

**THE INSTITUTE OF CHARTERED
ACCOUNTANTS (GHANA)**



**NOVEMBER 2009 EXAMINATIONS
(PROFESSIONAL)**

PART 3

**CORPORATE REPORTING STRATEGY
(Paper 3.1)**

Attempt ALL Questions

TIME ALLOWED: 3 HOURS

QUESTION 1

- a) The government of Ghana has secured a medium-term credit facility from Development Solutions incorporated, an international micro-finance facilitator. It intends to apply this facility towards the alleviation of rural poverty. Since all 230 districts in the country cannot benefit from this facility immediately, the Government decided that for the year 2009, the facility should be extended to the best performing manufacturing company in each of the regions. The facility is repayable with effect from 1st October, 2010.

Summary financial statements of the two best companies from the Upper East region are as follows:-

Income Statements for the year ended 30th September, 2009

	Hoe Ltd	Shea Ltd
	%	%
Raw materials consumed	15	20
Direct labour	18	30
Factory overheads	<u>35</u>	<u>25</u>
Goods available for sale	68	75
Goods sold	<u>100</u>	<u>100</u>
Gross profit	32	25
Less: Selling, General & Administrative expenses	<u>14</u>	<u>9</u>
Profit before interest & tax	18	16
Less: Interest	<u>2</u>	<u>-</u>
Profit before tax	16	16
Less: Tax	<u>4</u>	<u>4</u>
Profit after tax	<u>12</u>	<u>12</u>

Balance Sheet as at 30th September, 2009

	Hoe Ltd	Shea Ltd
	%	%
Property, Plant & Equipment	<u>85</u>	<u>55</u>
Current Assets		
Stock	14	27
Debtors	22	18
Cash at Bank	<u>34</u>	<u>24</u>
	70	69
Creditors	<u>(30)</u>	<u>(24)</u>
Net current assets	<u>40</u>	<u>45</u>
Total Assets less current liabilities	125	100
14% Credit Union Facility	<u>(25)</u>	<u>-</u>
Net assets	<u>100</u>	<u>100</u>
Financed By:		
Stated capital	50	80
Capital surplus	-	6
Income surplus	<u>50</u>	<u>14</u>
	<u>100</u>	<u>100</u>

Additional Information

i. Stated Capital

	Hoe Ltd	Shea Ltd
Authorised number of ordinary shares	100,000	100,000
Number of ordinary shares issued (for GH¢1.00 each)	50,000	80,000

ii. Hoe Ltd is a metal fabrication company and buys its scrap metal from Tema in the Greater Accra Region. Shea Ltd processes local shea nuts into butter for export.

iii. Hoe Ltd has 48 permanent employees. In addition to 56 permanent employees, Shea Ltd engages 224 casual workers who pick wild shea nuts for the company on commission basis.

iv. The percentage of bad debts to sales in the last four years are as follows:

Year ended 30 th September	Hoe Ltd %	Shea Ltd %
2009	12	3
2008	10	4
2007	2	6
2006	4	8

v. The underlisted ratios are relevant:

	Hoe Ltd	Shea Ltd
Stock turnover ratio	8 times	5 times
Debtor's collection period	35 days	42 days
Creditor's payment period	30 days	46 days

vi. Hoe Ltd has single-handedly constructed a bridge in order to prevent the town where it is located being cut off from the rest of the country during heavy rains.

vii. Hoe Ltd is sponsoring a total of 12 of its employees for a two-year fabrication course at the ITTU in Tema.

viii. Shea Ltd was cited in 2008 for failure to file VAT and NHIS returns on time and was fined GH¢500.00.

Required:

Advise which of the two companies should be given the credit facility. Your answer should take into account both quantitative and qualitative considerations.

(15 marks)

QUESTION 2

- a) Outline the provisions of Section 75 of Ghana Companies Code 1963 (Act 179) with respect to resolutions requiring confirmation of court for capital, shares or liability reduction.

(5 marks)

- b) Mango Ltd has been operating at a loss for a number of years. The directors of the company are considering whether to liquidate the company or undertake a capital reconstruction. The balance sheet of Mango Ltd as at 31st December 2007 is as follows:

Balance Sheet as at 31 December, 2007

	GH¢'000	GH¢'000
Non-Current Assets:		
Property, plant and equipment		14,360
Copyrights		<u>550</u>
		14,910
Current Assets:		
Inventories	6,701	
Trade receivables	15,880	
Investments	<u>9,980</u>	
	<u>32,561</u>	
Current Liabilities:		
Bank Loan (Secured on investments)	9,000	
Trade Payables	16,000	
Other payables	<u>100</u>	
	<u>25,100</u>	
Net current assets		<u>7,461</u>
		22,371
21% Debenture (secured on building)		<u>(12,500)</u>
		<u>9,871</u>
Financed by:		
Stated Capital		40,000
Capital Surplus		400
Income Surplus		<u>(30,529)</u>
		<u>9,871</u>

Additional information:

- (i) The stated capital is made up of 20 million ordinary shares, issued and fully paid for GH¢30 million and preference shares issued for GH¢10 million.
- (ii) Preference dividend is 2 years in arrears.
- (iii) Liquidators' expenses are estimated at GH¢20,000 while the costs of the reconstruction scheme are estimated at GH¢12,000.

(iv) Property, plant and equipment is made up as follows:

	GH¢'000
Building	10,860
Equipment, furniture and fittings	2,200
Motor vehicles	<u>1,300</u>
	<u>14,360</u>

(v) The building has been included in the balance sheet at its valuation on 31st December, 2007. It will yield net proceeds of GH¢12 million if it is sold.

(vi) If the copyrights are sold, the net sale proceeds will be GH¢100,000. The estimated present value of the future cash flows from the copyrights is GH¢250,000.

(vii) If the other assets are sold, their net sale proceeds will be as follows:

Inventories GH¢2.5million; Trade Receivables GH¢7 million; Investments GH¢6 million; Equipment, furniture and fittings GH¢1.2 million and Motor vehicles GH¢900,000.

(viii) Trade Receivables and Inventories have been over stated by GH¢2.3 million and GH¢4 million respectively in the financial statements.

(ix) Other payables represent VAT payable for the month of November 2007.

(x) The ordinary shareholders have promised to introduce cash amounting to GH¢12 million for new ordinary shares in the company.

Required:

Design a capital reconstruction scheme which is likely to be accepted by all stakeholders. Draw up the resultant balance sheet.

(15 marks)

(Total: 20 marks)

QUESTION 3

a) You have just been appointed as the Chief Accountant of an Oil Prospecting Company, DeepSea Oil Company. The Assistant Accountant who is responsible for preparing the final accounts of the company has encountered some difficulties in the treatment of some items when drafting the 2008 final accounts. He has approached you for some guidance.

The accounting year end of DeepSea Oil Company is 31st December.

- i) On 1st January 2008, DeepSea entered into a GH¢11,000,000 contract for the construction of an office complex in Takoradi. The building was completed at the end of December 2008. During the period, the following payments were made to the contractor:

Payment date	Amount (GH¢'000)
1 st January 2008	1,000
31 st March 2008	3,000
30 th September 2008	6,000
31 st December 2008	<u>1,000</u>
Total	<u>11,000</u>

DeepSea's borrowings as at its year end 31st December 2008 were as follows:

- 10% Four-year Loan Note with simple interest payable annually, which relates specifically to the building project; debts outstanding at 31st December 2008 amounted to GH¢3,500,000. Interest of GH¢350,000 was incurred on these borrowings during the year, and interest income of GH¢100,000 was earned on these funds while they were held in anticipation of payments.
- 12.5% Five-year Loan Note with simple interest payable annually; debt outstanding at 1st January 2008 amounted to GH¢5,000,000 and remained unchanged during the year.
- 10% Five-year Loan Note with simple interest payable annually; debt outstanding at 1 January 2008 amounted to GH¢7,500,000 and remained unchanged during the year.

Required:

Calculate the borrowing costs to be capitalised. (Interest expenses are the only borrowing costs).

(6 marks)

- ii) DeepSea Oil Company has a drilling platform in the Cape Three Points. It is required by legislation of Ghana to remove and dismantle the platform at the end of its useful life. Accordingly, the company has included an amount in its accounts for removal and dismantling costs.

The company is carrying out an exercise to establish whether there has been an impairment of the platform.

Its carrying amount in the statement of financial position (balance sheet) is GH¢15 million.

The company has received an offer of GH¢14 million for the platform from another oil company. The bidder would take over the responsibility and loss for dismantling and removing the platform at the end of its life.

The present value of the estimated cash flows from the platform's continued use is GH¢16.5 million.

The carrying amount in the statement of financial position for the provision for dismantling and removal is currently GH¢3.0 million.

Required:

What should be the value of the drilling platform in the Statement of Financial Position, and what, if any, is the impairment loss?

(5 marks)

iii) DeepSea Oil Company issued 5,000 convertible bonds at the beginning of 2008. The bonds have a three year term and are issued at par with a face value of GH¢1,000 per bond given total proceeds of GH¢5,000,000. Interest is payable annually in arrears at an annual interest rate of 10%. Each bond is convertible (at any time up to maturity) into equity shares. When the bonds were issued, the prevailing market interest rate for similar debt instruments without conversion option was 15%.

Required:

Determine the equity component of the compound instrument. (You may use the residual valuation of equity component approach).

(4 marks)

		Present Value	Annuity Factor
Discount Factors at 15%	Year 1	0.870	0.870
	2	0.756	1.626
	3	0.658	2.284

b) The Institute of Directors Ghana is organising a seminar for CEOs on the theme 'Maintaining Operational Capability of Business Entity in an era of Upward Price Level Changes'. You have been invited by the organisers as one of the resource persons to talk on the sub-themes:

- (i) Constant Purchasing Power (CPP) Accounting: Nature and its application in preparation of financial statements.
- (ii) Holding Gain: Meaning (with quantitative illustration) and recognition in financial statements.

Required:

Draft your presentation.

(10 marks)

(Total: 25 marks)

QUESTION 4

Banku Ltd is a private family business engaged in the brewery and sale of local beer. The company decided to raise capital at the stock exchange to expand its business and export the beer to other African countries. As such, a valuation of the business has become necessary.

Financial statements of Banku Ltd as at 30th September 2009 are as follows:-

Balance Sheet as at 30th September 2009

	GH¢	GH¢
Property, Plant & Equipment		126,700
Patent		<u>25,000</u>
		151,700
Current Assets		
Inventory	42,500	
Trade Receivables	27,000	
Bank & Cash	<u>15,600</u>	
	85,100	
Current Liabilities		
Trade payables	<u>22,800</u>	<u>62,300</u>
		214,000
Less 15% Medium Term Loan		<u>14,000</u>
Net Assets		<u>200,000</u>
Financed By:		
Stated capital		120,000
Capital surplus		15,800
Income surplus		<u>64,200</u>
		<u>200,000</u>

Income Statement for the year ended 30th September, 2009

	GH¢
Turnover	149,805
Cost of sales	<u>(74,500)</u>
Gross profit	75,305
Selling, General & Administrative expenses	<u>(38,600)</u>
Profit before interest & tax	36,705
Interest expenses	<u>(2,100)</u>
Profit before Tax	34,605
Taxation	<u>(8,651)</u>
Profit after tax	25,954
Less: cumulative preference share dividend	<u>(1,600)</u>
	24,354
Less: ordinary share dividend paid	<u>(12,000)</u>
Retained profit	<u>12,354</u>

Additional Information

- i) The stated capital of Banku Ltd is made up as follows:-

	GH¢
Ordinary shares issued at GH¢0.50	100,000
8% Cumulative preference shares	<u>20,000</u>
	<u>120,000</u>

- ii) The patent represents a licence to brew special high grade beer which is expected to generate a pre-tax profit of GH¢30,000 per year over the next five years.
- iii) An independent valuer has placed a value of GH¢150,000 on the property, plant and equipment and GH¢35,000 on inventory but 20% of trade receivables will not be realised.
- iv) The discounted present value of future cash payments in respect of the medium term loan is GH¢18,100.
- v) Profit before tax of Banku Ltd over the past four years is as follows:-

Year ended 30 th September	GH¢
2008	32,500
2007	26,050
2006	12,400
2005	21,000

- vi) Okro Ltd is a major competitor of Banku Ltd and is listed on the Ghana Stock Exchange. Data extracted from the most recent Published Financial Statements of Okro Ltd include the following:

Price per share	¢5.40
Earnings per share	¢0.90
Dividend pay-out ratio	60%

- vii) The discount rate of Banku Ltd is 12% per annum while the income tax rate for companies is 25%.

	Y1	Y2	Y3	Y4	Y5
Discount Factor at 12%	.0.893	0.797	0.712	0.636	0.567
Annuity Factor at 12%	0.893	1.690	2.402	3.038	3.605

Required:

- (a) Compute and discuss the values to be placed on the ordinary shares of Bank Ltd using the net asset base, dividend yield and earnings yield methods.

(12 marks)

- (b) Outline any **five (5)** factors that influence the estimations of future profits of a company.
(5 marks)

(Total: 17 marks)

QUESTION 5

- a) Outline the conditions under which a subsidiary may be excluded from Consolidated Financial Statements (with reference to Ghana Companies Code, 1963 (Act 179)).

(4 marks)

- b) Set below is a summary of the accounts of Afianepa Co. Ltd for the year ended 31st December, 2005 with 2004 comparative figures.

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31ST DECEMBER

	2005	2004
	€'000	€'000
Turnover	19,900	12,560
Less cost of sales	(9,865)	6,545
Gross profit	10,035	6,015
Selling, general and administrative expenses	(3,437)	(2,897)
Profit from operations	6,598	3,118
Income from interests in associates	440	-
Net interest expenses	(230)	-
Group profit before tax	6,808	3,118
Taxation: Group	500	450
Associates	100	80
	(600)	
Group profit after tax	6,208	
Minority interest	(160)	
Profit for the financial year	6,048	(530)
		2,588
		(120)
		2,468

INCOME SURPLUS ACCOUNTS

	2005	2004
	€'000	€'000
Income Surplus Accounts		
Balance b/f	23,468	25,000
Profit for the financial year	6,048	2,468
Dividends	(6,000)	(4,000)
Balance b/f	23,516	23,468

CONSOLIDATED BALANCE SHEETS AS AT 31ST DECEMBER

	€'000	2005 €'000	€'000	2004 €'000
<u>Fixed Assets</u>				
Goodwill	320		-	
Property, plant and equipment	20,500		10,400	
Investments in associates	9,000		10,000	
		29,820		20,400
<u>Current Assets</u>				
Inventories	10,200		12,400	
Accounts receivables	10,100		9,860	
Cash	5,000		4,000	
	25,300		26,260	
<u>Current Liabilities</u>				
Obligation under finance lease	2,400		2,000	
Overdraft	-		2,600	
Trade payables	6,000		5,400	
Income tax	2,400		1,800	
Dividends	1,200		3,200	
Accruals for interest and finance charges	200		200	
	12,200		15,200	
Net current assets		13,100		11,060
		42,920		31,460
Stated capital		15,000		3,500
Share deals account		1,454		1,092
Income surplus account		23,516		23,468
		39,970		28,060
Minority interest		2,000		2,200
Obligations under finance leases		950		1,200
		42,920		31,460

NOTES TO THE ACCOUNTS

1. Included in selling, general and administrative expenses is exceptional cost of the following:

	€'000
Closure cost	1,200
Tax	(500)
	700
	€'000

2. Property, plant and equipment:

Net book value at 1 January 2005	10,400
Additions	16,500
Net book value of disposals	(4,000)
Depreciation charge for year	(2,400)
Net book value at 31 December 2005	20,500

€1,200,000 of additions were acquired under finance leases. Assets disposed of comprise assets sold during the year for €1,000,000 cash and €200,000 trade-in allowance against new items of plant.

3. Accounts receivables can be further analysed as follows:

	2005	2004
	€'000	€'000
Trade receivables	10,000	9,860
Dividends receivable from associates	<u>100</u>	<u>-</u>
	<u>10,100</u>	<u>9,860</u>

4. Acquisition of subsidiary: Abroni Co. Ltd.

During the year an 80% holding in Abroni Co. Ltd was acquired. Details of the acquisition are as follows:

	€'000
Fixed asset:	
Property, plant and equipment	2,000
Stocks	800
Trade debtors	600
Cash	500
Trade payables	(350)
Income tax	(200)
	<u>3,350</u>
Minority interest (20%)	(670)
Goodwill	<u>320</u>
	<u>3,000</u>
Share issued at market value	1,000
Cash	<u>2,000</u>
	<u>3,000</u>

5. No impairment is recognized in respect of goodwill arising from the acquisition of Abroni Co. Ltd.

Required:

Prepare the group cash flow statement for Afianepa Co. Ltd for the year ended 31st December 2005, in accordance with IAS 7.

(19 marks)

(Total: 23 marks)