THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

MAY 2008 EXAMINATIONS
(PROFESSIONAL)

PART 3

CORPORATE REPORTING STRATEGY
(Paper 3.1)

Attempt ALL Questions

TIME ALLOWED: 3 HOURS

QUESTION 1

The following are balance sheets of Dan Ltd, So Ltd and Man Ltd as at 31st March, 2008:

Balance Sheets as at 31st March, 2008

	Dan Ltd GH¢	So Ltd GH¢	Man Ltd GH¢
Assets			
Non-current Assets:			
Property, plant & equipment	4,593,000	5,589,000	4,950,000
Long term investment	3,960,000	400,000	-
	8,553,000	5,989,000	4,950,000
Current Assets:			
Stocks	1,117,000	1,355,000	123,800
Accounts receivable	964,000	769,000	275,000
Cash & bank balance	307,000	243,000	57,200
	2,388,000	2,367,000	456,000
Total Assets	10,941,000	8,356,000	5,406,000
Liabilities and Owners' Equity			
Current Liabilities:			
Trade creditors	1,200,000	1,025,000	195,600
Sundry creditors	820,000	740,000	80,700
Accruals	340,000	280,000	49,700
	2,360,000	2,045,000	326,000
Long-term Loans	700,000	520,000	420,000
Owners' Equity:			
Stated capital	2,870,000	2,500,000	2,000,000
Capital surplus	1,651,000	1,265,000	950,000
Income surplus	3,360,000	2,026,000	1,710,000
	7,881,000	5,791,000	4,660,000
Total Liabilities & Owners' Equity	10,941,000	8,356,000	5,406,000

The following additional information is relevant:

(i) Property, plant & equipment comprising:

	Dan Ltd GH¢	So Ltd GH¢	Man Ltd GH¢
Buildings	1,867,000	3,283,000	2,280,000
Plant & equipment	2,161,000	1,834,000	1,990,000
Furniture & fittings	254,000	270,000	350,000
Motor vehicles	311,000	202,000	330,000
	4,593,000	5,589,000	4,950,000

(ii) The stated capitals are made up of:

	Dan Ltd	So Ltd	Man Ltd
	GH¢	GH¢	GH¢
Ordinary shares	2,200,000	2,000,000	1,600,000
Preference shares	670,000	500,000	400,000
	2,870,000	2,500,000	2,000,000

(iii) On 30th June, 2006 Dan Ltd purchased 20% of the ordinary shares of So Ltd for GH¢640,000. The balances on the capital surplus and income surplus accounts of So Ltd on that date were GH¢300,000 and GH¢700,000 respectively.

(iv) On 31st March, 2007 Dan Ltd purchased 40% of the ordinary shares of So Ltd for GH¢1,800,000. The balance on the capital surplus and income surplus accounts of So Ltd on that date were GH¢665,000 and GH¢1,200,000 respectively. Dan Ltd incurred consultancy fee of GH¢50,000 in connection with the acquisition and has charged it to finance cost.

(v) The fair value of the plant and equipment of So Ltd as of 31st March, 2007 was GH¢100,000 below its carrying amount. So Ltd has not incorporated this in its accounts. The group depreciates its plant and equipment at a rate of 20% per year using the straight line method.

(vi) On 30th September, 2007 So Ltd received GH¢90,000 in settlement of a debt which had been written off in February, 2007.

(vii) The goodwill on acquisition of So Ltd had suffered an impairment loss of GH¢45,000 as of 31st March, 2008.

(viii) Dan Ltd purchased 60% of the ordinary shares of Man Ltd for GH¢1,420,000 and 25% of its preference shares for GH¢100,000 on 30th September, 2007. The balance on the income surplus account of Man Ltd on that date was GH¢1,100,000. There was no movement in the capital surplus of Man Ltd since the acquisition. After the acquisition Dan Ltd reassessed the fair value of the identifiable assets and liabilities of Man Ltd and was satisfied that they agreed with their carrying amounts.

(ix) Dan Ltd bought goods amounting to GH¢200,000 from man Ltd on 1st March, 2008. Man Ltd made a profit of 20% on cost. As of 31st March, 2008 Dan Ltd had paid GH¢100,000 for the goods purchased. Goods in stock amounted to GH¢120,000 on that date.

Required:

(a) Prepare the consolidated balance sheet of Dan Ltd and its subsidiaries as at 31st March, 2008 in accordance with relevant International Financial Reporting Standards.

(***17 marks)***

(b) Paragraph 19 of IFRS 3 states, *inter alia*, that "a combining entity shall be presumed to have obtained control of another combining entity when it acquires more than one-half of that other entity's voting rights ….."

Define control and provide **two (2)** circumstances which might give rise to control even if one of the combining entities does not acquire more than one-half of the voting rights of another combining entity. (***3 marks)***

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

QUESTION 2

The financial statements of Sombo Limited for the year ended 31st December, 2007 are summarized as follows:

Balance Sheet as at 31st December, 2007

	GH¢	GH¢
Property, plant & equipment		180,000
Copyright		18,000
		198,000
Current Assets		
Stock	14,500	
Debtors	22,000	
Bank & Cash	16,000	
	52,500	
Current Liabilities		
Creditors	12,500	40,000
		238,000
Financed By:		
Stated capital		100,000
Income surplus		88,000
Debentures		50,000
		238,000

Additional information

i) The stated capital of Sombo Limited is made up of 25 million ordinary shares of no par value. The company is unquoted.

ii) Profit after tax for Sombo Limited over the last four years were as follows:

	GH¢
2006	26,000
2005	32,000
2004	18,000
2003	38,000

and profit after tax for the year ended 2007 transferred to income surplus was GH¢58,500.

iii) The copy rights represent a license to produce and sell a book on HIV Aids which is in very high demand. Over the next five years, sale of this book is expected to yield total net cash inflow of Gh¢3,500

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iv) The fair value of the property, plant & equipment is GH¢240,000. Debtors amounting to GH¢8,500 is considered irrecoverable.

v) The discounted present value of future cash payments in respect of the Debentures is GH¢72,000

vi) The discount rate of Sombo Ltd is 12% per annum.

vii) Banku Ltd is a competitor of Sombo Ltd and is quoted on the Ghana Stock Exchange with a price-earning ratio of 8 and a dividend yield of 4.2%.

viii) The shareholders of Sombo Ltd have decided to dispose of 40% of their shares in the company.

Required:

(a) Advise the directors of Sombo Ltd on the values to be placed on the shares using the following methods:
- assets basis
- earnings yield basis
- dividend yield basis. (***12 marks)***

(b) State any **three (3)** reasons why an unlisted company may wish to place a value on its shares. (***3 marks***)

(c) Briefly explain why in business valuation of unquoted companies, earnings yield is marked up while dividend is marked down. (***5 marks***)

(**Total: 20 marks**)

QUESTION 3

Sopy Ltd is in the stone quarry industry. It has suffered a spate of mishap in the last few years; a fire guttered its major production plant, employees who have not been paid for the past twelve months have filed a suit for their unpaid salaries, suppliers have cut supplies for non-payment and the banks have refused to provide further credit due to unpaid loans.

The balance sheet of Sopy Ltd as at 31st December, 2007 is set out below:

	GH¢	GH¢
Non-current Assets		18,600
Investments		1,400
		20,000
Current Assets:		
Stocks	18,500	
Debtors	16,600	
	35,100	
Current Liabilities:		
Bank overdraft	11,500	
Trade creditors	12,800	
Sundry creditors	6,800	
Short-term bank facility	5,000	
	36,100	
Net current liabilities		(1,000)
10% Long term bank facility		(4,000)
		15,000
Financed By:		
Stated capital		12,400
Capital surplus		5,160
Income surplus		(2,560)
		15,000

Additional information:

i) Analysis of Non-current Assets is as follows:

	Cost	Depreciation	NBV
	GH¢	GH¢	GH¢
Land & building	25,000	13,500	11,500
Plant & equipment	2,500	1,100	1,400
Furniture & fittings	1,800	560	1,240
Motor vehicles	2,900	725	2,175
Copyrights	600	-	600
Goodwill	2,050	365	1,685
	34,850	16,250	18,600

ii) The preference dividend is in arrears for three years and is cumulative in nature. The preference shareholders have agreed to waive this should the company be reorganised for more profitable operations.

iii) Credit Limited, provider of both the short and long term bank facility, has demanded immediate payment of the interest on the long-term facility which has been outstanding for the past four years. It has, however, agreed to waive this as well as 50% of the short term facility if the company decides to reorganize for more profitable operations.

iv) Asuo Ltd, a major customer representing 45% of total debtors, has gone into receivership and its creditors are assured of only 30% of their account balance. In addition, 60% of the remaining debts is irrecoverable.

v) Investment is worth 12% more than its carrying amount. Stock is valued at GH¢12,000.

vi) Copyrights are valued at 35% of their carrying amounts. Goodwill is to be written off.

vii) Fixed assets are valued as follows:

	GH¢
Land & buildings	14,000
Plant & equipment	650
Furniture & fittings	980
Motor vehicles	1,100

viii) Stated capital is made up as follows:

	GH¢
Ordinary shares (10 million shares of no par value)	10,000
12% Preference shares	2,400
	12,400

Required:

a) Advise the directors of Sopy Ltd whether to wind-up the company or to reorganize. **(*12 marks*)**

b) Prepare a balance sheet as at 1/1/2008 after the reconstruction. **(*5 marks*)**

c) Clearly distinguish between a capital reconstruction scheme and a structural reconstruction scheme **(*3 marks*)**

(Total: 20 marks)

QUESTION 4

(a) Just Lucky Ltd is one of few companies to benefit from the sale of 50 housing units in January, 2008 at the plush La-Wireless Estate after the Ghana @ 50 celebrations in 2007. It acquired 12 bungalows at a cost of GH¢350,000 each under a special Government of Ghana Disposal Scheme for sub-letting to its executive employees.

Additional information:

i) Just Lucky Ltd incurred GH¢45,000 in legal fees and another GH¢30,500 in professional valuation fees in acquiring the property.

ii) In anticipation of a horticultural landscape upliftment of the property, Just Lucky Ltd deposited a truck load of black soil at each of the bungalows valued at GH¢12,500 per load. These have now been washed away by torrential rains due to undue delay in starting the project.

iii) Just Lucky Ltd has recalled that it incurred certain incidental/miscellaneous expenses. However, the exact amount could not be established. It was certainly not below GH¢11,500 but could be as much as GH¢19,500

iv) The IRS has charged 2% of the value of the property as property stamp duty.

Required:

(a) 1. In accordance with IAS 40,

(i) Explain how each of the items – (i) to (iv) above should be treated in the books of Just Lucky Ltd. (***2 marks)***

(ii) Compute the cost of investment property to be included in the accounts of Just Lucky Ltd in 2008. (2 ***marks)***

(iii) State the **two (2)** principles under which an investment property is recognized as an asset. (***2 marks)***

(a) 2. In accordance with IAS 38, Intangible Assets, clearly outline any **four (4)** characteristics of goodwill which distinguish it from other intangible non-current assets. (***4 marks)***

(b) i. Farmers Friend Limited is a company engaged in the buying and shipment of Cashew-nuts. The industry is very competitive with twenty-two companies currently chasing farmers for produce.

Financial ratios obtained for the year ended 31st December, 2007 were as follows:

	Farmers Friend Limited	Industry Average
Quick ratio	0.52:1	0.84:1
Current ratio	1.20:1	1.80:1
Debtors collection period	46 days	41 days
Creditors payment period	70 days	50 days
Stock hold period	58 days	48 days
Dividend yield	3.6%	9 %
Debt to equity	85%	45%
Dividend cover	1.4 times	3.4 times
Gross profit margin	18%	28%
Net profit margin	8%	12.8&
Return on capital employed	28%	14%
Net assets turnover	4.2 times	1.9 times

Required:

Provide a technical assessment of the performance of Farmers Friend Ltd vis-à-vis the industry in the following areas:

1. Profitability
2. Liquidity
3. Efficiency
4. Shareholders Investment (***12*** m***arks***)

ii. It has been suggested that ratio analysis is not necessarily the best way of assessing a company's performance.

Required:

Identify any **three (3)** items of information which should be looked at to make ratio analysis more meaningful. (3 ***marks)***

(*Total: 25 marks*)

QUESTION 5

Financial statements prepared under the historical cost convention have been severely criticised by financial analysts as not being representative of current value.

Required:

a) Clearly explain the following alternative basis for valuation of assets.

   i. Replacement cost
   ii. Net realisable value
   iii. Economic value
   iv. Deprival value (***9 marks)***

b) State and explain the **three (3)** concepts of capital maintenance. (***6 marks***)

(*Total: 15 marks)*