

CORPORATE GOVERNANCE

SECTION A: CASE STUDY

QUESTION 1

Gracious Mart Consultancy

The history of business development in Ghana reveals that hundreds of businesses come and go every year. Some of them are barely noticed, some die before they find their feet while others succeed and make a massive impact on the economy. Gracious Mart Consultancy (GMC) belongs to the last category.

GMC started as a passion of Kwame Ansah, a graduate of Kwame Nkrumah University of Science and Technology (KNUST). For his final project work, he researched into reasons why small Ghanaian businesses had a high failure rate. From his research, he found out that most of them lack the financial resources to engage the services of management consultants. He therefore decided to form a business to pre-finance and develop tailor-made services for businesses which later paid for the services on installment basis. In 1998, he started with five small businesses. A decade later he had over two hundred small businesses who consulted GMC for advice and training. GMC has also been contracted by foreign companies to undertake consultancy assignments and training.

GMC is very conscious of ensuring the management of its employees is viewed as a key part of its overall strategic activities. Unless the human resource practice is seen in this light, according to the Chief Executive officer, 'GMC stands to lose. Managing employees is about developing and managing knowledge, skills, creativity, aptitude and talent and using them optimally'. GMC ensures that this objective is achieved by putting in place, measures to assess and retain employees' focuses on managing their physical and emotional strengths. For example, management ensures that basic tools needed for work such as computers and internet access, are all available. Consequently, for the past five years, no employee has resigned.

To improve on the effectiveness of its employees, the company is giving them the relevant training on how to write winning proposal, scanning the environment to determine the needs of micro and small businesses and developing training programmes to meet their specific needs. Motivation is a key aspect of the management of the employees. Compensation comes to employees in two ways – basic pay and commission of 10% of the net value of additional consultancy secured over target levels. Other motivational tools are social gatherings and family outings.

GMC also ensures that there is a good relationship between management, its Board and shareholders. In collaboration with the Chairman of the board, the CEO performs some duties as making recommendations for the appointment of chairmen for the various committees – Finance, Compensation, Marketing and Research and Development. For example, the CEO has sent a proposal to the Board Chairman for the replacement of the Chairman of the Compensation Committee who has finished serving his three year term as chair as stipulated by the Chair

Rotation Guidelines. The aim of doing this is to provide appropriate experience for chairing committees to all board members. The proposal stressed the importance of having someone who has no material dealings with GMC as two of the members are employees of GMC. The purpose and duties of each committee are outlined in a regulations handbook which is given to members on their appointment. At the end of every year, the guidelines are reviewed and changes are recommended to the Board. These guidelines have assisted greatly in separating the roles that each level of management has to play at GMC.

Internal and external structures have been put in place to direct and control this relationship aimed at securing the interest of all its shareholders. It ensures that all shareholders fully exercise their rights and the organization fully recognizes these rights. Attempts are made to ensure that dividend for shareholders are declared at the end of each accounting year before bonuses are paid to workers and the board members.

A value that GMC holds is that every business operation has to be fully accountable. That is, businesses should take responsibility for their actions, hence GMC is considering a socially relevant behaviour which it can take. According to the Finance Manager, such an activity involves huge financial outlays which should be looked at, at a later date. But the CEO is of the view that GMC has the obligation to protect and improve the welfare of the community within which it operates.

Required:

- (a) What human resource management practices have contributed to the success of GMC?
(9 marks)
- (b) Explain two (2) effects that good Human Resource practices can have on the productivity of GMC.
(6 marks)
- (c) In what three (3) ways did the corporate governance practices at GMC contribute to its success.
(9 marks)
- (d) Discuss three reasons why GMC should engage in socially responsible activities.
(6 marks)

(Total: 30 marks)

SECTION B

Answer any two questions from this section.

QUESTION 2

- (a) What are financial regulations? *(3 marks)*
- (b) Discuss three (3) supervisory roles of the financial regulator. *(6 marks)*
- (c) Explain three (3) controls that an organization can use to safeguard its resources. *(6 marks)*

(Total: 15 marks)

QUESTION 3

There is an on-going debate as to whether organizations should separate the roles of Chairman of Board and the Chief Executive Officer or combine them. Advance arguments for your position in this debate.

(15 marks)

QUESTION 4

- (a) Companies exist in relationship with their environments. Such relationships, to a large extent, define how well they perform. Describe three (3) ways by which the stakeholders of a company can assist to achieve its objectives. *(6 marks)*
- (b) Explain three (3) roles that the accountant of a business can play to promote corporate governance. *(9 marks)*

(Total: 15 marks)

SECTION C

Answer any two questions from this section.

QUESTION 5

- (a) What is venture capital? *(2 marks)*
- (b) A business goes public by selling its shares in order to obtain financial resources. Discuss three (3) advantages of going public. *(9 marks)*
- (c) If managers of organizations do not know where they are going, they cannot change to get there.

Explain (3) three sources for identifying the need for change.

(9 marks)

(Total: 20 marks)

QUESTION 6

- (a) What is the mission statement of an organization? *(2 marks)*
- (b) Explain three (3) reasons why organizations need to have a Mission. *(9 marks)*
- (c) Explain the steps that a modern organization should follow in filling the position of a Chief Executive Officer in the organization. *(9 marks)*

(Total: 20 marks)

QUESTION 7

Achiebus Holdings is a conglomerate of four businesses – a bank, an insurance company, a real estate company and an import/export company. Management of the company has decided to re-examine their allocation of resources to the various business units. After evaluating both business strengths and industry attractiveness, the units are rated as follows:

Industry Attractiveness

	Rating		
	High	Medium	Low
Bank	✓		
Insurance		✓	
Real Estate	✓		
Import/Export		✓	

Business Strength

	Rating		
	High	Medium	Low
Bank		✓	
Insurance		✓	
Real Estate	✓		
Import/Export			✓

Required:

- (a) Using the appropriate portfolio matrix, explain the right strategies for managing each of the business units in order to ensure an efficient allocation of resources. **(10 marks)**
- (b) Discuss four reasons why companies use retrenchment strategy. **(10 marks)**

(Total: 20 marks)

ADVANCED TAX PLANNING AND FISCAL POLICY

QUESTION 1

Apocha Ltd has been in business for several years, selling spare parts at Kokompe. He produced the following as his capital allowance schedule:

	Cost GH¢	Written Down Value 30/6/2008 GH¢
Leasehold Buildings	150,000	115,000
Furniture & Fittings	70,000	48,000
Motor Vehicles	120,000	60,000
Computers	45,000	28,000
Office Equipment	34,000	18,000

New assets purchased during the year are as indicated below:

	GH¢	DATE
Motor Vehicles	40,000	21/12/2010
Computers	34,000	18/6/2010

Furniture costing GH¢48,000 was disposed off on 15th September, 2010 for GH¢25,000. Apocha Ltd. presented the following to you as the Company's activities for the relevant years.

	Business Income GH¢	Taxable Investment Income GH¢
Year to 30/6/2008	70,000	28,000
Year to 30/6/2009	145,000	57,000
Year to 30/6/2010	97,000	70,000
Year to 30/6/2011	180,000	90,000
Year to 30/6/2012	240,000	120,000

You are required to determine the chargeable income of Apocha Ltd. for the year of assessment relating to 2009, 2010 and 2011.

(20 marks)

QUESTION 2

- (a) “The tax consequence of a business transaction depends on the interaction of four variables common to all transactions”
List and explain the four (4) basic Maxims of Tax Planning. *(16 marks)*
- (b) Briefly discuss two factors that can act as constraints to effective tax planning. *(4 marks)*

(Total: 20 marks)

QUESTION 3

- (a) What are chargeable assets? Give any exemptions thereof. *(10 marks)*
- (b) Pachecho had the following transaction in the shares of Astwe Ltd., a company which has not been listed on the stock exchange.

12/7/2010	-	Purchased 25,000 ordinary shares for GH¢15 per share
18/10/2010	-	Purchased 17,000 ordinary shares for GH¢10 per share
21/11/2011	-	Purchased 15,000 ordinary shares for GH¢18 per share
31/12/2011	-	Sold 54,000 ordinary shares for GH¢18.50 per share incurring realization cost of GH¢52,400.

The market value of a similar share on the Ghana Stock Exchange as at 31/12/2011 was GH¢20.00 per share.

Required:

Calculate the Capital Gains tax on the shares realized, if any.

(10 marks)
(Total: 20 marks)

QUESTION 4

- (a) Apitoro Ltd. and Achanga Ltd are companies in the Agricultural and Manufacturing Industry respectively. Apitoro acquired 35% of the ordinary shares of Achanga in 2009 year of assessment.

In May 2011, Apitoro transferred some of its trading inventory to Achanga for GH¢720,000.

The goods would have cost Achanga GH¢1,540,000 on the open market.

Required:

Explain how the Domestic Tax Division of the Ghana Revenue Authority would treat the above transaction for tax purposes.

(10 marks)

- b. Kwasi Sarpong inherited some lands from his late father in the year 2000. These lands were valued at GH¢250m. In the year 2009, due to certain difficulties and financial hardships, he sold the lands to Amutico Ltd. for GH¢700m. The company developed the land into serviced plots and sold them as such to individual persons. The company however made a gain or profit of GH¢350m on the sale.

Required:

What are the tax implications of these transactions?

(10 marks)
(Total: 20 marks)

QUESTION 5

- (a) Watara and Joe are friends who were residents in Great Britain for many years. They returned to Ghana on 15th October, 2011. They are however contemplating which sector of the Economy to invest in.

Upon careful consideration, they decided to invest in any of the following sectors:

- Agriculture,
- Manufacturing, or
- Real Estates

Required:

Explain to Watara and Joe, the specific Income Tax incentives, if any, available to them should they invest in any of the above sectors of the economy.

(15 marks)

- (b) “Under the Internal Revenue Act, 2000 (Act 592), every person is obliged to furnish a return of income to the Commissioner-General of the Ghana Revenue Authority for each year of assessment”.

Required:

State the reasons and benefits for filling tax returns.

(5 marks)

(Total: 20 marks)

ADVANCED FINANCIAL REPORTING

QUESTION 1

- (a) Section 56 of the Ghana Companies Code 1963, (Act 179) prohibits a company from engaging in some transactions in shares with some exceptions for the purpose of ensuring the maintenance of capital.

Required:

- (i) Explain four (4) prohibited transactions in shares **(6 marks)**
- (ii) Explain the exceptions to the prohibited transactions in shares. **(3 marks)**
- (b) IAS 29 - Financial Reporting in Hyper Inflationary Economies is to be applied to the financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.

Required:

Explain five characteristics exhibited by an economy experiencing hyperinflation as per IAS 29 - Financial Reporting in Hyper Inflationary Economics.

(5 marks)

(Total: 14 marks)

QUESTION 2

- (a) ABC Ltd has 30% equity shareholding in QRS Ltd. The Chief Executive Officer (CEO) and the Chief Operating Officer (COO) of ABC Ltd do not agree on the status of QRS Ltd. in terms of operating and financial reporting relationship. While the CEO wishes to treat the investee as an associate, the COO thinks otherwise. The Financial Accountant (FA), in trying to help resolve the disagreement stated that ‘an *associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture*’. Unfortunately, this explanation could not resolve the problem because the FA could not explain further how significant influence could be established.

Required:

As the Chief Finance Officer (CFO), explain the term - ‘significant influence’ and describe FOUR ways in which existence of significant influence can be evidenced.

(5 marks)

- (b) Below are the separate financial statements of Papa Ltd, and two investee companies which also operate in the same industry as the investor entity.

Income Statements and Other Comprehensive Income for the year ended 31 December 2012

	Papa Ltd GH¢'000	Susuka Ltd. GH¢'000	Obra Ltd. GH¢'000
Revenue	92,500	45,000	30,000
Cost of sales	<u>(70,500)</u>	<u>(36,000)</u>	<u>(18,000)</u>
Gross profit	22,000	9,000	12,000
Distribution costs	(2,500)	(1,200)	(1,000)
Administrative expenses	(5,500)	(2,400)	(2,000)
Finance costs	<u>(100)</u>	<u>-</u>	<u>-</u>
Profit before tax	13,900	5,400	9,000
Corporate tax	<u>(3,900)</u>	<u>(1,500)</u>	<u>(2,200)</u>
Profit for the year	10,000	3,900	6,800
Other comprehensive income:			
Gain on revaluation of land	<u>500</u>	<u>-</u>	<u>-</u>
Total comprehensive income	<u>10,500</u>	<u>3,900</u>	<u>6,800</u>

Statements of financial position as at 31 December 2012

Assets

Non-current assets

Property, plant and equipment	25,500	13,900	15,000
Investments	<u>5,400</u>	<u>-</u>	<u>-</u>

	30,900	13,900	15,000
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Current assets	<u>12,500</u>	<u>2,400</u>	<u>3,000</u>
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Total assets	<u>43,400</u>	<u>16,300</u>	<u>18,000</u>
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Equity and liabilities:

Equity:

Equity shares of GH¢1 each	15,000	5,000	6,000
Land revaluation reserve	2,000	-	-
Other equity reserve	500	-	-
Retained earnings	<u>12,900</u>	<u>4,500</u>	<u>5,000</u>

	30,400	9,500	11,000
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Non-current liabilities:

20% loan notes	3,000	-	-
Current liabilities	<u>10,000</u>	<u>6,800</u>	<u>7,000</u>

Total equity and liabilities	<u>43,400</u>	<u>16,300</u>	<u>18,000</u>
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The following additional information is relevant:

1. On 1 September 2012, Papa Ltd acquired 80% of the equity share capital of Susuka Ltd. The consideration consisted of two elements: a share exchange of three shares in Papa Ltd. for every five acquired shares in Susuka Ltd. and the issue of a GH¢100 6% loan note for every 500 shares acquired in Susuka Ltd. The share issue has not yet been recorded by Papa Ltd., but the issue of the loan notes has been recorded. At the date of acquisition, shares in Papa Ltd. had a market value of GH¢5 each and the shares of Susuka had a stock market price of GH¢3.50 each.

Papa Ltd. had earlier, on 1 July 2012, acquired 2.4 million shares in Obra Ltd. on the stock market at a price of GH¢1.50 per share.
2. At the date of acquisition, the fair values of Susuka Ltd's assets were equal to their carrying amounts with the exception of its property. This property has a fair value of GH¢1.2 million below its carrying amount. The effect of the fair value would lead to a reduction of the depreciation charge (in cost of sales) of GH¢50,000 in the post-acquisition period. Susuka Ltd. has not incorporated this value change into its separate financial statements.
3. Sales from Susuka Ltd. to Papa Ltd. throughout the year ended 31 December 2012 was GH¢12 million. Susuka made a mark-up on cost of 25% on these sales. Papa Ltd. had GH¢2 million (at cost to Papa Ltd.) of inventory that had been supplied in the post-acquisition period by Susuka Ltd. as at 31 December 2012.
4. In December 2012, Papa Ltd. sold goods to Obra Ltd. for GH¢2million achieving a profit mark-up of 25%. The entire consignment remained unsold and was included in the inventory of Obra Ltd. as at 31 December 2012.
5. Papa Ltd's investments included some available-for-sale investments that have increased in value by GH¢300,000 during the year. The other Equity Reserve relates to these investments and is based on their value as at 31 December 2011. There were no acquisitions or disposals of any of these investments during the year ended 31 December 2012.
6. Papa Ltd's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose Susuka Ltd's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.
7. Goodwill was tested at the end of the year. 10% of the Goodwill related to acquisition of Susuka Ltd. was found to be impaired.

Required:

- (i) Prepare the consolidated statement of comprehensive income for Papa Ltd. Group for the year ended 31 December 2012.

(10 marks)

- (ii) Prepare the consolidated statement of financial position for Papa Ltd. Group as at 31 December 2012.

(10 marks)

(Total: 25 marks)

QUESTION 3

Eye Den Ltd. is a company that carried on business as distributors of music CDs. As a result of stiff competition, coupled with poor management, the company has posted losses consistently for the past few years. The company has reconstituted its management team which has put in place a new marketing strategy of door to door sales, taking CDs to customers in their homes. The new management believes that the company will earn average annual profits before interest and tax of GH¢2,500 million for the next five years. Corporate tax is assumed to be at a rate of 25%. The new management team is proposing a scheme of reorganization to reposition the company and make it a viable going concern. The company's statement of financial position as at 30/06/2013 was as follows:

Eye Den Ltd.

Statement of Financial Position as at 30/06/2013

	GH¢ million
Non-current assets:	
Property Plant & Equipment	4,600
Investment Property	2,500
Goodwill	400
Intangible assets	<u>500</u>
	<u>8,000</u>
Current assets:	
Inventory	700
Trade Receivables	<u>300</u>
	<u>1,000</u>
Total Assets	9,000
Equity:	
Ordinary Shares of GH¢1,000 each fully paid	8,000
12% Cumulative Preference Shares of GH¢1,000 each, fully paid	1,500
Income Surplus	<u>(7,100)</u>
	2,400
Non-current Liabilities:	
15% Debentures (Secured on Property, Plant & Equipment)	4,500
Current Liabilities:	
Trade payables	1,200
Accrued expenses	400
Bank overdraft (Secured as a floating charge)	<u>500</u>
	<u>2,100</u>
Equity and liabilities	9,000
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The following information has been made available:

1. Property, Plant & Equipment in the statement of financial position comprises the following at net book values:

	GH¢ million
Land & Buildings	2,200
Furniture & Fittings	700
Equipment	800
Motor Vehicles	<u>900</u>
	<u>4,600</u>

It is ascertained that as at 1/07/2013, the Land & Buildings has a fair value of GH¢2,500 million but could be realized on that date for GH¢1,600 million. The values in use of Equipment and Motor Vehicles are GH¢750 million and GH¢800 million respectively. Equipment and Motor Vehicles have realizable values of GH¢600 million and 700 million respectively. Although Furniture & Fittings have been recognized at its fair value in the statement of financial position, their forced sale value is estimated at GH¢500 million.

2. The Investment Property of the company has a fair value of GH¢2,650 million but forced sale value is GH¢2,300 million.
3. Goodwill is considered worthless and 20% of trade receivables are irrecoverable.
4. Inventory can only be realized for GH¢380 million.
5. The recoverable amount of intangible assets is assessed at GH¢200 million.
6. Liquidation expenses are expected to be GH¢40 million while re-organization expenses will be GH¢30 million. Preference dividends are three years in arrears.
7. The reconstituted management team desires that Eye Den Ltd. should maintain a current ratio of 2.5:1 after the scheme of reorganization. The ordinary shareholders will be willing to introduce any additional capital necessary to achieve the desired working capital.

Required

- (a) Advise the Preference and Ordinary shareholders of their positions in case of liquidation.
(3 marks)
- (b) Propose a scheme of capital reduction that will be acceptable by all the stakeholders and prepare a statement of financial position as at 1/07/2013 after the reorganization scheme has been effected.
(10 marks)
- (c) Describe the legal process required for implementing a scheme of capital reduction.

(3 marks)
(Total: 16 marks)

QUESTION 4

Adepa Ltd., a large listed company, and Samanpa Ltd., a medium sized company, operate in the same industry (the bottling industry). The management of Adepa Ltd. would want to take over Samanpa Ltd. by means of a cash offer and has asked the management of Samanpa Ltd. to quote the price at which they would be willing to sell their business.

The following are extracts from the latest published financial statements of Samanpa Ltd.

Income Statement for the year ended 31 December 2012.

	GH¢'000
Profit before interest and tax (PBIT)	11,000
Interest	<u>(1,000)</u>
	10,000
Taxation (@ 25%)	<u>(2,500)</u>
Profit after tax	7,500
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Statement of Changes in Equity (Retained Earnings Column) for the year ended 31 December 2012.

	GH¢'000
Balance as at 31 December 2011	14,900
Profit for the year	7,500
Dividend paid: Preference	(400)
Ordinary	<u>(2,000)</u>
Balance as at 31 December 2012	20,000
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Statement of Financial Position as at 31 December 2012

	GH¢'000
Non-current assets:	
Freehold property	20,000
Plant and equipment	40,000
Intangible assets	10,000
Investments	10,000

	80,000

Current assets:	
Inventory	6,000
Receivables	12,000
Cash	2,000

	20,000

Total assets	100,000
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Equity:	
Ordinary share capital (issued at GH¢1)	40,000
Preference shares	8,000
Retained earnings	20,000

	68,000
Non-current liabilities	
5% Loan Stock	20,000
Current Liabilities:	
Trade payables	9,500
Taxation	2,500

	100,000
	=====

The following additional information is made available:

1. The loan stock is a deep discount bond carrying a nominal coupon rate of 5% and obtained on 1 January 2012 at par. Interest is paid in arrears at 31 December. It is redeemable on 31 December 2014 at a premium of GH¢4,724,000; thus resulting in an effective annual interest rate of 12%.
2. It has been ascertained that the current rental value of the freehold property is GH¢3million per annum, in perpetuity and that this could be sold to a financial institution on the basis of offering an 8% return to the freeholder.
3. The investments owned by Samanpa Ltd. are held-for-trading financial assets and have a current market value of GH¢15 million.
4. Included in the operating expenses charged against the income statement before arriving at the PBIT is rental charge of GH¢3 million relating to a leased machine. It is now ascertained that the agreement constituted a finance lease which required four years rental payments of GH¢3 million per annum, payable in advance on 1 January each year. The fair value of the asset at the inception of the lease on 1 January 2012 was GH¢9.85 million and the implicit interest rate is 15%. The machine is depreciable over the lease term with nil estimated residual value.

Two companies in the same business as Samanpa Ltd are quoted on the stock market. However, both are slightly bigger in size than Samanpa Ltd. The most recent financial data relating to these companies is given as follows:

Issue Price/share	Market Price/share	EPS	Dividend pay-out ratio
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Boafo Ltd.	GH¢1	GH¢4.8	GH¢0.80	80%
Nhyira Ltd.	GH¢0.50	GH¢2.4	GH¢0.30	70%

The directors of Samanpa are naturally interested in obtaining the highest price possible for their shares.

Required:

- (a) Based on Net Assets Value, Price Earnings Ratio and Dividend Yield, valuation methods, determine the highest possible asking price for the shares and comment on the alternative prices you have arrived at.

(12 marks)

- (b) Advise the directors on the lowest price at which they should be willing to sell.

(3 marks)

(Total: 15 marks)

QUESTION 5

- (a) The following Trial Balance has been extracted from the books of Printer Ltd. for the year ended 30 June, 2013.

PRINTERS LTD.
TRIAL BALANCE FOR THE YEAR ENDED 30 JUNE 2013

	DR GH¢	CR GH¢
Property, Plant and Equipment	450,000	-
Turnover	-	930,000
Accounts Receivables/Payables	98,500	85,500
10% Medium-Term Loan (2011-2015)	-	95,000
Purchases	583,100	-
Selling, General & Administration Expenses	191,000	-
Goodwill	62,500	-
Cash and Bank	84,000	-
Stated Capital	-	550,000
Income Surplus	-	74,000
Government Grant	50,000	-
Investment Property	60,000	-
Inventories	155,400	-
	----- 1,734,500 -----	----- 1,734,500 -----

The following Additional Information is available:

- (i) Inventories at 30th June 2013 was valued at GH¢128,500.
- (ii) Corporate tax provision of GH¢85,000 is to be made for the year.
- (iii) The Government Grant of GH¢50,000 was accrued during the year ended 30th June 2012 out of a total grant of GH¢90,000. The conditions for the outstanding grant of GH¢40,000 were subsequently met leading to the receipt of GH¢90,000 during the current year. This receipt has not been recorded in the books. The grant is related to income.
- (iv) The Investment Property is to be measured at Fair Value. The fair value as at 30th June 2013 was GH¢65,000.

(v) The composition of the selling, General and Administration Expenses is as follows:

	GH¢
Interest on Medium-Term Loan	2,200
Wages and Salaries	84,200
Rent and Rates	12,500
Depreciation on Property, Plant and Equipment	50,700
Social Security Fund – Employer Contribution	17,400
Selling and Distribution Expenses	24,000

	191,000

(vi) During the year a dividend of GH¢0.05 per share was paid. All the shares were issued at GH¢1.10 each. No entry was made for the payment of the dividend.

(vii) Wages and Salaries accrued during the year was GH¢12,400 and rent and rates prepaid was GH¢1,450.

Required:

(i) Prepare a Value Added Statement for the year ended 30th June 2013 to be incorporated in the Financial Statements of Printer Ltd.

(10 marks)

(ii) State any three (3) objectives of Value Added Statement.

(3 marks)

(iii) State any two (2) disadvantages of Value Added Statement.

(2 marks)

(b)

The Statement of Financial position of Oyeman Ltd. as at 31 December 2012 is as shown below:

	GH¢
Non-current assets	3,600
Stocks (200 units)	2,000
Debtors	2,400
Cash	<u>1,000</u>
	<u>9,000</u>
Stated Capital & Surplus	4,500
Loan (Interest free)	<u>4,500</u>
	<u>9,000</u>

Oyemam Ltd. buys for cash and sells on one month's credit. The company incurs no overhead expenses. The non-current assets are to be written off over three years on a straight line basis.

The mark-up on inventories is constant at 20% on historical cost determined using the first in first out method of inventory valuation. Inventory is held constant at 200 units. The monthly sales are 200 units. The cost of inventory at the end of the previous month was GH¢10 per unit. The cost of purchases increased by 10% at the beginning of the month.

The replacement cost of the non-current assets also increased by 50%.

Required:

- (i) Prepare historical Income Statement for the month of January 2013 and the historical Statement of Financial Position as at the date.

(4 marks)
- (ii) On the assumption that the current cost of the assets is measured at their replacement cost, prepare current cost income statement for January 2013 and Current Cost Statement of Financial Position as at 31 January, 2013.

(8 marks)
- (iii) Explain the difference between physical capital maintenance and financial capital maintenance.

(3 marks)

(Total: 30 marks)

ADVANCED AUDITING AND PROFESSIONAL ETHICS

QUESTION 1

Esslamp Toys Co. (Esslamp) is a manufacturer of children's building block toys. They have been trading for over 30 years and they sell to a wide variety of customers including large and small toy retailers across the country. The company's year-end is 31 May 2011.

The company has a large manufacturing plant, four large warehouses and a Head Office. Upon manufacturing the toys are stored in one of the warehouses until they are despatched to customers. The company does not have an Internal Audit Department.

SALES ORDERING, GOODS DESPTACHED AND INVOICING

Each customer has a unique customer account number and this is used to enter sale orders when they are received in writing from customers. The offers are entered by an order clerk and the system automatically checks that the goods are available and that the order will not take the customer over his credit limit. For new customers, a sales manager completes a credit application; this is checked through a credit agency and a credit limit is entered into the system of the Credit Controller. The company has a price list, which is updated twice a year. Larger customers, are entitled to a discount; this is agreed by the Sales Director and set up within the customers master file.

Once the order is entered, acceptance is automatically sent to the customer by mail/email confirming the goods ordered and a likely dispatch date. The order is then sorted by address of customer. The warehouse closest to the customer receives the order electronically and a despatch list and sequentially numbered goods despatch notes (GDNs) are automatically generated. The warehouse team pack the goods form the despatch list and, before they are sent out, a second member of the team double checks the despatch list to the GDN, which accompanies the goods.

Once despatched, a copy of the GDN is sent to the accounts team at Head Office and a sequentially numbered sales invoice is raised and checked to the GDN. Periodically a computer sequence check is performed for any missing sales invoice number.

FRAUD

During the year material fraud was uncovered. It involved cash receipts from customers being diverted into employees' personal accounts. In order to cover up the fraud, receipts form subsequent unrelated customers would then be recorded against the earlier outstanding receivable balances and this cycle of fraud would continue.

The fraud occurred because two members of staff 'who were related' colluded. One processed cash receipts and prepared the weekly bank reconciliation; the other employee recorded customer receipts in the sales ledger. An unrelated sales ledger clerk was supposed to send out monthly

customer statements but his duty was not performed. Each of the bank reconciliations had a small unreconciled amount but no-one reviewed the reconciliations after they were prepared. The fraud was only uncovered when the two employees went on holidays at the same time and it was discovered that cash receipts from different customers were being applied to older receivable balances to hide the earlier sums stolen.

Required:

- (a) Recommend FIVE tests of controls the auditor would normally carry out on the sale systems of Esslamp, and explain the objective for each test. ***(10 marks)***
- (b) Describe the substantive procedures the auditor should perform to confirm Esslamp's year end Receivables' balances. ***(5 marks)***
- (c) Identify and explain the controls Esslamp should implement to reduce the risk of fraud occurring again and, for each control, describe how it would mitigate the risk. ***(5 marks)***
- (Total: 20 marks)**

QUESTION 2

- (a) The auditor has a responsibility to design audit procedures to obtain sufficient and appropriate evidence. There are various audit procedures for obtaining evidence, such as external confirmation.

Required:

Apart from external confirmation:

- (i) State and explain FIVE procedures for obtaining evidence and; ***(5 marks)***
- (ii) For each procedure, describe an example relevant to the audit of purchases and other expenses. ***(5 marks)***
- (b) SOLFS Airways operates an airline business. The company's year end is 31 July 2011.

You are the Audit Senior and you have started planning the audit. Your manager has asked you to have a meeting with the client and to identify any relevant audit risks so that the audit plan can be completed.

From your meeting you ascertain the following:

In order to expand their flight network, SOLFS Airways will need to acquire more airplanes. They have placed orders for six planes at an estimated total cost of \$200 million and the company is not sure whether these planes will be received by the year end. In addition, the company has spent an estimated \$150 million on refurbishing their existing planes. In order to fund the expansion, SOLFS Airways has applied for a loan of \$250 million. It is yet to hear from the bank as to whether it will lend them the money or not.

The company receives bookings from travel agents as well as directly via its website. The travel agents are given a 90-day credit period to pay SOLFS Airways. Due to difficult trading conditions, a number of the receivables are struggling to pay. The website was launched in 2010 and has consistently encountered difficulties with customer complaints that tickets have been booked and paid for online but SOLFS Airways has no record of them and hence has sold the seat to other customers.

SOLFS Airways used to sell tickets via a large call centre located near to their head office. However, in May, they closed it down and made the large workforce redundant.

Required:

Using the information provided, describe FIVE audit risks and explain the auditor's response to each risk in planning the audit of SOLFS Airways.

(10 marks)

(Total: 20 marks)

QUESTION 3

The CEO of AJAAKO Company Ltd. attended a seminar on Audit Assurance Services where the resource person, who is an Auditor of repute said a lot about "Due Diligence". The CEO did not understand and has therefore, requested you to explain some few issues to him.

Required:

- (a) (i) State briefly what is due diligence assignment. ***(2 mark)***
- (ii) State and explain THREE types of due diligence. ***(3 marks)***
- (iii) Identify and explain FIVE purposes of due diligence. ***(7 marks)***

- (b) In accordance with ISA 570 Going Concern; the objectives of an audit, include: to obtain sufficient appropriate evidence regarding appropriateness of management's use of the going concern assumption.

Required:

- (i) In the light of the above, state in detail three responsibilities of the auditor. (3 marks)
- (ii) State TEN indicators of going concern risk that the auditor should consider. (5 marks)

(Total: 20 marks)

QUESTION 4

You are currently engaged in planning the audit of the financial statements of OPOLATSA Limited as at 30 June 2012. The company runs a wholesale electrical business buying directly from national and overseas suppliers and selling to both large and small retailers. This will be the first accounting period during which all transactions relating to the sales, purchases, wages and general ledger systems will be processed and recorded by computer. Your firm of Chartered Accountants has experience of auditing computerized accounting systems and has decided as a matter of policy that during this year's audit of the financial statements of Opolatsa Ltd., it will be essential to test all the controls over the computerized accounting systems and to use computer audit programs to test the accounting records.

Required:

- (a) Outline how an audit is affected by the accounting transactions and records being processed by computer and held on computer files. (6 marks)
- (b) Describe what is meant by:
- (i) Application Controls. (4 marks)
 - (ii) General Controls. (4 marks)
- (c) Give two examples of specific application control over data being processed through Opolatsa Ltd's purchase system describing the purpose of each control. (5 marks)

- (d) (i) Outline what you understand by the term Computer Assisted Audit Techniques (CAATs) and the benefits that may be derived from using them. *(3 marks)*
- ii) Give two examples of how CAATs might effectively be used in the audit of Opolatsa Ltd's year-end Trade Receivables. *(2 marks)*
- (Total: 20 marks)**

QUESTION 5

- (a) The principles of professional competence and due care impose certain obligations on the professional accountant.

Required:

State in details FOUR of these obligations on the professional accountant.

(6 marks)

- (b) As a Reporting Accountant, you have been tasked to review the profit forecasts of OSHEE Ltd. which has existed for a considerable number of years.

Required:

- (i) Enumerate in detail FIVE factors that you will consider in the course of your review of profit forecasts of your client. *(5 marks)*
- (ii) State FIVE main matters to be stated in your report of Oshee Ltd. *(5 marks)*
- (c) Your firm has been engaged by XYZ Ltd., an Oil and Gas company sited at Cape Three Points in the Western Region to prospect for oil in the Republic of Ghana.
- You have realized that XYZ Ltd., has environmental issues which could have an impact on the financial statements of the company.

Required:

State THREE appropriate audit procedures to deal with the environmental issues to serve the best interest of XYZ Ltd.

(4 marks)

THE INSTITUTE OF CHARTERED ACCOUNTANTS [GHANA]

CORPORATE STRATEGY AND GOVERNANCE

NOVEMBER 2013 SOLUTIONS

QUESTION 1

A]

The human resource conditions at GMC include:

- 1) GMC has a pool of employees that are well-trained. Employees are constantly being equipped with relevant training which they need to be able to perform well.
- 2) GMC also has a system in place to ensure that there is equitable compensation for employees. Therefore any employee who is able to bring in any additional consultancy assignment gets 10% commission of the net value of the assignment.
- 3) GMC is also concerned with managing the physical environment that employees work in. Hence efforts are made to ensure that basic things needed for work are provided.
- 4) There is a high level of employee satisfaction at GMC. This is based on the fact that for over five years, the business has not recorded any resignation.

B]

The effects of good Human Resource Practices on the productivity of GMC include the following:

1. Well trained employees are likely to come out with quality products that are likely to meet the needs of customers.
2. Another effect is that it enables the business to remain competitive. This is because such pool of employees will have a collective knowledge and competencies that change with the changing times.
3. GMC's employees have the potential to be innovative. The employees are encouraged to scan the environment and come out with products that customers need.

C] The corporate governance practices at GMC that have assisted in its success are:

1. There are clear separation of the duties of the various people charged with the management of GMC. There are also guidelines for managerial behaviors.
2. GMC in selecting board members, upholds the principle of director independence. Hence in recommending the replacement of the chairman of compensation committee, the Board chairman was reminded of having someone who has no material dealings with GMC.
3. Another key principle of corporate governance in the company is that there are committees which are charged with specific activities as finance and compensation committees.
4. GMC ensures that it protects the investments of its shareholders. Hence their profits are paid before bonuses are paid to workers and board members.

D] Three reasons why GMC should engage in social responsibility include the following:

1. A reason why GMC should engage in social responsibility is that it has been accepted in the business community that it is morally good for business to assist in solving social problems.
2. Social responsibility enables a business to deal with problems before they are blown out. It is recommended that it is best and cost-effective to deal with social issues before they become a challenge for management to deal with.
3. A socially responsible business is admired by the society. With such an image it is easier for the business to recruit efficient and effective employees. For some employees it is a sense of pride to work for such business.

QUESTION 2

A]

Financial regulations refer to a framework for supervision of financial institutions. Financial regulations spell out certain requirements, restrictions and guidelines. These activities are carried out to promote and maintain the integrity of the financial system. It therefore spells out the laws and rules that inform what financial institutions can do.

B]

1. A supervisory role of the financial regulator is to ensure that financial institutions follow laid down roles contained in banking acts. These rules cover all the operations of these institutions from their establishment and how they conduct their activities. The goal of this activity is to prevent unwelcomed events and scandals that would disrupt the functions of the banking system.

2. Another role is for the financial regulator to ensure that listed companies on the stock exchange comply with rules concerning trading acts. For example, it has to ensure that these companies publish their financial reports regularly. This is done to ensure that investors are able to obtain the important information needed to make informed assessment of the companies and their securities.
3. A key issue that economies have to deal with is money laundering. The anti-money laundering activity of the financial regulator is to ensure that funds obtained by criminal means do not find their way into the economy to threaten the reputation and integrity of the entire financial market.

C]

It can have an internal audit unit. An internal control of the business is internal auditors. The unit acts as a control because they have to review the internal financial controls and report their findings to the Board.

Another control is the internal activities of a business is to put in place a system to ensure that at the transaction level, payments include on behalf of the business are valid for services or products that have been properly authorized. This will assist in the reduction of fraud.

Another control is the use of budget. The budget is a quantified financial plan which is determined concerning the activities to be undertaken within a period. It sets the limits the amounts to be spent on various activities.

QUESTION 3

The case for splitting roles:

- More likely to guarantee proper checks and balances.
- Ideal way of tightening control over strategic decision making without placing it in the hands of one person; large boards are not always going to agree.
- Allows for complementary skills with each role requiring different expertise.
- Succession issues are likely to be less complicated.

The case for combined role:

- Allows for clear, strong and accountable leadership.
- Part-time, non-executive, chairman are unsuitable for large, complex, multi-national business-the job is too demanding.
- A non-executive deputy chairman is an ideal compromise.

- The strength of the Board as a whole, in terms of both executive and non-executive directors, is a more critical issue.
- The executive workload can be spread amongst all the executive directors, allowing for greater cohesion.

NOTE

It is important to ensure that the strategic leader does not become lonely and isolated. Again for the splitting roles, it is critical that the two people involved generally agree with each other and can work together.

Clearly there is no single answer which is appropriate for all companies. Strategic demands vary and individual abilities differ. The challenge is to establish both clear leadership and objectivity.

QUESTION 4

A]

1. A means that the board of directors can ensure that the company achieves its objectives is to put in place systems that ensure that resources are used efficiently and also comply with rules and regulations.
2. The employers as stakeholders of a company, have a role to play as far as ensuring that the company does not abuse its relationship with the environment. Thus they have to impress on management to follow ethical and social norms in their dealings.
3. The government can also ensure that business achieve their objectives by creating laws to protect the environment and also ensures that these laws are enforced. Business that knowingly break these laws should be made to face legal sanctions. For example their products may be banned.
4. Another stakeholder in the affairs of the business is the media. The role of the media is to investigate and report on the activities of a business.

B]

1. A role that the accountant of a company can play to ensure that good corporate governance is possible is to be the compliance expert by informing and assisting management to comply with the various requirements spelt out by national, regional and local regulators.
2. Managers and directors of the company are agents who are entrusted with the resources

of the shareholders. A problem that normally comes out is they are highly paid. A role that the accountant plays is to streamline such payments by informing management and directors on the ability of the company to take up such huge salaries.

3. Another role the accountant can play to promote corporate governance is to ensure that truth and fair financial reporting is made on the activities of the company. This is key because the aim of corporate governance is to ensure that each stakeholder gets its value. This can only be done when there is transparency and fairness.
4. Another role the accountant has to play in ensuring that corporate governance is practiced in a business is to ensure that internal controls like the budget is adhered to. This will ensure that there is no unnecessary over spending that would later on create financial problems for the business. This is likely to result in shareholders losing their investments.

QUESTION 5

- A] Venture capital is money or funds that are interested in a new business with a goal of earning profit. The venture capitalist makes money by owning equity in the business it invests in.
- B] There are various advantages for businesses which go public
1. When business go public to look for funds. One of such advantage is that it is easier to raise capital. Such capital can be used for capital expenditure or pay off existing debt.
 2. Another advantage is that it makes the public becomes aware of the business. This is a free means of advertising. This is because before the public decides to invest in the business they would seek information about the business. A good information may lead to increase in market share.
 3. An engagement in initial public offering also assists the business to have an increase in its value. Thus, insiders also have stocks may use it as collateral. This high value makes the business attractive and may make it easier for the business to have access to capital market in the future if the need arises.
 4. Another advantage is that it has the potential of ensuring that the business is managed efficiently. This is because such when business go public they are required by law to open and publish their annual operations publicly.

C] Sources of Change

1. A source that can be used to identify the need for change is to undertake a research on the customers of the business. Customers can be asked to give their impression on the product that the business is offering them. The responses obtained are then analyzed. The findings will assist the business to know where changes are needed.
2. Another source is to use the employees of the organization. Organizations need a high percentage of employees who are satisfied in order to achieve its goal. Dissatisfied employees will either leave or perform badly. Managers have to conduct research in order to find out what is causing their employees to be dissatisfied and put in place systems to correct them.
3. The quality of a product is important to customers. This is because they pay for it. Due to this total quality management has become critical for business success. It is therefore important for business to always use quality control measures to ensure that their quality level is maintained. A problem with the quality system calls for change.
4. Another means of identify change is to analyze the economic conditions that the business operates in. Businesses are set up to make profits where the investor seeks that the economic conditions are such that most of its profits will be taken away as taxes. Such a business will find ways of changing how it operates.

QUESTION 6

A]

The mission statement expresses the basic values of the business and also spells out the boundaries within which it operates. It defines the purpose or the organization's reason for existence.

B]

1. An organization needs a mission because the vision spells out or identifies what the organization stands for. Every organization should be known for something. The organization should be known for what it intends to achieve in the long term. For example Walt Disney stands for making people happy always.
2. The mission of the organization also indicates its principal products and services. There are various customers' needs. It is important that the vision spells out the principal products and services that the organization has to offer. This makes it easier for customers to know which product and services for example Coco cola is known for its high quality in soft drinks.

3. The mission spells out the values that informs the operations of the organization. Values are critical if organizations do not want to lose out on the market. The values of the organization are the set of guiding principles that represent its enduring tenets. For example a core value of UT Bank is to meet the loan needs within the shortest possible time.
4. The mission acts as a motivation for organizational activities. Thus it is important that the mission is well created before resources are gathered to form an organization. It is argued that when an organization is gathered without a vision it is likely to getting people ready and excited without giving them any directions. The vision is therefore needed to give direction to excited people who are in the organization.

C] Choosing a CEO

1. One of the activities in the recruitment and selection process is to be have an audit of job analysis. The job analysis is done to determine the gap that exist in terms of job specification need for the achievement of business goals. It therefore results in coming up with the gap that needs to be filled.
2. Another activity is the attracting of potential applicants. Normally this is done by advertising either internal or external. In attracting applicants I is important that for example the right channel is used to target these applicants. For when attracting managers at managerial level it is recommended to use national newspapers and appropriate journals.
3. When the applications are received it is important that information on the applicants is gathered. The information include their curriculum vitae, references etc. It is important the officers extract only the relevant information they need about the candidate.
4. The recruitment and selection process also involves the short listing applicants. This is aimed at deciding who to invite for the interview. Shortlisting is recommended to take place soon after the closing date for the submission of the applicants.

QUESTION 7

This question requires the use of the planning grid developed by General Electric. It is an approach for evaluating the different business units in a business portfolio using each unit's strengths and the industry's attractiveness.

The positions of the various businesses of Achiebus Holdings are shown planning the grid below:

		Industry Attractiveness		
		High	Medium	Low
High	Estate			
Medium	Bank	Insurance		
Low		Import/ Export		

- (i) According to this its position on the grid the Estate Development unit has a high business strength and is in an industry which is very attractive. The strategies needed here are 'grow and build' strategies. These include intensive market penetration, market development, product development and the integration strategies (vertical and horizontal integration).
- (ii) The bank is also in a very attractive industry but has moderate (medium) business strengths. Strategies recommended for it are also 'grow and build'. But this must be selective based on the unit strengths. It must therefore embark on market penetration, market development and other growth strategies mentioned above.
- (iii) The insurance company is in a moderating attractive industry and also has moderate business strengths. It can best be managed with the 'hold and maintain' strategies where an attempt is made to keep the profitable segments of the unit.
- (iv) The import business is weak in terms of strengths and is in a moderately attractive industry. The common prescription for a business in this situation is harvest or divestiture or exit strategy. This means a withdrawal of investment from the business. Sometimes turn around strategies are employed.

B] Reasons why companies use retrenchment strategy.

- (i) Poor performance in terms of lower earnings and profits without any means of recovery.
- (ii) When the survival of the firm is threatened by unanticipated problems in the product market.
- (iii) Some of the existing business unit or segments may be shed if alternative investment opportunities promise higher returns.
- (iv) The strategy is also suitable when the firm does not have adequate funds to sustain and develop a product market which requires the deployment of large financial resources. The best thing to do is to divest the particular product market and use the money elsewhere.
- (v) To secure better management and improved efficiency, it may be necessary to cut down some of the existing operations to simplify the range of enterprise activities and thus secure high efficiency of operations.

THE INSTITUTE OF CHARTERED ACCOUNTANTS [GHANA]

ADVANCED TAX PLANNING AND FISCAL POLICY

NOVEMBER 2013 SOLUTIONS

QUESTION 1

**APOCH LTD.
COMPUTATION OF CAPITAL ALLOWANCE**

	Class 1 (40%)	Class 2 (30%)	Class 4 (20%)	Total
2009 (1/7/08 – 30/6/09)				
WAV b/d	28,000	60,000	66,000	
C/A	<u>11,200</u>	<u>18,000</u>	<u>13,200</u>	<u>42,400</u>
WDV c/d	16,800	42,000	52,800	
2010 (1/7/09 – 30/6/10)				
WDV b/d	16,800	42,000	52,000	
Additions	<u>34,000</u>	<u>-</u>	<u>-</u>	
	50,000	42,000	52,800	
C/A	<u>20,320</u>	<u>12,600</u>	<u>10,560</u>	<u>43,480</u>
	30,480	29,400	42,240	
2011(1/7/10 – 3-/6/11)				
Additions	-	40,000	-	
Disposals	-	-	(25,000)	
CA	<u>12,192</u>	<u>20,820</u>	<u>3,448</u>	<u>36,460</u>
WDV %	<u>18,288</u>	<u>48,580</u>	<u>13,792</u>	

APOCH LTD.
COMPUTATION OF CHARGEABLE INCOME

	GHC
2009 (1/7/08 – 30/6/09)	
Business Income	145,000
Less: Capital allowance	<u>42,400</u>
b/d	102,600
Investment Income	
(1/1/09 – 31/12/09)	
(6/12 x 57,000 + 6/12 x 70,000)	<u>63,500</u>
Chargeable Income	166,100
2010 (1/7/09 – 30/6/10)	
Business Income	97,000
Less: Capital allowance	<u>43,480</u>
Additions	53,520
Investment Income	
(1/1/10 – 31/12/10)	
(6/12/ x 70,000 + 6/12 x 90,000)	<u>80,000</u>
Chargeable Income	<u>133,520</u>
2011 (1/7/10 – 30/6/11)	
Business Income	180,000
Less Capital allowance	<u>36,460</u>
b/d	143,540
Investment Income	
(1/1/11 – 31/12/11)	
6/12 x 90,000 + 6/12 x 120,000)	<u>105,000</u>
Chargeable Income	<u>248,540</u>

QUESTION 2

A] The basic maxims of tax planning are as follows:

Entity

This focuses essentially on individuals and companies as the two types of taxpaying entities involved in business and investment transactions. Given the progressive nature of income tax rates in Ghana, the marginal tax rate applying to each taxpaying entity will depend on that entity's particular circumstances. As a result the tax rates are bound to differ among these organizations. Entity variable tax planning therefore takes advantage of these rates differentials to improve NPV. Entity variable refers to planning opportunities that shift income to an entity, which is subject to a lower marginal rate of tax or a shift of deductions to an entity subject to higher marginal tax rate.

Time Period Variable

This maxim of tax planning recognizes that the payment of tax liability in the future is less costly in present value terms than current tax liability. Deferral of tax liability can be achieved by either postponing taxation of income items to the future or by accelerating tax deductions into earlier tax years. This planning technique is most effective when the taxation of the income can be deferred without differing the related cash flow from the income. In the same manner, greater tax savings will result if one is able to accelerate the deductions without altering the timing of the related cash payments.

Jurisdiction Variable

All citizens and residents, including companies incorporated in Ghana are subject to income tax provided the income is accrued in, derived from or brought into Ghana. In Ghana the rate of corporate income tax differ depending on where the entity is located or the type of industry in which the company is operating.

For example within the Ghana Tax Jurisdiction companies located in the Free Zone Areas have different rules. Manufacturing Companies in Accra/Tema, Regional capital and other areas enjoy location incentives. Agro-based companies established in and after 2004 enjoy tax holidays and companies producing cocoa by-products from cocoa waste have different tax rates depending on where they are located.

Character Variable

Most business income is characterized as ordinary income and taxed at the rates applicable to the taxpayer earning the income. Several tax characters may provide for taxation at a lower rate. For example individual taxpayers earning interest on Treasury bill issued by the Government of Ghana are exempted from tax. In addition Banks' lending to the agricultural sector have different rate from lending to other sectors of the economy.

When income is taxed at a preferential rate, the before-tax return earned may be lower than the returned earned on income subject to a higher tax rate. The reduction in pretax return inherent in tax-favoured investments is often referred to as an *implicit tax*. Implicit taxes arise in many jurisdictions in which preferential tax treatment is granted to certain activities but not to others. For instance most tax laws encourage the acquisition of business property by allowing accelerated depreciation of asset costs over recovery lives much shorter than the assets economic lives. This situation leads to tax benefits decreasing the after-tax cost of purchasing assets relative to leasing comparable property. As a result, the cost of leasing may decline to induce business to continue to rent rather than buy assets.

B] There are a variety of factors that limit effective tax planning. These factors can be Legislative, Judicial or Uncertainty in character. Brief discussions of these constraints are as follows:

LEGISLATIVE CONSTRAINTS

This refers to circumstance that limit effective tax planning as a result of restrictions imposed by certain provisions contained in the Act. An important assumption underlying business and investment decision is that parties to the transaction will act in their own self-interests. This arm's length transaction assumption is fundamental to a market economy and ensures that the economic results of transactions negotiated between independent, self-interested parties will be respected by the Internal Revenue Service. Where related-party transactions take place, legislative restrictions exist to prevent the achievement of tax advantages that are not consistent with arm's-length transactions. The Internal Revenue Act, specifically lists three legislative restrictions. The Internal Revenue Act, specifically lists three legislative restrictions (anti-avoidance rules). These could be found in sections 69 to 71 of the Act. The provisions relate to Income Splitting, Transfer Pricing and Thin Capitalization (refer to Principles of Taxation for detailed explanation on these terms).

In addition, section 112(1) of the Internal Revenue Act 200 gives the commissioner the power to relocate or re-characterize or disregard an arrangement or part of an arrangement that is entered into or carried out as part of a scheme aimed at achieving tax advantage which is:

- Fictitious or does not have a substantial economic effect: or
- The form of which does not reflect its substance.

The Act define "arrangement to mean any kind of arrangement, action, agreement, course of conduct, promise, transaction, understanding, or undertaking, whether express or implied, whether or not enforceable by legal proceedings and whether unilateral or involving more than one person. Tax avoidance scheme includes an arrangement, one of the main purpose of which is the avoidance or reduction of a person's tax liability.

Judicial constraints

There are three judicial doctrines that give tax authorities powers to rewrite the tax consequences of transactions to reflect their economic realities. The **business purpose** doctrine, which originated in USA in the case of Gregory v. Helvering, 293 US 465 (1935), ensures that tax planning experts follow not only the letter of the law but also its spirit. This doctrine disregards the results of transactions held to have no commercial purpose other than tax avoidance.

The second doctrine is termed substance over form. This doctrine seeks to permit the tax authorities to look through the legal form of a transaction to determine its true commercial substance and subject the parties involved to tax in accordance with that substance. For instance a rental payment which in reality turns out to have a political agenda will be ignored in form as a deductible expense.

Finally, the step transaction doctrine permits tax authorities to collapse a series of intermediate transactions in a single transaction to determine the resulting tax consequences. This doctrine is applied when it became clear that the parties involved would not have undertaken the initial transaction without believing that the entire series would take place.

Another important judicial restriction, which is closely related to the entity variable of tax planning, is the assignment of income doctrine. This doctrine requires that income taxed to the taxpayer who provides or owns the property with respect to which the income is paid. This therefore imply that shifting income to a low-entity cannot be accomplished by giving away the income without also transferring ownership of the underlying income-producing asset.

Uncertainty Constraints

Tax planning involves the projection of future cash inflows and outflows. These projections are based on different assumptions that involved the use of market data, trend analysis and estimates base on the advice of consultants. It is therefore pertinent that tax experts realize or recognize the uncertainty of these assumptions. When the assumptions used in a tax planning decision are wrong the cash flows that will be realized from a particular transaction may differ from their expectations. This is because where future cash flows are uncertain, the risk associated with the transaction might call for the use of either a higher or a lower discount rate for calculating the present value of such cash flows.

There are several uncertainties that are specific to tax costs and benefits. The calculation of a tax cost and benefit of a proposed transaction depends on the taxpayer's expected marginal rate to tax. It will be very difficult to predict or project a person's marginal rate of tax if that person's income fluctuates annually. Changes in tax law could also lead to difficulties in projecting ones marginal rate of tax. It becomes extremely difficult if not impossible where tax plan depends on certain specific provisions of the existing tax law. Changes in those specific provision could result in undesirable effect on future cash flows. In practice this does not seem to pose much problem, since in Ghana many provisions of our laws have remain relatively stable, thereby reducing the risk associated with reliance on current law for planning purposes.

QUESTION 3

(a) Chargeable assets are assets the disposal of which will attract capital gains tax. Section

97 of the IRS Act, describe chargeable assets as follows:

1. Building of a permanent or temporary nature situated in Ghana.
2. Business and business assets including goodwill of a permanent establishment situated in Ghana.
3. Land situated in Ghana.
4. Shares of a resident company.
5. Part of, or any right or interest in, to or over any of the assets referred to above chargeable assets.
6. Any assets declared as chargeable by legislative instrument under the Act.

In the case of a resident person, all of the above assets wherever situated.

The following capital gains from the realization of a chargeable asset are exempt:

- Capital gains of a person up to a total of 50 currency points per annum.
- Capital gains accruing to or derived by a company arising out of a merge, amalgamation or re-organization of the company, where there is continuing of underlying ownership in the asset of, at least twenty-five (25%) per cent.
- Capital gains arising from a transfer of ownership of the asset by person to that persons spouse, child, parent, brother, sister, aunt, uncle, nephew or niece.
- Capital gains resulting from a transfer of ownership of the asset between former spouses as part of a divorce settlement or a genuine separation agreement.
- Capital gains where the amount received on realization is, within one year of realization, used to acquire a chargeable assets of the same nature referred to as the replacement asset.
- Where only part of the amount received on realization is used to acquire a replacement asset, any part of the capital gain represented by the amount used to acquire the replacement assets less the cost base of the asset realized at the time of realization.

PACHECHO
COMPUTATION OF THE COST OF SHARES

	No. of Shares	Unit Price GH¢	Amount GH¢
12/7/2010	25,000	15	375,000
15/10/2011	17,000	10	170,000
21/10/2011	<u>15,000</u>	18	<u>270,000</u>
Total Shares Purchases	57,000		815,000
Less Shares Sold	<u>45,000</u>		
Shares Remaining	<u>12,000</u>		

Capital gains will be captured as follows:

$$\begin{aligned}
 \text{Cost base} &= \frac{\text{Cost of Shares} \times \text{Realized Sum Shares}}{\text{Market Value \& Remains Assets} + \text{Realized Sum}} \\
 &= \frac{815,000 \times (45,000 \times 18.5)}{[(12,000) + 45,000 \times 18.5]} \\
 &= \frac{815,000 \times 832,500}{240,000 + 832,500} \\
 &= \frac{678,487,500,000}{1,072,500} \\
 \text{Cost base} &= \underline{632,622.38}
 \end{aligned}$$

Computation of Capital Gains

		GH¢
Realized Sum		832,500
Less Cost Based:		
As computed	632,622	
Realization Cost	<u>52,400</u>	<u>685,022</u>
Taxable Capital Gains		147,478
Less Exempt Amount		<u>50</u>
Chargeable Capital Gain		<u>147,428</u>
Tax Thereon @ 15%		<u>22,114.20</u>

QUESTION 4

The Ghana Revenue Authority [GRA] would value the stock at cost ie. GH¢1,540,000. Any gain arising from the transfer would be taxed in the hands of Apitora Ltd. Achanga would be exempted from any tax emanating from the transfer.

The above treatment would hold if the following conditions are satisfied concurrently:

- i. That the stock would be treated as business assets of the transferee.
- ii. That both companies are resident in Ghana.
- iii. That the transferee is not exempt from tax.
- iv. That the transferor continues to have at least 25% underlying ownership in the stock transferred.
- v. That both companies have concurred to the above terms.

If any of the above conditions is not met. The GRA would value the stock at GH¢150,000,000 (ie. the market value), since in that instance the transaction would not have been at an arm's length. The solution to be rewritten on the principle of Arm's length delays will Who are released.

- b) the inheritance of the land by Kwesi Sarpong falls under Gift Tax and not Income Tax.

Therefore, it does not constitute trading.

- ii) The sale of the land by Kwesi to Amutico Ltd. does not consist of trading.

The reason is that Kwesi inherited the land but did not purchase it from the open market. The cycle of trading (ie. buying and selling) is incomplete. In fact, Kwesi sold the land as owner and not a trader.

- iii) The sale of lands by Amutico Ltd. constitutes trading. The reasons are as follows:

- The company bought the land but did not inherit it.
- The company developed or improved the land to make it more marketable.
- The time interval between purchase and sale was too short. This tends to lead to the conclusion that the company purchased the land with the view of selling for a profit.

QUESTION 5

Tax Incentives Package – Agriculture

Agric enjoys a tax holiday of 5 or 10 years depending on the nature of agricultural activity as shown below:

- i) Three crops like palm-nut, coconut, rubber etc. enjoy a tax holiday of 10 years from the date of first harvest.
- ii) Cattle – 10 years from the date of commencement.
- iii) Cash crops, poultry, livestock, fish-farming 5 years from commencement.
- iv) Carry forward of losses for 5 years.

He can register any business entity to enjoy the above benefits except (v) which is only for corporate entities.

Tax Incentives Package – Manufacturing

- i) Manufacturing companies enjoy location tax incentives specified below:

Accra – Tema	-	No Rebate
Other Regional Capitals	-	25% Rebate
Elsewhere	-	50% Rebate

- ii) Where the company produces for export, it can carry forward losses for 5 years.

To take advantage of (i) & (ii) he must register as a corporate entity. For (iii) he can register any business entity.

Tax Incentives Package – Rea Estate

Enjoy a tax holiday of 5 years if the company partners the Government in putting up affordable houses. The holiday is only for corporate bodies. He must therefore register the business as a corporate entity to take advantage of the

There are several reasons and benefits that may accrue to taxpayers for filling their income tax returns.

1. It is a stationery obligation.
2. It enables the Commissioner General to ascertain the correct tax liability of a person for particular year of assessment.
3. It enables the individual taxpayer to make a claim for personal reliefs such as marriage or responsibility, child education, old age, disability reliefs etc.
4. It enables a person in business to make a claim for capital allowances on business assets other than stock in trade.
5. It also enables a person who earns a business or investment income to make a claim for allowable expenses.
6. Finally, the filling of returns may help promote tax consciousness and good citizenship as well as ensure voluntary compliance of the tax laws to avoid penalties.

THE INSTITUTE OF CHARTERED ACCOUNTANTS [GHANA]

ADVANCED FINANCIAL REPORTING

NOVEMBER 2013 SOLUTIONS

QUESTION 1

A (i) PROHIBITED TRANSACTIONS IN SHARES

According to Section 56 of the Ghana Companies Code, 1963 Act 17,

A company shall not;

- (a) Alter the number of its shares or the amount remaining payable there on, except by alteration of its regulations
 - (b) Release any shareholder or former shareholder from any liability on the shares
 - (c) Provide any financial assistance, directly or indirectly for the subscription or purchase of its shares or the shares of its holding company
 - (d) Acquire by way of purchase or otherwise, any of its issued shares or any shares of its holding company
- (ii) Section 59 provides exceptions
- (a) Preference shares issued on terms that render them redeemable may be purchased by the company
 - (b) A company may alter its regulations to authorize the purchase of its own shares
 - (c) A company may acquire its own shares by voluntary transfer of the shares to the company

B] CHARACTERISTICS OF A COMPANY EXPERIENCING HYPER INFLATION

- (a) The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency
- (b) The general population regards monetary amounts not in terms of the local currency but in terms of that relatively stable foreign currency. Prices may be quoted in that foreign currency
- (c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period even if the period is short
- (d) interests rates, wages and prices are linked to a price index
- (e) the cumulative inflation rate over three years is approaching or exceeds 100%

QUESTION 2

A]

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

- (a) representation on the board of directors or equivalent governing body of the investee;
- (b) participation in policy-making processes, including participation in decisions about dividends or other distributions;
- (c) material transactions between the investor and the investee;
- (d) interchange of managerial personnel; or
- (e) provision of essential technical information

B]

PAPA LTD.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER, 2010

GH¢

Revenue (92,500 + (45,000 x 4/12) – 4,000 intra-group sales)	103,500
Cost of sales (w (i))	<u>(79,010)</u>
Gross profit	24,490
Distribution costs (2,500 + (1,200 x 4/12))	(2,900)
Administration expenses (5,500 + (2,400 x 4/12))	<u>(6,300)</u>
Net operating profit	14,360
Share of profit of associate (6,000 x 40% x 6/12)	<u>1,360</u>
	16,810
Finance costs	<u>(100)</u>
Profit before tax	15,620
Income tax expense (3,900 + (1,500 x 4/12))	<u>(4,400)</u>
Profit for the year	<u>11,220</u>
Other comprehensive income:	
Gain on available-for-sale investments	300
Gain on revaluation of property	<u>500</u>
Total other comprehensive income for the year	<u>800</u>
Total comprehensive income	<u>12,020</u>
Profit for year attributable to:	
Equity holders of the parent	11, 216
Non-controlling interest (1,300 see below – 400 URP + 500 reduced depreciation)-930 impairment loss x 20%)	4

	<u>11,220</u>

Total comprehensive income attributable to:	
Equity holders of the parent (10,760 + 300+500)	12,016
Non-controlling interest	4

	12,020

Susuka's profit for the year ended 31 December, 2010 of GHS 3.9 million are GHS2.6 million (3,900 x 8/12) pre-acquisition and GHS1.3 million (3,900 x 4/12) post-acquisition.

**(b) CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2010**

	GH¢
Assets	
Non-current assets	
Property, plant and equipment (w (ii))	38,250
Goodwill (w (iii))	8,370
Investment in Associate	4,800
Available-for-sale investments (1,800 – 800 consideration + 300 gain)	<u>1,300</u>
	52,720
Current assets (w (iv))	<u>14,150</u>
Total assets	<u>66,870</u>
Equity and liabilities	
Equity attributable to owners of the parent	
Equity shares of GHS1 each ((15,000 + 12,000) w (iii))	27,000
Land revaluation reserve	2,000
Other equity reserve (500 + 300)	800
Retained earnings (w (v))	<u>14,116</u>
	43,916
Non-controlling interest (w (vi))	<u>3,504</u>
Total equity	47,420
Non-current liabilities	
6% loan notes	3,000
Current liabilities (10,000 + 6,800 – 350 intra group balance)	<u>16,450</u>
Total equity and liabilities	<u>66,870</u>
Workings in GH¢	
Cost of sales	
Papa	70,500
Susuka (36,000 x 4/12)	12,000
Intra-group purchase	(4,000)
URP in inventory	400
Excess depreciation charge	(50)
URP- Associate	160

	<u>79,010</u>

The unrealized profit (URP) in inventory is calculated as GHS2 million x 25/125 = GHS400,000.

Non-current assets

Papa	25,500
Susuka	13,900
Fair value reduction at acquisition	(1,200)
Excess depreciation	<u>50</u>
	<u>38,250</u>

Goodwill in Susuka

Investment at cost

Shares (5,000 x 80% x 3/5 x GHS5)	12,000
6% loan notes (5,000 x 80% x 100/500)	800

	12,800
Fair value of NCI	3,500

	<u>16,300</u>

Net worth acquired

Stated capital	5,000
Pre-acquisition retained earnings	3,200
Adds: fair value adjustment for property	<u>(1,200)</u>
Net assets at date of acquisition	<u>7,000</u>
Total Goodwill	9,300
Impairment	(930)

	8,370

The 2.4 million shares ($5,000 \times 80\% \times \frac{3}{5}$) issued by Papa at GHS5 each would be recorded as share capital of GHS12million.

Current assets

Papa	12,500
Susuka	2,400
URP in inventory	(400)
Intra-group balance	<u>(350)</u>
	<u>14,150</u>

Retained earnings

Papa	12,900
Susuka's post-acquisition adjusted profit ((1,300 – 400 URP + 50 excess depreciation – 930 impairment) x 80%)	16
Associate's post acq profit	1,360
URP- Associate	(160)

	<u>14,116</u>

Non-controlling interest in statement of financial position

At date of acquisition	3,500
Post-acquisition profit from income statement	4

	<u>3,504</u>

Investment in associate

Cost [2.4m x 1.5]	3,600
Post acq retained profit	1,360
URP	(160)

	4,800
	=====

QUESTION 3

AYEDEN LTD.

A] Position in case of liquidation:

	GH¢m	GH¢m
Proceeds from liquidation:		
Land and buildings	1,600	
Equipment	600	
Motor vehicles	700	
Furniture and fittings	500	
Investment property	2,300	
Trade receivables	240	
Inventory	380	
Intangible assets	<u>200</u>	6,520

Settlement of claims:

Secured debts:

15% Debentures (1600 + 600 + 700 + 500)	3,400	
Bank overdraft	500	
Liquidation expenses	<u>40</u>	<u>3,940</u>
Residue for unsecured debts		<u>2,580</u>

Settlement of unsecured debts

15% Debentures (4,500 – 3,400)	1,100	1,045
Trade payables	1,200	1,140
Accrued expenses	<u>400</u>	<u>395</u>
	<u>2,700</u>	<u>2,580</u>

Deficiency ratios:

$$\text{Debenture holders will lose} = \frac{4,500 - (3,400 + 135)}{4,500}$$

$$= \frac{165}{4500} \times 100$$

$$= \underline{\underline{3.67\%}}$$

$$\text{Trade payables and accrued expenses} = \underline{\underline{15\%}}$$

The whole of dividends in arrears of (12% of 1,500 for 3 years) = GH¢540 will not be recovered.

The whole of preference share capital will be lost and the whole of ordinary share capital will be lost.

Advice to shareholders

In a liquidation unsecured debts will only recover 85% of their claims. Shareholders will not receive any part of their capital including the preference dividends in arrears.

Loss to be written off:

GH¢

Trade receivable	60
Income surplus	7,100
Land & buildings	(300)
Equipment	50
Motor vehicles	100
Investment property	(150)
Goodwill	400
Inventory	320
Intangible assets	300
Preference dividends in arrears	540
Re-organization expenses	<u>30</u>
	8,450
	=====

Sharing of loss

	Original capital	Sacrifice	New capital
Ordinary shareholder	8,000	6,800	1,200
Preference shareholder	1,500	960	540
Preference div. in arrears	540	540	-
Trade payables	1,200	120	1,080
Accrued expenses	400	<u>30</u>	370
		8,450	

The levels of sacrifices will be acceptable to all stakeholders because capitals lost are smaller than under liquidation.

Working capital required:

Desired ratio of current assets to current liabilities 2.5: 1

Current liabilities after write off:

Trade payables	1,080	
Accrued expenses	370	
Bank overdraft	<u>500</u>	
	<u>1,950</u>	

Desired current assets = 2.5 of 1,950 = 4,875

Loss prevailing current assets:

Inventory	380	
Trade receivables	<u>240</u>	<u>620</u>
Additional working capital needed		<u>4,255</u>

Proposed Scheme

1. Ordinary shares should have 85% of their capital written off and provide additional capital of GH¢4,255 million in ordinary shares.
2. The preference dividends that have been in arrears for three years should be written off.
3. The preference share capital should be reduced by 60%
4. The negative income surplus should be eliminated.
5. Goodwill should also be written off.
6. The following assets should be valued as follow:

GH¢m

Land & buildings	2,500
Equipment	750
Motor vehicles	800
Investment property	2,650
Inventory	380
Intangible assets	200

7. Provision of bad debts should be made at 20%

EYE DEN LIMITED
STATEMENT OF FINANCIAL POSITION AS AT 30/06/13

	GH¢m	GH¢m
Non-current assets		
Property, plant & equipment		
- Land & buildings	2,500	
- Equipment	750	
- Motor vehicle	800	
- Furniture & fittings	<u>700</u>	4,750
Investment property		2,650
Intangible assets		<u>200</u>
		<u>7,600</u>
Current Assets:		
Inventory		380
Trade receivables		240
Bank (4,255 – 30)		<u>4,225</u>
		<u>4,845</u>
Total Assets		12,445
		=====
Equity:		
Ordinary shares (1,200 + 4,255)		5,455
12% preference shares		<u>540</u>
		<u>5,995</u>
Non-current liabilities		
15% Debentures		<u>4,500</u>
Current liabilities		
Trade payables		1,080
Accrued expenses		370
Bank overdraft		<u>500</u>
		<u>1,950</u>
Total Equity and Liabilities		12,445
		=====

C] Legal process of scheme of capital reduction

1. Special resolution by the class of stakeholders affected, accepting the capital reduction.
2. Court confirmation of the special resolution
3. Gazetting of the court confirmation and the special resolution

QUESTION 4

Revised Profit

€ 000

Profit before interest and tax	11000
Adjustments:	
Fair valuation gain (FA)	5000
Lease rental	3000
Finance lease interest	(1028)
Depreciation on leased asset	(2463)
Interest expenses	<u>(2400)</u>
Profit before tax	13109
Tax @ 25%	<u>(3277)</u>
Earnings after tax	<u>9832</u>

Retained Profit

€ 000

Bal. b/f	14900
Profit	9832
Dividend: Pref.	(400)
Ordinary	<u>(2000)</u>
	<u>22332</u>

Revised SOFP

Freehold property	37,500
P & Eq.	40,000
Leased Plant	7387
Intangible Assets	10,000
Investment	<u>15,000</u>
Current assets	<u>20,000</u>
Total assets	<u>129,887</u>
Equity	
Ord. Shares	40,000
Retained earnings	22,332
Revaluation reserves (property)	<u>17,500</u>
	<u>79,832</u>
Liabilities:	
Pref. Shares	8000
Loan stock- Amortized cost	21,400
Finance lease obligation	7,878
Trade payable	9,500

Taxation	<u>3,277</u>
	<u>50,055</u>
Equity & Liabilities	<u>129,887</u>

PE Ratio: Boafo 6
 Nhyira 8
 Average 7

Dividend Yield: Boafo 13.3%
 Nhyira 8.75%
 Average 11%

Net Asset Method

Value of Business = Net Assets
 = ₦77,832,000

Value per Share = $\frac{\text{Net Assets}}{\text{No. of Shares}}$
 = $\frac{\text{₦77,832,000}}{40 \text{ million shares}}$
 = ₦1.99 or ₦2.00

Price Earnings Ratio Method

Value per Share = EPS x PE Ratio
 EPS = $\frac{\text{₦9,432,000}}{40,000,000 \text{ Shares}}$
 = 0.2358
 PE Ratio = Average of similar Listed Firms Discounted
 = 7 discounted to say 5 or (6)
 Value/Share = $\text{₦}0.2358 \times 5$
 = ₦1.179

Dividend Yield Method

Value per Share = $\frac{D_0}{DY}$

$$\begin{aligned} D_0 &= \frac{\text{€}2,000,000}{40 \text{ m Shares}} \\ &= 0.05 \end{aligned}$$

$$\begin{aligned} DY &= \text{Average of listed firms discounted} \\ &= 11\% \text{ discounted by } 12\% \text{ or } \dots \\ &= \frac{\text{€}0.05}{0.12} \\ &= \text{€}0.42 \end{aligned}$$

(b) Advice:

If the owners want to sell the business now, then the lowest price they should sell the shares, business is net assets method. However if they intend to hold on to the investment for some time, then perhaps the PE price is the lowest price they should accept.

QUESTION 5

(A) (i)

PRINTERS LTD. VALUE ADDED STATEMENTS FOR THE YEAR ENDED 30T JUNE, 2013

GH¢	GH¢	
		930,000
Turnover		
Bought-in Material & Services		
Opening Stock	155,400	
Purchases	583,100	
Closing Stock	(128,500)	
Rent and Rates	11,050	
Selling and Dist. Expenses	<u>24,000</u>	<u>645,050</u>
Value Added		284,950
Other income:		
Government Grant		30,000
Revaluation of Invest. Property		<u>5,000</u>
		<u>35,000</u>
To Employees		
Wages/Salaries	96,600	
SSF – Employee Cont.	<u>17,400</u>	114,000
To Government Tax		85,000
To Providers of Capital		
Interest	9,500	
Dividend	<u>25,000</u>	34,500
To Business: Depreciation	50,700	
Retained Profit	<u>35,750</u>	<u>86,450</u>
		<u>319,950</u>

(ii) Aims/Objectives of Value Added Statement

- (a) To identify the stakeholders for whom Financial Statement should be prepared.
- (b) To consider the most suitable means of measuring and reporting the economic position, performance and prospect, on an entity.
- (c) To put into proper perspective the collective efforts of capital, management, employer and the Government.
- (d) As a basis for negotiating wage increases.
- (e) As a means of performance evaluation and control.

(iii) Disadvantages of Value Added Statement

- (a) The statement is merely a restatement of information that appears in the income statement.
- (b) It only report data capable of being reported
- (c) That the individual elements of social benefits are limited to the traditional ones of shareholders, employees and the government, with others such as society and the customer ignored.

(b) i

HISTORICAL COST INCOME STATEMENT FOR THE MONTH ENDED 31ST JANUARY 2013

	GH¢	GH¢
Sales (200 x 12)		2,400
<u>Cost of Sales:</u>		
Opening stock (200 x 10)	2,000	
Purchases (200 x 11)	2,200	
Closing stock (200 x 11)	<u>2,200</u>	<u>2,000</u>
Gross Profit		400
Depreciation		<u>(100)</u>
Operating Profit		<u>300</u>

HISTORICAL COST STATEMENT OF FINANCIAL POSITION AS AT 31ST JANUARY 2013

	GH¢	GH¢
Non-current Assets	3,600	

Depreciation	<u>(100)</u>	3,500
<u>Current Assets:</u>		
Stock	2,200	
Debtors	2,400	
Cash	<u>1,200</u>	<u>5,800</u>
		<u>9,300</u>
Stated Capital and Surplus		4,800
Loan		<u>4,500</u>
		<u>9,300</u>

CURRENT COST INCOME STATEMENT FOR THE MONTH ENDED 31ST JANUARY
2013

	GH¢
Historical Cost Operating Profit	300
Cost of Sales Adjustment	(200)
Depreciation Adjustment	<u>(50)</u>
Operating Profit	<u>50</u>

CURRENT COST STATEMENT OF FINANCIAL POSITION AS AT 31ST JANUARY 2013

	GH¢	GH¢
Non-Current Assets	5,400	
Depreciation	<u>(150)</u>	5,250
Current Assets:		
Stock	2,200	
Debtors	2,400	
Cash	<u>1,200</u>	<u>5,800</u>
		<u>11,050</u>
Stated Capital and Surpluses		6,550
Loan		<u>4,500</u>
		<u>11,050</u>

Cost of Sales Adjustment

Current Cost (2000 x 11/10)	2,200
Historical Cost	<u>(2000)</u>
	<u>200</u>

Depreciation Adjustment

Current Cost (5,400/36)	150
Historical Cost	<u>(100)</u>
	<u>50</u>

Cash Account

Bal. b/d	1,000	Purchase	2,200
		Bal. c/d	<u>1,200</u>
Debtors	<u>2,400</u>		<u>3,400</u>
	<u>3,400</u>		

(iii) Difference between Physical Capital Maintenance and Financial Capital Maintenance

Physical Capital Maintenance

This is also called operating capital maintenance.

The operating concept states that the productive or operating capacity of the enterprise should be maintained as a prime objective in the income measurement process. With this concept, profit is a residue after provision has been made for replacing the resources exhausted in the course of operations. With this concept there can be no recognition of profit for a period unless capital employed in the business of the beginning of the period of the period has been maintained.

This concept values assets at their replacement costs. The use of current cost accounts reflects the physical or operating capital maintenance concept.

Financial Capital Maintenance

The object of this concept is to maintain the financial capital of an enterprise in real terms by constantly updating the historical cost of assets for changes in the value of money. This concept of capital maintenance purports to show the shareholders that their company kept pace with general inflationary pressure during the year by measuring profit in such a way that takes account of price level changes.

In effect, it intends to maintain the shareholders capital in terms of monetary units of Constant purchasing power.

The concept thus uses constant purchasing power accounting. This concept is also called the real money capital maintenance concept.

THE INSTITUTE OF CHARTERED ACCOUNTANTS [GHANA]

ADVANCED AUDIT AND PROFESSIONAL ETHICS

NOVEMBER 2013 SOLUTIONS

QUESTION 1

A] TEST OF CONTROLS

- (i) Enter an order for a fictitious customer account number and ensure the system does not accept it.
- (ii) Inspect a sample of processed credit applications from the credit agency and ensure the same credit limit appears in the sales system.
- (iii) For a sample of invoices showing discounts, agree the discount terms back to the customer master file information.
- (iv) For a sample of orders ensure that an order acceptance, email or letter was generated.
- (v) Visit a warehouse and observe whether all goods are double checked against the GDN and dispatch list before sending.
- (vi) With the client's permission, attempt to enter a sales order which will take a customer over the agreed credit limit and ensure the order is rejected as expected.
- (vii) Attempt to process an order with a sales discount for a customer not normally entitled to discounts to assess the application controls.
- (viii) Observe the sales order clerk processing orders and look for proof that the order acceptance is automatically generated (e.g. e-mail in sent folder).
- (ix) Inspect a sample of GDNs and agree that a valid sales invoice has been correctly raised.

Test Objectives

- (i) To ensure that orders are only accepted and processed for valid customers.
- (ii) To ensure that goods are only supplied to customers with acceptable credit ratings.
- (iii) To ensure that goods are only sold at authorized prices.
- (iv) To ensure that sale discounts are only provided to those customers the Sales Director has authorized.

- (v) To ensure that all orders are recorded completely and accurately.
- (vi) To ensure that goods are despatched correctly to customers and are of an adequate quality.
- (vii) To ensure that goods are not supplied to poor credit risks.
- (viii) To ensure that sales discounts are only provided to valid customers.
- (ix) To ensure that all orders are recorded completely and accurately.
- (x) To ensure that all goods despatched are correctly invoiced.

B] Substantive procedures to confirm Esslamp's year-end receivables balance.

- Circularize trade receivables for a representative sample of the year-end balances. If authorized by Esslamp's management, send an e-mail or reminder letter to follow up non-responses.
- Review cash receipts after the year-end in respect of pre year-end receivable balances to establish if anything is still outstanding. Where amounts are unpaid, investigate whether an allowance is needed.
- Review the reconciliation of the receivable ledger control account (sales ledger control account) to the list of receivables (sales ledger) balances and investigate unusual reconciling items.
- Review the aged receivables report to identify any old balances and discuss the probability of recovery with the Credit Controller to assess the need for an allowance.
- Calculate average receivable days and compare this to prior year end expectations, investigating any significant differences.
- Select a sample of goods despatched notes just before and just after the year end to ensure the related invoices are recorded in the correct accounting period.
- Review a sample of credit notes raised after the year end to identify any that relate to pre year-end transactions and confirmed that they have not been included in receivables.
- Review the aged receivables ledger for any credit balances and inquire of management whether these should be reclassified as payables.

- For slow moving/aged balances, review customer correspondence file to assess whether there are any invoices in dispute which require an allowance.
- Review Board minutes to assess whether there are any material disputed receivables.
- Select a sample of year-end receivable balances and agree back to a valid GDN and sales order to ensure existence.

C] Controls to reduce the risk of fraud re-occurring and explanation of how the risk is mitigated.

Control

- (i) Related members of staff should not be allowed to work in the same department where they can seek to override segregation of duty controls.
- (ii) Customer Statement should be sent out each month to all customers. The receivables ledger supervisor should check that all customers have been sent statements.
- (iii) Bank reconciliations should be reviewed regularly by an appropriate level of management who is not involved in its preparation. Unreconciled amounts should be investigated and resolved at the time of review.
- (iv) Two members of staff should process cash receipt.
- (v) Staff within the finance department should rotate duties on a regular basis.
- (vi) The receivables ledger should be reconciled to the receivables ledger control account on at least a monthly basis. This reconciliation should be reviewed by a responsible official and anomalies investigated.
- (vii) Management should consider establishing an internal audit department to assess and monitor the effectiveness of controls, identify any deficiencies, and carry out specific fraud investigations.

Explanation of how risk is mitigated by control

- (i) The risk of related staff colluding and being able to commit a fraud without easily being discovered will be reduced.

- (ii) Customers receiving statements may notice anomalies in the allocation of payments (either timing or amount) and may alert the company of these anomalies. This may draw attention to the sort of fraud that occurred at Esslamp (known as teeming and lading).
- (iii) Any compensating material balances netted off to a small difference on the bank reconciliation will be discovered quickly increasing the probability of uncovering fraud on a timely basis.
- (iv) This would mean another collusion would be necessary (on top of the one that has already occurred) to steal cash receipts. This therefore, reduces the risk of reoccurrence.
- (v) Rotation will act as a deterrent to fraud. This is because staff will be less likely to commit fraudulent activities due to an increased risk of the next person to be rotated to their position uncovering any wrong doing.
- (vi) This will increase the chance of discovering errors in the receivable balances and help to create a strong control environment likely to deter fraud.
- (vii) The presence of an internal audit department would help to deter employees committing fraud and identification of fraud would be more likely due to ongoing monitoring of internal controls.

QUESTION 2

- (a) Procedures to obtain audit evidence and examples relevant to auditing purchases and other expenses.

1. Inspection

This is the examination of documents and records, both internal and external, in paper, electronic or other forms.

In the audit of purchases the auditor may inspect a sample of purchase invoices to ensure they agree to the amount posted to the general ledger.

2. Observation

This involves watching a procedure or process being performed. An auditor may observe the checking of goods received against purchase orders in the goods received department.

3. Inquiry

This involves seeking financial or non-financial information from client staff or external sources.

An auditor may discuss with management whether there have been any changes in the key suppliers used and compare this to the purchase ledger to assess completeness and accuracy of purchases.

4. Recalculation

This consist of checking the mathematical accuracy of documents or records and can be performed through the use of IT.

The auditor may recalculate accruals and prepayments to gain evidence that other expenses are not over or understated.

5. Re-performance

This is the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

The auditor may re-perform the payables ledger control account reconciliation to ensure it has been properly carried out.

6. Analytical procedures

This is evaluating and comparing financial and/or non-financial data for plausible relationships. Also include the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

The auditor could review expenses on a monthly basis to identify significant fluctuations and discuss them with management.

(b) Audit Risks and Responses

(i) Audit risk

Six planes have been ordered pre year-end and it appears as though they may be delivered close to the year end. On average they

are \$33.3m each and there is a risk the assets and/or related liabilities are recorded in the wrong period, understating or overstating non-current assets.

risk the assets and/or related liabilities are understating or overstating non-current assets.

Response to risk

Due to the monetary value of each air craft all aircraft should be inserted and matched to those included in SOLFS's accounting records. This will immediately highlight any planes recorded not received (i.e., those that don't exist at the year-end date). It could also help to identify an asset received but not recorded.

(ii) Audit risk

The company has spent \$150m on refurbishing aircrafts. In order to classify this expenditure correctly (as either capital or revenue) accounting knowledge and judgment is required. Management of SOLFS may have classified the expenditure incorrectly either overstating or understating profit in the income statement as a result.

Response to risk

Analysis of the refurbishment costs should be reviewed and traced to invoices. The invoice description and supporting documents should be reviewed to assess the nature of the expenditure. Once established as either capital or revenue it should be traced to the general ledger and the financial statements to ensure it has been classified correctly as an asset or repairs.

(iii) Audit risk

SOLFS Co. has capital commitments to fulfill having already ordered the planes, but has not yet secured funding because the bank loan of \$250m has not been approved. This could cause going concern problems if the funding is refused.

Response to risk

Inquiries should be made as to the status of the loan application and progress in securing the funding should be monitored. A detailed going concern review is required.

(iv) Audit risk

Some of SOLFS's customers (the travel agents) are struggling to pay the amounts they owe to the company. This could result in irrecoverable debt not being written off and doubtful debts not being provided for. As a result the receivable balance and profit in the financial statements may be overstated.

Response to risk

The detailed aged receivables analysis should be discussed with management and a value for a provision estimated for any potentially irrecoverable or doubtful debts. The review of amounts received by customers in respect of your end debts should be extended as far as possible.

(v) Audit risk

SOLFS Co. is making staff redundant as a result of the closure of their call Centre which occurred pre-year end. There is a risk a redundancy provision has not been sent up for staff not paid before the year end as required by IAS 37 “provision, contingent liabilities and contingent assets” Profits may be overstated and provisions understated.

Response to risk

The auditor need to establish the full redundancy cost through discussion with managements and should corroborate to supporting evidence where necessary. The calculated redundancy cost should be compared to the actual provision included in the financial statements to ensure it is reasonable.

(vi) Audit risk

SOLFS Co’s website has consistently encountered difficulties with recording sales. This could result in sales of income recorded in the financial statements being incomplete.

Response to risk

Controls testing over the sales cycle should be increased to assess the extent of any potential understatement of revenue. Detailed testing should be performed over the completeness of income.

(vii) Audit risk

Tickets have been sold twice and some cutovers will require refunds. There is a risk that the tickets to be refunded have not been removed from sales.

Response to risk

The out-off treatment of customer refunds should be reviewed around the year end to ensure that sales to be refunded are not included in the revenue figure in the financial statements.

QUESTION 3

A]

i. Due diligence assignment

Due diligence assignment is a “fact finding exercise” and is usually conducted to reduce the risk of poor investment decisions.

Assurance services are an evolving field, and due diligence is one of the more increasingly common forms of assurance engagements. Due diligence is an example of a **DIRECT REPORTING ENGAGEMENTS**.

ii. Three types of due diligence

Due diligence can be categorized into three areas:

1. Financial due diligence

Analyzing and validating the target’s revenue; maintainable earnings; future cash flows; and financial position including identification and valuation of contingent liabilities and key assets.

2. Operational due diligence

Investigation of the operational risks; cost base; assets base; capex requirements; quality of IT and other systems; key customers and suppliers; and performance gaps of the target company.

3. Commercial and market due diligence

A comprehensive review of the target’s business plan in the context of the industry and market condition; including compliance with relevant legal, taxation, and regulatory frameworks.

iii. **Five purposes of due diligence**

- The main purpose of due diligence is information gathering: gathering of financial, operational, commercial and market information to ensure the acquirer has full knowledge of the operations, financial performance and position, commercial and market position of the target company. The aim is to reveal any potential problems before a decision regarding the acquisition is made.

Other purpose of engaging an advisor to carry out a due diligence review are:

- ❖ Reduce management time spent assessing the acquisition decision: Due diligence reviews can be performed internally, by the management of an acquiring company. However, this can be time consuming and the directors may lack the knowledge and experience necessary to perform the review adequately. Engaging an external advisor to carry out the review allows management to focus on strategic matters and running the existing group as well as ensuring an impartial review;
- ❖ Evaluation of operational issues and risk assessment of the target company: for example, possible contractual disputes following a takeover; potential breaches to

covenant attached to any finance; the adequacy of the skills and experience of key management within the target company; operational issues such as high turnover; or issues with supplies/suppliers or the retention of key customers. The acquiring company may decide the issues and risks identified are so significant that they do not want to proceed with the acquisition; they may use the issues to negotiate a reduced price; or require the vendor to resolve the issue before the acquisition completes.

- ❖ Contingent liabilities, other liabilities and assets will need to be identified: It is particularly important that the potential acquirer identifies internally generated intangibles (i.e., these not included on the statement of financial position but vital to purchasing decisions, such as internal brands) and contingent liabilities that may crystallize in the future, and considers the likelihood of them crystallizing and the potential financial consequences. These will affect the price the acquirer wishes to pay for the target as well as the value of the goodwill acquired;
- ❖ Identification of possible post-acquisition synergies and economies of scale and potential further costs such as redundancy/restructuring.

❖ **Planning the acquisition**

The due diligence provider can advise on change management following the acquisition, including integrating the new company into the group, held with any restructuring as well as the more immediate issues of determining an appropriate price and reviewing the terms of the sale and purchase agreements.

- ❖ Enhance the credibility of the investments decision; Engaging an external advisor to carry out the due diligence will ensure an independent, objective view is obtained on the investments decision, including the price to be paid; and
- ❖ Substantiate claims made by the vendor: For example; future order levels and current finance agreements.

(b) 1. Three responsibilities of the auditor (ISA 570)

The auditor's responsibilities can be listed as follows:

- To consider the appropriateness of management's use of the going concern assumption;

- To consider whether there are adequate disclosures regarding the going concern basis in the financial statements;
 - To consider the entity's ability to continue for the foreseeable future.
- ii Ten indicators of going concern risk that the another should consider:
- Rapid increasing costs;
 - Shortages of supplies;
 - Adverse movement in exchange rates;
 - Business failures amongst customers or suppliers;
 - Loan repayments falling due in the near future;
 - High gearing;
 - Nearness to present borrowing limits;
 - Companies financed by loans from directors;
 - Loss of key staff;
 - Loss of key suppliers/customers;
 - Technical obsolescence of product range;
 - Impact of major litigation; and
 - Other fundamental uncertainties

QUESTION 4

(a) Points to make include:

- Audit must still be conducted in accordance with the operational standard.
- Audit needs additional skills.

- Auditor must adapt to change in nature of internal control in a computer environment.
 - Loss of audit trail
 - Timing problems. Must be present when files exist and programs to be tested are still being used.
 - General controls are more important especially those over setting up programs and system and maintaining integrity of programs and files.
- (b) i. Applications controls are those which are applied to specific applications, e.g. to invoice production or gross wages calculation. They are designed to ensure completeness, accuracy and validity of entries in the accounting records. They may be manual or programmed.
- ii. General controls are controls which are concerned with the environment in which data processing is carried on. The objectives are to ensure the integrity of application development and of programs and files and of computer operations.

(c) Many controls are possible, some are:

- Establishing controls totals of batches of incoming invoices for subsequent checking with the computer generated total. Several totals may be required including hash totals.
- Sequence checking of pre-numbered purchase orders. This could be a program controls.
- Automatic matching of files e.g. of orders with invoices or stock movements.

The purpose of these controls would be to ensure that all the batch was processed (for example, an invoice could not be omitted or a fraudulent invoice be put in by a computer operator).

(d) i. CAATs are audit techniques performed through the computer or using an independent computer. The two main kinds are:

- Audit software which can be used to search or examine the contents of a computer file and/or perform logical or mathematical operations on the data in the file.
- Test picks which are real or dummy transactions which the auditor inputs to an operations program to determine if the program performs as it is supposed to.

The benefits that can be derived are:

(a) Four obligations on the professional accountants

- To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and

- To act diligently in accordance with applicable technical and professional standards when providing professional services.
- A professional accountant should take steps to ensure that those working under the professional accountant's authority in a professional capacity have appropriate training and supervision.
- Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on timely basis.
- Where appropriate, a professional accountant should make client, employers or other users of the professional services aware of limitations inherent in the services to avoid the misinterpretation of an expression of opinion as an assertion of fact.

(b) i. Five factors of profit forecasts

- the general character and recent history of the company's business with particular reference to its main product, markets, customers, suppliers, labour force, and trend of results.
- The accounting policies normally adopted in preparing the company's annual accounts and the fact that these have been consistently applied in the preparation of the profit forecasts.
- The accountant must satisfy himself that the preparation of the forecasts is consistent with the economic, commercial, marketing and financial assumptions which the directors have stated to be the underlying basis.
- The company's general procedures in the preparation of forecasts, in particular, the accountant's wish to ascertain whether pre casts are regularly prepared for management purposed and if so, the degree of accuracy and reliability normally must be achieved; he will also wish to discover the extent to which the forecast results of expired periods are supported by reliable interim accounts, and how the forecast take account of any material exceptional items.
- Matters of general concern include the adequacy of provisions made for foreseeable losses and contingencies, and the adequacy of working capital as indicated by properly prepared cash flow forecast.

(ii) Five main matters to be stated in Accountant's Report

- Indicate in general terms the work carried out, ie, review of accounting losses and calculations on which profit forecasts are based;

- Ensure specific identification of the forecasts and the documents to which the report refers.
- If an audit of estimated results for expired periods has not been carried out, include a statement to that effect.
- Express an opinion as to whether forecasts are properly compiled on the basis of assumptions made by the Board, and the figures presented on basis consistent with normal practices.
- Qualify the report of appropriate (qualifications may be necessary on grounds of substantial restriction of time).

(c) Three appropriate actions of steps

- Obtain an appropriate understanding of the company, its operations and, in particular, its environmental issues.
- Evaluate whether there is any possible risk of misstatements in the financial statements as a result of environmental issues.
- Enquire from Management about any systems or controls which are in place to identify risk, evaluate control, and account for environmental matters.