHS100,000 and guaranteed the directors their jobs.
- v. Development expenditure and goodwill are to be eliminated.
- vi. The cost of reconstruction scheme is GHS5,000 while liquidation cost is estimated at GHS6,000.
- vii. Trade payables include tax liability of GHS500, SSNIT payable of GHS600.
- viii. The directors have decided to purchase additional plant costing GHS30,000 to modernise the production system.
- ix. The estimated break up values in respect of liquidation and replacement costs of assets are given below:

	Liquidated values	Replacement costs
	GHS	GHS
Land and building	120,000	110,000
Fixtures and fittings	10,000	12,000
Plant	30,000	25,000
Investment	55,000	60,000
Inventories	45,000	24,000
Account receivable	100,000	115,000

**Required:**

Suggest a scheme of reconstruction which will be accepted to all parties concerned. The report should include a reconstructed statement of financial position of Adomfa Ltd after the reconstruction scheme.

**15 marks**