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THEME:

Corporate Governance and its impact on Organization's Performance

ICAG

INTEGRITY

CONTENT

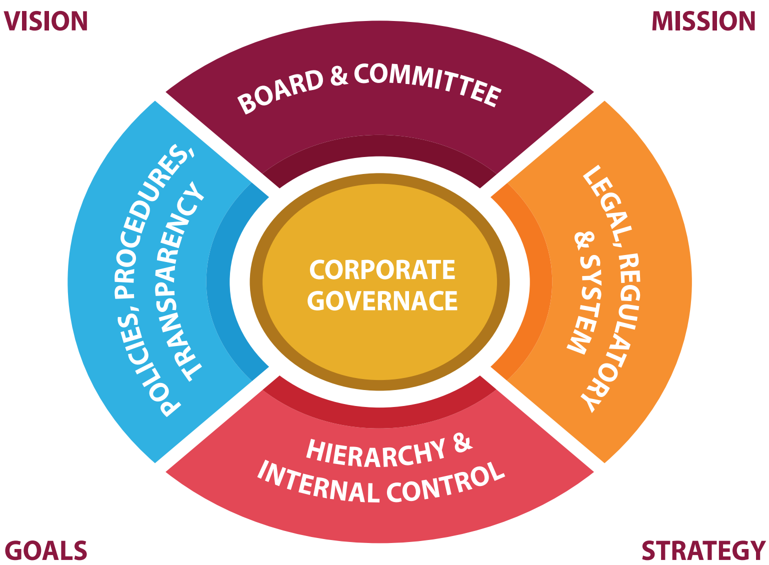
CORPORATE GOVERNANCE AND ITS IMPACT ON ORGANIZATION'S PERFORMANCE

By Yaw Ofori

Corporate governance is the system of rules, practices, and processes by which a firm is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, financiers, the government, and the community.

Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure

FIGURE 1: Key elements of Corporate Governance



Corporate governance is important because it creates a system of rules and practices that determine how a company operates and how it aligns the interest of all its stakeholders. Good corporate governance leads to ethical business practices, which leads to financial viability.

The basic principles of corporate governance are accountability, transparency, fairness, and responsibility.

Corporate governance is the system by which companies are directed and controlled. Good corporate governance is important because the owners of a company and the people who manage the company are not always the same.

Corporate governance is the system by which companies are directed and controlled. There are various stakeholders in companies. These include:

- Directors: responsible for corporate governance
- Shareholders: linked to the directors by the financial statements
- Other relevant parties: such as employees, customers and suppliers (stakeholders)

Governance refers specifically to the set of rules, controls, policies, and resolutions put in place to dictate corporate behavior. A company's corporate governance is important to investors since it shows a company's direction and business integrity. Good corporate governance helps companies build trust with investors and the community. As a result, corporate governance helps promote financial viability by creating a long-term investment opportunity for market participants. Communicating a firm's corporate governance is a key component of community and investor relations.

In some companies, the shareholders are fully informed about the management of the business because they are directors themselves, whereas in other companies, the shareholders only have an opportunity to find out about the management of the company at the AGM (annual general meeting).

The day-to-day running of a company is the responsibility of the directors and other management staff to whom they delegate, and although the company's results are submitted for shareholders' approval at the AGM, there is often apathy and acquiescence to directors' recommendations. AGMs are often very poorly attended. For these reasons, there is the potential for conflicts of interest between management and shareholders.

Most companies strive to have a high level of corporate governance. For many shareholders, it is not enough for a company to merely be profitable; it also needs to demonstrate good corporate citizenship through environmental awareness, ethical behavior, and sound corporate governance practices. Good corporate governance creates a transparent set of rules and controls in which shareholders, directors, and officers have aligned incentives.

Good Corporate Governance are built on six pillars. *These are*

- *Rules of law.*
- *Moral integrity.*
- *Transparency.*
- *Participation.*
- *Responsibility and accountability.*
- *Effectiveness and efficiency.*
-

The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies.

Corporate governance is important because it ensures that stakeholders with a relevant interest in the company's business are fully taken into account. In other words, it is necessary for structures to be in place to ensure that every stakeholder in the company is not disadvantaged. As it is the directors that manage the company, the burden of good corporate governance falls on them. It is important that they manage the company in the best way for the shareholders, employees and other parties.

The **OECD** Principles of Corporate Governance set out the rights of shareholders, the importance of disclosure and transparency and the responsibilities of the board of directors. An important question to consider is 'Will the same way of managing companies be the best method for all companies?' The answer is likely to be no. Companies are different from each other, and globally, they operate in different legal systems with different institutions, frameworks and traditions. It would not be possible to construct one single way of operating companies that could be described as good practice for all.

The key issue in corporate governance is that 'a high degree of priority [is] placed on the interests of shareholders, who place their trust in corporations to use their investment funds wisely and effectively'. Shareholders in a company might be a family, they might be the general public or they might be institutional investors representing, in particular, people's future pensions. These shareholders will vary in their degree of interaction with the company and their directors.

OECD Principles of Corporate Governance

1. The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
2. The corporate governance framework should protect and facilitate the exercise of shareholders' rights.
3. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
4. The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises.
5. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
6. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The global financial crisis prompted the **OECD** to investigate the shortcomings in corporate governance highlighted by the crisis. This investigation started in 2008 and led to the publication of 'Conclusions and emerging good practices to enhance implementation of the Principles' in February 2010. The guidance includes recommendations to help companies and governments to overcome corporate governance weaknesses and support a more effective implementation of the OECD principles described above.

It concentrates on the following areas:

- Governance of remuneration and incentives
- Improving the governance of risk management
- Improving board practices
- The exercise of shareholder rights

The UK Corporate Governance Code produced by the FRC sets out standards of good practice regarding board leadership and effectiveness, accountability (including audit), remuneration and relations with shareholders.

All companies with a Premium Listing of equity shares in the UK are required under the Listing Rules to report on how they have applied the Code in their annual report and accounts (regardless of whether the company is incorporated in the UK or elsewhere). The Code contains broad principles and more specific provisions. Listed companies have to report how they have applied the principles, and either confirm that they have applied the provisions or if they have not, to provide an explanation. There is a separate section of the Code devoted to the application of this 'comply or explain' concept. It sets out that choosing not to follow a provision may be justified by the board if good governance is achieved by other means. However the reasons for not complying should be clearly and fully explained to the shareholders. Any explanation must include details as to how actual practices are consistent with the overall principle to which a provision relates.
The four P's of corporate governance are people, process, performance, and purpose.

Principles of the UK Corporate Governance Code (for listed UK companies)

Leadership - Every company should be headed by an effective board, which is collectively responsible for the long-term success of the company. There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should and help develop proposals on strategy.

Effectiveness - The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively. There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge. The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Accountability - The board should present a balanced and understandable assessment of the company's position and prospects. The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems. The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor.

Remuneration - Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance. There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Relations with shareholders - There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. The board should use the AGM to communicate with investors and to encourage their participation.

Types of bad governance practices include:

- Companies that do not cooperate sufficiently with auditors or do not select auditors with the appropriate scale, resulting in the publication of spurious or noncompliant financial documents.
- Bad executive compensation packages that fail to create an optimal incentive for corporate officers.
- Poorly structured boards that make it too difficult for shareholders to oust ineffective incumbents.

These are all areas an investor can research before making an investment decision.

'The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor. Auditors have an important role to play in maintaining good corporate governance. If information is disclosed and audited according to a high quality, the reliability and comparability of reporting will be increased and investors will be able to make better investment decisions. Shareholders should benefit from auditor's checks on the disclosures made by the board in order to comply with corporate governance best practice.

So for example, auditors could be asked to check whether companies are applying certain aspects of corporate governance codes. What auditors need to check and report on will depend on the laws and regulations applicable in specific countries.

Systems, controls and monitoring

Directors are responsible for the systems put in place to achieve the company policies and the controls put in place to mitigate risks. Under the UK Corporate Governance Code, UK boards (through the audit committee) are required to consider annually whether an internal audit department is required. If there is no internal audit function, the reasons for not having one need to be explained in the annual report.

The directors are also responsible for monitoring the effectiveness of systems and controls but remember it is the directors that are responsible for determining whether to have an internal audit department to assist them in monitoring in the first place.

In the UK, the Turnbull report on internal control made the following recommendations which formed the basis of guidance on internal control issued by the FRC ('Internal Control: Guidance for Directors') aimed at assisting companies in applying the UK Corporate Governance Code internal control provisions.

Turnbull Guidelines

- Have a defined process for the effectiveness of internal control
- Review regular reports on internal control
- Consider key risks and how they have been managed
- Check the adequacy of action taken to remedy weaknesses and incidents
- Consider the adequacy of monitoring
- Conduct an annual assessment of risks and the effectiveness of internal control
- Make a statement on this process in the annual report

Composition of Boards

A board of directors should consist of a diverse group of individuals, those that have skills and knowledge of the business, as well as those who can bring a fresh perspective from outside of the company and industry. The board of directors must ensure that the company's corporate governance policies incorporate the corporate strategy, risk management, accountability, transparency, and ethical business practices.

Non-executive directors are directors who do not have day-to-day operational responsibility for the company. They are not employees of the company or affiliated with it in any other way. An important recommendation of the principles of the UK Corporate Governance Code is that the board contains some non-executive directors to ensure that it exercises objective judgement. The UK Corporate Governance Code requires 'an appropriate combination' of executive and non-executive directors on the board and recommends that at least half the board should comprise non-executive directors.

Such non-executive directors may have a particular role in some sensitive areas such as company reporting, nomination of directors and remuneration of executive directors. It is important, therefore, that they have the appropriate mix of skills, commitment, experience and independence to carry out their roles effectively. One of the non-executives should be appointed as the senior independent director who will be available to shareholders if they have concerns.

IAS 2 prescribes the basis of determining and accounting for inventories as an asset until the related revenues are recognized. The standard also provides guidance on the valuation of inventories and their consequent write-down as an expense, and the treatment to be adopted on related revenues being recognized. It applies to all inventories except

- WIP under IFRS 15
- Financial Instruments (shares and bonds) [IAS 32, IAS 39, IFRS 7 & 9]
- Biological assets (IAS 41)

Key Definitions

Inventories are assets that are:

- held for sale in the ordinary course of business (e.g., finished goods); or
- In the process of production for such sale;
- In the form of materials or supplies to be consumed in the production process or in the rendering of service (raw materials or WIP)

Net realizable value (NRV): The estimated selling price that is realizable in the normal course of business less the estimated cost required to complete and make the sale.

Fair value: The value at which an asset can be exchanged or a liability can be settled in an arm's-length transaction between two or more knowledgeable and willing parties.

Types of Inventories

- Goods purchased and held for sale
- Finished goods
- WIP being produced
- Raw materials awaiting use
- Consumables

Measurement Initial Measurement:

Inventories are recognized initially at cost

Subsequent measurement: subsequently, at lower of cost and Net Realizable Value
Cost of Inventory

The cost of inventories comprises all

- Costs of purchase of the inventories
- Costs of conversion – direct labour costs and attributable production overheads (direct costs and production overheads) and
- Other costs incurred in bringing the inventories to their present location and condition
- The cost of purchase of the inventories shall comprise:
- Purchase price
- Import duties and other non-recoverable taxes,
- Transport and handling charges
- Trade discounts

Excluded Costs

Certain costs are not included in valuing inventory. They are recognized as expenses during the period they are incurred. Examples of such costs are:

- Abnormal amounts of wasted materials, labor, or other production costs
- Storage costs unless they are essential to the production process
- Administrative overheads that do not contribute to bringing inventories to their present location and condition
- Selling costs
- Interest cost [where settlements deferred] (IAS 23 Borrowing costs identifies rare circumstances where borrowing costs can be included)

Cost measurement

The cost of inventories is measured using one of the following:

- Specific identification

- First-in, first-out (FIFO) method
- Weighted average cost method

The use of LIFO is prohibited

Measurement Techniques

The standard cost method takes into account normal levels of material, labour, efficiency, and capacity utilization. They are regularly reviewed and, if necessary, revised in the light of current condition.

The retail method is often used by entities in the retail industry for which large numbers of inventory items have similar gross profit margins. The cost is determined by subtracting the percentage gross margin from the sales value.

The percentage used takes into account inventory that has been marked down to market value (if market is lower than cost).

Net Realisable Value (NRV) is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs to make the sale.

As a general rule, assets should not be carried at amounts greater than those expected to be realized from sale or use. In the case of inventories this amount could fall below cost.

The main situations in which NRV is likely to be less than cost are as following:

- An increase in costs or a fall in selling price
- A physical deterioration in the condition of inventory
- Obsolescence of products
- A decision as part of marketing strategy to manufacture and sell products at a loss
- Errors in production of purchasing

A write down on inventories from cost to NRV would normally take place on an item by item basis but similar or related items may be grouped together.

Inventory of Service Providers

The inventories of service providers are measured at costs of their production. These costs consist primarily of labor and other costs of personnel directly used in providing the service, including cost of supervisory personnel, and attributable overheads. The costs of inventories of service providers should not include profit margins or non-attributable overheads that are generally used in prices quoted by service providers to their customers.

Disclosures:

The financial statements should disclose:

- Accounting policies adopted for measuring inventories and the cost measurement formula (FIFO, Weighted average or specific identification) used
- The total carrying amount of inventories along with their appropriate classifications (FG, WIP, RM etc.)
- Carrying amount of any inventories carried at fair value less costs to sell
- Amount of inventory recognized as expense during the period
- Amount of any write-down of inventories recognized as an expense in the period
- Amount of any reversal of a write-down to net realizable value and the circumstances that led to such reversal.
- Circumstances requiring a reversal of the write-down
- Carrying amount of inventories pledged as security for liabilities

THEME: "ECONOMIC REVITALIZATION THROUGH COMPLETION, CONSOLIDATION AND CONTINUITY"

2020 Macroeconomic Performance

Overall real GDP – September 0.2%

Non-Oil real GDP – September 0.4%

End-period Inflation – December 10.4%

Overall budget deficit on cash basis as % of GDP – September 11.4%

Primary Balance – September 5.3% (Deficit)

Debt to GDP – 76.1%

Gross International Reserves (Import cover) – 4.1

2021 Key Programmes to be implemented

Implementation of Covid 19 containment measures including vaccination

Economic revitalization and transformation through implementation of the CARES programmed whiles ensuring debt sustainability

Consolidation and completion of existing programs/projects to ensure value for money

Creation of fiscal space for implementation of priority programs/projects

Creating and sustaining jobs

Security

Entrepreneurship and wealth creation

2021 Budget Informed Policy Direction

President's Coordinated Programme of Economic and Social Development Programme (2017 – 2024)

Ghana Covid 19 Alleviation, Revitalization and Enterprise Support Programme (CARES)

Ghana Beyond Aid Agenda

Public Financial Management Act, 2015 (Act 921) and its companion Regulations

The 2020 Manifesto of the New Patriotic Party (NPP)

African Union Agenda 2063; and

UN Sustainable Development Goals

2021 Macroeconomic Targets

Overall Real GDP growth of 5.0%

Non-Oil Real GDP growth of 6.7%

End-period inflation of 8.0%

Fiscal deficit of 9.5% of GDP

Primary surplus of 0.9% of GDP

Gross International Reserves – not less than 4.0 months of imports of goods and services

Some proposed Tax Measures in 2021 Budget Statement

1. **Introduction of 5% Financial Sector Cleanup Levy on Profit before Tax on Banks.**
2. **Increment in road tolls**
3. **Increment in Special Petroleum Levy by 10ps per litre.**
4. **Waiver of interest and penalty on unpaid taxes if paid by September 2021 (Amnesty).**

5) Increment in NHIL by 1% (from 2.5% to 3.5%) as COVID- 19 Levy.

6) Increment in VAT Flat rate by 1% as COVID 19 levy.

AUDIT REPORTING FRAMEWORK

By Yaw Ofori

Introduction

An auditor's report is a written letter from the auditor containing their opinion on whether a company's financial statements comply with International Standards on Auditing (ISAs) and are free from material misstatement.

The independent and external audit report is typically published with the company's annual report. The auditor's report is important because banks and creditors require an audit of a company's financial statements before lending to them.

However, an auditor's report is not an evaluation of whether a company is a good investment. Also, the audit report is not an analysis of the company's earnings performance for the period. Instead, the report is merely a measure of the reliability of the financial statements. The auditor's letter follows a standard format, as established by

International Standards on Auditing (ISAs). A report usually consists of three parts.

- The first part states the responsibilities of the auditor and directors.
- The second part contains the scope, stating that a set of standard accounting practices was the guide.
- The third part contains the auditor's opinion.

An additional paragraph may inform the investor of the results of a separate audit on another function of the entity. The investor will key in on the third paragraph, where the opinion is stated.

The type of report issued will be dependent on the findings by the auditor.

The final step in the audit process is to evaluate the audit evidence obtained, consider the impact of any misstatements identified, form an audit opinion, and prepare an appropriately worded audit report. The auditor's report is the means by which the external auditors express their opinion on the truth and fairness of a company's financial statements. Many of the contents of the auditor's report are prescribed by statute. They are also subject to professional requirements in the form of ISA 700 Forming an opinion and reporting on financial statements.

The Auditor's report may be modified or unmodified. For audits conducted in accordance with ISAs, the wording of the unmodified auditor's report will contain a minimum number of consistent elements so that users know the audit has been conducted in accordance with the recognized standards. The wording will be standard, except where additional paragraphs are added for an emphasis of a matter or other reporting matters.

Consistency in the auditor's report helps:

- Promote credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards; and
- Promote the user's understanding and helps to identify unusual circumstances (such as modifications to the auditor's report) when they occur.

In order to form the opinion, the auditor needs to conclude as to whether reasonable assurance has been obtained that the financial statements are free from material misstatement.

The auditor's conclusion needs to consider the following:

- Whether sufficient appropriate audit evidence has been obtained (ISA 330)
- Whether uncorrected misstatements are material (ISA 450)
- Qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements
    - Whether the financial statements adequately disclose the significant accounting policies selected and applied
    - Whether the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate
    - Whether accounting estimates made by management are reasonable
    - Whether the information in the financial statements is relevant, reliable, comparable and understandable
- Whether the financial statements provide adequate disclosures to allow users to understand the effect of material transactions and events on the information presented in the financial statements
- Whether the terminology used in the financial statements is appropriate
- The overall presentation, structure and content of the financial statements
- Whether the financial statements represent the underlying transactions and events so as to achieve fair presentation
- Whether the financial statements adequately refer to or describe the applicable financial reporting framework

Note

- The applicable financial reporting frameworks include:
- International Financial Reporting Standard for Small and Medium-sized Entities;
- International Financial Reporting Standards; and
- International Public Sector Accounting Standards.

Forming an opinion

When the auditors have gathered all the evidence required, the audit engagement partner will form the audit opinion as to truth and fairness of the financial statements as a whole. The following standards apply for the various audit opinions that can be given:

ISA 700 (as amended) - Forming an opinion and reporting on financial statements

ISA 705 - Modifications to the opinion in the independent auditor's report

ISA 706 - Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report

When forming their opinion, there are some key matters that the auditor must consider. These can be illustrated in the form of three questions:

Question 1 - Have all the procedures necessary to meet auditing standards and to obtain all the information and explanations necessary for the audit been carried out?

Question 2 - Have the financial statements been prepared in accordance with the applicable accounting requirements?

Question 3 - Do the financial statements give a true and fair view? (Are they fairly presented?)

True: Information is factual and conforms with reality, not false. In addition the information conforms with required standards and law. The accounts have been correctly extracted from the books and records.

Fair: Information is free from discrimination and bias and in compliance with expected standards and rules. The accounts should reflect the commercial substance of the company's underlying transactions.

The Audit Report as a means of Communication

Implied information

Unmodified audit reports may not appear to give a great deal of information. The report says much, however, by implication. Remember that the auditor's report by exception, so an unmodified standard report tells the user that, for example:

- Adequate accounting records have been kept.
- The accounts agree with the records.
- The auditors have received all necessary information.
- All directors' transactions have been disclosed.
- The directors' report is consistent with the accounts.

The real problem here is that, unfortunately, most users do not know that this is what an unmodified audit report tells them. This issue is also confused by the fact that many users do not understand the responsibilities of either the auditors or the directors in relation to the financial statements. In addition to the above, the auditor's report communicates the following information to the reader among others:

- Responsibilities of management for the financial statements;
- Responsibilities of the auditor and a description of the audit;
- The audit was conducted in accordance with International Standards on Auditing;
- The financial reporting framework used; and
- The auditor's opinion on the financial statements.
- Other reporting responsibilities

The act of communication

In essence, the auditor's job is straightforward. They carry out tests and enquiries and evaluate evidence received with the purpose of drawing an audit opinion. They then communicate that opinion, in the form of an audit report. This can cause problems.

The communication problem is caused by a number of different problems that can be identified under three headings, although some of the issues are broadly linked between categories.
The three problematic areas are: Understandability; Responsibility; Availability.

a) Understandability

Although the essence of the auditors' role is simple, in practice it is surrounded by auditing standards and guidance as it is a technical art. It also involves relevant language, or 'jargon' that non-auditors may not understand. This can be seen in a definition of what audit is. 'An audit is an exercise designed to show whether financial statements are free from material misstatement and give a true and fair view.' The highlighted words reveal the problem. Communicating the audit opinion in a way that people can understand is a challenge.

b) Responsibility

Connected with the problem of what the audit is and what the audit opinion means is the issue of what the auditor is responsible for. As far as the law is concerned, auditors have a restricted number of duties. Professional standards and other bodies place other duties on auditors.

Users of financial statements, and the public, may not have a very clear perception of what the auditors are responsible for and what the audit opinion relates to, or what context it is in.

- The issue of auditors' liability ties in here. Audit reports are addressed to shareholders, to whom auditors have their primary and legal responsibility. However, audited accounts are used by significantly more people than that. Should this fact be addressed in the audit report?

c) Availability

The availability of audit reports has been increased by the trend to publish financial statements on companies' websites. Auditors should consider the risks relating to this.

The fact that a significant number of people use audited accounts has just been mentioned. Audit reports are publicly available, as they are often held on public record. This fact alone may add to any perception that exists that auditors address their report to more than just shareholders.

- The problem of availability is exacerbated by the fact that many companies publish their financial statements on their website.
- The IAASB Paper Financial reporting on the internet: responsibilities of directors and management stresses the need for directors and senior management to ensure that any financial information provided has the same

integrity as that published in paper form.

- This also means that millions of people around the world have access to the audit report. The IAASB Paper states that management should implement procedures to ensure access.

However, this issue may add significant misunderstandings.

Language barriers may cause additional understandability problems

It may not be clear which financial information an audit report refers to

The audit report may be subject to malicious tampering by hackers or personnel

If an audit report is published electronically, auditors lose control of the physical positioning of the report, that is, what it is published with. This might significantly impact on understandability and also perceived responsibility.

Expectations gap

- This difference between the actual and the public perception is part of what is called the 'expectations gap', defined as the difference between the apparent public perceptions of the responsibilities of auditors on the one hand (and hence the assurance that their involvement provides) and the legal and professional reality on the other.
- The question remains: how can we make the meaning of an unqualified audit report clear to the user?
- The above definition of the expectations gap is not definitive but we can highlight some specific issues.

(a) Misunderstandings of the nature of audited financial statements, for example that:

- The statement of financial position provides a fair valuation of the reporting entity.
- The amounts in the financial statements are stated precisely.
- The audited financial statements will guarantee that the entity concerned will continue to exist.

(b) Misunderstanding as to the type and extent of work undertaken by auditors

(c) Misunderstanding about the level of assurance provided by auditors, for example that:

An unmodified auditor's report means that no frauds have occurred in the period.

The auditors provide absolute assurance that the figures in the financial statements are correct (ignoring the concept of materiality and the problems of estimation).

The Auditor's Objective

- The objectives of the auditor are:

    a. To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
    b. To express clearly that opinion through a written report that also describes the basis for that opinion.

General Purpose Frameworks

- There are two types of general purpose frameworks:
    - the "fair presentation framework" and
    - the "compliance" framework."

These frameworks are described in the following exhibit.

Fair Presentation Framework

- A financial reporting framework (such as International Financial Reporting Standards) that requires compliance with the requirements of the framework, and:

i. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

ii. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

- The auditor reports on whether the financial statements "present fairly, in all material respects" or "give a true and fair view of" the information that the financial statements are designed to present.

Compliance Framework

A financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above for "fair" presentation. The auditor is not required to evaluate whether the financial statements achieve fair presentation. An example would be a financial reporting framework stipulated by a law or regulation that is designed to meet the financial information needs of a wide range of users.

The auditor reports on whether the financial statements are prepared, in all material respects, in accordance with, for example, "Jurisdiction X Corporations Act." / Ghana's Companies Code, 1963, Act 179

National Standards

- A reference in the auditor's report to both International Standards on Auditing and the national auditing standards is appropriate when no conflict exists between the requirements of both sets of standards.
- If a conflict exists, the auditor's report would only refer to the auditing standards (either International Standards on Auditing or the national auditing standards) in accordance with which one the auditor's report has been prepared.
- For example, ISA 570 requires the auditor to add an Emphasis of Matter paragraph to highlight a going concern problem, whereas some national auditing standards prohibit such a paragraph.

Type of Opinion	Auditor's Consideration
Unmodified Opinion	The financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, and an unmodified opinion would be appropriate.
Modified Opinion (Qualified, Adverse, or Disclaimer)	• Based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or • Sufficient appropriate audit evidence could not be obtained to conclude that the financial statements as a whole are free from material misstatement.

Unmodified Auditor's Report

- An unmodified opinion is the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- *Note the distinction between that of Fair Presentation and that of Compliance*

Modified Auditor's Report

a) The nature of a modified audit report

An audit report is said to be modified where either:

a matter arises which does not affect the opinion given by the auditor, but which gives rise to an 'emphasis of matter paragraph' or an 'other matter paragraph' in the audit report (covered by ISA 706), or

a matter arises which does affect the opinion issued on the financial statements. This will give rise to a qualified opinion, a disclaimer of opinion or an adverse opinion (covered by ISA 705).

- A modified audit report can therefore either have an unmodified audit opinion or a modified audit opinion.
- Before issuing a modified report, the auditor should discuss with management the reason for the modification. The reason should be explained and the auditor should ask the client entity's management to amend the financial statements.
    - If management makes the necessary adjustments, the auditor will not need to issue a modified report.
    - If management refuses to make the amendments, a modified report may be the only course of action available to the auditor.

- **NOVEMBER 2020 PROFESSIONAL EXAMINATIONS MANAGEMENT ACCOUNTING (PAPER 2.2)**
- **CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**
- **STANDARD OF THE PAPER**

Candidates were examined in the areas of projected financial analysis statements, costing techniques and budgeting, standard costing and variance analysis, investment appraisal and break – even analysis. All these subjects are within the approved syllabus of the Institute. No errors were noted in the questions and the contents were considered appropriate (Not loaded).

The weighting of the written and calculated questions was considered imbalance. This is because written questions accounted for 24% of the total marks whilst calculations accounted for 76%. A weighing of at least 35/65 will be appropriate.

Performance
The general performance of the candidates was not satisfactory. The pass rate for this paper was 12%. Majority of candidates scored below 35% with the lowest score being 3%.

Notable Weaknesses Of Candidates
Lack of knowledge and understanding of some of the concepts and techniques they were examined on such as Kaizen Costing, the use of High – Low methods of cost estimation and Balanced Score Card. Inability to present operating financial statements using the marginal costing approach. They could not come out clearly with the revenue, cost of sales, contribution, fixed costs and profits correctly.

Question One
A motor car manufacturer has been specializing in the production and sale of Bedford model of cars. The model is somewhat outmoded and the current sales forecast indicates that the current (2018) sales level of 150,000 will be the same as 2019 but will decline to 130,000 cars in 2020, and 110,000 cars in 2021. The company supplies according to orders received and no stocks are held. Carbon monoxide emission regulations will prevent the model from being manufactured and sold after December 2021.

The company's current estimates of the selling price and costs in 2019 are as follows:

Per car	GH¢
Selling Price	11,200
Production costs:	

Material and Labour (vary with production volume)	3,600
Assembly	4,000
Delivery	2,500

75% and 40% of the assembly and delivery costs respectively are fixed and the remainder vary with production volume.

In addition, the company estimates that it will incur the following non-production costs:
- Marketing costs of GH¢60 million would be amortised on straight line basis over three years.
- The Administration costs of GH¢10 million are fixed per annum.
- The selling price, variable costs per car and total fixed costs are expected to remain constant throughout the period from 2019 to 2021.
-

The company's Managing Director is unhappy with the current annual profit forecasts for 2019–2021 based on the information above and believes that the company has the potential to increase the profit to a desired level of GH¢245 million in each of the years 2019 to 2021. The Managing Director has undertaken a strategic review and developed the following strategies in order to eliminate the gap:

Strategy 1
A marketing proposal will enable the company to enter a new overseas market with the result that the total (including the overseas market) sales level will be stabilised at 160,000 cars per annum from 2019 to 2021. The market entry costs will be GH¢30 million for each of the three years.

Strategy 2
A re-design of the car will enhance its sales appeal and will permit the company to increase its selling price to GH¢12,000. The re-design costs are GH¢30 million and are to be amortised over three years on a straight line basis.

Strategy 3
A radical cost reduction programme will improve efficiency and lower all variable costs by 20%. This will add GH¢70 million to the annual fixed overheads each year from 2019 to 2021.

Required:
a) Prepare a financial analysis statement showing the current annual forecast of costs, revenues and profits for each of the years 2019 to 2021 and briefly comment on the figures. (Ignore time value of money) (9 marks)
b) Calculate the profit gap for 2019, 2020 and 2021 (3 marks)
c) Estimate the profit in 2019 if:
i) Strategy 1 was implemented; (2 marks)
ii) Strategy 2 was implemented; (2 marks)
iii) Strategy 3 was implemented. (2 marks)
d) Evaluate which strategy to implement. (2 marks) (Total: 20marks)

QUESTION TWO
a) In cost management, Target costing and Kaizen costing play key roles. Distinguish between these two cost techniques. (5 marks)
b) Mercury Company's management wants to prepare budgets for one of its products, TomaCan, for October 2019. The firm sells the product for GH¢75 per unit and has the following expected sales (in units) for these months in 2019:

July	August	September	October	November	December
6,000	7,000	8,000	9,000	10,000	11,000

The production process requires 5 kilos of Atadwe and 3 kilos of Ginger. The firm's policy is to maintain an ending finished goods. Inventory each month equal to 15% of the following month's budgeted sales, but in no case less than 1,300 units. All materials inventories are to be maintained at 10 % of the production needs for the next month, but not to exceed 3,000 kilos. The firm expects all inventories at the end of September to be within the guidelines. The purchase department expects the materials to cost GH¢1.75 per kilo and GH¢5.00 per kilo for Ginger and Atadwe respectively.

The production process requires direct labour at two Skill Levels (SL). The rate for labour at SL1 is GH¢45 per hour and for SL2 is GH¢25 per hour. SL1 can process one batch of TomaCan per hour while SL2 uses double the time of SL1 for the same output. Each batch consists of 10 units.

Variable manufacturing overhead is GH¢100 per batch plus GH¢75 per direct labour-hour. Fixed production overhead is GH¢51,240. It is the plan of Mercury Company to spend a third of variable and fixed production overhead costs on selling and administration expenses. The company is in the 25% tax bracket but enjoys a rebate of 50% because of its location. The company uses an actual cost system. The unit cost of production in October is the same as that of September.

Required:

On the basis of the preceding data and projections, prepare the following budgets:

i) Production budget for October (in units). (2 marks)
ii) Direct materials purchases budget for October (in kilos). (2 marks)
iii) Direct materials purchases budget for October (in Cedis). (1 marks)
iv) Direct manufacturing labour budget for October (in Cedis). (2 marks)
v) Income statement for the month of October 2019. (8 marks) (Total: 20 marks)

QUESTION THREE

a) The aim of a balanced scorecard is to provide a comprehensive framework for translating a company's strategic objectives into a coherent set of performance measures. It allows managers to look at the business from four different perspectives.

Required:

Identify and explain these FOUR (4) perspectives. (10 marks)

b) Zip Ltd, a premium food manufacturer, is reviewing its operations for a three-month period for 2019. The company operates a standard marginal costing system and manufactures one product, ZP, for which the following standard revenue and cost data per unit of product is available:

Selling price	GH¢12.00
Direct material A	2.5 kg at GH¢1.70 per kg
Direct material B	1.5 kg at GH¢1.20 per kg
Direct labour	0.45 hours at GH¢6.00 per hour

Fixed production overheads for the three-month period were expected to be GH¢62,500.

Actual data for the three-month period was as follows:

Sales and production	48,000 units of ZP were produced and sold for GH¢580,800
Direct material A	121,951kg were used at a cost of GH¢200,000
Direct material B	67,200 kg were used at a cost of GH¢84,000
Direct labour	Employees worked for 18,900 hours, but 19,200 hours were paid at a cost of GH¢117,120
Fixed production overheads	GH¢64,000.

Budgeted sales for the three-month period were 50,000 units of Product ZP.

Required:

Calculate the following variances.

i) Sales volume contribution and sales price variances

ii) Price, mix and yield variances for each material

iii) Labour rate, labour efficiency and idle time variance (10 marks) (Total: 20 marks)

QUESTION FOUR

a) Jayjay & Co is a medium sized company that is engaged in delivery services. As a result of the recent increase in the demand for his services the Managing Director (MD) is planning to acquire a delivery van at the cost of GH¢85,000. The expected net cash flow per year are as follows:

Year 1	Year 2	Year 3	Year 4	Year 5
GH¢25,000	GH¢28,000	GH¢39,000	GH¢34,000	GH¢24,000

The Sales Manager has indicated to the MD that the company will recoup its investment in less than four years and for that reason, it's a good investment. The Management Accountant has however drawn the MD's attention to the fact that the Sales Manager has not factored in time value of money and the cost of capital into his analysis. The Management Accountant could not however suggest the cost of capital since financial institutions are charging different interest rates.

Required:

i) Calculate the cost of capital that when used will make the investment break-even when the useful life of the van is five years with residual value of GH¢8,500. (11 marks)

i) Explain TWO (2) advantages and TWO (2) disadvantages of the payback method of investment appraisal and show how it compares to the discounted cash flow method. (4 marks)

b) Explain THREE (3) advantages and TWO (2) disadvantages of standard cost. (5 marks)

(Total: 20 marks)

QUESTION FIVE

Quickspray Ltd offers professional car spraying services at Suame Magazine. The company is planning its activities for the month of June 2018 for its saloon car spraying section. The company charges service fee of GH¢1,000 and incurs fixed cost (excluding fixed maintenance cost) and variable cost per unit (excluding variable maintenance cost) of GH¢35,000 and GH¢644.39 respectively for spraying of a saloon car.

The following data also relates to Quickspray Ltd on the maintenance hours of its key machine, revenue and profit for the six months ended April 2018.

Month	Maintenance Hours	Revenue (GH¢)	Profit(GH¢)
November, 2017	1,200	19,000	700
December, 2017	1,425	24,000	1,425
January, 2018	1,410	20,100	650
February, 2018	1,400	20,000	1,000
March, 2018	1,175	18,000	(125)
April, 2018	1,275	19,000	175

Total fixed cost increases by GH¢1,120 when maintenance hours go beyond 1,400.

Required:

a) Determine the total maintenance cost of production, using high-low method if;

i) Maintenance hours of May was budgeted to be 1,520.

ii) Maintenance hours of June is budgeted to be 1,075. (10 marks)

b) Calculate for the month of May the;

i) Break-even point in units and value (4 marks)

ii) Sales level in order to make an after-tax profit of GH¢21,150, assuming Quickspray Ltd is in the 25% tax bracket. (4 marks)

iii) Margin of safety if the target after-tax profit of GH¢21,150 is achieved. (2 marks)

(Total: 20 marks)

SOLUTION TO QUESTIONS
QUESTION ONE

a)

	2019	2020	2021
Sales Units	150,000	130,000	110,000
	GH¢'million	GH¢'million	GH¢'million
Revenue	1680	1456	1232
Materials& Labour	540	468	396
Assembly 1,000	150	130	110
Delivery 1,500	225	195	165
Total Variable Cost	915	793	671
Contribution	765	663	561
Less: Fixed Cost			
Assembly	450	450	450
Delivery	150	150	150
Marketing	20	20	20
Administrating Costs	10	10	10
Total Fixed Costs	630	630	630
Profit	135	33	(69)

(9 marks evenly spread)

b) Profit Gap	(110)	(212)	(314)	(3 marks)

c)

	Original	Strategy 1	Strategy 2	Strategy 3
Sales Units	150,000	160,000	150,000	150,000
	GH¢'million	GH¢'million	GH¢'million	GH¢'million
Revenue	1680	1792	1800	1680
Materials& Labour	540	576	540	432
Assembly 1,000	150	160	150	120
Delivery 1,500	225	240	225	180
Total Variable Cost	915	976	915	732
Contribution	765	816	885	948
Less: Fixed Cost				
Assembly	450	450	450	450
Delivery	150	150	150	150
Marketing	20	20	20	20
Administrative Costs	10	10	10	10
Strategy I entitycost	-	30	10	70
Total Fixed Costs	630	660	640	700
Profit	135	156	245	248

(6 marks evenly spread using ticks)

d) Strategy 3 should be selected as it is not only higher than the original profit, but also closes the profit gap. (2 marks) (Total: 20 marks)

EXAMINER'S COMMENTS

Performance in this question is not satisfactory. Most of the candidates could not present the suggested solution in a well layout marginal costing format to bring out clearly the revenue, VC, Contribution, FC and the profit. The candidates did not also understand what a "Profit Gap" is which is simply the difference between the desired profit and the actual profit. The major problem faced by the candidates in this question is their inability to interpret and analyse the effects of the various strategies on the entry costs, redesign costs and annual fixed costs of GH¢30 million, GH¢30 million and GH¢70 million respectively for the three strategies.

QUESTION TWO

a) Target costing Vs Kaizen costing

• Kaizen costing is a Japanese concept focused on obtaining small incremental cost reductions during the production stage of the Product Life Cycle using principles such as Value Analysis and Functional Analysis. Kaizen Costing is typically based on the following principles: Employees are the source of solutions; Cost reductions are achieved by continuous improvement; Cost reduction targets are set every month.

• Target costing ie estimated selling price -target cost=desired level of profit. It is an integral part of a strategic profit management system. The determination of the target cost starts by determining an estimate of the selling price for a new product that will help achieve the required share of the market (revenue/market size *100). This selling price is then reduced to obtain the desired level of profit, having regard for the firm's required rate of return on new capital investments and working capital requirements. The difference b/n the SP and the desired profit produces the target cost. This target cost is then compared with the estimated current cost level. Where a gap exists it is bridged by using value analysis, value engineering, functional analysis, continuous improvement etc.

• While target costing is a critical means of managing the costs in a new product design and development stage, Kaizen costing supports continuous improvement activities in the manufacturing phase. It is an alternative to ABC and combined with target costing, Kaizen costing helps Japanese manufacturers accomplish their objective of cost reduction in the full cycle of design-development-production cycle.

(2 points well explained @2.5 marks each=5 marks)

b) Sales Budget for October 2019

Units to sell	9,000
Selling price	GH¢75
	GH¢675,000

i) Production Budget for October 2019

Desired ending inventory (15% x 10,000 or 1,300 if less)	1,500	
Budgeted units to sell	9,000	
Total units required	10,500	
Less expected opening inventory (15% 9000 or 1,000 if less)	1,350	
Units to produce	9,150	
Production Budget for November 2019		
Desired ending inventory (15% x 11,000 or 1,300 if less)	1,650	
Budgeted units to sell	10,000	
Total units required	11,650	
Less expected opening inventory (15% 10,000 or 1,300 if less)	1,500	
Units to produce	10,150	(2 marks)

ii) Direct Materials Purchases Budget (in kilos) For October 2019

Direct Materials

	Atadwe (5 kilos each)	Ginger (3 kilos each)	
Materials required for budgeted Production (9,150 units of TomCan)	45,750	27,450	
Add: Target inventories (lower of 3,000 or 10 percent of November production needs)	3,000*	3,000*	
Total materials requirements	48,750	30,910	
Less: Expected beginning inventories (lower of 3,000 or 10 percent of October needs)	3,000	2,745	
Direct materials to be purchased	45,750	27,705	(2 marks)

iii) Direct Materials Purchases Budget (in Cedis) For October 2019

Budgeted Purchases	Kilos	Expected Purchase Price per Unit	Total
Atadwe- 100	45,750	GH¢5.00	GH¢228,750.00
Ginger-50	27,705	GH¢1.75	GH¢48,483.75
Budgeted purchases			GH¢277,238.75 (1 mark)

iv) Direct Manufacturing Labor Budget For October 2019

Direct Labour-Hours

Direct Labour	Class per Batch	Number of Batches	Total Hours	Rate per Hour	Total
SL1	1	915*	915	GH¢45	GH¢41,175

SL2	2	915*	1,830	GH¢25	GH¢45,750
Total			2,745		GH¢86,925
					(2 marks)

v) Budgeted Income Statement For October 2019

	GH¢	GH¢
Sales		675,000
Less Cost of goods sold, FIFO basis* GH¢77.85 x 9,000		(700,650)
Gross margin		(25,650)
Less Selling and administrative expenses:		
Variable (1/3 x (915 x GH¢100)+(GH¢75 x 2,745))		(99,125)
Fixed (1/3 x GH¢51,240)		(17,080)
Operating income (Loss) before tax		(141,855)
* Actual manufacturing cost per unit; October 2019:		
Direct materials:		
Atadwe 5 kilos x GH¢5.00 =	25.00	
Ginger 3 kilos x GH¢1.75 =	5.25	30.25
Direct labor:		
SL1 labor 0.1 hour x GH¢45 =	4.50	
SL2 labor 0.2 hour x GH¢25 =	5.00	9.50
Factory overhead:		
Batch-related (915 x GH¢100)/9,150 =	10.00	
DLH-related (GH¢75 x 2,745)/9,150 =	22.50	
Fixed (GH¢51,240/9,150) =	5.60	38.10
Cost per unit, units produced in October		77.35

(8 marks evenly spread using ticks) (Total: 20 marks)

EXAMINER'S COMMENTS

Performance in this question was very poor. Most of the candidates did not understand or appears not to have heard of the Kaizen Costing techniques before. This technique is a Japanese concept based on the principles of cost reductions through continuous improvement. Employees are the source of the solutions and cost reduction targets are set every month. Few of the candidates could not determine the direct materials to be purchased. Moreover, 90% of the candidates could not determine the actual manufacturing cost per unit that should be used to determine the cost of goods sold in order to prepare the Budgeted Income Statement.

QUESTION THREE

a) The balanced scorecard approach emphasizes the need to provide management with a set of information which covers all relevant areas of performance in an objective and unbiased fashion. The information provided may be both financial and non-financial and cover areas such as profitability, customer satisfaction, internal efficiency and innovation.

Perspectives

The balanced scorecard focuses on four different perspectives, as follows.
Perspective Question Explanation

Customer

In the customer perspective of the Balanced Scorecard, managers identify the customer and market segments in which the business unit will compete and the measures of the business unit's performance in these targeted segments. This perspective typically includes several core or generic measures of the successful outcomes from a well-formulated and implemented strategy.

The core outcome measures include customer satisfaction, customer retention, new customer acquisition, customer profitability, and market share in targeted segments. But the customer perspective should also include specific measures of the value propositions that the company will deliver to customers in targeted market segments. The segment-specific drivers of core customer outcomes represent those factors that are

critical for customers to switch to or remain loyal to their suppliers. For example, customers could value short lead times and on-time delivery. Or a constant stream of innovative products and services.
• What do existing and new customers value from us?
• Gives rise to targets that matter to customers: cost, quality, delivery, inspection, handling and so on. (2.5 marks for points well explained)

Internal

In the internal-business-process perspective, managers identify the critical internal processes in which the organization must excel. These processes enable the business organizations to:
i) Deliver the value propositions that will attract and retain customers in targeted market segments, and
ii) Satisfy shareholder expectations of excellent financial returns.
The key to excellence in any organization is control of its processes to produce reliable and consistent products and services. Performing the right processes in the right manner leads to consistent levels of product and service quality. The difficulty lies in finding the right process variables to measure and setting the standards appropriate to performance levels of each of the process measures.

Process and operational measures are leading-edge measures that are more shortterm-focused.

- What processes must we excel at to achieve our financial and customer objectives?
- Aims to improve internal processes and decision making. (2.5 marks for points well explained)

Innovation and learning

For incentive purposes, the learning and innovation perspective focuses on the capabilities of people. Managers would be responsible for developing employee capabilities. Key measures for evaluating managers' performance would be employee satisfaction, employee retention, and employee productivity.

- Can we continue to improve and create future value?
- Considers the business's capacity to maintain its competitive position through the acquisition of new skills and the development of new products. (2.5 marks for points well explained)

Financial

The balanced scorecard uses financial performance measures, such as net income and return on investment, because all for-profit organisations use them. Financial performance measures provide a common language for analysing and comparing companies. People who provide funds to companies, such as financial institutions and shareholders, rely heavily on financial performance measures in deciding whether to lend or invest funds. Properly designed financial measures can provide an aggregate view of an organisation's success.

Financial measures by themselves do not provide incentives for success. Financial measures tell a story about the past, but not the future; they have importance, but will not guide performance in creating value.

- How do we create value for our shareholders?
- Covers traditional measures such as growth, profitability and shareholder value but set through talking to the shareholder or shareholders direct. (2.5 marks for points well explained)

b)

i)	GH¢
Standard sales price	12.00
Material A GH¢1.70*2.5	4.25
Material B GH¢1.20*1.5	1.80
Labour GH¢6.00*0.45	2.70
Standard contribution	3.25
Sales Volume contribution variance	
Budgeted sales volume	50,000 units
Actual sales volume	48,000 units
Sales volume variance in units	2,000 units (A)
*standard contribution per unit (GH¢3.25) *	GH¢3.25
Sales volume variance	GH¢6,500 (A)
Sales price variance	GH¢

Sales revenue for 48,000 units should have been (*GH¢12)	576,000
But was	580,800
Selling price variance	4,800 (F)
iiii) Direct material price variance	GH¢
121,951 kgs of A should have cost (*GH¢1.70)	207,317
But did cost	200,000
Material A price variance	7,317 (F)
67,200kg of B should have costs (*GH¢1.20)	80,640
But did cost	84,000
Material B price variance	3,360 (A)
Material mix variances	
Total quantity used (121,951 + 67200) kgs	189,151
Standard mix for actual use 2.5/4 A	118,219
1.5/4 B	70,932

Material	Actual Quantity Standard Mix	Actual Quantity Actual Mix	Variance	Standard Cost Per Kg	Variance
	Kgs	Kgs	Kgs	GH¢	GH¢
A	118,219	121,951	3,732 (A)	1.70	6,344 (A)
B	70,932	67,200	3,732 (F)	1.20	4,478 (F)
	189,151	189,151			1,866 (A)

Material yield variances in total		GH¢
Each unit of product ZP requires	2.5kg of A, costing	4.25
	1.5kg of B, costing	1.80
	4.0kg	6.05
189,151 kg should have yielded (÷ 4kg)		47,288 units
But did yield		48,000 units
Yield variance in units		712 units (F)
*standard cost per unit of output *		GH¢6.05
Yield variance		GH¢4,308 (F)

For Individual Materials

Material	Actual Quantity Standard Mix	Actual Quantity Actual Mix	Variance	Standard Cost per Kg	Variance
	Kgs	Kgs	kgs	GH¢	GH¢
A	120,000	118,219	1,781 (F)	1.70	3,028 (F)
B	72,000	70,932	1,068 (F)	1.20	1,282 (F)
	192,00	189,151	2,849 (F)		4,310 (F)

iii) Labour rate variance	GH¢
19,200 hours of works should have cost (*GH¢6 per hr.)	115,200
But did cost	117,120
Labour rate variance	1,920 (A)
Labour Efficiency Variance	
48,000 units of ZP should have taken (* 0.45 hrs)	21,600 hrs
But did take	18,900 hrs
Efficiency variance in hours	2,700 hrs (F)
*standard rate per hour *	GH¢6
Efficiency variance	GH¢16,200 (F)
Idle time variance	
18,900 hours were worked but 19,200 hours were paid for.	
Idle time variance= 300 hours (A) * GH¢6=	GH¢1,800 (A)
(10 marks evenly spread using ticks)	(Total: 20 marks)

EXAMINER' COMMENTS

Performance in this question was satisfactory. Most of the candidates had the computations of the variances right. Few of the candidates had problem with the concept of the Balanced Score Card. They were able to identify all the four different perspectives. However, they could not explain the concepts well that made them lose some marks especially the Internal Perspectives, which relates the company's processes and procedures. That is, the processes necessary to achieve financial and customer objectives, to improve internal processes and decision–making.

QUESTION FOUR

a)

i) Cost of capital that can make the Investment break even

Year	Cash Flow	30%	DCF	20%	DCF
	GH¢		GH¢		GH¢
0	(85,000)	1	(85,000)	1	(85,000)
1	25,000	0.769	19,225	0.833	20,825
2	28,000	0.592	16,576	0.694	19,432
3	39,000	0.455	17,745	0.579	22,581
4	34,000	0.350	11,900	0.482	16,388
5	24,000	0.269	6456	0.402	9,648
8	500	0.269	2286.5	0.402	3417
NPV			(10,811.5)		7,291

IRR = 20% + 7,291 x 10%
(7,291--10,811.5)
= 24.028 (11 marks evenly spread using ticks)

ii) Advantages of Payback Method and how it compares with Discounted Cashflow

- It is Simple

Payback is easy to calculate. Payback method looks at the number of years which make it simple and easy to understand.

- Offers Quick Evaluation

Determining which projects can generate fast returns is important to companies especially those with limited resources. Managers of such companies use this method to make a quick evaluation regarding projects with the small investment and short payback period.

- It shows the importance of considering liquidity when making investment decisions.

- It offers the shortest approach to calculating capital expenditure. (Any 2 points well explained for 2 marks)

Disadvantages of the Payback Method and how it compares with Discounted

Cash flow

- Ignores the time value of money: The most serious disadvantage of the payback method is that it does not consider the time value of money. Cash flows received during the early years of a project get a higher weight than cash flows received in later years. Two projects could have the same payback period, but one project generates more cash flow in the early years, whereas the other project has higher cash flows in the later years. In this instance, the payback method does not provide a clear determination as to which project to select.

- Neglects cash flows received after payback period: For some projects, the largest cash flows may not occur until after the payback period has ended. These projects could have higher returns on investment and may be preferable to projects that have shorter payback times.

- Ignores a project's profitability: Just because a project has a short payback period does not mean that it is profitable. If the cash flows end at the payback period or are drastically reduced, a project might never return a profit and therefore, it would be an unwise investment.

- Does not consider a project's return on investment: Some companies require capital investments to exceed a certain hurdle of rate of return; otherwise the project is declined. The payback method does not consider a project's rate of return. (Any 2 points well explained for 2 marks)

b) Advantages that result from a business using a standard cost system are:

- Improved cost control: Companies can gain greater cost control by setting standards for each type of cost incurred and then highlighting exceptions or variances—instances where things did not go as planned. Variances provide a starting point for judging the effectiveness of managers in controlling the costs for which they are held responsible.

- Assume, for example, that in a production center, actual direct materials costs of GH¢52,015 exceeded standard costs by GH¢6,015. Knowing that actual direct materials costs exceeded standard costs by GH¢ 6,015 is more useful than merely knowing the actual direct materials costs amounted to GH¢52,015. Now the firm can investigate the cause of the excess of actual costs over standard costs and take action.

- More useful information for managerial planning and decision making: When management develops appropriate cost standards and succeeds in controlling production costs, future actual costs should be close to the standard. As a result, management can use standard costs in preparing more accurate budgets and in estimating costs for bidding on jobs. A standard cost system can be valuable for top management in planning and decision making.

- More reasonable and easier inventory measurements: A standard cost system provides easier inventory valuation than an actual cost system. Under an actual cost system, unit costs for batches of identical products may differ widely. For example, this variation can occur because of a machine malfunction during the production of a given batch that increases the labor and overhead charged to that batch. Under a standard cost system, the company would not include such unusual costs in inventory. Rather, it would charge these excess costs to variance accounts after comparing actual costs to standard costs.

Thus, in a standard cost system, a company assumes that all units of a given product produced during a particular time period have the same unit cost. Logically, identical physical units produced in a given time period should be recorded at the same cost.

- Cost savings in record-keeping: Although a standard cost system may seem to require more detailed record-keeping during the accounting period than an actual cost system, the reverse is true. For example, a system that accumulates only actual costs shows cost flows between inventory accounts and eventually into cost of goods sold. It records these varying amounts of actual unit costs that must be calculated during the period. In a standard cost system, a company shows the cost flows between inventory accounts and into cost of goods sold at consistent standard amounts during the period. It needs no special calculations to determine actual unit costs during the period. Instead, companies may print standard cost sheets in advance showing standard quantities and standard unit costs for the materials, labour, and overhead needed to produce a certain product.

- Possible reductions in production costs: A standard cost system may lead to cost savings. The use of standard costs may cause employees to become more cost conscious and to seek improved methods of completing their tasks. Only when employees become active in reducing costs can companies really become successful in cost control. (Any 3 points for 3 marks)

Disadvantages that result from a business using standard costs are:

- Controversial materiality limits for variances: Determining the materiality limits of the variances may be controversial. The management of each business has the responsibility for determining what constitutes a material or unusual variance. Because materiality involves individual judgment, many problems or conflicts may arise in setting materiality limits.

- No reporting of certain variances: Workers do not always report all exceptions or variances. If management only investigates unusual variances, workers may not report negative exceptions to the budget or may try to minimize these exceptions to conceal inefficiency. Workers who succeed in hiding variances diminish the effectiveness of budgeting.

- Low morale for some workers: The management by exception approach focuses on the unusual variances. Management often focuses on unfavorable variances while ignoring favorable variances. Workers might believe that poor performance gets attention while good performance is ignored. As a result, the morale of these workers may suffer. (Any 2 points for 2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Performance was below expectation. Apart from the written questions relating to the merits and demerits of Payback Method of investment appraisal and the use of a standard cost system, about 50% of the candidates had difficulties in determining the IRR at which the investment break–even. The simplest way is to use two discount factors to evaluate the cashflows and make sure that, one of the rates given results in a negative NPV and the other positive, and then interpolate to arrive at the rate. However, the discount table given had a maximum rate of 20% which is below the rate required. Candidates therefore spent a lot of time deriving the discount factors.

This is the major challenge faced by the candidates on this question.

QUESTION FIVE

a)

Month	Maintenance Hours	Sales	Profit	Cost
Nov, 2017	1,200	19,000	700	18,300
Dec, 2017	1,425	24,000	1,425	22,575
Jan, 2018	1,410	20,100	650	19,450
Feb, 2018	1,400	20,000	1,000	19,000
Mar, 2018	1,175	18,000	-125	18,125
April, 2018	1,275	19,000	175	18,825

Using High- Low Method

Variable Cost per unit = <u>Highest Cost – Lowest Cost</u>

Highest Activity Level – Lowest Activity Level

= GH¢22,575-GH¢1,120 - GH¢18,125

1,425 machine hours – 1,175 machine hours

= GH¢3,330 /250 machine hours = GH¢13.32 per machine hour (3 marks)

Total Fixed Cost if Activity exceeds 1,400 machine hours:

Total Fixed Cost = Total Cost (Maximum Activity level) – Total Variable Cost at Maximum Activity Level

= GH¢22,575 – (GH¢13.32 x 1,425 machine hours)

= GH¢22,575 – GH¢18,981 = GH¢3,594 (2 marks)

Fixed Cost if Activity is below 1,400 will be:

GH¢3,594 – GH¢1,120 = GH¢2,474.00 (1 mark)

Expected Maintenance Cost in May 2018 based on 1,520 maintenance hours:

Maintenance Cost = GH¢3,594 + (GH¢13.32 x 1,520 maintenance hrs.)

= GH¢3,594+ GH¢20,246.40 = GH¢23,840.40 (2 marks)

Expected Maintenance Cost in June 2018 based on 1,075 maintenance hours:

Maintenance Cost = GH¢2,474 + (GH¢13.32 x 1075 maintenance hrs)

=GH¢2,474 + GH¢14,319 = GH¢16,793 (2 marks)

b)

i) BEP (May) = Total Fixed Cost / Contribution per unit = GH¢35,000 + GH¢3,594 / GH¢1,000–(GH¢644.39+GH¢13.32) = 113 cars

In sales Value = 113 cars x GH¢1,000 = GH¢113,000 (4 marks)

ii) Sales level to make an after-tax profit of GH¢21,150.00 =

Total Fixed Cost + Profit/0.75

Contribution Margin Ratio

= GH¢38,594 + GH¢21,150/(1-0.25) / 342.29/1,000 = GH¢38765 + GH¢28,200 / 0.34229

= GH¢195,138.63 (4 marks)

iii) Margin of Safety = Budgeted Sales Level – Break-even Sales x 100 / Break-even Sales

$$= \frac{\text{GH¢}195{,}138.63 - \text{GH¢}113{,}000}{\text{GH¢}113{,}000} \times 100$$

= 72.69% (2 marks) (Total: 20 marks)

EXAMINER'S COMMENTS

Performance in this question was very poor. The main difficulty was how the candidates, with the table given, will determine the effect of Total Fixed Cost increasing by GH¢1,120 when maintenance hours go beyond 1,400. Candidates were not able to determine the VC/Unit using the High-Low method.

CONCLUSION

The general performance was unsatisfactory. The examination questions were within the approved syllabus and the questions requirements were acceptable. The Institute should be considering compulsory tuition for all candidates and the exemption policy of the Institute should be looked at again.

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