THE INSTITUTE OF CHARTERED

ACCOUNTANTS (GHANA)

NOVEMBER 2011 EXAMINATIONS

(PROFESSIONAL)

PART 3

FINANCIAL REPORTING

(Paper 3.1)

Attempt ALL Questions

TIME ALLOWED:

Reading & Planning - 15 Minutes

Workings - 3 Hours

QUESTION 1

(a) Control is presumed to exist when the parent owns directly or indirectly through subsidiaries, more than one-half of the ordinary shares of an entity. In some exceptional circumstances, however, control can be presumed even though the investor entity owns 50% or less of the shares of the investee entity.

Outline **four (4)** of such exceptional circumstances. (***4 marks***)

(b) EAA is a subsidiary of SKA Ltd. the statements of financial position of the two companies as at 31/12/10 were as follows:

	SKA Ltd.	EAA
	GHS'000	GHS'000
Premises	50,000	20,000
Motor vehicles	30,000	50,000
Plant & machinery (NBV)	60,000	30,000
	140,000	100,000
Investments: Shares in EAA	70,000	
	210,000	100,000
Current Assets		
Inventory	70,000	75,000
Trade receivables	50,000	30,000
Loan to EAA	15,000	
Cash & cash equivalents	12,500	1,000
	147,500	116,000
Current Liabilities		
Trade payable	45,000	30,000
Loan		22,500
Corporate tax	40,000	30,000
Dividends payable	10,000	5,000
	95,000	87,500
Net Current Assets	52,500	28,500
Net Assets	262,500	128,500
Financed by:		
Ordinary shares (issued at GHS5 per share)	150,000	100,000
Capital surplus	50,000	10,000
Income surplus:		
31/12/09	30,000	10,000
31/12/10	32,500	8,500
	262,500	128,500

Additional Information

i. SKA Ltd acquired 12 million shares in EAA on 31/03/10. There has been no movement in the capital surplus balance of EAA since the date of acquisition.

ii. In April 2010, SKA Ltd purchased a machine from EAA for GHS5,000,000 which yielded a profit on selling price of 20% to EAA. It is the group's policy to depreciate similar machines at the rate of 10% on cost. Full year's depreciation is charged in the year of acquisition and no depreciation is charged in the year of disposal.

iii. In October 2010, SKA Ltd sold goods invoiced at GHS100,000 to EAA making a profit mark-up of 25%. As at 31/12/10, all the goods had been sold out except GHS10,000 worth of it which still remained in inventory.

iv. SKA has not taken credit for its share of the dividend declared by EAA. The dividends relate to the 12 months period ended 31 December 2010.

v. The loan of GHS15,000,000 from SKA to EAA attracts an interest of 10% per annum, which is included in the income statement of SKA and EAA. Although SKA has taken credit for the interest income, the amount is yet to be paid. The interest has therefore been included in the Trade receivables of SKA and Trade Payables of EAA. The loan was granted on 1st July 2010.

vi. It is the policy of the group to value non-controlling interest at proportionate share of the subsidiary's net assets.

vii. Ignore goodwill impairment.

Required:

Prepare consolidated statement of financial position of SKA Group as at 31/12/10.

(***16 marks***)
(**Total: 20 marks**)

QUESTION 2

The following financial statements relating to the 2010 financial year (together with comparable figures for 2009) were submitted by the CFO of Oforisuo Ltd to the audit committee for preliminary discussion before submission to the Board of Directors for approval:

Income Statement for the year ended 31 December

	2010	2009
	GHS'000	GHS'000
Revenue	11,480	10,000
Cost of sale	(9,680)	(8,000)
Gross profit	1,800	2,000
Income from investment property	80	-
Gain from fair valuation of investment property	40	-
Distribution costs	(240)	(200)
Administration expenses	(700)	(600)
Finance costs	(100)	(50)
Profit before tax	880	1,150
Income tax expense	(320)	(400)
Profit for the year	560	750

Statement of Financial Position as at 31 December

	2010 GHS'000	2009 GHS'000
Non-current asset		
Property, plant and equipment	5,760	3,720
Investment property	840	800
	6,600	4,520
Current assets		
Inventory	2,440	1,620
Trade receivable	960	1,080
Bank	-	100
	3,400	2,800
Total assets	10,000	7,320
Financed by:		
Equity and liability:		
Shareholders' fund		
Stated capital	3,000	1,200
Share deals	200	-
Revaluation reserve	300	100
Retained earnings	2,880	2,620
	6,380	3,920
Non-current liabilities		
Loan note	-	800
Deferred tax provision	100	60
	100	860
Current liabilities:		
Trade payables	2,400	2,240
Bank overdraft	420	-
Warranty provision	400	200
Current tax payable	300	100
	3,520	2,540
Total equity and liabilities	10,000	7,320

The following supporting information is available:

i) An item of plant with a carrying amount of GHS480,000 was sold at a loss of GHS180,000 during the year. This loss is included in administration expenses.

ii) Depreciation of GHS560,000 was charged (to cost of sales) for property, plant and equipment in the year ended 31 December 2010. Oforisuo uses the fair value model in IAS 40 'Investment property'. There was no purchase or sale of investment property during the year.

iii) The loan notes were redeemed earlier than agreed in the loan agreement, thus incurring a penalty payment of GHS40,000 which has been charged as part of administration expenses in the income statement.

iv) There was an issue of new share for cash on 1 July 2010. On 15th December 2010, some shares in treasury were also issued for cash consideration. There were no bonus issues of shares during the year.

v) Ofrisuo gives 12-month warranty on some of the products it sells. The amounts shown in current liabilities as warranty provision are an accurate assessment, (based on past experience) of the amount of claims likely to be made in respect of the warranties outstanding at each year end. Warranty costs are included in cost of sales.

vi) The only movements in the retained earnings during the year ended 31 December 2010 were the earned profit and dividend payment.

vii) Stated capital represents the value of ordinary shares issued at GHS0.60 per share.

During the preliminary discussions of the financial statements, one of the directors expressed dissatisfaction with the cash position. He did not understand why in spite of profit of GHS560,000, the cash position should worsen from a positive balance of GHS100,000 in December 2009 to a deficit of GHS420,000 in December 2010. He suspects embezzlement on the part of the Chief Finance Officer.

Required:

a) Prepare a statement of cash flows for Oforisuo for the year to 31 December 2010 in accordance with IAS 7 'Statement of Cash flows' to explain the situation to the worried director. (***15 marks***)

b) Comment on the cash flow management of Oforisuo as revealed by the statement of cash flow and information provided by the above financial statements.

(***5 marks***)

(**Total 20 marks**)

QUESTION 3

(a) Outline the provisions of Section 50 of the Incorporated Partnership Act, 1962 (Act 152) with respect to rules relating to application of a firm's property in settling accounts between partners. (***5 marks***)

(b) Sreso, Jachie and Feyiase have been in partnership sharing profits and losses in the ratio 3:4:3 respectively. As a result of unresolved misunderstanding, the partners agreed to dissolve the firm on 30th September, 2010.

The draft statement of financial position as at 30th September 2010 was as follows:

	GHS'000	GHS'000
Non-current assets		30,000
Current assets: Stocks	187,500	
Accounts receivable	50,000	
Cash	45,000	
	282,500	

Current liabilities:			
	Accounts payable	62,500	220,000
			250,000
Financed by:			
Capital:	Sreso	25,000	
	Jachie	100,000	
	Feyiase	125,000	250,000

Additional information:

Even though business transactions ceased after 30th September 2010, it took some time for the dissolution to be completed as follows:

02/10/2010	Sreso, agreed to settle an amount of GHS3,750,000 owed to a leasing company (included in the accounts payable).
07/10/2010	An accounts receivable of GHS42,500,000 was assigned to Feyiase.
10/10/2010	Feyiase settled GHS1,875,000 owed to a creditor through a transfer of a personal house.
15/10/2010	A portion of non-current assets was auctioned for GHS21,250,000. Feyiase took over another portion of non-current assets for a book value of GHS5,625,000.
25/10/2010	The remaining accounts payable were settled together with dissolution expenses. The dissolution expenses amounted to GHS4,375,000.
30/10/2010	Cash transfers among partners were completed

Required:

Write up the following ledger accounts to close the books of Sreso, Jachie and Feyiase partnership.

(i) Realisation

(ii) Partners' Capital (in columnar format)

(iii) cash (***10 marks***)

(**Total: 15 marks**)

QUESTION 4

(a) Measurement is a key criteria underpinning Financial Reporting Standards. Explain the **four (4)** measurement bases proposed by the IASB Conceptual Framework of accounting. (***6 marks***)

(b) IAS 23 "Borrowing Costs" regulates the extent to which entities are allowed to capitalize borrowing costs incurred on money borrowed to finance the acquisition of certain assets. Biakoye Ltd is a retail supermarket chain which constructs its own malls.

On 1 January, 2010, it started the construction of a supermarket. It acquired 50-year leasehold interest in the site for GHS3 million. The construction of the building cost GHS9 million and fixtures and fittings cost GHS6 million.

Fixtures and fittings would have an estimated economic useful life of ten years. The construction was completed on 30th September, 2010 and was put to use immediately. The building is expected to have a useful life of 50 years. Biakoye Ltd borrowed GHS18 million on 1st January, 2010 to finance the project. The loan carried an interest rate of 10% p.a and was repaid on 30th June, 2011.

Required:

i. State the conditions to be met for:

(a) Capitalization of borrowing costs to commence. (***3 marks***)

(b) Capitalization of borrowing costs to cease. (***3 marks***)

ii. Assuming that borrowing costs are capitalized where appropriate, calculate

(a) the carrying amount to be included in non-current assets in respect of the Shopping mall at 31st December 2010. (***3 marks***)

(b) the total amount to be charged to the income statement in respect of the interest expense and depreciation for the year to 31st December, 2010. (***3 marks***)

(c) ABC Company is incorporated as a Ghanaian Company with head office in Accra. The presentation currency is GHS. It operates a branch in New York which operates as a foreign entity with high degree of autonomy. The New York branch's trial balance at 31 December 2009 is as follows:

	Debit	Credit
	$	$
Property, plant and equipment	62,000	
Stocks - 1 January 2009	15,000	
Goods from Head Office	9,680	
Purchases	87,120	
Trade receivables	9,216	
Bank	3,828	
Operating expenses	14,500	
Sales		120,886
Trade payables		3,968
Head Office current account		76,490
	201,344	201,344

The following additional information is given:

i. All the non-current assets were bought on 1st January 2009. Depreciation is calculated at the rate of 10% per annum on cost.

ii. The total cedi invoice received from Head Office in respect of goods transferred was GHS14,500.
iii. At 31 December 2009, the branch had an accrued expenses of $500.
iv. At 31 December 2009 inventory in trade amounted to $44,286.
v. The balance on the branch current account in the Head Office books stood at GHS114,800. This balance did not take cognizance of cash in transit of $250 transferred from New York to Accra on 30th December 2009. Accra received a credit of GHS400 on 2nd January 2010 in respect of this transfer.
vi. The applicable exchange rates are as follows:

1 January 2009	=	GHS1.4 = $1
31 December 2009	=	GHS1.6 = $1
Average or 2009	=	GHS1.5 = $1

You are required to translate the Branch's trial balance into the presentation currency of ABC, taking into consideration the additional information given in note (i-vi).

(***12 marks***)

(**Total: 30 marks**)

QUESTION 5

We Are Done Limited, manufactures a variety of consumer products. The company's founders have managed the company for thirty years and are now interested in selling the company and retiring. Seekers Limited is looking into the acquisition of We Are Done Limited and has requested the company's latest financial statements and selected financial ratios in order to evaluate We Are Done Limited's financial stability and operating efficiency. The summary of information provided by We Are Done Limited is presented below:

We Are Done Limited
Income Statement for the year ended 31st December, 2009

	GHS'000	GHS'000
Revenues		30,500
Expenses:		
Cost of goods sold	17,600	
Selling and administrative expense	3,050	
Depreciation and amortization expense	1,890	
Interest expense	9,000	23,440
Income before taxes		7,060
Income taxes		2,900
Net income		4,160

Statement of Financial Position as at December 31, 2008 and 2009

	2009 GHS'000	2008 GHS'000
Assets:		
Current assets:		
Cash	400	500
Marketable securities	500	200
Accounts receivable, net	3,200	2,900
Inventory	5,800	5,400
Total current assets	9,900	9,000
Property, plant and equipment, net	7,100	7,000
Total assets	17,000	16,000
Liabilities and Shareholders' Equity:		
Current liabilities:		
Accounts payable	3,700	3,400
Income taxes payable	900	800
Accrued expenses	1,700	1,400
Total current liabilities	6,300	5,600
Long-term debt	2,000	1,800
Total liabilities	8,300	7,400
Ordinary shares	2,700	2,700
Share deals	1,000	1,000
Income surplus	5,000	4,900
Total shareholders' equity	8,700	8,600
Total liabilities and shareholders' equity	17,000	16,000

Selected Financial Ratios

	We Are Done Limited 2008	Current Industry Average
Current ratio	1.61	1.63
Acid-test ratio	0.64	0.68
Inventory turnover	3.17	3.18
Times interest earned	8.55	8.45
Debt-to-equity ratio	0.86	1.03

Required:

(a) Calculate the above ratios for the year 2009 for We Are Done Limited. (***5 marks***)

(b) What do these ratios tell you about the company's operations and ability to take on additional debt? (***5 marks***)

(c) Identify **five (5)** limitations of ratio analysis. (***5 marks***)

(**Total: 15 marks**)