THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

NOVEMBER 2007 EXAMINATIONS
(PROFESSIONAL)

PART 3

CORPORATE REPORTING STRATEGY
(Paper 3.1)

Attempt ALL Questions

TIME ALLOWED: 3 HOURS

QUESTION 1

CH Bank Ltd and RT Bank Ltd were licensed as Merchant Banks and have been in existence since 1968. The shareholders of RT Bank are in discussion with CH Bank, the first to be listed on the Ghana Stock Exchange, for a possible merger following the inability of RT to raise its stated capital to the minimum prescribed by the Bank of Ghana.

The Balance Sheets of the Banks as at 31st December, 2006 are presented below:

	CH BANK LTD	RT BANK LTD
ASSETS	¢'m	¢'m
Cash and Balances with Bank of Ghana	150,148	120,238
Government Securities	291,847	176,222
Due from other Banks and Financial Institutions	116,000	124,980
Loans and Advances to Customers	524,612	348,700
Other Assets	115,794	89,590
Property, Plant and Equipment	28,500	15,600
TOTAL ASSETS	1,226,901	875,330
LIABILITIES		
	932,786	717,279
Customer Deposits	49,400	32,440
Due to Banks and other Financial Institutions	76,206	38,423
Borrowings	61,309	41,438
Other Liabilities	1,119,701	829,580
TOTAL LIABILITIES		
SHAREHOLDERS' FUNDS		
Stated Capital	86,200	30,000
Income Surplus	8,500	6,350
Capital surplus	-	2,500
Statutory Reserve Fund	12,500	6,900
TOTAL SHAREHOLDERS' FUND	107,200	45,750
TOTAL LIABILITIES AND SHAREHOLDERS' FUND	1,226,901	875,330

The Profit and Loss Account of RT Ltd for the year ended 31st December, 2006 is shown below:

	¢'m
Total Income	32,400
Operating Expenses	(16,144)
Charge for bad & doubtful debts	(4,500)
Profit before tax	11,756
Taxation	(2,351)
Profit after tax	9,405
Transfer to Statutory Reserve	(4,703)
	4,702

The Directors of the two Banks after several discussions agreed on goodwill of ¢6,000 million for RT Bank Ltd and have commissioned Brains Consult to carry out an independent valuation of the shares of RT Bank. A review of the books and records of RT Bank revealed the following:

(i) In September 2006, an on-site examination conducted by Bank of Ghana revealed that RT had underprovided for bad and doubtful debts to the tune of ¢5,600 million. In line with the banking Act 2004, (Act 673), Bank of Ghana imposed a penalty of ¢1,200 million on RT Bank. These have not been provided for in the accounts of RT Bank Ltd.

(ii) Other assets of RT Bank Ltd include investment of ¢2,300 million in SAM Limited, a wholly owned subsidiary of RT Bank Ltd. This investment is now considered worthless.

(iii) An amount of ¢1,400 million representing cheques sent to Palam Rural Bank Ltd. for collection in 2004 is included in balances due from other Banks. Recent correspondence from Palam Rural Bank Ltd indicates that those cheques were never received.

(iv) The Bank of Ghana debited the clearing account of RT Bank Ltd with a cheque amounting to ¢1,800 million drawn in favour of RT Bank Ltd in 2003. This amount was written off to Profit and Loss Account in 2004 by RT Bank Ltd. The Bank of Ghana subsequently corrected the error in June 2006 but is not reflected in the books of RT Bank Ltd.

(v) The investment in government securities was understated by ¢853 million resulting from discount earned on the bills for 2006.

(vi) Property, plant and equipment of RT Ltd were revalued in 2005 by an independent valuer. The assets are depreciated at 15% per annum. The directors of both Banks estimate that the market price of the fixed assets has increased by approximately 10% of their current carrying value and that the net realizable value of the assets is ¢19,000 million.

(vii) Information obtained from the Ghana Stock Exchange bulletin indicates that market price per share of CH Bank Ltd is ¢1,500 with earnings per share of ¢100. CH Bank Ltd is registered with 150,000,000 ordinary shares of no par value out of which 90,000,000 have been issued and fully paid for.

(viii) The stated capital of RT Bank Ltd is made up of 50,000,000 ordinary shares of no par value.

(ix) The corporate tax rate of RT Bank Ltd for 2006 was 20%.

Required:

a) Determine the price per share of RT Bank Ltd using

   (i) Net assets basis (going concern) ***(7 marks)***
   (ii) Earnings yield basis (***7 marks)***

b) Prepare the Balance Sheet of CH Ltd assuming net assets basis of valuation was adopted and the purchase consideration was fully settled by issuing ordinary shares to owners of RT Bank Ltd. (***6 marks)***

(Total: 20 marks)

QUESTION 2

The profit and loss and income surplus accounts of Ogyam Ltd, Asuo Ltd, and Masa Ltd for the year ended 30th June, 2006 and their balance sheets as at that date are as follows:

Profit and Loss Account for the Year Ended 30th June, 2006

	Ogyam Ltd	Asuo Ltd	Masa Ltd
	¢'m	¢'m	¢'m
Sales	24,120	8,700	5,123
Cost of sales	(18,090)	(5,048)	(3,153)
Gross profit	6,030	3,652	1,970
Selling, general and administrative expenses	(3,498)	(2,034)	(953)
Other income	227	-	-
Profit before tax	2,759	1,618	1,017
Taxation	(905)	(574)	(351)
Net profit for the year transferred to income surplus account	1,854	1,044	666

Income surplus accounts for the year ended 30th June, 2006

	Ogyam Ltd	Asuo Ltd	Masa Ltd
	¢'m	¢'m	¢'m
Balance brought forward	936	846	774
Net profit for the year transferred from profit and loss account	1,854	1,044	666
Dividend paid	(900)	(360)	(360)
Balance carried forward	1,890	1,530	1,080

Balance sheets as at 30th June, 2006

	Ogyam Ltd	Asuo Ltd	Masa Ltd
	¢'m	¢'m	¢'m
Property, plant and equipment (net book value)	4,140	2,160	1,188
Investments	1,440	-	-
	5,580	2,160	1,188
Current assets:			
Stocks	2,232	1,854	1,098
Debtors	2,466	990	1,782
Cash and bank balances	378	108	324
	5,076	2,952	3,204
Current liabilities:			
Creditors	1,206	522	612
Sundry creditors	2,160	1,260	900
	3,366	1,782	1,512
Net current assets	1,710	1,170	1,692
	7,290	3,330	2,880
State capital	5,400	1,800	1,800
Income surplus	1,890	1,530	1,080
	7,290	3,330	2,880

Additional information:

(i) The stated capital of the three companies comprised ordinary shares only.

(ii) Ogyam Limited purchased 80% of the shares of Asuo Limited several years ago for ¢920 million when the balance on the income surplus account of Asuo Limited was ¢800 million deficit. On 30th September, 2000 Ogyam Limited purchased 30% of the shares of Masa Limited for ¢520 million. The balance on the income surplus account of Masa Limited on that date was ¢82 million.

(iii) On 4th June, 2006 Ogyam Limited sold goods worth ¢100 million to Asuo Limited at a margin of 20%. All the stock was sold out by Asuo Limited before the end of the month. A cheque issued by Asuo Limited for ¢40 million in settlement of the final instalment on 25th June, 2006 did not reach Ogyam Limited until 3rd July, 2006.

(iv) All the three companies paid the interim dividends in January 2006.

(v) The group adopts a policy of immediate write off of goodwill arising on consolidation.

(vi) On 31st March, 2006 Ogyam Limited sold 25% of its holding of the equity shares of Asuo Limited for ¢750 million. This transaction has not been reflected in the accounts of the Ogyam Limited. Assume capital gain tax of 10% on the gain arising on the disposal of the shares in the subsidiary.

(vii) Profits accrue evenly over the year.

Required:

Prepare for Ogyam Limited Group

(a) Consolidated profit and loss account for the year ended 30th June, 2006;

(b) Consolidated income surplus account for the year ended 30th June, 2006; and

(c) Consolidated balance sheet as at 30th June, 2006.

(20 marks)

QUESTION 3

Akutu Limited has been operating as a dealer in general merchandise for the past twenty five years. In recent times, the company has suffered operating losses consistently coupled with deteriorating working capital. The directors are faced with an option of reconstructing the company or liquidating it.

The balance sheets of Akutu Limited as at 31st December 2006 and 2005 are given below:

Akutu Limited

Balance Sheets as at 31st December

	2006	2005
	¢'m	¢'m
Intangible assets	5,900	7,080
Land and buildings	1,340	1,608
Fixtures and fittings	3,120	3,744
Motor vehicles	3,450	4,140
Computers and accessories	2,062	2,472
Furniture and equipment	4,045	4,652
	19,917	23,696
Current Assets		
Stocks	6,120	3,978
Debtors	5,400	3,510
Short term investments (Treasury Bills)	5,520	3,588
Cash and bank	1,360	10,832
	18,400	21,908
Current Liabilities		
Trade creditors	(14,860)	(11,888)
Sundry creditors	(7,880)	(6,304)
	(22,740)	(18,192)
Net current (liabilities)/assets	(4,340)	3,716
Bank loan (secured on land and buildings)	(5,000)	(5,000)
12% debentures	(10,000)	(10,000)
Net Assets	577	12,412
Stated Capital:		
1,000,000 Ordinary shares of no par value	25,.000	25,000
500,000 8% Cumulative Preference shares	10,000	10,000
Share Deals	8,343	8,343
Income Surplus	(42,766)	(30,931)
	577	12,412

Additional information:

(i) Dividends on the preference shares are five years in arrears.

(ii) Sundry creditors is made up of the following:

	2006	2005
	¢'m	¢'m
Debenture interest	4,800	3,600
Taxation	2,000	2,000
National Reconstruction Levy	500	500
Employer's Social Security Contribution	580	204

(iii) The debenture holders have expressed their willingness to exchange their arrears of interest for equity of one-half of the amount of the arrears. They have also agreed to provide ¢3,100 million cash (on a floating charge) out of which IRS and SSNIT would be paid.

(iv) Intangible assets of Akutu Limited comprised the following:

	2006	2005
	¢'m	¢'m
Goodwill	2,500	2,000
Patents and copyrights	1,400	3.080
Development expenditure	2,000	2,000

The goodwill is considered worthless and patents and copyrights at 31st December, 2006 are worth ¢800 million. The balance on the development expenditure account, which was to have been written off in 2004, was still being carried in the books to prevent the company from declaring further losses.

(v) Stocks at 31st December, 2006 include obsolete items amounting to ¢150 million. Treasury bills held at 31st December, 2005 have been overstated by ¢520 million and carried over to 2006.

(vi) The tangible assets were revalued at 31st December, 2006 as follows:

	¢'m
Land and buildings	10,000
Computer and accessories	4,100
Furniture and equipment	2,800
Motor vehicles	3,000
Fixtures and fittings	4,800

(vii) A doubtful debt provision of 10% is to be made on debtors at 31st December, 2006. Reconstruction expenses and winding up expenses are estimated at ¢700 million and ¢1,200 million respectively.

(viii) Expected break up values of assets as at 31st December, 2006 are:

	¢'m
Land and buildings	5,800
Fixtures and fittings	2,300
Motor vehicles	3,000
Computer and accessories	3,300
Furniture and equipment	3,000
Debtors	4,100
Stock	4,200

(ix) The preference shareholders have agreed to waive 75% of the arrears of dividend and to convert the rest together with their existing shares into equity. They have also agreed to invest an additional amount of ¢5,000 million in the ordinary shares to enable the company pay off the bank loan.

(x) The existing ordinary shareholders are prepared to inject fresh capital of ¢15,000 million into the business. An investment of ¢2,500 million is to be made to revamp the company's information technology system to meet challenges posed by the redenomination of the cedi.

Required:

a) Draft a suggested capital re-organisation scheme which should be acceptable to all stakeholders.

(***14 marks)***

b) Redraft the Balance Sheet of Akutu Limited after the scheme has been put in place.

(***6 marks***)

(**Total: 20 marks)**

QUESTION 4

a) Ohia Ltd is a private limited liability company engaged in the processing of mango. The Board has resolved to raise additional capital through an initial (provisional listing) public offering from the Ghana Stock Exchange for expansion of its operations.

The following financial ratios were computed for Ohia Company Ltd for each of the five years ended 31/12/06.

	2006	2005	2004	2003	2002
Profitability NP (%)	26.4	43.0	48.8	70.4	73.8
Retention on Assets (%)	10.1	9.9	12.7	19.2	39.2
Dividend Cover (times)	-	-	-	9.9	22.7
Debt to Equity (%)	103.1	74.4	93.1	98.9	25.8
EPS (index to 2002) (%)	70	81	91	153	100
Net Assets/Share (index to 2002) (%)	131	171	117	126	100

Required:

(i) Advise potential investors whether Ohia Ltd is a viable company for investment

(***8 marks)***

(ii) Outline the benefits of 5-year summaries as a basis for interpreting a company's financial performance.

(***4 marks)***

(iii) Under what circumstances are ratio analyses not a good guide to management decision?

(***3 marks***)

b)

(i) Under what circumstances can development expenditure be capitlised?

(***5 marks)***

(ii) A company revalues its buildings and decides to incorporate the revaluation into the books of account. The following information is relevant.

i. Extract from the balance sheet at 31 December 2005

	¢'m
Buildings at cost	3,000
Depreciation	900
	2,100

ii. Depreciation has been provided at 2% per annum on a straight line basis.

iii. The building is revalued on 30th June 2006 at ¢2,760 million. There is no change in its remaining estimated future life.

Required:

Show the relevant extracts from the 2006 final accounts.

(*5 marks)*

(Total: 25 marks)

QUESTION 5

(a) "In general, the advantage of accounting effects of changing prices are that it overcomes the defects of a historical cost system, in that, being a current value system of accounting, its aim is to represent as far as possible, the commercial reality of the situation to which it refers".

Required:

Explain the terms "holding gains arising during the year" and "inflation adjustments to shareholders' funds" in relation to current cost

(***5 marks)***

(b) The value to a business or deprival value of an asset is the minimum compensation a business would require if deprived of the use of an asset."

Required:

(i) Explain the criteria for valuation of assets under the deprival value concepts.

(***5 marks)***

(ii) Determine the value to be placed on each of the underlisted assets.

Assets	Replacement Cost ¢ million	Net Relisable value ¢ million	Present Value ¢ million
A	140,000	120,000	180,000
B	200,000	110,000	190,000
C	150,000	240,000	185,000
D	170,000	160,000	140,000
E	110,000	210,000	260,000

(***5 marks)***

(Total: 15 marks)