THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

INTEGRITY

MAY 2010 EXAMINATIONS
(PROFESSIONAL)

PART 3

FINANCIAL REPORTING
(Paper 3.1)

Attempt ALL Questions

TIME ALLOWED:

Reading & Planning	-	**15 Minutes**
Working	-	**3 Hours**

QUESTION 1

a) Explain the principles and reasoning for the use of equity accounting in preparing consolidated financial statements.

(3 marks)

b) Big company Ltd acquired 270,000 shares in Small Company Ltd on 1 January 2003. The income surplus of Small Company Ltd at the date of acquisition was GH¢40,000. The capital surplus balance as of that date was also GH¢20,000.

The draft balance sheets of both companies are given below as at 31 December 2009.

	Big Ltd GH¢	Small Ltd GH¢
Assets		
Non-Current Assets		
Tangible Assets	700,000	420,000
Investment in Small Ltd	380,000	-
	1,080,000	420,000
Current Assets		
Inventories	166,000	84,000
Trade Receivables	204,000	96,000
Current A/C – Small Ltd	10,000	-
Bank	80,000	24,000
	1,540,000	624,000
Equity Shares issued @ GH¢1.00 each	800,000	300,000
Income Surplus	380,000	198,000
Capital Surplus	120,000	30,000
	1,300,000	528,000
Current Liabilities		
Trade payables	180,000	74,000
Current A/C – Big Ltd	-	2,000
Dividends Payable	60,000	20,000
	240,000	96,000
Total Equity and Liabilities	1,540,000	624,000

Additional Information

(i) The fair value of tangible assets of Small Ltd on 1 January 2003 was assessed to be GH¢30,000 higher than the carrying value. This adjustment has since not been reflected in the statement of financial position of Small Ltd.

(ii) Big Ltd has not yet accounted for its share of the dividend payable by Small Ltd (Assume that the dividend was declared before the year end but cheques have not been issued to shareholders).

(iii) On 30th December 2009, Small Ltd sent a cheque for GH¢8,000 to Big Ltd which was not received until 7 January 2010.

(iv) On 1st December 2009, Small transferred goods costing GH¢5,000 to Big for GH¢6,000. These goods were not sold by Big at 31 December 2009 and remained in stock. Big has since paid for the goods.

(v) Goodwill arising on consolidation has been impaired. The amount of the impairment is GH¢18,000.

Required:

Prepare the Consolidated Balance Sheet of Big Ltd Group as at 31 December 2009.

(*12 marks*)

(Total: 15 marks)

QUESTION 2

Adu and Tetteh both Chartered Accountants and Management Consultants are in partnership operating as AT & Associates.

As a Trainee Accountant engaged with the firm, you have been provided with the following summarised draft statement of financial position as at 31st December 2009.

Assets	GH¢'000
Freehold Buildings	36,000
Furniture & Equipment	24,000
Motor Vehicles	15,900
Investments	15,000
Account Receivables	22,000
Cash & Bank	20,120
	133,020
Capital Liabilities	
Capital @ 01/01/09:	
Adu	60,000
Tetteh	30,000
Current Account:	
Adu	5,420
Tetteh	6,100
Account payables	13,400
Profit for the year	
Adu	9,050
Tetteh	9,050
	133,020

During the course of your examination of the books, you ascertain that the following adjustments are required:

(i) Interest is to be allowed on partners' opening capital account balances less drawings during the year at 5%.

(ii) The investment represents shares purchased in a mutual fund 5 years ago. The market value of the investment at the statement of financial position date is 65% of the carrying amount.

(iii) The partners made cash drawings during the year as follows: Adu – Gh¢2,000 Tetteh - GH¢3,800. These drawings were not recorded in the books.

(iv) The office manager had misappropriated GH¢2,050 from the cash holdings.

(v) Professional indemnity insurance of GH¢350 had been paid in advance for the year ending 31st December 2010 and debited in full to the Income Statement, whilst bank charges of GH¢110 had not been accounted for in the Cash Book.

(vi) A posting of GH¢4,630 has been fraudulently made into the cash book and the purchases ledger creating the impression that a payment has been made to a supplier.

Required:

(a) Prepare an adjusted Income Statement for the year and a revised Appropriation Account.

(b) Prepare partners' Current Account.

(c) Prepare a revised Statement of Financial Position as on 31st December 2009.

20 marks

QUESTION 3

The following trial balance relates to Boafo Ye Na Ltd at 31 December 2009:

	GH¢'000	GH¢'000
Leasehold property – at valuation 1 January 2009 (note (i))	25,000	
Plant and equipment – at cost (note (i))	38,300	
Plant and equipment – accumulated depreciation at 1 January 2009		12,300
Capitalised development expenditure – at 1 January 2009(note (ii))	10,000	
Development expenditure – accumulated amortisation at 1 January 2009		3,000
Closing inventory at 31 December 2009	10,000	
Trade receivables	21,500	
Bank		650
Trade payables and provisions (note (iii))		11,900
Revenue (note (i))		150,000
Cost of sales	102,000	
Administrative expenses (note (iii))	18,400	
Preference dividend paid (note (v))	400	
Interest on bank borrowings	100	
Equity dividend paid	3,000	
Research and development costs (note (ii))	4,300	
Equity shares of 25 pesewa each		25,000
12% redeemable preference shares of GH¢1 each (note (v))		10,000
Income surplus at 1 January 2009		12,250
Deferred tax (Note (iv))		2,900
Leasehold property revaluation reserve		5,000
	233,000	233,000

The following notes are relevant:

(i) Non-current assets – tangible:
The leasehold property had a remaining life of 20 years at 1 January 2009. The company's policy is to revalue its property at each year end and at 31 December 2009, it was valued at GH¢21.5 million. Ignore deferred tax on the revaluation.

On 1 January 2009, an item of plant was disposed of for GH¢1.25 million cash. The proceeds have been treated as sales revenue by Boafo Ye Na Ltd. The plant is still included in the above trial balance figures at its cost of GH¢4 million and accumulated depreciation of GH¢2 million (to the date of disposal).

All plant is depreciated at 20% per annum using the reducing balance method. Depreciation and amortisation of all non-current assets is charged to cost of sales.

(ii) Non-current assets – intangible:
In addition to the capitalised development expenditure (of GH¢10 million), further research and development costs were incurred on a new project which commenced on 1 January 2009. The research stage of the new project lasted until 31 March 2009 and incurred GH¢0.7 million of costs. From that date, the project incurred development costs of GH¢400,000 per month. On 1 July 2009, the directors became confident that the project would be successful and yield a profit well in excess of its costs. The project is still in development at 31 December 2009.

Capitalised development expenditure is amortised at 20% per annum using the straight-line method. All expensed research and development is charged to cost of sales.

(iii) Boafo Ye Na Ltd is being sued by a customer for GH¢1 million for breach of contract over a cancelled order. Boafo Ye Na Ltd has obtained legal opinion that there is a 20% chance that Boafo Ye Na Ltd will lose the case. Accordingly Boafo Ye Na Ltd has provided GH¢200,000 (GH¢1 million x 20%) included in administrative expenses in respect of the claim. The unrecoverable legal costs of defending the action are estimated at GH¢50,000. These have not been provided for as the legal action will not go to court until next year.

(iv) The directors have estimated the provision for income tax for the year ended 31 December 2009 at GH¢5.7 million. The required deferred tax provision at 31 December 2009 is GH¢3 million.

(v) The 12% preference shares were all issued on 1 July 2009.

Required:

(a) Prepare the Income Statement for the year ended 31 December 2009.
(*8 marks*)

(b) Prepare the statement of charges in equity for the year ended 31 December 2009.
(*4 marks*)

(c) Prepare the statement of financial position (balance sheet) as at 31 December 2009.
(*8 marks*)

Note: notes to the financial statements are not required.

(Total: 20 marks)

QUESTION 4

a) Kaf Transport Solution is a company with a fleet of vehicles for rents. Below is a summary of ratios computed over a three year period (2006 – 2008).

RATIOS

Profitability ratio	2008	2007	2006
i) Gross profit margin ratio (%)	42	56	29
ii) Net profit ratio (%)	-12	18	4
iii) Return on capital employed (%)	-	32	9.6
Liquidity/short-term Solvency ratio			
i) Current assets ratio (Times)	0.90:1	0.94:1	0.83:1
ii) Debtors collection period (Days)	70	95	52
Activity/Efficiency ratio			
i) Fixed Assets turnover ratio (Times)	1.36	1.72	2.34
Gearing/Long-term Solvency ratio			
i) Equity to assets ratio (%)	25	59	56
ii) Total debts to Equity ratio (%)	75	41	44
Actual Growth Rates			
Sales Growth %	16	0.4	-
Increase in operating cost (%)	53	(38)	-

Required:

Prepare a report to the Board of Directors discussing the performance of Kaf Transport Solution using the ratios computed for the three year period.

(***15 marks***)

b) What are the advantages of international harmonisation ("are size fits all" global standard) to:

i) Investors/lenders

ii) Multinational companies

iii) Others

(***10 marks***)

(Total: 25 marks)

QUESTION 5

a) On 1 January 2009, Nagode Construction Ltd (NCL) entered into a lease agreement to rent a tractor from Pool Plant Ltd (PPL) for a six year period after which it will be returned to the lessor and scrapped. The agreement provides for an annual payments of GH¢9,210 made in advance (the first payment made on 1 January 2009). The market price of equipment on the date of the transaction was GH¢43,000. The present value of minimum lease payments amounts to GH¢42,000 (discounted at the implicit interest rate of 12.5% per annum).

NCL expects to be in the construction business during the first 5 years of the lease term only but has leased the equipment for 6 years as this is the requirement of the lessor.

Required:

Explain how NCL would account for the above lease for the year ending December 2009. Show also the relevant extracts from the 2009 statement of comprehensive income (income statement) and the statement of financial position.

(***10 marks***)

b) Nii Plant Ltd acquired equipment on 1st January 2006 from Palm Fruits Ltd under a two-year purchase agreement. This required an immediate deposit of GH¢32,000 and a further half yearly installment of GH¢32,000 starting on 1st July 2006. The cash price was GH¢150,880. The company's financial year ends on 30th September. Assume the finance charge is GH¢9,120 (GH¢160,000 – GH¢150,880) is allocated as follows:

Year End	GH¢
30.09.06	4,960.00
30.09.07	3,680.00
30.09.08	480.00
	9,120.00

Required:

Show the relevant ledger entries in the books of Nii Plant Ltd to record the above transaction.

(***5 marks***)

c) Briefly state and describe **five (5)** main weaknesses of the Historical Cost Convention in financial reporting.

(***5 marks***)

(Total: 20 marks)