NOVEMBER 2020 PROFESSIONAL EXAMINATION
CORPORATE REPORTING (PAPER 3.1)
CHIEF EXAMINER'S REPORT, QUESTIONS & MARKING SCHEME

EXAMINER'S GENERAL COMMENTS

The difficulty level of the November 2020 paper was relatively higher compared to the May 2020 paper. Generally, candidates struggled with almost all the questions and performance was far below average.

The questions generally followed the syllabus structure and marks allocated to different questions as suggested in the syllabus. The marking scheme was appropriate and provided a clear marking guide.

Candidates' performance was however, abysmal and below average compared to the previous diet.

STANDARD OF THE PAPER

The standard of the questions was appropriate for the level being assessed, although the difficulty level was relatively higher compared to the May 2020 diet. The requirements of the questions were clear.

Weights to the questions followed the pattern of the previous sittings and is generally consistent in standard with the previous papers. The questions required critical thinking and a good mastery of the relevant areas of the syllabus.

The mark allocations generally followed the weightings in the syllabus grid and marks were fairly allocated to questions and sub questions. The marks allocated to questions were commensurate with the amount of time and effort required to answer the questions.

PERFORMANCE OF CANDIDATES

The performance of candidates was very poor with a pass rate of about 25% compared with the pass rate of May 2020 diet of about 60%.

Candidates' poor performance was consistent and was evenly spread across most centres.

There were no signs of copying at any centre.

The worst attempted question was the question on the application of IFRS and the question on preparing consolidated financial statements. Candidates lacked the skills to apply the IFRS to the given scenarios and were unable to prepare consolidated financial statements.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

The questions that candidates attempted averagely better were question five on ratios and financial analysis; question three c) on ethics and question four a) on business valuation. The rest of the questions; consolidated financial statements and IFRS were poorly attempted.

Candidates' weakest point was application of IFRS and preparation of consolidated financial statements.

The fundamental weaknesses observed is lack of appropriate knowledge, bad strategy in use of time, wrong order in which questions were attempted, and inability to apply concepts to practical scenarios.
Candidates lacked effective time management skills.
Some candidates numbered their questions wrongly.
Some candidates had very poor handwriting which made it difficult to read the answers properly.
Some candidates answered the same question on several non-conservative pages without cross referencing. This made tallying their marks very difficult.
Most candidates displayed inadequate knowledge of the issues in the syllabus.

QUESTION ONE

Bolga Ltd is a limited liability company in Ghana, which has investments in a number of other companies. The draft statements of profit or loss for Bolga Ltd and its other investments for the year ended April 30 2020 are given below:

	Bolga Ltd	Navrongo Ltd	Serrekunda Ltd
	GH¢'000	GH¢'000	GMD'000
Revenue	286,000	136,000	840,000
Cost of sales	(122,000)	(84,000)	(504,000)
Gross profit	164,000	52,000	336,000
Distribution costs	(20,000)	(12,000)	(56,000)
Administrative expenses	(46,000)	(20,000)	(116,000)
Operating profit	98,000	20,000	164,000
Investment income	2,000	4,000	-
Finance costs	(4,000)	(8,000)	(12,000)
Profit before tax	96,000	16,000	152,000
Income tax expenses	(22,000)	(4,000)	(36,000)
Profit for the period	**74,000**	**12,000**	**116,000**

Additional relevant information:

i) Bolga Ltd purchased 80% of Navrongo Ltd's three million GH¢5 ordinary shares for GH¢12 million two years ago. At the acquisition date, the carrying value of Navrongo's net assets was GH¢10 million, and this was deemed to be the same as their fair value. The non-controlling interest was measured using the proportion of net assets method. Goodwill on acquisition of Navrongo is not impaired. On 31 October 2019, Bolga Ltd sold one million, four hundred and forty thousand of its shares in Navrongo Ltd for GH¢13 million. The fair value of the interest retained was GH¢19 million. The retained earnings of Navrongo Ltd was GH¢5 million as at April 30, 2019. The only entry posted in Bolga Ltd's individual financial statements was the GH¢13 million cash received. This was debited to the bank account and the credit posted to the suspense account.

ii) On 1 May 2019, Bolga Ltd acquired 60% of Serrekunda Ltd's one million GMD1 ordinary shares for GMD284 million. Serrekunda is a Gambian based company with Gambian Dalasi (GMD) as its currency. The non-controlling interest at acquisition was valued at GMD116 million using the fair value method. At 1 May 2019, the carrying amount of Serrekunda Ltd's net assets was GMD240 million but the fair value was GMD280 million. The excess in the fair value was due to a brand with a remaining useful economic life of 5 years at the date of acquisition.

On 30 April 2020, it was determined that goodwill arising on the purchased of Serrekunda Ltd was impaired by GMD16 million. Goodwill impairments are charged as administrative expenses.

iii) On 28 February 2020, Navrongo Ltd paid a dividend of GH¢2 million to its ordinary shareholders.

iv) On 1 June 2019, Bolga Ltd started a construction of a new building project and financed this out of its general borrowings. The construction was completed on 30 April 2020 at a total cost of GH¢20 million excluding interest on borrowings. Bolga Ltd has had the following loans outstanding for the whole financial year:

	GH¢000
10% bank loan	28,000
8% loan notes	12,000

All the interest for the year has been expensed to the statement of profit or loss. None of the loan notes are held by any other companies within the Bolga Ltd.

v) On 1 November 2019, Bolga Ltd granted 20,000 share options to each of its 100 managers. These options will vest on 31 October 2021 if the managers are still employed. However, five managers had left the company by 30 April, 2020 and it is expected that another five will leave by 31 October 2021. The fair value of the share options was GH¢3.10 on 1 November 2019 and GH¢10 on 30 April, 2020. There have not been any accounting entries posted in relation to this scheme.

vi) **The following exchange rates are relevant:**

	GMD: GH¢1
May 1 2019	10.0
April 30 2020	8.0
Average for the year ended 30 April 2020	9.2

Required:
Prepare the consolidated statement of profit or loss and other comprehensive income for the year ended 30 April 2020.

(Total: 20 marks)

QUESTION TWO

a) Katamanso Ltd (Katamanso) is a company which is a subsidiary of a media company. Katamanso's principal asset is the rights it owns to a classic film. Katamanso had the following intangible assets as at the year end 31 December 2017:

	Classic film	Website	Total
	GH¢'000	GH¢'000	GH¢'000
Cost	10,000	150	10,150
Accumulated amortisation	(6,000)	(90)	(6,090)
Carrying amount	**4,000**	**60**	**4,060**

The following information includes all relevant events that occurred during the year ended 31 December 2018:

i) The film was originally published on 1 January 1970 and the rights were acquired by Katamanso on 1 January 2015 for GH¢10 million. Copyright was set at 50 years from the date the film was originally published. The film was amortised by Katamanso using straight line method over the remaining copyright period. However, recent legislative changes passed on 1 January 2018 have extended the copyright period from 50 years to 70 years, subject to payment of a registration fee prior to the original expiry date. This, together with associated legal costs, amounted to GH¢70,000 and was paid on 1 January 2018.

As a result, the market value of the rights to the film was GH¢12.1 million at 31 December 2018, according to Katamanso's professional valuers, who determined the valuation on 1 January 2018.

ii) During the year Katamanso developed a new interactive website to market the film and associated merchandise given its extended copyright period. The website includes its own e-commerce system for online DVD sales, direct streaming of the film and associated material and merchandise sales.

Costs incurred were as follows:	**GH¢'000**
Planning the new website	8
Registration of various domain names	18
Internal design costs	85
External contractor design costs	112
New content development	38
Advertising of the new website	22

The new website went live on 1 July 2018 and the old website, which was being amortised using straight line method over five years, was taken offline on that date and will not be used for any other purpose.

Required:
Prepare a note reconciling the carrying amount of Katamanso's intangible assets from the beginning to the year ended 31 December 2018 as required by ***IAS 38: Intangible Assets***.
(Note: Comparative information is not required. All amounts are material)

(10 marks)

b) Tekyiman Ltd (Tekyiman) sold one of its warehouses on 1 July 2019 to a finance house and leased it back under an operating lease on the same date. The carrying amount of the warehouse on 1 July 2019 was GH¢16 million. The terms of the sale and leaseback were as follows; sale proceeds of GH¢23.5 million and half-yearly lease rental payments of GH¢1 million paid in arrears on 31 December and 30 June over a period of 4 years.
The open market value of the property would have been GH¢20 million if not leased back on these terms. The lease rental payments were approximately double market rates for such a lease. The finance house can terminate the lease at any time with a month's notice to Tekyiman, at which point any excess of the sales proceeds over market value of the property not yet repaid becomes repayable immediately.

Tekyiman depreciated the property up to 1 July 2019 and then derecognised it, recognising a profit of GH¢7.5 million (netted against expenses in the statement of profit or loss). The first GH¢1 million, 6 monthly lease rental payment, made on 31 December 2019 has been charged to cost of sales. No other accounting entries have been made.

Tekyiman now wishes to amortise the excess of the sales proceeds over market value on a straight line basis over the period the warehouse will be used (4 years).

Required:

Advise the directors of the entity of the correct accounting treatment of the above transaction under ***IFRS 16: Leases*** (as the information permits) for the year ended 31 December 2019. **(6 marks)**

c) A company is being sued by a customer in respect of some products supplied which the customer claims are faulty. The customer is suing for GH¢220,000 plus damage. Court costs are likely to amount to GH¢40,000. The company's lawyer has advised that there is an 80% chance that the case will be lost and that the full amount claimed by the customer will become payable against the company.

The company is fully insured and the lawyer has advised that the insurance policy covers the event and should be utilized.

Required:
Determine the amount that should be recognised as a provision and charged to profit or loss and determine the treatment of the insurance claim. **(4 marks)**

(Total: 20 marks)

QUESTION THREE

a) Tato Company (Tato), a listed company, purchased a significant item of equipment on 1 July 2018. The list price of the equipment was GH¢12 million, although the supplier always gives Tato a 10% discount on its list prices. Tato was unable to finance the purchase outright and the supplier therefore agreed to accept an arrangement whereby the amount of the payment would be determined by Tato's share price on 30 June 2020.

At 30 June 2020, under the terms of the agreement, the supplier can choose to receive either:

- cash, equal to the value of 500,000 of Tato's shares on that date; or
- 540,000 Tato's shares on 30 June 2020, provided that they cannot be sold for 1 year after that date.

Tato's share price was GH¢19.80 per share on 1 July 2018 and GH¢20.40 on 30 June 2019.

Required:
Demonstrate with suitable calculations, how the arrangement should be accounted for in Tato Company's financial statements for the year ended 30 June 2019. **(6 marks)**

b) During the year ended 31 December 2018 Pakyi Ltd invested in a convertible bond on its issue date. The bond matures four years after the issue date and at that date the bond can be converted into ordinary shares of the investee or repaid at par. The entity's plan for the bond is to hold it until it matures and collect the cash flows.

Required:
Advise the directors of Pakyi Ltd of the accounting treatment on the above transaction under ***IFRS 9: Financial Instruments*** for the year ended 31 December 2018. **(4 marks)**

c) Goodman recently qualified as accountant with the Institute of Chartered Accountants (Ghana). He works with a manufacturing company in Tamale, Ghana, and he has been asked, by his line manager, to complete a costing exercise and given a very short deadline as well as limited resources for the exercise. Goodman thinks that the President of the company is planning to use this information to restructure the company, including making some of Goodman's close colleagues redundant. Goodman is very worried that the outcome of his work cannot be robust enough to be used for such a big business decision by the company, but his line manager is putting him under a lot of pressure to complete the work pretty much quickly.

Required:
Evaluate **FOUR (4)** ethical issues facing Goodman and recommend **FOUR (4)** possible courses of action Goodman should consider taking. **(10 marks)**

(Total: 20 marks)

QUESTION FOUR

a) Anidaso Ltd operates in the manufacturing industry in Ghana. The company is in the process of selling some of its shares to the general public in order to raise enough funds to expand its operations. Below are the financial statements of the company:

Statement of profit or loss for the year ended 30 September, 2019

	GH¢000
Revenue	122,900
Cost of sales	(58,650)
Gross profit	64,250
Selling, general & administration expenses	(43,570)
Profit before interest & taxes	20,680
Finance cost	(1,680)
Profit before taxation	19,000
Taxation @ 20%	(4,750)
Profit after tax	**14,250**

Statement of changes in equity (extracts) for the year ended 30 September, 2019

	GH¢000
Retained Earnings at October 1, 2018	47,970
Profit for the year	14,250
Dividend paid	(6,200)
Retained Earnings at 30 September, 2019	**56,020**

Statement of Financial Position as at 30 September, 2019

Non-current assets:	**GH¢000**	**GH¢000**
Development expenditure		13,050
Patents		8,200
Property, plant and equipment		98,750
		120,000
Current assets:		
Inventories	21,700	
Trade receivables	12,501	
Bank and cash	5,944	
	40,145	
Current liabilities:		
Trade payables	(15,400)	24,745
Net current assets		144,745
Non-current liabilities:		
10% Debenture loan stock		(12, 000)
		132,745
Equity:		
Share capital		50, 000
Revaluation Surplus		26,725
Retained Earnings		56,020
		132,745

Additional relevant information:

- The share capital of the company is composed of:

	GH¢000
20% redeemable preference shares	10,000
Ordinary shares (issued @GH¢0.20 each)	40,000
	50,000

- A review of the development expenditure indicated that only 50% of it is worthwhile.

- An independent valuer has placed values on some of the assets of Anidaso Ltd below:

	GH¢000
Property, plant & equipment	111, 000
Inventories	16, 200
Trade receivables	10, 000
	137, 200

- Profit forecasts for the next five years of Anidaso Ltd are as follows: The estimated profit before tax figures are arrived at before charging the estimated depreciation charges.

Year-end 30 September	Profit before Tax GH¢000	Depreciation Charge GH¢000
2020	14,900	1,100
2021	16,000	1,225
2022	19,250	1,550
2023	19,800	2,025
2024	21,550	2,130

- The patents in the statement of financial position represents a license to produce an improved variety of a product and is expected to generate a pre-tax profit of GH¢10,000 per year for the next five years.

- Abiola Limited is a competitor company listed on the Ghana Stock Exchange and data extracted from its recently published financial statements revealed the following details:

Market capitalisation	GH¢1,000,000
Number of ordinary shares	800,000
Earnings per share	GH¢0.20
Dividend payout ratio	80%

- The cost of capital of Anidaso Ltd is 10%.

Required:

Determine the value to be placed on each share of Anidaso Ltd using the following methods of valuation:

i) Net assets; **(4 marks)**
ii) Price-earnings ratio; **(4 marks)**
iii) Dividend yield; **(3 marks)**
iv) Discounted cash flow. **(4 marks)**

b) Under ***IFRS 3: Business Combinations***, the identifiable assets, liabilities and contingent liabilities of subsidiaries are therefore required to be brought into the consolidated financial statements at their fair value rather than their book value. The difference between fair values and book values is a consolidation adjustment made only for the purposes of the consolidated financial statements.

Required:
Explain the justification for undertaking fair value exercise when a parent acquires a controlling stake in a subsidiary company. **(5 marks)**

(Total: 20 marks)

QUESTION FIVE

The following are the accounts of Bounce Back Ltd, a company that manufactures playground equipment, for the year ended 30 November, 2019.

Statement of comprehensive income for year ended 30 November

	2019	2018
	GH¢'000	GH¢'000
Profit before interest and tax	2,200	1,570
Interest expense	(170)	(150)
Profit before tax	2,030	1,420
Taxation	(730)	(520)
Profit after tax	1,300	900
Dividends paid	(250)	(250)
Retained profit	1,050	650

Statement of financial position as at 30 November 2019

	2019	2018
	GH¢'000	GH¢'000
Non-current assets (written-down value)	6,350	5,600
Current assets		
Trade receivables	2,100	2,070
Inventories	1,710	1,540
Total current assets	3,810	3,610
Creditors: amounts due within one year		
Trade payables	1,040	1,130
Taxation	550	450
Bank overdraft	370	480
Total current liabilities	1,960	2,060
Net current assets	1,850	1,550
Total net assets	**8,200**	**7,150**

Creditors: amounts due after more than one year		
10% debentures 2020/ 2021	1,500	1,500
Equity:		
Share Capital (ordinary shares of 50p fully paid up)	3,000	3,000
Retained earnings	3,700	2,650
	6,700	5,650
Long term liabilities and Equity	**8,200**	**7,150**

Required:

a) Calculate, for both years, the return on equity and the return on capital employed. **(4 marks)**

b) Calculate, for both years, **TWO (2)** investment ratios of interest to a potential investor. **(4 marks)**

c) Calculate, for both years, **TWO (2)** ratios of interest to a potential long-term lender. **(4 marks)**

d) Report on the performance and state of the business from the view point of a potential shareholder and lender using the ratios calculated above and explain any weaknesses in these ratios. **(8 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

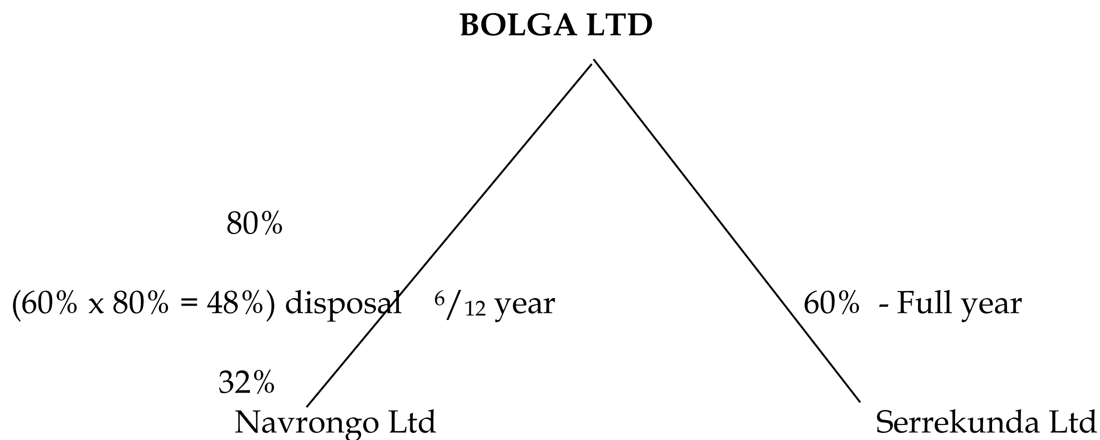
QUESTION ONE

Bolga Group
Consolidated statement of profit or loss and other comprehensive income for the year ended 30 of April, 2020

	GH¢ million
Revenue (GH¢286+ (GH¢136 x 6/12) + (GMD840/9.2)	445.3
Cost of sales (GH¢122 + (GH¢84 x 6/12) + (GMD504/9.2)	(218.2)
Gross profit	227.1
Distribution costs (GH¢20 + (GH¢12 x 6/12) + (GMD56/9.2)	(32.1)
Administrative expenses (GH¢46 + (GH¢20 x 6/12) + (GMD116/9.2) + (1.7) + (1.4) + (GMD8/9.2)	(72.6)
Operating profit	122.4
Share of profit of associate (GH¢12 million x 6/12 x 32%)	1.92
Profit on disposal (w6)	7.2
Investment income (GH¢2 + (GH¢4 x 6/12) – GH¢0.64	3.36
Finance costs (GH¢4 + (GH¢8 x 6/12) + (GMD12/9.2) - (GH¢1.7) Borrowing costs (w4)	(7.6)
Profit before taxation	126.9
Income tax expenses (GH¢22 + (GH¢4 x 6/12) + (GMD36/9.2))	(27.9)
Profit for the year	99
Other comprehensive income:	
Total exchange gains on retranslation of foreign subsidiary (GH¢2.7 (w7) + GH¢8.8 (w8)	11.5
Total comprehensive income	110.5
Profit attributable to:	
Shareholders of parent company	93.8
Non-controlling interest (see w9)	5.2
	99
Total comprehensive income attributable to:	
Shareholders of parent	100.7
Non-controlling interest (GH¢5.2 million + (GH¢1.1 million w7) + (GH¢3.5 million w8)	9.8
	110.5

Workings

Group structure



W1) Brand of Serrekunda Ltd

	GMD million
Fair value of net asset at acquisition date	280
Carrying amount of net assets at acquisition date	(240)
	40

The excess amortization is depreciated over 5 years (GMD40/5years) GMD8/9.2. This is treated as administration expenses in the statement of profit.

W2) Dividend paid – At the time the dividend was paid on February 2020 Bolga Ltd had only 32% holdings in Navrongo Ltd. Therefore, investment income of GH¢0.64 million (GH¢2 x 32%) must be removed from consolidated profit or loss.

W3) The group share of the associate profit for the six months to 30 April 2020 is GH¢1.92 million (GH¢12 million x 6/12 x 32%) per IAS 28 equity accounting.

W4). Borrowing cost (IAS 23)
Weighted average cost of borrowing should be calculated first, which is 9.4% (GH¢28 million x 10%) + (GH¢12 million x 8%)/ GH¢40). Therefore, the interest to be capitalized for the 11 months' period (June 1 2019 to April 30, 2020) is GH¢20 million x 9.4% x 11/12 = GH¢1.7 million.
Accounting treatment:

Dr. Property, plant and equipment	GH¢ 1.7 million	
Cr. Finance costs (profit or loss)		GH¢1.7 million

W5). Share options (IFRS 2)
This is an equity share option scheme and the expense to the profit or loss should be based on the total number of shares expected to invest and the fair value of the share option at the grant date. IFRS 2 requires that the expense is spread over the vesting period.

Year		Expense	Equity
To 30/4/20	(100-5-5) x 20,000 options x GH¢3.10 x 6/24 months	GH¢1.4	GH¢1.4

Administrative expenses will be debited with GH¢1.4 and equity or special equity credited with same for the year ended 30 April 2020.

W6). Profit on disposal of subsidiary Navrongo half-way into accounting period

	GH¢ million	GH¢ million
Proceeds from disposal		13
Fair value of the retained investment		19
		32
Net asset at disposal date	26	
Goodwill at disposal	4	
Non-controlling interest	(5.2)	(24.8)
Profit on disposal		**7.2**
NB:		
Net asset at disposal calculated as:		
Share capital (3 million shares x GH¢5)	15	
Retained earnings brought forward	5	
Profit up to disposal date (GH¢12 x 6/12)	6	26
Goodwill at acquisition:		
Cost of investment	12	
Non-controlling interest on acquisition (GH¢10 x 20%)	2	
Net asset at acquisition date	(10)	4
NCI at disposal calculated as:		
NCI at acquisition date (GH¢10 x 20%)	2	
NCI % share of post-acquisition profits up to disposal date (20% x(GH¢26 - GH¢10))	3.2	5.2

W7). Goodwill of the foreign subsidiary functional currency (GMD) – Serrekunda Ltd

	GMD million
Cost of investment	284
Fair value of non-controlling interest at acquisition date	116
	400
Fair value of net assets ate acquisition date	(280)
	120
Impairment loss	(16)
	104

Retranslation of goodwill into presentation currency- Gain on retranslation

	GMD million	Rate of exchange	GH¢ million
Goodwill	120	10	12
Impairment	(16)	9.2	(1.7)
			10.3
Foreign exchange gain on retranslation			2.7
Balance sheet date	104	8.0	13

The forex gain attributable to the non-controlling interest is GH¢1.1 million (GH¢2.7 million x 40%) and the parent company share is GH¢1.6 million (GH¢2.7 million x 60%).

W9). Foreign exchange gain on translation of net assets and profit

	GMDmillion	**Exchange rate**	**GH¢ Million**
Opening net asset	280	10	28
Profit for the year (GMD116 million – GMD 8 million – brand amortization at acquisition	108	9.2	11.7
			39.7
Forex gain on retranslation	-	-	8.8
Closing net asset at year end	**388**	**8.0**	**48.5**

The forex gain on the retranslation of net asset is attributable to the non-controlling interest at GH¢3.5 million (GH¢8.8 million x 40%) and Bolga Ltd GH¢5.3 (GH¢8.8 x 60%).

W10). Profit for the year attributable to the non-controlling interest

	GH¢ million
NCI share in Navrongo Ltd (GH¢12 x 6/12 x 20%)	1.2
NCI share in Serrekunda Ltd (GMD116 million – GMD8 million /9.2 x 40%)	4.7
NCI share of goodwill impairment (GH¢1.7 million (w8) x 40%)	(0.7)
	5.2

Suggested marking scheme: 100 ticks at 0.2 marks each up to maximum of 20 marks. These include relevant workings.

EXAMINER'S COMMENTS

This question was on Consolidated Statement of Profit or Loss and Other Comprehensive Income of a parent, foreign subsidiary and associate company and attracted 20 marks. Question four b) was on justification for fair value in consolidation and was for 5 marks making consolidation to have a total mark of 25 marks as suggested in the syllabus.

The question was on translation of the results of a foreign subsidiary from foreign currency to the presentation currency and also involved the disposal of a subsidiary

to an associate status. These were generally difficult concepts for candidates to grasp. Candidates demonstrated a lack of understanding of both concepts. A greater number of the candidates were not able to solve this question and scored poor marks.

QUESTION TWO

a)

	Classic film GH¢'000	Website GH¢'000	Total GH¢'000
Carrying amount at 1 January 2018	4,000	60	4,060
Additions (W1)	70	215	285
Amortisation (W2)	(185)	(20)	(205)
Disposals (60 – (W2) 15)		(45)	(45)
Carrying amount at 31 December 2018	3,885	210	4,095
At 31 December 2018			
Cost/valuation (10,000 + 70)/(W1)	10,070	215	10,285
Accumulated amortisation			
((10,000/5 x 3) + (W2) 185)/(W2)	(6,185)	(5)	(6,190)
Carrying amount	**3,885**	**210**	**4,095**

Workings 1

Website development costs	GH¢'000
Planning – expensed as akin to research per SIC-32	–
Registration of various domain names	18
Internal design costs	85
External contractor design costs	112
New content development - expensed because developed to market the entity's own products (SIC-32 para 8)	–
Advertising of new website - marketing expensed as no intangible asset is created (IAS 38 para 69(c))	–
	215

Workings 2

Amortisation		GH¢'000
Classic film (4,000 + 70)/22 years		185
Website:		
Old website (150/5 years x 6/12)	15	
New website ((W1) 215/21½ years x 6/12)	5	
		20
		205

(20 ticks @ 0.5 = 10 marks)

b) Sale and leaseback

Double entries performed by Tekyiman:

	GH¢'000	GH¢'000
DR Cash	23,500	
CR Property		16,000
CR (P/L)		7,500
DR Cost of sales (P/L)	1,000	
CR Cash		1,000

Correcting double entries required for excess of sale proceeds over fair value:

	GH¢'000
DR (P/L) (23,500 – 16,000)	7,500
CR Other income (P/L) (20,000 – 16,000)	4,000 genuine profit - moved
CR Deferred income (SOFP) (23,500 – 20,000)	3,500 excess profit – deferred

The deferred income should be amortised to profit or loss (other income) over the period the asset is expected to be used:

	GH¢'000	
DR Deferred income (3,500/4 years x 6/12)	438	
CR Other income (P/L)		438

Reversal of profit on sale: 1 mark
Recognition of fair value through profit or loss: 1 mark
Deferred income (excess profit): 2 marks
Journal entries for deferred income: 2 marks
(6 marks)

c) Provision is made for probable amount:
GH¢220,000 + GH¢40,000 = GH¢260,000
GH¢260,000 is charged to profit or loss.

The insurance recovery, while disclosed, is not virtually certain (as the court case itself has not been lost) and therefore is disclosed as a contingent asset.

Provision for legal claim/damages charged to Profit or Loss: 3 marks
Disclosure of insurance claim as a contingent asset: 1 mark
(4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The question required candidates to apply the principles and concepts of IFRS to resolve given cases. Application of IFRS has always been a challenge for candidates. This question was the worse attempted question by candidates in the paper. The question focused on IAS 38: Intangible Assets; IFRS 16: Leases and IAS 37: Provisions, Contingent Liabilities and Contingent Assets. Candidates could not apply the principles in the respective IFRS to the scenarios raised in the questions.

QUESTION THREE

a) This arrangement is a share-based payment with a choice of settlement. As the counterparty (the supplier) has the choice of settlement terms, a compound instrument has been issued and needs to be split into liability and equity components at the grant date.
The equity component is calculated as a residual after measuring the liability component at the grant date:

	GH¢m	**GH¢m**
DR Plant (12 x 90%)	10.8	
CR Liability (500,000 x GH¢19.80)		9.9
CR Equity (balancing figure)		0.9

The liability component is subsequently revalued to fair value at the year-end:
Fair value of liability at year end (500,000 x GH¢20.40) = GH¢10.2m

	GH¢m	**GH¢m**
DR Profit or loss (10.2 – 9.9)	0.3	
CR Liability		0.3

Determination of fair value of equipment: 1 mark
Determination of liability component @ initial recognition: 1 mark
Determination of equity component @ initial recognition: 1 mark
Fair value of liability at year end: 1 mark
Charge to Profit or Loss for the year: 2 marks
(6 marks)

b) Investment in convertible loan

- An investment in a convertible loan effectively contains two elements: a loan instrument and an equity option. The entity plans to hold the bond until it matures so it would appear to fall into a group of assets where the entity's business model is to hold the assets to collect the interest and principal cash flows.
- However, for the instrument to be held at amortised cost in this category, the terms of the instrument must give rise to cash flows that are solely payments of principal and interest on the principal outstanding. That is not the case here as the bond can be converted into equity at the end of its life.
- Consequently, the bond must be measured at its fair value with changes in value being recognised in profit or loss.

Classification of the nature of financial instrument: 1 mark
Initial recognition and measurement of the financial instrument: 2 marks
Subsequent measurement of the financial asset: 1 mark
(4 marks)

c) Fundamental principles

- **Integrity**

Goodman could be honest and straightforward with the line manager and the president of the company about the short time and limited resource to do a very robust work capable of meeting the big business decision it is intended to be used for. Can Goodman realistically produce a costing information with the time and resources available, without compromising the standard of his work?

- **Objectivity**
  Goodman could maintain an unbiased stance throughout the assignment given him, in view of his close relationship with other colleagues in the company. Goodman must not allow conflict of interest, bias and undue influence or pressure to influence his professional judgement. For example, his line manager is putting him under a lot of pressure to complete the work pretty much quickly.

- **Professional competence and due care**
  The company may be restructuring, and the president needs to have the most up to date and complete financial information to inform any big business decisions. As a professional accountant, you must ensure that any financial information you provide is robust. Can Goodman realistically produce a costing information, with the time and resources available, without compromising the standard of his work?

- **Confidentiality**
  Given the sensitivity of the situation, Goodman should maintain discretion and not share your concerns with other staff, who may not be aware of the president's intentions. Is there anyone else in the company with whom Goodman can raise his concerns? Is there a senior finance officer who could advise Goodman, or another member of the board with whom Goodman can discuss his dilemma?

(4 ethical issues well explained @ 1.5 marks each = 6 marks)

Possible courses of action

- Goodman thinks that the president of the company is planning to use the information he is asked to produce to restructure the company. As a professional accountant, Goodman has a duty to make his line manager and other users of the information aware of the limitations in the scope of his work.

- Goodman should attempt to obtain certainty regarding the use of the information from his line manager and the president of the company. He should arrange a meeting with his line manager and explain that he is unwilling to do the work to the deadline requested, with the resources available, because the work could not be relied upon. The process of clarifying the intended use of the information and expressing his concerns regarding its reliability is likely to enhance your credibility.
- Goodman could ask for more time to complete the work to the required standard, or ask for the work to be outsourced altogether. This would have the added benefit of enhanced objectivity.

- Goodman could suggest that his head of department discuss the issue with the president or other members of the board, as appropriate. If his head of department is unsympathetic to his concerns, he should not allow himself to be associated with information that may be misleading.

- Goodman should consider the most appropriate way in which to make his concerns known to the board. This may be through the president or the company secretary.

- If, after exploring all these routes of communication, he still finds himself under unreasonable time pressure, he may have to make clear his refusal to conduct the work, and possibly resign from the company.

- Goodman should document, in detail, the steps that he has taken in resolving his dilemma, in case his ethical judgement is challenged in future period.

(1 mark for each action taken up to a maximum of 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
Question three a) and b) were a continuation of IFRS focusing on IFRS 2: Share Based Payment and IFRS 9: Financial Instruments for a total of 10 marks to add to the 20 marks IFRS issues in question two thus bringing the total marks for IFRS to 30 marks. Candidates could not apply the principles in the respective IFRS to the scenarios raised in the questions.
Question three c) was on ethics and was well attempted by candidates. Candidates were able to identify the ethical issues and suggested cause of action to resolve those issues.

QUESTION FOUR

a) Anidaso Ltd

i) Net Assets Method

	GH¢000
Property, plant and equipment	111,000
Patents (GH¢10,000 x 3.791)	37,910
Development expenditure (GH¢13,050 x 50%)	6,525
Inventories	16,200
Receivables	10,000
Bank & cash	5,944

Payables	(15,400)
10% Debenture loan	(12,000)
20% redeemable preference share	(10,000)
NET ASSETS	**150,179**

Value per share = Net assets/No of shares issued
= GH¢150,179/ (GH¢40,000 ÷ 0.20)
= **GH¢0.751** **(4 marks)**

ii) **Price/Earnings Ratio Method**

Value per share = P/E ratio x EPS

Earnings per share (EPS) = Earnings Attributable to Ordinary Shareholders / Total No of Shares Issued
= (GH¢14,250 – GH¢2,000) ÷ 200,000
= GH¢0.061

Abiola P/E Ratio: GH¢1.25/0.20 = 6.25 adjusted downwards 5 (80% x 6.25)

Value Per share = P/E Ratio x EPS
= 5 x GH¢0.061
= GH¢0.31 **(4 marks)**

iii) **Dividend Yield Method**

Value per share = Dividend per Share ÷ Dividend Yield

Dividend per Share = Total dividends paid to ordinary shareholders / No of shares issued
= (GH¢6,200 – GH¢2,000) ÷ 200,000
= GH¢0.021

Dividend yield = GH¢0.16/ GH¢1.25 x 100% = 12.8 adjusted upwards to 15 (1.2 x 12.8).

Value per share = Dividend per share ÷ Dividend yield
= GH¢0.021 ÷ 0.15
= **GH¢0.14** **(3 marks)**

iv) **Discounted Cash Flow Method**

Value per share = Present value of discounted cash flows ÷ Total No. of Share issued.

Determination of Discounted Cash Flow

Year	Net cash flows GH¢	Risk Factor 10%	PV of NCF GH¢
2020	14,900	0.909	13,544.10
2021	16,000	0.826	13,216.00
2022	19,250	0.751	14,456.75
2023	19,800	0.683	13,523.40
2024	21,550	0.621	13,382.55
Present value			**68,122.80**

Value per share = PV of NCF ÷ Total No. of shares
= GH¢68,122.80 ÷ 200,000
= **GH¢0.34** **(4 marks)**

b) **Fair value of assets and liabilities acquired**

Assets and liabilities in an entity's own financial statements are often not stated at their fair value, for example, where the entity's accounting policy is to use the cost model for assets. If the subsidiary's financial statements are not adjusted to their fair values, where, for example, an asset's value has risen since purchase, goodwill would be overstated (as it would include the increase in value of the asset).

Consolidated accounts are prepared from the perspective of the group, rather than from the perspectives of the individual companies. The book values of the subsidiary's assets and liabilities are largely irrelevant, because the consolidated accounts must reflect their cost to the group (i.e. to the parent), not their original cost to the subsidiary. The cost to the group is their fair value at the date of acquisition.

Purchased goodwill is the difference between the value of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities. If fair values are not used, the value of goodwill will be meaningless.

(5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question required the computation of values to be placed on shares using various methods. The question was moderate and did not require adjustments to the financial statements before the determination of the value per share

Most candidates deviated with respect to the application of the net cash flow method to determine discounted cash flows. The question indicated that the profit before tax was before charging depreciation but most candidates added back depreciation to it, thus rendering their efforts to go unrewarded. The profit before tax was just to be taken and discounted straight away. Candidates did not pay attention to details and were not meticulous enough to spot this in the question.

QUESTION FIVE

a) **Computation of return on equity and return on capital employed**

Return on Equity = $\frac{Profit\ after\ tax\ and\ preference\ dividend}{Equity\ shareholders\ fund} \times 100\%$

$$2019\ ROE = \frac{1{,}300}{6{,}700} \times 100 = 19.4\%$$

$$2018\ ROE = \frac{900}{5{,}650} \times 100 = 15.93\%$$

Return on Capital Employed = $\frac{Profit\ before\ interest\ and\ tax}{Total\ asset - Current\ liabilities(capital\ employed)} \times 100\%$

$$2019, ROCE = \frac{2{,}200}{8{,}200} \times 100 = 26.83\%$$

$$2018, ROCE = \frac{1{,}570}{7{,}150} \times 100\% = 21.96\%$$

b) Computation of investment ratios

Dividend per share = $\frac{Dividend\ paid}{Total\ number\ of\ ordinary\ shares}$

$$2019, DPS = \frac{250}{6{,}000} = ¢0.042\ pershare$$

$$2018, DPS = \frac{250}{6{,}000} = ¢0.042\ pershare$$

Earnings per share = $\frac{Profit\ after\ tax\ and\ preference\ dividend}{Total\ number\ of\ ordinary\ shares}$

$$2019, EPS = \frac{1{,}300}{6{,}000} = ¢0.22$$

$$2018, EPS = \frac{900}{6{,}000} = ¢0.15$$

Dividend Cover = $\frac{EPS}{DPS}$

$$2019 = \frac{0.22}{0.042} = 5.23$$

$$2018 = \frac{0.15}{0.042} = 3.57$$

Dividend Pay-out ratio = $\frac{DPS}{EPS}$

$$2019 = \frac{0.042}{0.22} x\ 100\% = 19.23\%$$

$$2018 = \frac{0.042}{0.15} x\ 100\% = 27.78\%$$

c) Computation of ratios of interest to a potential long-term lender

$$Debt\ ratio = \frac{Total\ debt}{Total\ assets}$$

$$2019 = \frac{3{,}460}{10{,}160} = 34.06\%$$

$$2018 = \frac{3{,}560}{9{,}210} = 38.65\%$$

Gearing = $\frac{Interest\ bearing\ debt\ (Long-term\ debt)}{Shareholder's\ equity + Interest\ bearing\ debt} \times 100\%$

$$2019 = \frac{1500}{6{,}700 + 1{,}500} = \frac{1{,}500}{8{,}200} = 18.29\%$$

$$2018 = \frac{1{,}500}{5{,}650 + 1{,}500} = \frac{1{,}500}{7{,}150} = 20.98\%$$

Debt to equity ratio = $\frac{Interest\ bearing\ debt\ (Long-term\ debt)}{Shareholder's\ equity} \times 100\%$

$$2019 = \frac{1500}{6{,}700} = 22\%$$

$$2018 = \frac{1,500}{5,650} = 27\%$$

Interest Cover: $\frac{EBIT}{Interest\ charges}$

$$2019 = \frac{2,200}{170} = 12.9\ times$$

$$2018 = \frac{1,570}{150} = 10.5\ times$$

1 mark each for computation of return on equity x 2 years = 2 marks
1 mark each for computation of return on capital employed x 2 years = 2 marks
1 mark each for computation of 2 investment ratios of interest x 2 years = 4 marks
1 mark each for computation of 2 ratios of interest to a potential long-term lender x 2 years = 4 marks

(12 marks)

d) Report on performance and state of the business from the view point of a potential shareholder and weaknesses in the ratios

From the view point of a potential shareholder who would be interested in the returns on his investment, ratios such as return on equity, return on capital employed, dividend per share, earnings per share, dividend yield and dividend cover would be of essence to assessing the performance of the business.

The return on equity tells us the returns from the use of the shareholders fund and this has increased from 15.93% to 19.4% between 2018 and 2019. This means the business is performing well. The return on capital employed, tells us how the total assets less current liabilities have been utilised to generate returns. The business has an improved performance, because it has increased its return on capital employed by 4.87% (26.83-21.96) between 2018 and 2019.

The earnings per share tells us about the earnings before interest and tax that is attributable to ordinary shareholders and this has increased from ¢0.26 to ¢0.37. This could increase shareholders confidence in the business from the viewpoint of the lender, who would be interested in how the business can pay back it debt when they fall due.

Debt ratio talks about the ratio of debt to asset in the business. Usually, a debt ratio of less than 50% is considered acceptable. The business has managed to reduce this ratio within the period under review. Gearing tells us about the ratio of long-term debt in the business. Again, the business has performed well to reduce it between the two years. This will increase her chance of getting more borrowings if needed. Further, a gearing ratio of less than 50% is said to be low gearing and is acceptable since the company depend less on borrowing. There is a reduction in risk that little will be available for distribution to ordinary shareholders.

Interest cover tells us whether the business has earned enough profit before interest and tax to pay its interest cost. From the analysis, the business has made enough EBIT to pay it interest cost by 10.5 times in 2018 and 12.9 times in 2019. It can be concluded that the business state of affairs currently is good and acceptable. It has improved on her performance between 2018 and 2019.

Weaknesses in the ratios

- The ratios computed are not an end in themselves. More detailed analysis would be required to draw any meaningful conclusions.
- Since the ratios are based on the accounting statements, they measure what has happened in the past and not necessarily what will happen in the future.
- The interpretation of the ratios is sometimes dependent on how the ratio was formulated.
- The accounting policies of the entity may have influenced the results of these ratios. Different accounting methods (e.g. FIFO versus LIFO inventory valuation) can have an impact on financial ratios. Ratios may therefore not reflect real differences in the operations and financial health of companies.
- Making comparisons across industries can be difficult. Companies in different industries tend to have different financial ratios.

***Analysis of performance* = 6 marks**
***Any two weaknesses identified* = 2 marks**
(8 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question on analysis of financial statements was well answered by a number of candidates. A few ill prepared candidates could not compute the ratios correctly and therefore had their analysis wrong.

CONCLUSION

Quite clearly, candidates lacked a proper appreciation and grasp of issues in IFRS and preparation of consolidated financial statements. The Institute should try to focus candidates in relevant IFRS for future exams as well as relevant concepts relating to

the preparation of consolidated financial statements. This can be done through special intervention programmes.
The Institute should consider a meet the examiner series as is done by other professional examination bodies so that examiners share their observations of why candidates repeatedly fail.