SOLUTION FINANCIAL REPORTING MAY 2010

(a) Equity accounting is one of the methods for a company with subsidiaries to account for investments in its subsidiaries.

The investment is initially recorded in the consolidated statement of financial position at cost to the group which is also the fair value of the group share of the acquired assets and liabilities including goodwill arising on the investment. The carrying amount is adjusted for any write-off or impairment of goodwill and is increased or decreased to recognize its share of the profits or losses after the date of acquisition.

The equity method of accounting for investments in subsidiaries is suitable for interest greater than 20% but less than 50% of the net assets in the subsidiary. It is normally referred to as Associates where there is significant influence/interest but not controlling interest.

(b) Group Structure

Group (270/300)	90%
Non-Controlling Interest	10%
	100%

Cost of Control

	GH¢		GH¢
		Small Ltd	
Cost of ……..	380,000	Eq. shares (90% x 300,000)	270,000
		Ret. Earnings (90% x 40,000)	36,000
		Cap. Surplus (90% x 20,000)	18,000
		Fair valuation surplus 90% x 30,000	27,000
		Goodwill	29,000
	380,000		380,000

Goodwill a/c

	GH¢		GH¢
Cost of control	29,000	Cons. Inc. surplus: Impairment	18,000
		Bal c/d	11,000
	29,000		29,000
Bal b/d	14,000		

Minority Interest/Non Controlling Interest

	GH¢		GH¢
Unrealized Profit	100	Small Ltd	
CBS	55,700	Eq. shares (10% x 300,000)	30,000
		Ret. Earnings (10% x 198,000)	19,800
		Cap. Surplus (10% x 30,000)	3,000
		Fair valuation surplus10% x 30,000	3,000
	55,800		55,800

SOLUTION FINANCIAL REPORTING MAY 2010

Consolidated Capital Surplus

	GH¢		GH¢
CBS	129,000	Balance b/f	120,000
		Small Ltd (90% x 10,000)	9,000
	129,000		129,000

Consolidated Income Surplus

	GH¢		GH¢
Goodwill Impairment	18,000	Balance b/f	380,000
Unrealised Profit	900	Small Ltd (90% x 158,000)	142,200
CBS	521,300	Dividend … (90% x 20,000)	18,000
	540,200	Receivable	540,200

Big Ltd Group

Consolidated Statement of Financial Position as at 31 December 2009

Assets	GH¢
Non current Asset	
Tangible Assets (700,000 + 429,000) – 30,000	1,150,000
Goodwill (29,000 – 18,000)	11,000
	1,161,000
Current Assets	
Inventories (166,000 + 84,000) – 1,000	249,000
T. Receivables (204,000 + 96,000)	300,000
Bank (80,000 + 24,000 + 8,000)	112,000
	661,000
Total Assets	1,822,000
Equity & Liabilities	
Equity shares	800,000
Income surplus	521,300
Capital surplus	129,000
Shareholder fund	1,450,300
Minority Interest	55,700
Liabilities	1,506,000
Trade payables	254,000
Dividend payable - Big Ltd	60,000
- MI	2,000
Total Equity & Liabilities	1,822,000

SOLUTION FINANCIAL REPORTING MAY 2010

QUESTION 2

(a) AT & Associates

Adjusted Profit and Loss Account for the year ended 31st December 2009

	Add	Deduct	GH¢'000
Net profit for the year (9,050 x 2)			18,100
Adjustments			
Loss in value of Investments (15,000 x 35%)	-	5,250	
Cash misappropriated	-	2,050	
Bank charges	-	110	
Insurance prepaid	350	-	
	350	7,410	
Adjusted Net Profit			(7,060)
			11,040

Appropriation of Profit

Net profit		
Interest on capital:		
Addo	2,900	
Tetteh	1,310	4,210
Share of profits		
Addo	3,415	
Tetteh	3,415	6,830
		11,040

Workings

(1) Interest on Capital

		GH¢
Addo – (60,000 – 2,000) x 5%	=	2,900
Tetteh – (30,000 – 3,800) x 5%	=	1,310

(2) Cash & Bank

Balance as per B/S	-	20,120
Add cheques/payment no due	-	4,630
Less cash misappropriated	-	2,050
Less Bank charges	-	110
		22,590
Less drawings		5,800
		16,790

(3) Accounts Payable

Balance per B/S	-	13,400
Add payments not due	-	4,630
		18,030

(4) Investments

Carrying amount	-	15,000
Market value	-	9,750
Loss in value		5,250

(b) Partners' Current Account

	Addo	Tetteh		Addo	Tetteh
	GH¢'000	GH¢'000		GH¢'000	GH¢'000
Drawings	2,000	3,800	Bal b/d	5,420	6,100
Bal c/d	9,735	7,025	Int. on capital	2,900	1,310
			Share of profit	3,415	3,415
	11,735	10,825		11,735	10,825
				9,735	7,025

	Addo	Tetteh
	GH¢'000	GH¢'000
Balance b/d	5,420	6,100
Interest on capital	2,900	1,310
Share of profit	3,415	3,415
Drawings	(2,000)	(3,800)
	9,735	7,025

(c) AT & Associates

Balance Sheet as at 31st December 2009

	GH¢'000	GH¢'000
Fixed Assets		
Freehold buildings		36,000
Furniture & equipment		24,000
Motor vehicles		15,900
		75,900
Investment		9,750
Current Assets		
Accounts receivable	22,000	
Cash & Bank	16,790	
Prepayments	350	
	39,140	
Current Liabilities		
Accounts payable	(18,030)	
		21,110
		106,760
Capital Account:		
Addo		60,000
Tetteh		30,000
Current Account:		
Addo		9,735
Tetteh		7,025
		106,760

SOLUTION FINANCIAL REPORTING MAY 2010

Adjusted Income Statement

	GH¢
Profit for the year per draft I & S	18,100,000
Adjusts:	
Loss in value of investment	(5,250,000)
Cash misappropriated	(2,050)
Bank charges	(110)
Insurance prepaid	350
	12,848,190

Profit and Loss Appropriation Account

	GH¢	GH¢
Net profit		12,848,190
Interest on capital		
Addo	2,999,900	
Tetteh	1,499,810	4,499,710
		8,348,480
Share of profit		
Addo	4,174,240	
Tetteh	4,174,240	
		8,348,480

Partners Current Accounts

	GH¢	GH¢
Balance b/f	5,420,000	6,100,000
Interest on capital	2,999,900	1,499,810
Share of profit	4,174,240	4,174,240
Drawings	(2,000)	(3,800)
	12,592,140	11,770,250

Statement of Financial Position as at 31 December 2009

	GH¢	GH¢
Non Current Assets		
Freehold building		36,000,000
Furniture and equipment		24,000,000
Motor vehicles		15,900,000
		75,900,000
Investments		9,750,000
		85,650,000
Current Assets		
Accounts receivables	22,000,000	
Cash & budget	20,116,670	
Prepayment	350	

	42,117,020	
Current Liabilities		
Accounts payable	13,404,630	
Net current assets		28,712,390
		114,362,390
Capital:		
Addo		
Tetteh		60,000,000
		30,000,000
Current Accounts:		90,000,000
Addo	12,595,140	
Tetteh	11,770,250	
		24,362,390
		114,.362,390

Workings

(1) Interest on Capital

		GH¢
Addo (30,000,000 – 200) x 5%	=	2,999,900
Tetteh (30,000,000 – 3800) x 5%	=	1,499,810

(2) Accounts Payable

Balance per SFP	13,400,000
Add ….. ……	4,630
	13,404,630

(3) Investments

Carry amount	15,000,000
Market value	9,750,000
Loss in value	5,250,000

(4) Cash & Budget

Balance per SFP	20,120,000
Adjusts:	
Interest payment	4,630
Cash misappropriated	(2,050)
Bank charges	(110)
Drawings	(5,800)
	20,116,670

SOLUTION FINANCIAL REPORTING MAY 2010

QUESTION 3

(a) Boafo Ye Na

Income Statement for the year ended 31 December 2009

	GH¢'000
Revenue (150,000 – 1,250)	148,750
Cost of sales (w (i))	(112,700)
Gross profit	36,050
Distribution costs	(7,250)
Administrative expenses (11,100 – 200 + 50 see note below)	(10,950)
Finance costs	(100)
Profit before tax	17,750
(income tax expense (5,700 + (3,000 – 2,900) deferred tax))	(5,800)
Profit for the year	11,950)

Note: As is considered that the outcome of the legal action against Boafo Ye Na is unlikely to succeed (only a 20% chance) it is inappropriate to provide for any damages. The potential damages are an example of a contingent liability which should be disclosed (at GH¢1 million) as a note to the financial statements. The unrecoverable legal costs are a liability (the start of the legal action is a past event) and should be provided for in full.

(b) Boafo Ye Na – Statement of changes in equity for the year ended 31 December 2009

	Equity Shares GH¢'000	Revaluation Reserve GH¢'000	Retained Earnings GH¢'000	Total Equity GH¢'000
Balance at 1 January 2009	25,000	5,000	12,250	42,250
Dividend			(3,600)	(3,600)
Revaluation deficit		(2,250)		(2,250)
Profit for the year			11,950	11,950
Balance at 31 December 2009	25,000	2,750	20,600	48,350

(c) Boafo Ye Na – Statement of financial Position as at 31 December 2009

	GH¢'000	GH¢'000
Assets		
Non-current assets (w (iii))		
Property, plant and equipment (21,500 + 19,200)		40,700
Development costs		7,400
		48,100
Current assets		
Inventory	10,000	
Trade receivables	21,550	31,550
Total assets		79,650

Equity and liabilities:		
Equity (from (b))		
Equity shares of 25 cents each		25,000
12% preference shares		10,000
Revaluation reserves	2,750	
Retained earnings	20,600	23,350
		58,350
Non-current liabilities		
Deferred tax		3,000
Current liabilities		
Trade payables (11,900 – 200 + 50 – re legal action)	11,750	
Bank overdraft	650	
Current tax payable	5,700	
Accrued preference dividend	200	18,300
Total equity and liabilities		79,650

Workings (figures in brackets in GH¢'000)

		GH¢'000
(i)	Cost of sales	
	Per trial balance	102,000
	Depreciation (w (iii) – leasehold property	1,250
	- plant & Equipment	4,800
	Loss on disposal of plant (2,000 – 1,250)	750
	Amortization of development costs (w (iii))	2,000
	Research and development expensed (700 + 1,200 (w (iii)))	1,900
		112,700

(ii) The preference dividend of GH¢600,000 for the preference shares is based on the effective rate of 12% applied to GH¢10 million issue proceeds of the shares for the six months they have been in issue (10m x 12% x 6/12). The dividend paid is GH¢400,000. The additional GH¢200,000 (accrual) is shown as part of current liability.

(iii) Non-current assets:

Leasehold property	
Valuation at 1 January 2009	25,000
Depreciation for year (20 year life)	(1,250)
Carrying amount at date of revaluation	23,750
Valuation at 31 December 2009	(21,500)
Revaluation deficit	2,250

	GH¢'000
Plant and Equipment per trial balance (38,300 – 12,300)	26,000
Disposal (4,000 – 2,000)	(2,000)
	24,000
Depreciation for year (20%)	(4,800)
Carrying amount at 31 December 2009	19,200

Capitalized/deferred development costs	
Carrying amount at 1 January 2009 (10,000 – 3,000)	7,000
Amortised for year (10,000 x 20%)	(2,000)
Capitalized during year (400 x 6 months)	2,400
Carrying amount at 31 December 2009	7,400

Note: development costs can only be treated as an asset from the point where they meet the recognition criteria in IAS 38 ***Intangible assets***. Thus development costs from 1 July to 31 December 2009 of GH¢204 million (400,000 x 6 months) can be capitalised. These will not be amortised as the projects is still in development. The research costs of GH¢700,000 plus three months' development costs of GH¢1.2 million (400 x 3 months) (i.e. those incurred before 1 July 2009) are treated as an expense.

QUESTION 4

A.

a) Sales Growth

There was a tremendous increase in sales in 2008 compared to 2007 and 2006. In 2008, sales increased by 16% as compared to 2007 which increased by 0.4%.

b) Profitability

Although there was an improvement in sales in 2008, there was a deadline in the gross profit percentage for 2008 compared to the other two years. The gross profit percentage increased from 29% in 2006 to 56% in 2007 which was very good but dropped to 42% in 2008. The reduction in the gross profit in 2008 was contributed to a high increase in operating cost in 2008. The operating cost in 2008 increased by 53% compared to 2007 which reduced drastically by 38% compared to 2006.

Net profit margin ratio on the other hand showed a similar pattern. The net profit percentage increased from 6% in 2006 to 18% in 2007 but reduced drastically (12%) in 2008 recording a net loss of GH¢130,782. The recording of the net loss in 2008 was due to a high increase in finance cost and depreciation expenses in 2008.

c) Short term Financial Strength

The working capital position of the company seems weak over the three year period. The current assets rates over the three year period were 0.83, 0.94 and 0.90 in 2006, 2007 and 2008 respectively. With the three years current ratios computed it indicates that on average the current assets when realized can cover only 90% of the current liabilities. The current assets of the company over the three years when realized cannot meet all it's current liabilities. This indicates that the company is not financially strong.

d) Efficiency of Operations

Management has really not utilized the assets of the company well in generating revenue because there was a consistent decline in the fixed assets turnover ratio over the three year period. It dropped from 2.34 times in 2006 to 1.72 times in 2007 and further dropped to 1.36

times in 2008. This indicates that the fixed assets were under utilized in generating revenue. On average, every cedi value of fixed assets was used to generate GH¢1.80 work of sales.
Also, it was realized that the debtors collection period was too long. The debtors collection period computed indicate that debtors do not pay the company on time resulting in illiquidity of the company. Although, there was an improvement in the debtors collection period in 2008 from 95 days in 2007 to 70 days in 2008 still there is delay in the company collecting its receivables.

e) Gering and Long Term Solvency

The company's debt to equity ratios over the three year period were 44%, 41% and 75% for 3006, 2007 and 2008 respectively. This indicates that the company in 2006 and 2007 was lowly geared their dependence on external funds for operations was on average 43%. This also means that their debt capital was lower than the equity fund.

In 2008, the company was highly geared because the company was financed by external funds of about 75%. The company's debt capital is higher than the equity fund. The debt capital is 75% of the total company's equity fund.

This is supported by the increase in total liabilities from GH¢337,023 in 2007 to GH¢1,090,228.00 in 2008.B.

i) Investors/Lenders

a) "By using common sets of accounting standards, cross border investors will be able to compare apples with apples" with a minimal adjustment of nearly transparent company financial statements.

b) Most non-domestic investors made by public investment companies and ….. …… are made by using analysts who specialize in examination of financial statements from different countries leading to higher cost of communication.

c) By using international standards, investors' comparability and understanding ability of financial statements will be enhanced leading to better investment decisions.

ii) Multinational Companies

By using international standards, companies will improve their image and thus avoid "financial principle shopping" syndrome.

The benefits of harmonization are as follows:

a) Preparation of consolidated accounts will be easier

b) Internal communication and comparison of results would be enhanced leading to improved management control

c) Access to international funds will be easier with an added benefit of lower cost of capital

d) Appraisal of foreign enterprises for takeover will be more straightforward; and

e) Cost savings and efficiency will result from less staff training in accounting departments.

iii) Others

a) Tax authorities: harmonization will lead to greater efficiency and productivity regarding collection of taxes and problems regarding transfer pricing.

b) Developing countries: taxing and regulating multinationals will be easier.

c) International economic groupings: gross-border trade and investments will be easier, eg. EU, USA, China, Japan, etc.

QUESTION 5

(a) The lease appears to be a finance lease for the following reasons:

- The present value of the minimum lease payments amount to 98% (42,000/43,000) of the fair value of the asset at inception of the lease, which can be regarded as 'substantially all'.
- The asset will be used by NCL for the whole of its economic life as it will be scrapped by the lessor at the end of the lease.

Consequently, the asset should be capitalised in the statement of financial position. The asset should be depreciated over the shorter of its useful life (5 years) and the lease period (6 years).

A lease liability will be recognized in the SFP reduced by lease payments made in advance and increased by interest calculated using the implicit rate of 12.5% .

Both the asset and lease liability will be initially recognized at GH¢42,000.

Financial Statements Extracts

	GH¢
Statement of comprehensive Income	
Depreciation charge	8,400
Finance charge (42,000 – 9,210) x 12.5%	4,099
Statement of Financial Position extract	
Non-Current Asset	
Leased Tractor (cost)	42,000
Depreciation	8,400
	33,600
Non-current Liability	
Finance Lease Liability (36,889 – 9,210)	27,679
Current Liability	
Finance Lease liability (36,889 – 27,679)	9,210*

*		
	Interest payable	4,099
	Capital Liability	5,111

(b) Nii Plant Ltd

Equipment

		GH¢		GH¢
01:01:06	Palm Fruits Ltd	150,880		

Palm Fruits Ltd

		GH¢			GH¢
01.07.06	Bank	32,000	01:01:06	Equipment	150,880
01:07:06	Bank	32,000	30:09:06	Interest	7,960
30:09:06	Balance c/d	91,840			
		155,840			155,840
01:01:07	Bank	32,000	01:10:06	Balance b/d	91,840
01:07:07	Bank	32,000	30:09:07	Interest	3,680
30:09:07	Balance c/d	31,520			
		95,520			95,520
01:01:08	Bank	32,000	01:10:07	Balance b/d	31,520
			30:09:08	Interest	480
		32,000			32,000

Interest Payable A/C

		GH¢			GH¢
30:09:06	Palm Fruits Ltd	4,960	30:09:06	P & L A/C	4,960
30:09:07	Palm Fruits Ltd	3,680	30:09:07	P & L A/C	3,680
30:09:08	Palm Fruits Ltd	480	30:09:08	P & L A/C	480

(c)

1. Return on Capital Employed (ROCE) can be distorted as a result of profits being overstated in real terms and assets such as fixed assets being understated.
2. Historical Cost Accounts may fail to show whether a company is earning sufficient funds to enable it to maintain its capital real.
3. Also, historical cost accounts may fail to show the extent to which funds can prudently be distributed in the form of dividends.
4. Historical cost accounts can give misleading impression of growth and profitability.
5. It does not express in current prices all of the resources employed in a business.
6. Another possible weakness is the matching of current revenues expresses in current prices with historical cost may result in inflated profits being reported.