

**MAY 2021 PROFESSIONAL EXAMINATIONS**  
**CORPORATE REPORTING (PAPER 3.1)**  
**QUESTIONS AND MARKING SCHEME**

**QUESTION ONE**

Blavo Ltd (Blavo), a government business entity has acquired two subsidiaries and an associate. The draft statement of financial position for each entity as at 31 May 2020 is as follows:

	<b>Blavo</b> <b>GH¢million</b>	<b>Scarlet</b> <b>GH¢million</b>	<b>Flint</b> <b>GH¢million</b>
<b><i>Non-current assets</i></b>			
Property, plant and equipment	265	230	161
Investments in subsidiaries:			
Scarlet Ltd	300		
Flint Ltd	128		
Investment in associate – Charity Ltd	20		
Financial assets through OCI	<u>51</u>	<u>6</u>	<u>5</u>
	<b><u>764</u></b>	<b><u>236</u></b>	<b><u>166</u></b>
<b><i>Current assets</i></b>			
Inventories	135	55	73
Trade receivables	91	45	32
Cash and cash equivalents	<u>102</u>	<u>100</u>	<u>8</u>
	<b><u>328</u></b>	<b><u>200</u></b>	<b><u>113</u></b>
<b>Total assets</b>	<b><u>1,092</u></b>	<b><u>436</u></b>	<b><u>279</u></b>
<b><i>Equity and liabilities</i></b>			
Stated capital	520	220	100
Retained earnings	240	150	80
Other components of equity	<u>12</u>	<u>4</u>	<u>7</u>
<b>Total equity</b>	<b><u>772</u></b>	<b><u>374</u></b>	<b><u>187</u></b>
<b><i>Non-current liabilities</i></b>			
Long-term borrowings	<u>145</u>	<u>24</u>	<u>8</u>
	<b><u>145</u></b>	<b><u>24</u></b>	<b><u>8</u></b>
<b><i>Current liabilities</i></b>			
Trade and other payables	115	30	60
Current tax payable	<u>60</u>	<u>8</u>	<u>24</u>
	<b><u>175</u></b>	<b><u>38</u></b>	<b><u>84</u></b>
<b>Total liabilities</b>	<b><u>320</u></b>	<b><u>62</u></b>	<b><u>92</u></b>
<b>Total equity and liabilities</b>	<b><u>1,092</u></b>	<b><u>436</u></b>	<b><u>279</u></b>

The following information is relevant to the preparation of the group financial statements:

- i) On 1 June 2019, Blavo acquired 80% of the equity interests of Scarlet Ltd (Scarlet), a private entity. The purchase consideration was cash of GH¢300 million. The fair value of

the identifiable net assets of Scarlet was GH¢400 million, including any related deferred tax liability arising on acquisition. The owners of Scarlet had to dispose of the entity for tax purposes by a specified date and, therefore, sold the entity to the first company to bid for it, which was Blavo. An independent valuer has stated that the fair value of the non-controlling interest in Scarlet was GH¢86 million on 1 June 2019. Blavo does not wish to measure the non-controlling interest in subsidiaries based on the proportionate interest in the identifiable net assets but hopes to use the 'full goodwill' method. The retained earnings of Scarlet were GH¢136 million, and other components of equity were GH¢4 million at the date of acquisition. There had been no new issue of capital by Scarlet since the date of acquisition and the excess of the fair value of the net assets is due to an increase in the value of non-depreciable land.

- ii) On 1 June 2018, Blavo acquired 6% of the ordinary shares of Flint Ltd (Flint). Blavo had treated this investment as a financial asset through OCI in the financial statements to 31 May 2019 but had restated the investment at cost on Flint becoming a subsidiary. On 1 June 2019, Blavo acquired a further 64% of the ordinary shares of Flint and gained control of the company. The consideration for the acquisitions was as follows:

	<b>Holding %</b>	<b>Consideration GH¢'million</b>
<b>1 June 2018</b>	6	10
<b>1 June 2019</b>	<u>64</u>	<u>118</u>
	<u>70</u>	<u>128</u>

Under the purchase agreement, on 1 June 2019, Blavo is required to pay the former shareholders 30% of the profits of Flint on 31 May 2021 for each of the financial years to 31 May 2020 and 31 May 2021. The fair value of this arrangement was estimated at GH¢12 million on 1 June 2019, and on 31 May 2020, this value had not changed. This amount has not been included in the financial statements.

On 1 June 2019, the fair value of the equity interest in Flint held by Blavo before the business combination was GH¢15 million. The fair value of the non-controlling interest in Flint was GH¢53 million.

The fair value of the identifiable net assets at 1 June 2019 of Flint was GH¢170 million, and the retained earnings and other components of equity were GH¢55 million and GH¢7 million, respectively. There had been no new issue of share capital by Flint since the date of acquisition, and the excess of the fair value of the net assets is due to an increase in the value of property, plant and equipment (PPE). The fair value of the PPE was provisional pending receipt of the final valuations for these assets. These valuations were received on 1 December 2019, and they resulted in a further increase of GH¢6 million in the fair value of the net assets at the date of acquisition. This increase does not affect the fair value of the non-controlling interest. PPE is depreciated on a straight-line basis over seven years. Ignore any tax implications.

- iii) Blavo acquired a 10% interest in Charity Ltd, a government business entity, on 1 June 2018 for GH¢8 million. The investment was accounted for as a financial asset through OCI, and on 31 May 2019, its value was GH¢9 million. On 1 June 2019, Blavo acquired an additional 15% interest in Charity for GH¢11 million and achieved significant influence. Charity made profits after dividends of GH¢6 million and GH¢10 million for the years to 31 May 2019 and 31 May 2020.

- iv) On 1 June 2018, Blavo purchased a foreign equity instrument of 11 million dinars at its fair value. The instrument was classified as a financial asset through OCI. The relevant exchange rates and fair values were as follows:

	<b>GH¢ to dinars</b>	<b>Fair value of instrument – dinars million</b>
<b>1 June 2018</b>	4.5	11
<b>31 May 2019</b>	5.1	10
<b>31 May 2020</b>	4.8	7

Blavo has not recorded any change in the value of the instrument since 31 May 2019. The reduction in fair value as at 31 May 2020 is deemed to be as a result of impairment.

- v) There is no impairment of goodwill arising on the acquisitions.

**Required:**

Prepare a consolidated statement of financial position as at 31 May, 2020 for the Blavo Group. **(20 marks)**

## QUESTION TWO

- a) Gyamfi Ltd (Gyamfi) is an international company with a presence in Ghana providing spare parts for the automotive industry. It operates in many different jurisdictions with different currencies. During 2020, Gyamfi experienced financial difficulties partly due to the COVID- 19 pandemic marked by a decline in revenue, a reorganisation and restructuring of the business and as a result reported a loss for the year. An impairment test of goodwill was performed, but no impairment was recognised. Gyamfi applied one discount rate for all cash flows for all cash-generating units (CGUs), regardless of the currency in which the cash flows would be generated. The discount rate used was the weighted average cost of capital (WACC), and Gyamfi used the 10-year government bond rate at its jurisdiction as the risk-free rate in this calculation.

Furthermore, Gyamfi built its model using a forecast denominated in the parent company's functional currency. Gyamfi felt that any other approach would require a level of detail that was unrealistic and impracticable. Gyamfi argued that the different CGUs represented different risk profiles in the short term. Still, there was no basis for claiming that their risk profiles were different over a longer business cycle.

Gyamfi has tested for the impairment of its non-current assets. It was decided that a building located overseas was impaired due to flooding in the area. The building was acquired on 1 April 2020 at 25 million dinars when the exchange rate was 2 dinars to the Ghana Cedi. The building is carried at cost. On 31 March 2021, the building's recoverable amount was deemed 17.5 million dinars. The exchange rate at 31 March 2021 was 2.5 dinars to the Ghana Cedi. Buildings are depreciated over 25 years. The tax base and carrying amounts

of the non-current assets before the impairment write-down were identical. The impairment of the non-current assets is not allowable for tax purposes. Gyamfi has not made any impairment or deferred tax adjustment for the above. Gyamfi expects to make profits for the foreseeable future and assume the tax rate is 25%. No other deferred tax effects must be taken into account other than on the above non-current assets.

**Required:**

- i) Evaluate the acceptability of the above accounting practices under *IAS 36: Impairment of Assets*. (6 marks)
  - ii) Recommend the accounting treatment of the above transaction to the directors of Gyamfi for the year ended 31 March 2021, including financial statements extracts in accordance with relevant International Financial Reporting Standards. (5 marks)
- b) Berko Ltd acquired all the equity shares in Jamila Ltd on 1 January 2018 for a consideration of GH¢1,250 million. The carrying amount and fair value of the identifiable net assets at acquisition were GH¢1,230 million. On 31 December 2020, Berko Ltd was in the process of selling its entire shareholding in Jamila Ltd, and so it was decided that Jamila Ltd should be treated as a disposal group held for sale in accordance with *IFRS 5: Non-current Assets Held for Sale and Discontinued Operations* at that date. The carrying amounts of Jamila Ltd's net assets before classification as held for sale at 31 December 2020 in the individual statement of financial position are as follows:

	GH¢'million
Property, plant and equipment	836
Intangibles (excluding goodwill)	428
Current assets (at recoverable amount)	584
Non-current liabilities	(322)
Current liabilities	(254)
	<b><u>1,272</u></b>

The group has a policy of revaluing its property, plant and equipment in accordance with *IAS 16: Property, Plant and Equipment*. There have been no revaluations or any other gains or losses included within Jamila Ltd's different components of equity since the date of acquisition as the carrying amount was deemed to be a close enough approximation to its fair value. However, on 31 December 2020, property with a carrying amount of GH¢330 million was considered to have a fair value of GH¢340 million. No adjustment has yet been made for this fair value. The total fair value less costs to sell off the disposal group at 31 December was estimated to be GH¢1,220 million. There have been no previous impairments to the goodwill of Jamila Ltd.

**Required:**

Recommend to the directors of Berko Ltd how the above transaction should be accounted for in the consolidated financial statements as at 31 December 2020 including financial statement extracts in accordance with relevant International Financial Reporting Standards. (9 marks)

(Total: 20 marks)

### QUESTION THREE

- a) Meagya Ltd is a government business entity in Ghana. Meagya Ltd operates a defined benefit scheme which at 31 December 2019 was in deficit by GH¢120 million. Details for the current year are as follows:

	GH¢'million
Current service cost	55
Cash contribution to the scheme	100
Benefits paid in the year	80
Net loss on curtailment	11
Gain on remeasurement of liability at 31 December 2020	9

The rate of interest applicable to corporate bonds was 5% at 31 December 2019. The cash contributions for the scheme have been correctly accounted for in the financial statements for the year ended 31 December 2020. This is the only adjustment that has been made in respect of the scheme.

**Required:**

Recommend the correct accounting treatment of the above transactions to the directors of Meagya Ltd in the financial statements for the year ended 31 December 2020, including financial statements extracts in accordance with *IAS 19: Employee Benefits*. (5 marks)

- b) GHBank Ltd is a government-controlled bank. GHBank Ltd was taken over by the government of Ghana during the recent financial sector clean up by the Bank of Ghana. GHBank Ltd does not directly trade with other government-controlled banks but has underwritten the development of the nationally owned postal service and the newly created railway ministry. The directors of GHBank Ltd are concerned about the volume and cost of disclosing its related party interests because they extend theoretically to all other government-controlled enterprises and banks. The directors require general advice on the nature and importance of the disclosure of related party relationships and specific advice on the disclosure of the above relationships in the financial statements.

**Required:**

Advise the directors of the company on how to deal with the above transaction in the financial statements in accordance with *IAS 24: Related Party Disclosures*. (5 marks)

- c) You are the Finance Director of a limited liability company. The company started trading with a handful of employees but now has a workforce of 200. You are aware that staff purchases of goods manufactured by the company are authorised by production managers, and then processed outside the accounting system. The proceeds from these sales are used to fund the company's annual christmas party, organised for Directors of the company.

**Required:**

Discuss the possible actions that you will take in order not to breach the fundamental principles of the *IFAC's Code of Ethics*. (10 marks)

(Total: 20 marks)

## QUESTION FOUR

- a) Kanzo Ltd (Kanzo) is a company located in the Savannah Region. The company was strategically located to produce cashew nuts and to take advantage of available tax incentives. However, the company has incurred trading losses for many years now. The Directors are considering the alternatives of liquidation and capital reduction. The company's Statement of Financial Position as at 31 December 2020 is as follows:

<b>Non-current assets</b>	<b>GH¢'million</b>
Property, plant and equipment	3,250
Patent	<u>350</u>
	<u>3,600</u>
<b>Current assets</b>	
Inventories	1,000
Accounts receivables	<u>500</u>
	<u>1,500</u>
<b>Total assets</b>	<b><u>5,100</u></b>
<b>Equity &amp; Liabilities</b>	
Ordinary share capital (@GH¢1)	2,000
Retained earnings	<u>(750)</u>
	<u>1,250</u>
20% Preference shares	<u>1,100</u>
<b>Non-Current liabilities</b>	
25% Debentures (unsecured)	<u>1,000</u>
<b>Current liabilities</b>	
Accounts payables	1,000
Bank overdraft (secured on property, plant & equipment)	<u>750</u>
	<u>1,750</u>
<b>Total Equity &amp; Liabilities</b>	<b><u>5,100</u></b>

**You are provided with the following additional information:**

- In the event of a forced sale, the assets would probably raise the following amounts.
 

	<b>GH¢'million</b>
Property, Plant and Equipment	1,500
Inventories	400
Accounts receivable	450
- The company is developing a new product, which is expected to generate profit before interest and tax of GH¢500 million per annum in anticipation of an immediate capital injection of GH¢2,000 million.
- The Ordinary share capital should be written down to 200 million shares of GH¢1.00 each. In addition, they have agreed to provide the immediate capital injection.
- The 20% preference shares are to be converted into 500 million ordinary shares valued at GH¢1 per share.
- It is proposed for GH¢650 million of the 25% Debentures to be converted into ordinary shares at GH¢1 per share and the remainder to be converted into GH¢350 million 20% Debentures.

- Accounts payables to accept immediate payment of 50% and a moratorium of six (6) months in payment of the remaining balance. New supplies would be paid for on delivery.
- A two-for-one rights issue will be made at a price of GH¢1 per share for cash after the above conversions.
- Property, plant and equipment are to be revalued at GH¢2,250 million, inventories at GH¢800 million and Accounts Receivables at GH¢450 million.
- The accumulated losses and intangible assets are to be written off.
- The corporate tax rate is 25%.
- Liquidation expenses will amount to GH¢10 million.

**Required:**

- Prepare a Statement of Financial Position after reconstruction on the assumption that the capital injection took place. **(6 marks)**
  - Compute the *expected profit after tax* and the *earnings per share* after the reconstruction. **(2 marks)**
  - Prepare a statement of distribution if the company were to be liquidated now. **(2 marks)**
  - Describe the steps the Directors of Kanzo Ltd should follow to appraise the proposed scheme of reconstruction with an emphasis on the interest of shareholders. **(5 marks)**
- b) Accra Ltd, a government business entity, acquires 40% of the voting rights of Tema Ltd. The remaining investors each hold 5% of the voting rights of Tema Ltd. A shareholder agreement grants Accra Ltd the right to appoint, remove and set the remuneration of management responsible for key business decisions of Tema Ltd. To change this agreement, a two-thirds majority vote of the shareholders is required.

**Required:**

In accordance with *IFRS 10: Consolidated Financial Statements*, discuss whether Accra Ltd controls Tema Ltd.

**(5 marks)**

**(Total: 20 marks)**

## QUESTION FIVE

Shop First Ltd operates supermarket chains across the sixteen (16) regions of Ghana. The firm has been in commercial operation for more than two decades, growing its operations through an effective supply chain and financial management. However, in the last few years, keen competition and worsening general economic performance have steadied the consistent growths experienced over the years, resulting in the entity disposing off part of its operations. Below are the financial statements of Shop First Ltd:

### Income statement for the year ended 31 December 2020 (with comparatives)

	2020			2019		
	Continuing operations	Discontinued operations	Total	Continuing operations	Discontinued operations	Total
	GH¢000	GH¢000	GH¢000	GH¢000	GH¢000	GH¢000
Revenue	37,400	5,650	43,050	31,350	7,440	38,790
Cost of sales	(32,190)	(4,830)	(37,020)	(26,030)	(6,390)	(32,420)
Gross profit	5,210	820	6,030	5,320	1,050	6,370
Distribution costs	(1,302)	(425)	(1,727)	(1,160)	(502)	(1,662)
Administrative expenses	(2,225)	(657)	(2,882)	(1,330)	(460)	(1,790)
Interest payable	(340)	(12)	(352)	(284)	(31)	(315)
Profit/(loss) before tax	1,343	(274)	1,069	2,546	57	2,603
Tax (expense) /credit	(826)	50	(776)	(1,210)	(45)	(1255)
<b>Profit for the period</b>	<b>517</b>	<b>(224)</b>	<b>293</b>	<b>1,336</b>	<b>12</b>	<b>1,348</b>

### Abridged statement of financial position as at 31 December 2020 (with comparatives)

	2020	2019
	GH¢000	GH¢000
Non-current assets	11,775	14,080
<b>Current assets:</b>		
Inventories	4,986	5,445
Other current assets	4,044	6,525
<b>Total assets</b>	<b>20,805</b>	<b>26,050</b>
Share capital & reserves	8,896	8,798
<b>Non-current liabilities:</b>		
Debenture loan	5,800	9,100
Current liabilities	6,109	8,152
<b>Total equity and liabilities</b>	<b>20,805</b>	<b>26,050</b>



**Additional information**

- i) At a class meeting of key shareholders and debentures held on 30 June 2020, a decision was taken to sell the entire operations of one of the firm's major retail shops as a response to teething operational difficulties that started in the early part of the current period. Operations, however, continued until 30 September 2020, when the sale transaction finally closed and proceeds received. Results from these operations for the current period are separately shown in the above income statement. Loss on sale of the operations amounting to GH¢217,000 has been included within administrative expenses.
- ii) On 31 December 2020, there was litigation and claim amounting to GH¢2.05 million against the company by a supplier whose contract was terminated as part of the closure process. Its legal counsel has advised the company that it has a good defence against the claim. Accordingly, no provision has been made in respect of the potential liability in these financial statements.
- iii) The following ratios have been computed based on the 2019 financial statements of Shop First Ltd

Gross profit margin	16.42%
Profit (before interest and tax) margin	6.71%
Return on equity	15.32%
Return on capital employed	16.30%
Inventory turnover	5.95
Current ratio	1.47
Assets turnover	2.17
Debt/debt+equity ratio	50.84%

**Required:**

Write a report to the Board of Directors analysing the financial performance and position of Shop First Ltd, drawing their attention to the effects (or potential effects) of the discontinued operations and the contingencies on overall performance. **(20 marks)**

## SOLUTION TO QUESTIONS

### QUESTION ONE

Blavo Group  
Consolidated Statement of Financial Position at 31 May 2020

	GH¢m
<b>Assets:</b>	
<i>Non-current assets:</i>	
Property, plant and equipment (265+230+161+40+14-2)W7	708
Goodwill W2	22
Investment in associate W3	22.5
Available for sale financial assets (51+6+5-17.4)	<u>44.6</u>
	797.1
<i>Current assets:</i>	
Inventories (135+55+73)	263
Trade receivables (91+45+32)	168
Cash and cash equivalents (102+100+8)	<u>210</u>
	641
<b>Total assets</b>	<b><u>1,438.1</u></b>
<b>Equity and liabilities</b>	
<i>Equity attributable to owners of parent</i>	
Share capital	520
Retained earnings W5	273.9
Other components of equity W5	<u>9.5</u>
	803.4
Non-controlling interest W7	<u>148.7</u>
	952.1
<i>Non-current liabilities</i>	
Long-term borrowings (145+24+8)	177
<b>Total non-current liabilities</b>	<b><u>177</u></b>
<i>Current liabilities</i>	
Trade and other payables (115+30+60+12)	217
Current tax payable (60+8+24)	<u>92</u>
Total current liabilities	309
Total liabilities	<u>486</u>
<b>Total equity and liabilities</b>	<b><u>1,438.1</u></b>

## WORKINGS

### 1. Group structure

	Scarlet	Flint	Charity
Blavo's interest	80%	70%	25%
NCI/Outside interest	20%	30%	75%
	100%	100%	100%
	1 year subsidiary	1 year subsidiary	1 year associate

#### Net Assets: Scarlet

	At Reporting	At Acquisition	Post-Acquisition
Stated capital	220	220	-
Retained earnings	150	136	14
Other components	4	4	-
Fair value adjustment - Land	40	40	-
	<b>414</b>	<b>400</b>	<b>14</b>
<b>Net Assets: Flint</b>			
	At Reporting	At Acquisition	Post-Acquisition
Stated capital	100	100	-
Retained earnings	80	55	25
Other components	7	7	-
Fair value adjustment - PPE	12	14 (8+4)	2
	<b>414</b>	<b>400</b>	<b>14</b>

### 2. Goodwill

#### Scarlet:

	GH¢m
Fair value of consideration for 80% interest	300
Fair value of non-controlling interest	86
	<u>386</u>
Amount of identifiable net assets acquired	<u>(400)</u>
Gain on bargain purchase	<u>(14)</u>

Essentially the entries would be:

Dr	Net identifiable assets	400	
Cr	Cash		300
Cr	Gain on bargain purchase		14
Cr	Equity - non-controlling interest		86

**Flint:**

	<b>GH¢m</b>
1 June 2020 (128 – 10)	118
Contingent consideration	12
Total consideration transferred	<u>130</u>
Fair value of equity interest held before business combination	15
Fair value of consideration	<u>145</u>
 Fair value of non-controlling interest	 <u>53</u>
	198
Identifiable net assets	(170)
Increase in value	(6)
Goodwill	<u>22</u>

**3. Investment in associate - Charity**

The gain of 1 recorded within other equity should now be deemed realised once the shareholding has been increased to 25%. An adjustment is required to reclassify this gain.

Dr	Other components of equity (9 – 8)	1
	Cr Profit or Loss (Retained Earnings)	1

The amount included in the consolidated statement of financial position would be:

	<b>GH¢m</b>
Cost (GH¢9 million + GH¢11 million)	20
Share of post-acquisition profits (GH¢10 million x 25%)	<u>2.5</u>
	<u>22.5</u>

**4. Financial asset through OCI**

Date	Exchange Rate	Value Dinars m	GH¢m	Change in fair value
1 June 2018	4.5	11	49.5	
31 May 2019	5.1	10	51	1.5
31 May 2020	4.8	7	33.6	(17.4)

The asset's fair value in the overseas currency has declined for successive periods. However, no impairment loss is recognised in the year ended 31 May 2019 as there is no loss in the reporting currency (GH¢). The gain of GH¢1.5 million would be recorded in equity. However, in the year to 31 May 2020 an impairment loss of GH¢17.4 million will be recorded as follows:

Dr Other components of equity	1.5	
Dr Profit or loss	15.9	
Cr Financial asset through OCI		17.4

## 5. Retained earnings

### Blavo:

Balance at 31 May 2020	240
Associate profits (25% x 10)	2.5
Financial asset impairment W4	(15.9)
Increase in fair value of Clarity now realized	1
Increase in fair value of equity interest – Flint (15 – 10)	5
Gain on bargain purchase	14
Post-acquisition reserves:	
Scarlet: (150 -136) x 80%	11.2
Flint: [(80-55) - 2] x 70%	<u>16.1</u>
	<b>273.9</b>

### Blavo: Other components of equity

	<b>GH¢m</b>
Balance at 31 May 2020	12
Investment in associate W3	(1)
Financial asset Impairment loss W4	<u>(1.5)</u>
	<b><u>9.5</u></b>

## 6. Non-controlling interest

	<b>GH¢m</b>
Scarlet	86
Post-acquisition reserves (20% x 14)	<u>2.8</u>
	88.8
Flint	53
Post-acquisition reserves [(80-55)-2] x 30%	<u>6.9</u>
<b>Total</b>	<b><u>148.7</u></b>

## 7. Property, plant and equipment

	<b>GH¢m</b>
Blavo	265
Scarlet	230
Flint	<u>161</u>
	656
Increase in value of land – Scarlet (400 – 220 – 136 – 4)	40
Increase in value of PPE – Flint (176 – 100 – 55 – 7)	14
Less: increased depreciation (14 ÷ 7)	<u>(2)</u>
	<b>708</b>

(100 ticks for maximum of 100 correct entries x 0.2 = 20 marks)

## QUESTION TWO

a)

i)

- The discount rate used by Gyamfi Ltd has not been calculated in accordance with the requirements of IAS 36 *Impairment of Assets*. According to IAS 36, the future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. IAS 36 requires the present value to be translated using the spot exchange rate at the date of the value in use calculation.
- Furthermore, the currency in which the estimated cash flows are denominated affects many of the inputs to the WACC calculation, including the risk-free interest rate.

Gyamfi Ltd has used the 10-year government bond rate for its jurisdiction as the risk-free rate in the calculation of the discount rate. As government bond rates differ between countries due to different expectations about future inflation, value in use could be calculated incorrectly due to the disparity between the expected inflation reflected in the estimated cash flows and the risk-free rate.

- According to IAS 36, the discount rate should reflect the risks specific to the asset. Accordingly, one discount rate for all the CGUs does not represent the risk profile of each CGU. The discount rate generally should be determined using the WACC of the CGU or of the company of which the CGU is currently part. Using a company's WACC for all CGUs is appropriate only if the specific risks associated with the specific CGUs do not diverge materially from the remainder of the group. In the case of Gyamfi Ltd, this is not apparent.

**(Three points well explained @ 2 marks each = 6 marks)**

ii) A number of IASs are required to answer this question, which include the knowledge of *IAS 16, IAS 36, IAS 12 and IAS 21*

- Carrying amount of building at 31 March 2021 GH¢ (25 - 1 depreciation) million, i.e. 24 million dinars/2 = GH¢12 million. **(0.5 mark)**
- Recoverable amount of building at 31 March 2021 (17.5 million dinars/2.5) = GH¢7 million. **(0.5 mark)**
- Impairment loss to profit or loss = GH¢5 million (GH¢12 million - GH¢7 million) **(0.5 mark)**
- The tax base and carrying amount of the non-current assets are the same before the impairment charge. After the impairment charge, there will be a difference of GH¢ 5 million. This will create a deferred tax asset of GH¢5 million × 25%, = GH¢1.25 million.

As Gyamfi Ltd expects to make profits for the foreseeable future, this can be recognised in the financial statements. **(1.5 marks)**

*Statement of profit or loss for the year ended 31/3/2021 extract*

	GH¢ million
Impairment of building	(5)
Depreciation of building (25 dinnars/25 yrs = 1dinnar/2	(0.5)
	<b>(1 mark)</b>

*Statement of financial position extracts as at 31/3/2021*

Non-current assets:	
Deferred tax assets	1.25
Building (12 – 5)	7
	<b>(1 mark)</b>

**b) Jamila Ltd**

- Goodwill in Jamila Ltd would originally be calculated as GH¢20 million (GH¢1,250 million – GH¢1,230 million). The net assets in Jamila Ltd are now GH¢1,292 million at 31st December 2020 (GH¢1,272 million per question and GH¢20 million goodwill).
- Since the group has a revaluation policy under IAS 16 *Property, Plant and Equipment*, the group must revalue the property plant and equipment of Jamila Ltd to fair value of GH¢340 million on classification as held for sale. A gain of GH¢10 million (GH¢340 million – GH¢330 million) would be recorded within other components of equity.
- The net assets of Jamila Ltd would now have a carrying amount of GH¢1,302 million including GH¢846 million for property, plant and equipment. On classification as held for sale, Jamila Ltd must be measured at the lower of carrying amount and fair value less costs to sell. An impairment arises of GH¢82 million (GH¢1,302 million – GH¢1,220 million).
- This will first be allocated to the goodwill of GH¢20 million. The remaining impairment of GH¢62 million is allocated to non-current assets to which the measurement requirements of IFRS5 *Non-current Assets Held for Sale and Discontinued Operations* apply. No impairment will therefore be allocated to the current assets of Jamila Ltd.

**Calculations**

*The remaining impairment loss of GH¢62 million should be allocated to property, plant and equipment and other intangible assets in proportion to their respective carrying amounts as follows:*

*Property, plant and equipment  $\text{GH¢}62 \text{ million} \times (\text{GH¢}846\text{m} / (\text{GH¢}846 \text{ million} + \text{GH¢}428 \text{ million})) = \text{GH¢}41 \text{ million}$*   
*Other intangible assets  $\text{GH¢} 62 \text{ million} \times (\text{GH¢}428 \text{ million} / (\text{GH¢}846 \text{ million} + \text{GH¢}428 \text{ million})) = \text{GH¢}21 \text{ million}.$*

**Alternatively**

The table below summarises the allocation of the impairment:

	Carrying amount Allocated Carrying amount before reclassified impairment after allocation of as held for sale	Allocated impairment	Carrying amount after allocation of impairment loss
	GH¢ million	GH¢ million	GH¢ million
Goodwill	20	(20)	Nil
Property, plant and equipment	846	(41)	805
Other intangible assets	428	(21)	407
Current assets	584	nil	584
Non-current liabilities	(322)	nil	(322)
Current liabilities	<u>(254)</u>	<u>nil</u>	<u>(254)</u>
<b>Total</b>	<b><u>1,302</u></b>	<b><u>(82)</u></b>	<b><u>1,220</u></b>

The assets and the liabilities of the disposal group should be separately presented within the current assets and current liabilities of the consolidated financial statements. GH¢1,796 million (GH¢805 million + GH¢407 million + GH¢584 million) or (GH¢836 + GH¢10 + GH¢428 – GH¢62 + GH¢584) will be included within current assets and GH¢576 million (GH¢322 million + GH¢254 million) within current liabilities.

**(5 marks evenly spread using ticks)**

**Statement of financial position as at (extract)**

GH¢ million

Current assets:

Current assets -held for sale (805+407+584) 1,796

Equity and Liability

OCI – revaluation gain (340 – 330) 10

Current Liabilities:

Current liabilities – held for sale (322 + 254) 576

**(3 marks)**

**Statement of profit or loss for the year ended 31/12/2020**

GH¢ million

Share impairment (82)

**(1 mark)**

**(Total: 20 marks)**



### QUESTION THREE

#### a) Pension scheme

The defined benefit scheme for the year should have been recorded as follows:

	<b>GH¢ million</b>
Net obligation at 31 December 2019	120
Cash contribution into the scheme	(100)
Net finance cost for the year (GH¢120 million × 5%)	6
Current service cost	55
Loss on curtailment	11
Gain on remeasurement	<u>(9)</u>
Net liability at 31 December 2020	<u>83</u>

The benefits paid do not affect the net liability for the year. Since only the cash contributions have been recorded for the year, the net obligation should be increased by GH¢63 million (GH¢83 million – GH¢20 million). GH¢72 million should be expensed to profit or loss (W12) being the service cost component (current and curtailment) plus the interest charge. GH¢9 million should be credited to other components of equity being the gain on remeasurement.

#### Statement of profit or loss extract for the year ended (Extract)

	<b>GH¢ million</b>
Defined benefit scheme (GH¢55 + GH¢6 + GH¢11)	(72)

#### Statement of financial position extract

	<b>GH¢ million</b>
Equity and liability:	
OCI – remeasurment component	9
Non-current liabilities:	
Increased in defined benefit obligation	63

**3 marks for financial statement extracts**  
**2 marks for reconciliation and movements**

- b) Under IAS 24: *Related Party Disclosures*, disclosures are required in respect of an entity's transactions with related parties. Related parties include parents, subsidiaries, members of key management personnel of the entity or of a parent of the entity and post-employment benefit plans. Where there have been related party transactions during the period, management discloses the nature of the relationship, as well as information about the transactions and outstanding balances, including commitments, necessary for users to understand the potential

impact of the relationship on the financial statements. Disclosure is made by category of related party and by major type of transaction. Management only discloses that related party transactions were made on terms equivalent to those which prevail in arm's length transactions if such terms can be substantiated.

Government-related entities are defined as entities which are controlled, jointly controlled or significantly influenced by the government. The financial crisis in the financial services sector in Ghana widened the range of entities subject to the related party disclosure requirements. This is not only peculiar in Ghana but many countries. The financial support provided by government to financial institutions in many countries meant that the government controls significantly influenced some of those entities.

A government-controlled bank would, in principle, be required to disclose details of its transactions, deposits and commitments with all other government-controlled banks and with the Bank of Ghana or central bank. However, IAS 24 has an exemption from all of the disclosure requirements of IAS 24 for transactions between government-related entities and the government, and all other government-related entities.

GHBank Limited is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, in relation to the following:

- (a) a government which has control, joint control or significant influence over the reporting entity; and
- (b) another entity which is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

Those disclosures are replaced with a requirement to disclose:

- The name of the government and the nature of their relationship; and
- The nature and amount of any individually significant transactions; and
- The extent of any collectively significant transactions qualitatively or quantitatively.

**(1 mark per valid point up to a maximum of 5 marks)**

**c) Integrity**

You need to be honest and straightforward in exercising your integrity. Omitting income from staff sales will result in the financial statements being misleading. Again, this practice is dishonest, and what should be done is to formalise the current system employed for staff sales and funding of Christmas party.

**Objectivity**

The reputation of your company may be vulnerable, and you should discuss this ethical dilemma with your production managers and subsequently directors.

**Professional competence and due care**

You must ensure that the financial information that you produce for the company is in accordance with technical and professional standards.

**Professional behaviour**

You need to act professionally in such a way to protect your reputation as a Finance Director, and the accounting profession in general. In so doing, you need to consider relevant accounting standards and any applicable laws and regulations. You need to also determine the system currently employed for controlling and controlling staff sales and funding the directors' Christmas party.

**Conflict of interest**

There appears to be conflict of interest. You must be objective in reporting fully on staff purchases of company goods.

**Possible causes of action**

- After bringing the issue to the attention of your partners and obtained the relevant details of the client's system for accounting for staff sales, you should raise your concerns with the directors of the client company.
- You will also have to determine whether the financial statements of previous years are likely to be misleading and, if so, consider your responsibility (or that of your client) to inform the relevant authorities (including the tax authority).
- You should strongly advise the directors that a staff sales policy should be introduced to ensure that these sales are fully recorded in the company's accounting system in the future.
- You should explain to the directors the implications of their actions, and that you are safeguarding the interests of the company and its staff in advising how the situation may be rectified.
- If the directors are co-operative, you should advise them of the recommended changes to the accounting system and how they might disclose the past undisclosed income to the tax authority.
- If the directors appear unwilling to change the system in respect of staff sales, you are obliged to disassociate yourself from any involvement with the company's financial statements, and this will require you to resign as the company's finance director.
- At any time, you may seek advice from your professional body.
- In view of this, you are obliged to consider your whistleblowing obligations, and may have to report the matter to one or more authorities. This will be in the public interest and does not amount to breach of confidentiality.
- As a last resort, you should document, in detail, the steps that you take in resolving your dilemma, in case your ethical judgement is challenged in the future.

**(Any 5 causes of action to be taken @ 2 marks each = 10 marks)**

**(Total: 20 marks)**

**a)**

i)

## Statement of Financial Position as at 31st December 2020

## EQUITY & LIABILITIES

## EQUITY

## Non-Current Liabilities

10% Debenture	350
---------------	-----

## Current Liabilities

Accounts Payables	<u>500</u>
<b>Total Equity &amp; Liabilities</b>	<b>10,950</b>

**(6 marks)**

### ii) Expected Profit after Tax and EPS

	<b>GH¢'million</b>
Expected Profit before Interest and tax	500
Debenture Interest [20% x 350,000]	<u>(70)</u>
Profit before Tax	430
Tax (25% x 430)	<u>(107.50)</u>
Profit attributable to ordinary shareholder	322.50

Number of shares issued after reconstruction = 6,700 million shares [2 x (200+150+650)]

$$\text{Earnings Per Share} = \text{GH}\frac{322.50\text{m}}{10,050} = \text{GH}\text{c } 0.032$$

**(2 marks)**

### iii) Statement of Distribution on Liquidation

	GH¢'million	GH¢'million
Total Proceeds on liquidation		
Property, plant & equipment		1,500
Inventories		400
Accounts receivable		<u>450</u>
		2,350
Distribution		
Liquidation Expenses	10	
Secured Creditors – Bank Overdraft	<u>750</u>	<u>(760)</u>
Unsecured Creditors		
25% Debenture holders	795	
Accounts payable	795	<u>(2,350)</u>
		<u>nil</u>

Since the unsecured creditors, who are the 25% Debenture holders and the accounts payables amount to GH¢2,000 million they would receive GH¢0.795 per GH¢1. [1,590 million/2,000 million]

Capital Reduction Account				
	GH¢'million			GH¢'million
Property, plant & equipment	1,000	Ordinary shares		1,800
Inventories	200	Preference shares		600
Prov. - Bad Debts	50			
Retained earnings	750			
Capital reserve	50			
Patent	350			
	<u>2,400</u>			<u>2,400</u>

Ordinary Share Account				
	GH¢'million			GH¢'million
Capital reduction	1,800	Balance b/d		2,000
Balance c/d	10,050	Bank – immediate cash		2,000
		Bank – rights issue		6,700
		Debenture holders		650
		Preference Shares		<u>500</u>
	<u>11,850</u>			<u>11,850</u>

Preference Share Account				
	GH¢'million			GH¢'million
Ordinary Share	500	Balance b/d		1,100
Capital reduction	600			
	<u>1,100</u>			<u>1,100</u>

<b>Bank Account</b>			
	GH¢'million		GH¢'million
Ordinary Share – immediate cash	2,000	Balance b/d	750
Ordinary Share – rights issue	6,700	Accounts payable	500
		Balance c/d	7,450
	<u>8,700</u>		<u>8,700</u>

Total earnings for existing shareholders would be  $[0.032 \times 4,400 \text{ million shares}]$  amounting to GH¢140.8 million per annum. This might seem a worthwhile return, therefore they should accept the reconstruction.

(2 marks)

iv) **Steps to follow to appraise a scheme**

- A scheme of capital reduction will affect the rights of the various parties who have a financial stake in the business including shareholders.
- The starting point is to construct a working showing how much cash could be raised in the event of liquidation and to whom that cash would be paid. This would provide an indication as to how much shareholders are to gain or lose.
- The scheme is designed to take this information into consideration. The party with the most to gain from the scheme (usually the shareholders) would have to demonstrate their commitment to the scheme by carrying the larger share of its cost.
- The scheme must meet the following criteria:
  - ✓ The scheme must ensure that there is equitable share in allocating losses
  - ✓ The scheme must return to the entity to profitability
  - ✓ The losses to be incurred under liquidation must exceed the losses to be incurred under the capital reduction scheme
  - ✓ The existing control structure must be maintained
  - ✓ Present debt or liabilities should be settled under the capital reduction scheme
  - ✓ The scheme must provide adequate working capital.

(Any 4 points @ 1.25 = 5 marks)

b) **Composition of control according to IFRS 10.**

• **Power over the investee to direct relevant activities**

The absolute size of Accra Ltd' shareholding in Tema Ltd (40%) and the relative size of the other shareholdings alone are not conclusive in determining whether Accra Ltd has rights sufficient to give it power. However, the shareholder agreement which grants Accra Ltd the right to appoint, remove and set the remuneration of management responsible for the key business decisions of Tema Ltd gives Accra Ltd power to direct the relevant activities of Tema Ltd. This is supported by the fact that a two-thirds majority is required to change the shareholder agreement and, as Accra Ltd owns more than one-third of the voting

rights, the other shareholders will be unable to change the agreement whilst Accra Ltd owns 40%.

- **Exposure or rights to variable returns of the investee**

As Accra Ltd owns a 40% shareholding in Tema Ltd, it will be entitled to receive a dividend. The amount of this dividend will vary according to Tema Ltd's performance and Tema Ltd's dividend policy. Therefore, Accra Ltd has exposure to the variable returns of Tema Ltd.

- **Ability to use power over the investee**

The fact that Accra Ltd might not exercise the right to appoint, remove and set the remuneration of Tema Ltd's management should not be considered when determining whether Accra Ltd has power over Tema Ltd. It is just the ability to use the power which is required and this ability comes from the shareholder agreement.

- **Conclusion**

The IFRS 10 definition of control has been met. Accra Ltd controls Tema Ltd and therefore Accra Ltd should consolidate Tema Ltd as a subsidiary in its group financial statements.

(Any 2 points at 2.5 marks each = 5 marks)

(Total: 20 marks)

## QUESTION FIVE

### Report

To: Board of Directors of Shop First Plc  
From: Accountant  
Date: 10 January, 2021  
Subject: Analysis of the financial performance and position of Shop First Plc

Following the discussion we had on the above subject matter, this report is submitted for your perusal. The report looks at profitability, working capital management and gearing of the company for the year ended 31 December 2020, as against its comparative period. This report should be read with the attached appendix.

#### **Profitability**

There has been a fractional improvement in revenue in 2020 over 2019. This steady rise in revenue resulted largely due to discontinuation of the retail shop. The sold shop contributed 13.12% of the total revenue generated in 2020 against 19.18% in 2019. The company could however not keep its operational costs in line with the revenue changes as all the profitability measures have dropped in 2020. Management did poorly in controlling both direct trading costs and overheads as gross profit margin as well as net profit margin has fallen. A separate analysis carried out on margins between continuing and discontinued operations reveals that while the stopped operations may have significantly contributed to the poor operating margins especially because of the disposal loss recorded this part of the entity operated on better gross margins than the rest of the company. Hence, the company is likely not become any better after the sale of the operations if cost controls are not significantly tightened for the remaining operations.

The low margins have had hugely negative impact on returns made for providers of capital in 2020. Both ROCE and return on equity have slipped considerably even though the company has seen some noticeable improvements in net asset and inventory turnovers. Asset turnover shows that the firm turned its resources roughly three times into sales this year as against little over two times in 2019. Thus, the decline in profitability can be clearly attributed to high operating cost levels.

#### **Working capital management**

Overall, working capital has been effectively managed by Shop First Plc. With current ratio of 1.48 in 2020, Shop First Plc's current assets provide a good cover for its short-term obligations. And this ratio is slightly up from 1.47 it had back in 2019. Current ratio measures how well a firm is positioned to apply current assets to pay off current liabilities when they mature. The current ratio of 1.48 implies that the company maintains GH¢1.48 of current assets to pay every GH¢1 of current debt owed. As a cushion, Shop First achieves a good inventory turnover rate and records a clear improvement over last year. This should reduce any fear of liquidity concerns. On inventory turnover of 7.42 (as against 5.95 in 2019), the



company is able to empty its warehouse 7.5 times on average within 2020, as against approximately 6 times back in 2019. The strong liquidity situation is further helped by Shop First Plc being a retail firm which makes it more likely that it would convert resources into liquid assets at an accelerated rate. However, were the contingent liability to crystallize any time soon, it would have a damaging effect on liquidity by bringing it down below 2019's level.

### Gearing

This measures the extent to which the firm finances its operations with funds provided by external parties. Under this section, investors and lenders determine how much risk the firm exposes them to. The proportion of debts in the total long-term capital has seen a decline, as shown by its capital gearing ratio. While little more than half of the total resources in 2019 was provided by lenders, around six percent of total funds came from within for 2020. The reduction in debt used implies that the firm is facing lower financial risk now, and the company is looking healthy. But if profitability concerns are not overturned sooner than later, keeping even minimal level of gearing may be unsustainable.

### Conclusion

The analysis above has revealed that Shop First Plc' profitability has worsened and operational costs seem out of control. However, liquidity, efficiency and gearing levels do not raise any concerns. Management are therefore entreated to institute investigation into unearthing how best it can put costs under check and consolidate its strong position.

I am available to provide any further clarification, if so needed. Thank you

(Signed)  
Accountant

### Appendix

Ratios	Formula	2020	2019 (given)
Gross profit margin	$\frac{\text{Gross profit}}{\text{Sales}} \times 100$	$\frac{6,030}{43,050} \times 100$ = 14.01%	16.42%
Profit (before interest and tax) margin	$\frac{\text{PBIT}}{\text{Sales}} \times 100$	$\frac{(1,069+352)}{43,050} \times 100$ = 3.30%	7.52%
Return on yearend equity	$\frac{\text{PAT} - \text{pref. div}}{\text{Equity}} \times 100$	$\frac{293}{8,896} \times 100$ = 3.29%	15.32%

Return (before interest and tax) on yearend capital employed	$\frac{\text{PBIT}}{\text{Capital employed}} \times 100$	$\frac{(1,069+352)}{(8,896+5,800)} \times 100$ =9.67%	16.30%
Inventory turnover	$\frac{\text{Cost of sales}}{\text{Inventory}}$	$\frac{37,020}{4,986}$ = <u>7.42</u>	5.95
Current ratio	$\frac{\text{Current asset}}{\text{Current liabilities}}$	$\frac{(4,986+4,044)}{6,109}$ =1.48	<u>1.47</u>
Assets turnover	$\frac{\text{Sales}}{\text{Capital employed}}$	$\frac{43,050}{14,696}$ =2.93	2.17
Debt/ debt + equity	$\frac{\text{Long-term loan}}{\text{Long-term loan} + \text{Equity}} \times 100$	$\frac{5,800}{(5,800+8,896)} \times 100$ = 39.47%	50.84%

#### Separate analyses

Ratios	2020		2019	
	Continuing operations	Discontinued operations	Continuing operations	Discontinued operations
Revenue share	$\frac{37,400}{43,050} \times 100$ = 86.88%	$\frac{5,650}{43,050} \times 100$ =13.12%	$\frac{31,350}{38,790} \times 100$ = 80.82%	$\frac{7,440}{38,790} \times 100$ =19.18%
Gross profit margin	$\frac{5,210}{37,400} \times 100$ = 13.93%	$\frac{820}{5,650} \times 100$ =14.51%	$\frac{5,320}{31,350} \times 100$ = 16.97%	$\frac{1,050}{7,440} \times 100$ =14.11%
Profit/(loss) before tax margin	$\frac{1,343}{37,400} \times 100$ = 3.59%	$\frac{(274)}{5,650} \times 100$ =(4.85%)	$\frac{2,546}{31,350} \times 100$ = 8.12%	$\frac{57}{7,440} \times 100$ =0.77%

*Computation of 2020 ratios; 10 x 1 mark = 10 marks*

*Report on the analysis = 6 marks*

*Comment on the effects of the discontinued operations = 4 marks*

**(Total: 20 marks)**