NOVEMBER 2018 PROFESSIONAL EXAMINATIONS
FINANCIAL REPORTING (PAPER 2.1)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

EXAMINER'S GENERAL COMMENTS

The general performance of most of the candidates was as usual below average. It showed that most of the candidates were not prepared and ready for the examination. They showed lack of knowledge in the Accounting Standards and the double entry principles. Candidates with high understanding of the Accounting Standards scored high marks especially in questions two and five (a). The orderly and logical presentation of answers continued to be a challenge to most candidates.

STANDARD OF THE PAPER

The standard of the questions was quite high, compared to those of the earlier years administered except in terms of the volume of work required in a few of the questions. The questions covered all the relevant sections of the syllabus. All the questions reflected the weighting of the topics in the syllabus, and the mark allocations followed a similar pattern in the previous exams. There were no ambiguities and typographical errors in the paper.

GENERAL PERFORMANCE OF CANDIDATES

The general performance of the candidates was far below average. About 60% of the candidates scored less than 40% of the total marks while a candidate scored as low as 0%. The poor performance could be attributed to inadequate preparation by candidates, or the low level of education achieved in their previous levels of studies. A few excellent candidates scored between 70 and 80% of the total marks. The level of preparedness of candidates for the exams was low and it reflected in their poor performance.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

Candidates who prepared adequately and were ready for the examinations scored above 50% and a few scored more than 70% of the total marks. The candidates' strengths were in the preparation of the Consolidated Income Statement in question one, the cash flow in question three and Ratio Analysis in question four. These are areas which any serious candidate would not like to ignore while preparing for the exams. Suggested areas in which such strengths can be enhanced include the International Financial Reporting Standards (IFRS).

The general weaknesses shown were in respect of either lack of preparation or the background of most of the candidates entering the examinations at this level. The weaknesses were widespread as could be seen in the general performance. The reasons for the weaknesses shown were in respect of lack of preparation and the basic foundational knowledge for most of the candidates entering the examinations at this level.

QUESTION ONE

a) Explain the accounting treatment for ***'deferred consideration'*** and ***'contingent consideration'*** in the context of the acquisition of a subsidiary by a parent entity. **(4 marks)**

b) You are the Financial Accountant of Faisal Ltd (Faisal), a Ghanaian listed company, involved in food retailing. During 2017, Faisal acquired interests in Zaytuna Ltd (Zaytuna) and Medeama Ltd (Medeama).The Statement of profit or loss for Faisal, Zaytuna and Medeama for the year ended 31 December 2017 are as follows:

Statement of profit or loss account for the year ended 31 December 2017

	Faisal	**Zaytuna**	**Medeama**
	GH¢'million	**GH¢'million**	**GH¢'million**
Revenue	450	150	75
Cost of sales	(300)	(90)	(45)
Gross profit	150	60	30
Operating expenses	(25)	(15)	(5)
Operating profit	125	45	25
Interest and similar charges	(15)	(5)	(1)
Profit on ordinary activities before taxation	110	40	24
Income tax expense	(27.5)	(10)	(6)
Profit on ordinary activities after taxation	82.5	30	18
Retained earnings at start of year	117.5	45	7
Retained earnings at end of year	**200**	**75**	**25**

Additional information:

i) On 1 April 2017, Faisal purchased 12 million of the 15 million GH¢1 ordinary shares in Zaytuna at a cost of GH¢8 per ordinary share. At the date of acquisition the fair values of Zaytuna's net assets were equal to their book value with the exception of property, the details of which are as follows:

	GH¢'million
Cost	75
Accumulated depreciation at 1 January 2017	(6)
Net book value at 1 January 2017	**69**

The property, which had a useful economic life of 25 years on 1 January 2015, is in a prime commercial location and has increased dramatically in value since it was purchased by Zaytuna on 1 January 2015. The replacement cost of a similar building, with a similar remaining useful economic life at 1 April 2017, is GH¢100 million. The fair value at acquisition has not been reflected in the records of Zaytuna.

ii) On 1 July 2017, Faisal purchased 4 million of the 10 million GH¢1 ordinary shares in Medeama at a cost of GH¢6 per ordinary share. At the date of acquisition the fair values of Medeama's net assets were equal to their book value with the exception of property that had a fair value of GH¢9 million in excess of its book value and a remaining useful life of four years.

iii) In August 2017, Faisal sold goods to Zaytuna for GH¢7.5 million and 20% of these goods remained unsold at 31 December 2017. Faisal prices its sales at cost plus 50%.

iv) On 23 January 2018, Faisal sold its former head office administrative building for GH¢1.25 million. At 31 December 2017, the building was for sale and unoccupied, with staff having moved to a new premises. The book value of the building in the statement of financial position of Faisal as at 31 December 2017 was GH¢2 million.

v) Each company charges depreciation on a time apportionment basis to operating expenses.

vi) The directors of Faisal believe that any goodwill arising on the acquisition of Zaytuna and Medeama has been impaired by 25% as at 31 December 2017. The directors have a policy of measuring non-controlling interests at the proportionate share of identifiable net assets.

(Note: All calculations may be taken to the nearest GH¢0.01 million and assume all expenses and gains accrue evenly throughout the year unless otherwise instructed.)

Required:
Prepare the consolidated statement of profit or loss account of Faisal Group for the year ended 31 December 2017 in accordance with International Financial Reporting Standards (IFRS).
(16 marks)

(Total: 20 marks)

QUESTION TWO

a) Saboba Ltd (Saboba) manufactures plastic water tanks for the farming industry. On 31 May 2018, its closing inventory consisted of 950kg of plastic resin raw material, and also 250 finished units (plastic water tanks). Further information is provided as follows:

i) **Plastic:** The purchase price of plastic resin was GH¢3 per kg throughout the year to 31 May 2018, plus an additional GH¢0.50 per kg of delivery cost. Saboba has a policy of always keeping plenty of plastic resin in inventory, as its supply can be unreliable. However, close to the year-end, the price of plastic resin reduced due to supply exceeding demand. The purchase price of Saboba's raw material is now GH¢2.10 per kg plus the GH¢0.50 per kg delivery charge. The existing inventory of plastic resin can be sold in the market for GH¢1.80 per kg net of all costs.

ii) **Tanks:** Each tank requires 10 kg of plastic to manufacture, and each unit incurs GH¢25 in conversion costs (labour and overhead). Saboba sells the tanks for GH¢100. It is expected that this price will drop to GH¢90 as a result of the fall in the market price of plastic. All completed units sold by Saboba incur a GH¢6 selling and distribution cost.

Required:
Calculate the value of closing inventory in the books of Saboba Ltd at 31 May 2018 applying the principles of ***IAS 2: Inventories*.** **(5 marks)**

b) Due to a change in Pusiga Ltd's production plans, an item of machinery with a carrying value of GH¢11 million at 31 December 2017 (after adjusting for depreciation for the year) may be impaired due to a change in use. An impairment test conducted on 31 December 2017, revealed its fair value less cost of disposal to be GH¢5 million. The machine is now expected to generate an annual net income of GH¢2 million for the next three years at which point the asset would be sold for GH¢2.4 million. An appropriate discount rate is 10%. Pusiga charges depreciation at 20% on reducing balance method on machinery.

Note:

- The present value of ordinary annuity of GH¢1 at 10% for one year, two years and three years are 0.909,1.736 and 2.487 respectively.
- The present value of GH¢1 at 10% for one year, two years and three years 0.909, 0.826 and 0.751 respectively

Required:
In accordance with ***IAS 36: Impairment of Assets*,** explain with justification the required accounting treatment in the financial statements of Pusiga Ltd for the year ended 31 December 2017. **(3 marks)**

c) Talensi, a company reporting under IFRS, is considering making the following changes to its financial statements for the year ended 31 December 2017. Talensi presents one year of comparative information.

i) Changing the method of depreciation of its plant from straight line depreciation over five years (with a nil residual value) to reducing balance at 20% per annum with effect from1 January 2017. The plant originally cost GH¢100 million on 1 January 2015.

ii) Changing the basis of valuation of certain non-seasonal inventories from first-in first-out (FIFO) to weighted average cost (WAC). Inventories were valued as follows under the two different methods:

	31 December 2015	**31 December 2016**	**31 December 2017**
	GH¢ million	**GH¢ million**	**GH¢ million**
FIFO	64	66	71
WAC	62	63	67

iii) Changing the revenue recognition basis for certain seasonal goods that were first sold in 2015 such that revenue is recognised on delivery to the customer rather than on shipment. This has arisen as a result of a change in delivery arrangements such that, with effect from 1 January 2017, risks are now borne by Talensi until delivery has been made to the customer.

	2015	**2016**	**2017**
	GH¢ million	**GH¢ million**	**GH¢ million**
Revenue based on shipment date	50	86	90
Revenue based on delivery date	46	84	88

The cost of the seasonal goods is consistently 80% of sales price.

Profit (calculated using existing policies and accounting estimates) was GH¢240 million for the year ended 31 December 2017.

Required:
Calculate the adjustment to opening retained earnings in the statement of ***changes in equity*** (including 2016 comparative figures) in the financial statements for the year ended 31 December 2017; and profit or loss for the year ended 31 December 2017. **(6 marks)**

d) The following events occurred after the year end, but before the financial statements were authorised for issue:
i) Enactment by the government of a revised tax rate affecting the amount of the settlement of the deferred tax liability included in the financial statements.
ii) A share split in respect of the earnings per share calculation.
iii) Criteria being met in order to classify non-current assets as held for sale.
iv) A material, but not fundamental, error arising in the comparative figures.

Required:
In accordance with ***IAS 10: Events after the reporting period,*** explain with justification whether each of the above is an ***adjusting*** or a ***non-adjusting*** event after the reporting period.
(4 marks)

e) In accordance with ***IAS: 12 Income Taxes,*** deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Required:
Explain ***temporary differences.*** **(2 marks)**

(Total: 20 marks)

QUESTION THREE

a) The following financial statements relate to Conso Bank Ghana Limited for the year ended 31 December 2017.

Statement of Comprehensive Income for the year ended 31 December 2017

	Note	GH¢'000
Interest income	(iii)	364,524
Interest expense	(iv)	(107,571)
Net interest income		256,953
Fees and commission income		132,374
Fees and commission expense		(24,183)
Net fees and commission income		108,191
Other income	(v)	9,727
Operating income		374,871
Impairment charge on loans and advances		(93,492)
Operating expenses	(vi)	(169,317)
Profit before tax		112,062
Income tax expense		(33,617)
Profit for the year		**78,445**

Statement of Financial Position as at 31 December 2017

	Note	2017 GH¢'000	2016 GH¢'000
Assets			
Cash and cash equivalents		577,767	752,303
Government securities		2,037,292	1,857,337
Advances to banks		214,875	107,407
Loans and advances to customers		1,190,782	1,145,133
Property and equipment	(vii)	139,889	123,936
Intangible assets	(viii)	18,131	12,162
Income tax asset		6,626	5,778
Total assets		**4,185,362**	**4,004,056**
Liabilities			
Deposits from customers		3,368,406	3,078,071
Other liabilities and provisions		171,718	359,192
Total liabilities		**3,540,124**	**3,437,263**
Equity			
Stated capital		100,000	100,000
Retained earnings		545,238	466,793
Total equity		645,238	566,793
Total liabilities and equity		**4,185,362**	**4,004,056**

i) **The reporting entity**

Conso Bank Ghana Limited is a limited liability company incorporated and domiciled in Ghana. The financial statements of the Bank as at and for the year ended 31 December 2017 comprise statement of comprehensive income and the statement of financial position together with the notes accompanying the financial statements.

ii) **Basis of Preparation**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). Additional information required under the Companies Act, 1963 (Act 179) and the Banking Act, 2004 (Act 673) as amended by the Banking (Amendment) Act, 2007 (Act 738) have been included, where appropriate.

iii) **Interest Income**

	GH¢'000
Cash and short term funds	37,652
Loans and advances	326,872
	364,524

During the year, interest received amounted to GH¢131,292 while interest paid amounted to GH¢94,578.

iv) **Interest Expense**

	GH¢'000
Current and savings account	57,253
Time and other deposits	38,828
Borrowings	11,490
	107,571

v) **Other Income**

	GH¢'000
Dividends	9,685
Profit on sale of property and equipment	42
	9,727

Dividends paid during the year amounted to GH¢4,800

vi) **Operating Expenses**

	GH¢'000
Staff salaries	125,160
Advertising and marketing expenses	498
Training cost	4,241
Audit fees	696
Directors fees	1,957
Depreciation of property and equipment	30,688
Amortisation of software	6,077

vii) **Property and Equipment**

	2017 GH¢'000	2016 GH¢'000
Cost		
At 1 January	228,657	165,128
Additions	46,641	63,672
Disposal	(120)	(143)
At 31 December	275,178	228,657
Depreciation		
At 1 January	104,721	83,729
Charge for the year	30,688	21,135
Released on disposals	(120)	(143)
At 31 December	135,289	104,721
Net book value at 31 December	**139,889**	**123,936**

viii) **Intangible assets**

	2017 GH¢'000	2016 GH¢'000
Cost		
At 1 January	24,241	13,077
Additions	12,046	11,164
At 31 December	36,287	24,241
Depreciation		
At 1 January	12,079	9,123
Charge for the year	6,077	2,956
At 31 December	18,156	12,079
Net book value at 31 December	**18,131**	**12,162**

Required:
Using the indirect method, prepare a statement of cash flows for the year ended 31 December 2017, in accordance with ***IAS 7: Statement of Cash Flows***. **(16 marks)**

b) An entity shall prepare a statement of cash flows in accordance with the requirements of ***IAS 7: Statement of Cash Flows*** and shall present it as an integral part of its financial statements for each period for which financial statements are presented.

Required:
Explain **FOUR (4)** benefits of cash flow information to ***users of financial statements***.
(4 marks)

(Total: 20 marks)

QUESTION FOUR

Salt Ltd is a Government Business Entity that would like to acquire (100% of) a viable private company. It has obtained the following draft financial statements for two companies, Light Ltd and Favour Ltd Ltd. They operate in the same industry and their managements have indicated that they would be receptive to a takeover.

Statement of profit or loss account for the year ended 31 December 2017

	Light Ltd	**Favour Ltd Ltd**
	GH¢'000	**GH¢'000**
Revenue	12,000	20,500
Cost of sales	(10,500)	(18,000)
Gross profit	1,500	2,500
Operating expenses	(240)	(500)
Finance costs	(210)	(600)
Profit before tax	1,050	1,400
Income tax expense	(150)	(400)
Profit for the year	**900**	**1,000**
Note: Dividends paid during the year	250	700

Statements of financial position as at 31 December 2017

Assets	**Light Ltd**	**Favour Ltd Ltd**
Non-current assets	**GH¢'000**	**GH¢'000**
Freehold factory (note(i)	4,400	-
Owned plant (note (ii))	5,000	2,200
Leased plant (note (ii))	-	5,300
	9,400	7,500
Current assets		
Inventory	2,000	3,600
Trade receivables	2,400	3,700
Bank	600	-
	5,000	7,300
Total assets	**14,400**	**14,800**
Equity and liabilities		
Equity shares of GH¢1 each	2,000	2,000
Property revaluation reserve	900	-
Retained earnings	2,600	800
	5,500	2,800
Non-current liabilities		
Finance lease obligations (note (iii))	-	3,200
7% loan notes	3,000	-
10% loan notes	-	3,000

Deferred tax	600	100
Government grants	1,200	-
	4,800	6,300
Current liabilities		
Bank overdraft	-	1,200
Trade payables	3,100	3,800
Government grants	400	-
Finance lease obligations (note (iii))	-	500
Taxation	600	200
	4,100	5,700
Total equity and liabilities	**14,400**	**14,800**

Notes:

i) Both companies operate from same premises.

ii) Additional details of the two companies' plant are:

	Light Ltd	**Favour Ltd Ltd**
	GH¢'000	**GH¢'000**
Owned plant – Historical cost	8,000	10,000
Leased plant – original fair value	-	7,500

There were no disposals of plant during the year by either company.

iii) The interest rate implicit within Favour Ltd Ltd's finance leases is 7.5% per annum. For the purpose of calculating ROCE and gearing, all finance lease obligations are treated as long-term interest bearing borrowings.

Required:

Assess the relative ***financial performance*** and ***financial position*** of Light Ltd and Favour Ltd Ltd for the year ended 31 December 2017 to inform the directors of Salt Ltd in their acquisition decision. Your analysis should focus on profitability, liquidity and gearing.

(15 marks)

QUESTION FIVE

a) Alex, Dennis and Francis have been in partnership business for a number of years, sharing profits in the ratio 6:5:3 respectively. The statement of financial position of the partnership as at 31 March, 2018, showed the following positon:

	GH¢		GH¢
Capital: Alex	50,000	Tangible non-current assets	44,800
Dennis	36,000	Goodwill	25,900
Francis	17,400	Sundry receivables	147,000
Sundry payables	135,200	Bank balance	20,900
	238,600		**238,600**

Additional Information:

On 31 March, 2018, Alex retired from the partnership and the remaining Partners agreed to admit George as a partner on the following terms:

- Goodwill in the old partnership was to be revalued to two years purchase of the average profits over the last three years. The profits of the last three years have been GH¢24,800, GH¢27,200 and GH¢28,010. Goodwill was to be written off in the new partnership.
- Alex was to take his car out of the partnership assets at an agreed value of GH¢2,000. The car had been included in the accounts as of 31 March, 2018, at a written down value of GH¢1,188.
- The new partnership of made up of Dennis, Francis and George were to share profits in the ratio 5:3:2 respectively. The initial capital was to be GH¢50,000 subscribed in the profit sharing ratio.
- Dennis, Francis and George were each to pay to Alex the sum of GH¢10,000 out of their personal resources in part repayment of his share of the partnership.
- Alex was to lend to George any amount required to make up his capital in the firm from the monies due to him (Alex) and any further balance due to Alex was to be left in the new partnership as a loan, bearing interest at 20% per annum. Any adjustments required to the capital account of Dennis and Francis were to be paid into or withdrawn from the partnership bank account.

Required:

i) Prepare the partners' capital accounts, in columnar form, reflecting the adjustments required on the change in partnership. **(5 marks)**

ii) Prepare the statement of financial position on completion. **(5 marks)**

iii) For registration of partnership to be effected, there shall be sent to the Registrar General's Department a copy of the partnership agreement and a statement on a prescribed form signed by all the partners. Outline the main contents of the statement on the prescribed form. **(2 marks)**

iv) In accordance with the ***Incorporated Private Partnership Act 1962 (Act 152),*** state **THREE (3)** grounds upon which the Registrar General's Department may not register a partnership business. **(3 marks)**

b) Under the IASB's Conceptual Framework for Financial Reporting, certain qualitative characteristics of useful financial information are identified. These are subdivided into characteristics considered fundamental and those considered to be enhancing. The two fundamental characteristics identified by the framework are 'relevance' and 'faithful representation'. In order for financial transactions to be represented faithfully in the financial statements, the principle of 'substance over form' should be applied. This means that wherever there is a difference between the legal form of a transaction and its economic substance, the financial statements should reflect the economic substance.

Required:

i) Discuss the ***importance*** of the concept ***'substance over form'***. **(4 marks)**

ii) Describe **FOUR (4)** ***features of a transaction*** that suggest that its economic substance may differ from its legal form. **(6 marks)**

(Total: 25 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) Accounting treatment of deferred consideration:

- Deferred consideration must be recognised by the purchaser at the acquisition date at its fair value.
- This is usually recognised as part of the cost of investment and a liability in the Consolidated Statement of Financial Position.
- This is normally the agreed cash amount discounted to the acquisition date at the purchaser's cost of capital.
- The discount is unwound over time by the purchaser, by recognising it as a finance cost in the post-acquisition period as time passes.
- The liability at any reporting date will be the initial fair value plus the amount of the discount that has unwound to date.

(4 points @0.5 marks each=2 marks)

Accounting treatment of contingent consideration:

- Any contingent consideration must also be recognised at acquisition at its fair value. This will normally include a discount to reflect the time delay before payment, plus a discount to reflect the probability that the amount will be paid in part or in full.
- Goodwill is calculated based on this estimate. At each reporting date after acquisition, the fair value is re-estimated, with any change being taken to profit or loss (of the purchaser) in the year of re-estimation.
- Any change due to the unwinding of the time value of money discount is recognised as a finance cost.
- The revised amount is carried as a liability until further re-estimated, or paid.

(4 points @0.5 marks each=2 marks)

b)

Faisal Group

Consolidated statement of profit or loss account for the year ended 31 December 2017

	GH¢'million
Revenue (450 + (150*9/12) – 7.5 (W4)	555
Cost of sales (300 + (90*9/12) -7.5 (W4) + 0.5(W4)	360.5
Gross profit	194.5
Operating expenses (25+ (15*9/12)+4.15(W1)+1.05(W3)+0.75 (W7)	(42.2)
Operating profit	152.3
Interest payable and similar charges (15 + 5*(9/12)	(18.75)
Share of profit of associate (Medeama) W6	3.15

Profit on ordinary activities before tax	136.7
Tax on profit on ordinary activities (27.5 + 10*9/12	(35)
Profit on ordinary activities after tax	101.7
Non-controlling interest (W5)	**(4.29)**
	97.41
Retained earnings at start of year	**117.5**
Retained earnings at end of the year	**212.41**

1) Goodwill

	GH¢million	GH¢million
Investment at cost	96	
Non-controlling interest (20% x99.25)	19.85	
		115.85
Net assets acquired		
GH¢1 ordinary shares	15	
Pre-acquisition profits (01/01/2017)	45	
Pre-acquisition profits (GH¢30million *3/12)	7.5	
Fair value adjustment (W2)	31.75	
		99.25
		16.60
Impairment @ (25% x16.60)		4.15
		12.45

Alternative approach
Goodwill

	GH¢million	GH¢million
Investment at cost		96
Net assets acquired		
GH¢1 ordinary shares	15	
Pre-acquisition profits (01/01/2017)	45	
Pre-acquisition profits (GH¢30million *3/12)	7.5	
Fair value adjustment (W2)	31.75	
	99.25	
Group Share (80% x 99.25)		79.40
		16.60

Impairment @ (25% x16.60)		4.15
		12.45

2) **Fair value adjustment** | **GH¢million** | **GH¢million**

	GH¢million	GH¢million
Replacement cost @ 01/04/2017		100
Net book value @ 01/01/2017	69	
Depreciation 01/01/2017 to 01/04/2017:		
(GH¢75 million/25) * 3/12	(0.75)	68.25
		31.75

3) Additional depreciation on fair value adjustment **GH¢million**

(GH¢31.75 million/22.75) * 9/12 1.05

4) **Intercompany transactions**

Eliminate intercompany sales and cost of sales: GH¢7.5 million

Eliminate inventory profit (GH¢7.5 million/5) * 50/150 GH¢0.5 million

5) **Non-controlling interest charge** **GH¢million**

		GH¢million	
Net profit for the year (9/12 x30m)		22.5	
Less depreciation on fair value adjustment		1.05	
		21.45	
	X 20%		**4.29**

6) Share of profit of associate **GH¢million**

	GH¢million
Profit after tax (GH¢18 million * 6/12 * 0.4)	3.6
Depreciation adjustment (GH¢9 million/4 * 0.4 *6/12)	(0.45)
	3.15

Faisal

7) **Sale of former head office**

IAS 10 Events after the Reporting Period states that sales of non-current assets are non-adjusting events and accounts would not normally be amended to reflect this (although it would be disclosed in the notes). However, in this case, it could be argued that the sale price is evidence of impairment at the year-end and unless it can be shown that the conditions causing the impairment arose after the year-end then the accounts should be adjusted. Given that the sale took place on 23 January 2018, it is likely that the conditions existed at the date of statement of financial position.

Therefore the impairment should be charged in the 2017 financial statements in accordance with **IAS 36 Impairment of Assets**.

Dr Income statement – operating expenses	GH¢0.75 million	
Cr Property		GH¢0.75 million

The property would be classified as a 'non-current asset held for sale' in accordance with IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations.

(80 ticks @ 0.25 marks = 16 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The approach to the (a) section was well handled even though a few candidates could not explain the accounting treatment for Deferred Consideration and Contingent consideration in the context of acquisition of a Subsidiary by a parent company.

The section (b) was on Consolidated Statements of profit or loss. The general observations are as follows:

- The approach by a few candidates was quite good as they scored the maximum marks.
- Some of the candidates did not realise that Associate companies are not consolidated as they attempted consolidating the Associate.
- The apportionment of the date between pre and post-acquisition was properly done compared to that of the previous sitting.

QUESTION TWO

a) The inventory of Saboba Ltd should be valued as follows:
Finished goods:

Cost per unit:	GH¢
Material – 10kg *GH¢3	30
Conversion	25
Total	55

Net realisable value:

Expected selling price	90
Less selling costs estimate	(6)
Net realisable value	84

As the Net Realisable Value exceeds the cost, the finished goods are valued in the books at cost. Hence a value of 250 *GH¢55 =GH¢13,750 will be entered into the books as closing inventory of finished goods.

Raw Material:	**GH¢**
Cost per unit:	
Purchase price	3.00
Delivery costs	0.50
Total cost	3.50

Net realisable value:

Expected sale proceeds if sold as inventory	1.80
Expected sale proceeds if sold as finished units	90
Less selling cost	(6)
Less completion costs: Conversion	(25)
Net realisable value	59
NRV per kg of raw material	GH¢5.90

The NRV of the raw material if sold as raw material is lower than the cost. However the NRV if processed into finished units is higher than cost. Therefore the inventory should not be written down, and should be recorded in the books at cost. Hence a value of 950 *GH¢3.50 =GH¢3,325 will be entered into the books as closing inventory. Total closing inventory = 3,325 + 13,750 =GH¢17,075.

(Maximum 15 ticks @ 0.33 = 5 marks)

b) Under IAS 36 Impairment, The machinery needs to be tested for impairment.

		GH¢m
Carrying value		11
Recoverable amount	(GH¢2 x 2.4868) + (GH¢2.4 x 0.7513)	(6.8)
Impairment		4.2

Recoverable amount is the higher of value in use (GH¢6.8m) and fair value less costs of disposal (GH¢5m)

	GH¢m	GH¢m
Cr (PPE)		4.2
Dr SPLOCI - Serox	4.2	

(3 marks)

c)

Opening retained earnings	**Profit GH¢ million**	**(1 Jan 2016) GH¢million**
Profit using existing policies	-	240
Depreciation method (change in estimate)		
Old depreciation 100 / 5 years		20
Revised depreciation (100 x 3/5) x 20%		(12)
Inventory valuation (change in policy)		
Adj to opening inventories (62 – 64)/(63 – 66)	(2)	3
Adj to closing inventories (67 – 71)		(4)
Revenue (change in nature not policy, therefore apply from 1 Jan 2017) (88 – 90) x 20%		(0.4)
	(2)	**246.6**

(15 ticks @ 0.4 = 6 marks)

d)

i) Enactment by the government of a revised tax rate affecting the amount of the settlement of the deferred tax liability included in the financial statements
Non-adjusting event (IAS 10 para 22(h)) – rates enacted after the year end do not meet the definition of a liability at the year end **(1 mark)**

ii) **A share split in respect of the earnings per share calculation**

Adjusting event in respect of the earnings per share calculation (IAS 33 para 64) – although a non-adjusting event for the statement of financial position, if a share spit occurs before the financial statements are issued to shareholders, earnings per share is adjusted as it would otherwise be misleading as the shareholders' shareholdings have been diluted before they receive the financial statements. **(1 mark)**

iii) Criteria being met in order to classify non-current assets as held for sale
Non-adjusting event (IAS 10 para 22(c)) – IFRS 5 requires the criteria to be met at any given point in time so if the criteria are not met at the year end, the assets cannot be classified as held for sale. **(1 mark)**

iv) A material, but not fundamental, error arising in the comparative figures
Adjusting event – all material errors are corrected retrospectively under IAS 8. **(1 mark)**

e) Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. Temporary differences may be either:

Taxable temporary differences which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or
Deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

(2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
Most of the candidates could not apply their understanding of the issues raised in the various IFRS statements given. Over 80% of the candidates either did not understand the requirements or lack the basic knowledge of the Accounting Standards. This resulted in the loss of vital marks. A few of the candidates never attempted the question.

a) This was a question in respect of the valuation of inventory as IAS 2, which most candidates could not compute the closing inventory.
b) Most of the candidates were able to explain Impairment of Assets in accordance with IAS 36 and the treatment in the financial statements.
c) This question provided various scenarios in changes in accounting estimates, changes in policy with retrospective effect and change in nature not policy. This was a disaster to most of the candidates, who attempted it.
d) Most of the candidates attempted this question but the approach showed that they do not understand what constitutes adjusting and non-adjusting events and were therefore gambling with the process.
e) The approach to this sub question was above average. Most Candidates were able to explain temporary differences between the carrying amount of an asset or liability and its tax base.

QUESTION THREE

a)

Conso Bank Ghana Limited

Statement of Cash Flows for the year ended 31 December 2017

Cash flows from operating activities	**GH¢'000**
Profit for the year	78,445
Adjustments for:	
Depreciation	30,688
Amortisation	6,077
Other operating expenses(169,317-30,688-6,077)	132,552
Impairment charge on loans and advances	93,492
Net interest income	(256,953)
Dividend income	(9,685)
Profit on sale of property and equipment	(42)
Tax expense	33,617
	108,191
Change in:	
Loans and advances to customers (1,190,782-1,145,133)	(45,649)
Advances to banks (214,875-107,407)	(107,468)
Deposits from customers (3,368,406-3,078,071)	290,335
Other liabilities and provisions (171,718-359,192)	(187,474)
Government Securities (2,037,292-1,857,337)	(179,955)
	(230,211)
Interest received	131,292
Dividend received	8,680
Interest paid	(94,578)
Income tax paid (33,617-5,778+6,626)	(34,465)
	10,929
Net cash flow from operating activities	**111,091**
Cash flows from investing activities	
Acquisition of property and equipment	(46,641)
Proceeds from sale of property and equipment (120-120+42)	42
Acquisition of intangible assets	(12,046)
Net cash used in investing activities	**(58,645)**
Cash flow from financing activities	
Dividend paid	(4,800)
Net cash used in financing activities	**(4,800)**
Net decrease in cash and cash equivalents	**(174,356)**
Cash and cash equivalents at 1 January 2017	752,303
Cash and cash equivalents at 31 December 2017	**577,767**

(50 ticks @ 0.32 = 16 marks)

b) Benefits of cash flow information to users of financial statement

- Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities.
- It provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts of timing of cash flows in order to adapt to changing circumstances and opportunities.
- It also enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events.
- Cash flow information is often used as an indicator of the amount, timing and certainty of cash flows.
- It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

(4 points for 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The approach to the preparation of Statements of Cash Flows was satisfactory. However, a few candidates could not explain the benefits of cash flow to users of the financial statements.

QUESTION FOUR

Assessment of the relative performance and financial position of Light Ltd and Favour Ltd Favour Ltd for the year ended 31 December 2017.

Appendix

Ratio	**Formula**	**Light Ltd**	**Favour Ltd Ltd**
Gross profit margin	Gross Profit/Revenue	1,500/12,000*100 =12.5%	2,500/20,500*100 =12.2%
Operating profit margin	Profit before interest and tax/Revenue	1,260/12,000*100 =10.5%	2,000/20,500*100 =9.8%
ROCE	Profit before interest and tax/(Shareholders' fund + Long-term interest bearing borrowings)	1,260/(5,500+3,000)*100 =14.8%	2,000/(2,800+6,700)*100 =21%
Return on equity	Profit after Tax/Shareholders' funds	900/5,500*100 =16.4%	1,000/2,800*100 =35.7%
Pre-tax Return on equity	Profit before Tax/Shareholders' funds	1,050/5,500*100 =19.1%	1,400/2,800*100 =50%
Net assets turnover	Revenue /(Total Assets – Total liabilities)	12,000/5,500 =2.2 times	20,500/2,800 =7.3 times
Current ratio	Current assets/Current liabilities	5,000/4,100 =1.2:1	7,300/5,700 =1.3:1
Acid test ratio	(Currents assets-Inventory)/Current liabilities	(5,000-2,000)/4,100 =0.73:1	(7,300-3,600)/5,700 =0.65:1
Interest cover	Profit before interest and tax/Interest	1,260/210 =6 times	2,000/600 =3.3 times
Closing inventory holding period	$\frac{\text{Closing inventory}}{\text{Cost of sales}}$ x 365 days	$\frac{2,000}{10,500}$ x 365 =70 days	$\frac{3,600}{18,000}$ x 365 =73 days
Trade receivables collection period	$\frac{\text{Trade receivables}}{\text{Revenue}}$ x 365 days	$\frac{2,400}{12,000}$ x 365 =73 days	$\frac{3,700}{20,500}$ x 365 =66 days
Trade payables payment period	$\frac{\text{Trade payables}}{\text{Cost of sales}}$ x 365 days	$\frac{3,100}{10,500}$ x 365 =108 days	$\frac{3,800}{18,000}$ x 365 =77 days
Gearing ratio	Interest bearing debt/(Interest bearing debt + Shareholders' fund) *100	3,000/(3,000+5,500)*100 =35.3%	6,700/(6,700+2,800)*100 =70.5%
Dividend cover	Profit after tax/Dividends	900/250 =3.6 times	1,000/700 =1.4 times

(12 ratios correctly computed x 1/3 = 4 marks)

(12 ticks x 1/3 marks = 4 marks)

Introduction

This report is based on the draft financial statements supplied and the ratios shown in (a) above. Although covering many aspects of performance and financial position, the report has been approached from the point of view of a prospective acquisition of the entire equity of one of the two companies. **(1 mark)**

Profitability (4 marks)

The ROCE of 20·9% of Favour Ltd is far superior to the 14·8% return achieved by Light Ltd. ROCE is traditionally seen as a measure of management's overall efficiency in the use of the finance/assets at its disposal. More detailed analysis reveals that Favour Ltd's superior performance is due to its efficiency in the use of its net assets; it achieved a net asset turnover of 2·3 times compared to only 1·2 times for Light Ltd. Put another way, Favour Ltd makes sales of GH¢2·30 per GH¢1 invested in net assets compared to sales of only GH¢1·20 per GH¢1 invested for Light Ltd.

The other element contributing to the ROCE is profit margins. In this area Favour Ltd's overall performance is slightly inferior to that of Light Ltd, gross profit margins are almost identical, but Light Ltd's operating profit margin is 10·5% compared to Favour Ltd's 9·8%. In this situation, where one company's ROCE is superior to another's it is useful to look behind the figures and consider possible reasons for the superiority other than the obvious one of greater efficiency on Favour Ltd's part. A major component of the ROCE is normally the carrying amount of the non-current assets. Consideration of these in this case reveals some interesting issues. Favour Ltd does not own its premises whereas Light Ltd does. Such a situation would not necessarily give a ROCE advantage to either company as the increase in capital employed of a company owning its factory would be compensated by a higher return due to not having a rental expense (and vice versa). If Favour Ltd's rental cost, as a percentage of the value of the related factory, was less than its overall ROCE, then it would be contributing to its higher ROCE.

There is insufficient information to determine this. Another relevant point may be that Favour Ltd's owned plant is nearing the end of its useful life (carrying amount is only 22% of its cost) and the company seems to be replacing owned plant with leased plant. Again this does not necessarily give Favour Ltd an advantage, but the finance cost of the leased assets at only 7·5% is much lower than the overall ROCE (of either company) and therefore this does help to improve Favour Ltd's ROCE. The other important issue within the composition of the ROCE is the valuation basis of the companies' non-current assets. From the question, it appears that Light Ltd's factory is at current value (there is a property revaluation reserve) and note (ii) of the question indicates the use of historical cost for plant. The use of current value for the factory (as opposed to historical cost) will be adversely impacting on Light Ltd's ROCE. Favour Ltd does not suffer this deterioration as it does not own its factory.

The ROCE measures the overall efficiency of management; however, as Salt is considering buying the equity of one of the two companies, it would be useful to consider the return on equity (ROE) – as this is what Salt is buying. The ratios calculated are based on pre-tax profits; this takes into account finance costs, but does not cause taxation issues to distort the comparison. Clearly Favour Ltd's ROE at 50% is far superior to Light Ltd's 19·1%. Again the issue of the revaluation of Light Ltd's factory is making this ratio appear comparatively worse (than it would be if there had not been a revaluation). In these circumstances it would be more meaningful if the ROE was calculated based on the asking price of each company (which has not been disclosed) as this would effectively be the carrying amount of the relevant equity for Salt Ltd. **(4 marks)**

Gearing

From the gearing ratio it can be seen that 71% of Favour Ltd's assets are financed by borrowings (39% is attributable to Favour Ltd's policy of leasing its plant). This is very high in absolute terms and double Light Ltd's level of gearing. The effect of gearing means that all of the profit after finance costs is attributable to the equity even though (in Favour Ltd's case) the equity represents only 29% of the financing of the net assets. Whilst this may seem advantageous to the equity shareholders of Favour Ltd, it does not come without risk. The interest cover of Favour Ltd is only 3·3 times whereas that of Light Ltd is 6 times. Favour Ltd's low interest cover is a direct consequence of its high gearing and it makes profits vulnerable to relatively small changes in operating activity. For example, small reductions in sales, profit margins or small increases in operating expenses could result in losses and mean that interest charges would not be covered. Another observation is that Light Ltd has been able to take advantage of the receipt of government grants; Favour Ltd has not. This may be due to Light Ltd purchasing its plant (which may then be eligible for grants) whereas Favour Ltd leases its plant. It may be that the lessor has received any grants available on the purchase of the plant and passed some of this benefit on to Favour Ltd via lower lease finance costs (at 7·5% per annum, this is considerably lower than Favour Ltd has to pay on its 10% loan notes).

Liquidity

Both companies have relatively low liquid ratios of 1·2 and 1·3 for Light Ltd and Favour Ltd respectively, although at least Light Ltd has GH¢600,000 in the bank whereas Favour Ltd has a GH¢1·2 million overdraft. In this respect Favour Ltd's policy of high dividend payouts (leading to a low dividend cover and low retained earnings) is very questionable. Looking in more depth, both companies have similar inventory days; Favour Ltd collects its receivables one week earlier than Light Ltd (perhaps its credit control procedures are more active due to its large overdraft), and of notable difference is that Light Ltd receives (or takes) a lot longer credit period from its suppliers (108 days compared to 77 days). This may be a reflection of Light Ltd being able to negotiate better credit terms because it has a higher credit rating.

(4 marks)

Summary
Although both companies may operate in a similar industry and have similar profits after tax, they would represent very different purchases. Favour Ltd's sales revenues are over 70% more than those of Light Ltd, it is financed by high levels of debt, it rents rather than owns property and it chooses to lease rather than buy its replacement plant. Also its remaining owned plant is nearing the end of its life. Its replacement will either require a cash injection if it is to be purchased (Favour Ltd's overdraft of GH¢1·2 million already requires serious attention) or create even higher levels of gearing if it continues its policy of leasing. In short although Favour Ltd's overall return seems more attractive than that of Light Ltd, it would represent a much more risky investment. Ultimately the investment decision may be determined by Salt's attitude to risk, possible synergies with its existing business activities, and not least, by the asking price for each investment (which has not been disclosed to us). **(2 marks)**

EXAMINER'S COMMENTS
This could have been a bonus question, but as usual, most candidates could not interpret the financial statements provided and as usual messed up in computing the ratios. Some candidates could not calculate basic ratios such as gross profit margin and liquidity ratios.

The analysis of the ratios were poorly done.

QUESTION FIVE

a)

i) Capital Accounts: Alex, Dennis, Francis and George

Details	Alex	Dennis	Francis	George	Details	Alex	Dennis	Francis	George
	GH¢	GH¢	GH¢	GH¢		GH¢	GH¢	GH¢	GH¢
Goodwill	-	26,670	16,002	10,668	Bal b/f	50,000	36,000	17,400	-
Car	2,000	-	-	-	Goodwill	11,760	9,800	5,880	-
S+Dj+A	30,000	-	-	-	Rev, Car	348	290	174	-
George	10,668	-	-	-	Alex	-	10,000	10,000	10,000
Loan	19,440	-	-	-	Alex	-	-	-	10,668
Bank	-	4,420	2,452	-					
Bal c/f	-	25,000	15,000	10,000					
	62,108	**56,090**	**33,454**	**20,668**		**62,108**	**56,090**	**33,454**	**20,668**

Alternative:

Capital Accounts:	**Alex**	**Dennis**	**Francis**	**George**
	GH¢	**GH¢**	**GH¢**	**GH¢**
Bal b/f	50,000	36,000	17,400	-
Goodwill (surplus)	11,760	9,800	5,880	-
Goodwill (written off)	-	(26,670)	(16,002)	(10,668)
Revaluation, Car (surplus)	348	290	174	-
Car taken over	(2,000)	-	-	-
Contribution, personal resources	(30,000)	10,000	10,000	10,000
Loan to George	(10,668)			
Loan from Alex	-	-	-	10,668
20% Loan to New Partnership	(19,440)			
Bank (Amount withdrawn)	-	(4,420)	(2,452)	.
Balance c/d	**-**	**25,000**	**15,000**	**10,000**

(20 ticks @ 0.25 marks= 5 marks)

ii)

Statement of Financial Position as at 31st March 2018	**GH¢**
Tangible Fixed assets (44,800 – 1,188)	43,612
Current assets	
Receivables	147,000
Bank (20,900 – 4,420 – 2,452)	14,028
	204,640
Capital Accounts: Dennis	25,000
Francis	15,000
George	10,000
Current Liabilities: Payables	135,200
Non-current Liabilities: Alex's 20% loan account	19,440
	204,640

Workings:

1. ***Goodwill Calculation:***

$2\left(\frac{24800+27200+28010}{3}\right) = 53{,}340$ Goodwill (Surplus) = 53,340 – 25,900 = 27,440

Goodwill Account

Balance b/f	25,900		
Capital Accounts:		Capital Accounts:	
Alex (6/14 x 27,440)	11,760	Alex	-
Dennis (5/14 x 27,440)	9,800	Dennis (5/10 x 53,340)	26,670
Francis (3/14 x 27,440)	5,880	Francis (3/10 x 53,340)	16,002
George	-	George (2/10 x 53,340)	10,668
	53,340		53,340

2. ***Revaluation surplus on car*****:** 2,000 – 1,188 = 812; Alex 348, Dennis 290, Francis 174.

(20 ticks @ 0.25 marks= 5 marks)

iii) For registration of partnership to be effected, there shall be sent to the Registrar a copy of the partnership agreement and a statement on a prescribed form signed by all the partners. Outline the main contents of the statement on the prescribed form.

(i) The firm name of the partnership.
(ii) The general nature of the business.
(iii) The address and Post Office Box number of
- the principal place of business of the partnership,
- all other places in Ghana at which the business is carried on.

(iv) The names and any former names, residential addresses and business occupation of the partners.
(v) The date of commencement of the partnership- unless the partnership has commenced more than 12 months prior to the date of the statement.
(vi) Particulars of any charges requiring registration under section 25 of Act 152 or statement that there are no such charges and where particulars of any charge require registration under section 25 of the Act, the statement shall be accompanied by the documents required by that Section.

(Any 4 items x ½ mark= 2 marks)

iv) **In accordance with Section 5(2) of Act 152, 1962, state three grounds upon which the Registrar may not register a partnership business.**

i) The partnership is not one which is registerable under Act 152, for example, if it has more than 20 persons;

ii) Any of the business which the partnership has been carrying on or is to carry on is unlawful;

iii) The name of the firm is misleading or undesirable;

iv) Any of the partners is an infant or of unsound mind or a person who within the preceding 5 years has been guilty of fraud or dishonesty whether convicted or not in connection with any trade or business or is an undischarged bankrupt or

v) The statement is incomplete, illegible, inaccurate, irregular or on paper insufficiently durable to be suitable for registration, the Registrar shall, upon the payment of the prescribed fee register the said statement.

(Any 3 items x 1 mark =3 marks)

b)

i) Importance of Substance over form

- **Economic Reality is more important**:

In substance over form principle the economic reality of transaction is more important than legal form of the transaction. Thus the transaction are not recorded merely on the bases of legal reality and economic reality is more relevant for accounting for the transaction. This is an important characteristic of this principle.

- **Portray Real Nature of Transaction:**

Another important characteristic of Substance over form principle is portraying the real picture of the transactions. This approach discourages the hiding the actual nature of transaction. This concept has been explained with few examples.

- **Achieve Faithful Representation:**

Application of prudence concept helps in achieving the faithful representation of financial statements. Faithful representation of financial statements is an important accounting principle.

- It has become clear that any hard rule can be creatively circumvented by contriving transactions appropriately. This is because transactions are necessarily structured between parties as they wish, and to suit their business needs. Regulators cannot anticipate the needs of transacting parties, and rules by their nature always lag behind the transactions themselves. In other words, as regulators see a transaction that is not covered by the existing rules, they seek to "plug the gap". This is not a satisfactory way to ensure that financial statements reflect truth and fairness.

(2 valid points for 4 marks)

ii) **Features indicating that the substance of a transaction may differ from its legal form:**

There are some key tell-tale indicators that should alert the accountant to the possibility that substance and form issues may exist. Some of these are:

- If two or more transactions are executed together, and the combined effect of both taken together is different from the effect of each individually, this is worth investigating. For example a sale transaction selling an asset (possibly at a price in excess of market) and an agreement to lease back that same asset (possibly at an inflated rental).

- Business arrangements entered into which seem to disproportionately advantage one party over another. There is nothing legally wrong with entering into an arrangement that is not in your best interests, but rational businesspeople tend not to do so unless there is a benefit elsewhere.
- Contrived option arrangements that serve to divert risk from where it might otherwise lie.
- Unusual terms in business agreements that might affect our assessment of the timing of revenues and costs.
- Transactions that may be structured to manipulate the reported results, for example by misreporting expenses as assets, or liabilities as revenue.

(Any 4 points for 6 marks)

(Total: 25 marks)

EXAMINER'S COMMENTS

a)

i) The approach to the Partnership Account was below average. Most candidates could not go beyond opening the Capital Accounts and bringing the partners' capital balances forward.

ii) A few candidates opened Current Accounts for the partnership even though the question asked for fluctuating capital.

iii) A few candidates also failed to show the presentation in columnar form as requested.

iv) Most candidates were able to prepare the Statement of Financial Position of the Partnership.

v) Most candidates were able to outline the contents of the form to the Registrar General's Department.

b) The approach to the question was poor.

CONCLUSION

Candidates presented wrong or contrary answers mainly because they did not know the expected answers, which reflected in their poor performance.