MAY 2016 PROFESSIONAL EXAMINATION
CORPORATE REPORTING (3.1)
EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

EXAMINER'S REPORT

STANDARD OF THE PAPER

This paper covered all the topics in the syllabus. The syllabus weightings were fairly respected in this diet. The questions were spread well enough to cover all areas of the syllabus.

GENERAL PERFORMANCE

Generally, there was improvement in performance as compared to previous diets. However, performance in centres outside Accra was generally poor. ICAG should consider providing tuition for students in those locations.

ICAG should organise orientation sessions for students to make them aware of the current nature and trend of corporate reporting requirements. There was no similarity of answers to suggest any possible copying.

STRENGTHS OF CANDIDATES

Candidates showed improved understanding of appraisal of financial performance and valuation of business; they scored high marks in those areas.

WEAKNESSES OF CANDIDATES

Weaknesses of candidates can be summarized as follows:

Candidates were weak in integrated reporting, professional ethics and accounting for financial instruments. They will need intensive tuition to catch up in those areas.

Some candidates showed lack of effective time management in answering questions. They spent too much time on questions they believed they could handle; this left them little time to tackle other questions satisfactorily. Some candidates answered the same question on several non-consecutive pages without cross-referencing the pages. Also, some answered two different questions on the same page. These show that they jumped into answering the questions without proper planning.

Some candidates presented themselves for the examination without adequate preparation and as a result scored very low marks. Obviously, they were not ready for the examination. They wasted time and money.

Candidates did extensive calculations when the question clearly stated ***"Calculations are not required"***. Precious time was thus wasted through not reading the question well. Several candidates did not attempt all parts of the questions. This attitude reduced their chances of scoring pass marks.

CORPORATE REPORTING QUESTIONS

QUESTION ONE

The Avocado Ltd is preparing its consolidated financial statements for the year ended 31st December, 2015. Avocado Ltd has a number of investments in other entities. Details of these investments are as follows;

Investment in Akwadu Productions
Avocado acquired 12% of the issued ordinary share capital of Akwadu Productions on 1st January 2010 for GH¢10,000,000. On 1st October, 2015 Avocado acquired a further 45% of the issued ordinary share capital for GH¢45,000,000. The fair value of the net assets at 1st October 2015 was GH¢120,000,000 and on 1st January 2010 was GH¢80,000,000. The previously held interest had a fair value on 1st October 2015 of GH¢17,000,000.

Investment in Akpakpa Ventures Ltd
Avocado Ltd acquired 90% of the issued ordinary share capital of Akpakpa Ventures Ltd on 1st March 2015 for GH¢6,000,000 when the book value of the net assets was GH¢5,800,000. The fair value of these net assets was estimated at GH¢6,800,000 at the date of acquisition. The difference between fair value and the book value of the net assets related to depreciable property with a remaining useful life at the date of acquisition of 40 years.

Investment in Waatre Impex Ltd
At the date of acquisition of Akpakpa Ventures Ltd, Akpakpa Ventures Ltd held 65% of the issued ordinary share capital of Waatre Impex Ltd. The operations of Waatre Impex Ltd do not fit within the strategic plans of Avocado Ltd and so the directors plan to sell this investment. The investment is currently being marketed with a view to selling it within 4 months.

Investment in Akutu Brothers Ltd
Avocado Ltd acquired 40% of the issued ordinary share capital of Akutu brothers on 1st January 2014 for GH¢2,000,000 when the book value of the net assets was GH¢5,500,000. The fair value of these net assets was estimated at GH¢6,000,000 at the date of acquisition.

Required:

a) Discuss the appropriate treatment of each investment in the consolidated financial statements of the Avocado Group Ltd as at 31st December 2015. **(10 marks)**
(Note: Calculations are not required)

b) Nanniama Ltd is constructing a warehouse that will take about 18 months to complete. It began construction on 1st January 2014. The following payments were made during 2014:

	GH¢'000
31st January	200
31st March	450
30th June	100
31st October	200
30th November	250

The first payment on 31st January was funded from the entity's pool of debt. However, the entity succeeded in raising a medium-term loan for an amount of GH¢800,000 on 31st March, 2014, with simple interest of 9 percent per annum, calculated and payable monthly in arrears. These funds were specifically used for this construction. Excess funds were temporarily invested at 6 percent per annum monthly in arrears and payable in cash. The pool of debt was again used to an amount of GH¢200,000 for the payment on 30th November, which could not be funded from the medium-term loan. The construction project was temporarily halted for 3 weeks in May when substantial technical and administrative work was carried out.

Nanniama Ltd adopted the accounting policy of capitalizing borrowing costs.

The following amounts of debt were outstanding at the balance sheet date, 31st December 2014:

	GH¢'000
Medium-term loan (see description above)	800
Bank overdraft	1,200
(The weighted average amount outstanding during the year was GH¢750,000 and total interest charged by the bank amounted to GH¢33,800 for the year)	
A 10%, 7-year note dated 31st October 2018 with simple interest payable annually at 31st December	9,000

Required:

Calculate the borrowing costs to be capitalized **(10 marks)**

(Total: 20 marks)

QUESTION TWO

a) Analyze the circumstances under which impairment losses arise and demonstrate the circumstances that may indicate that a company's assets may have become impaired as per the provisions of ***IAS 36 – Impairment of Assets***. **(5 marks)**

b) AT Group Ltd is preparing its financial statements to 30th June 2015. The following situations have been identified by an impairment review team;
On 1st July 2014, AT Group Ltd acquired the whole share capital of two subsidiary companies, Accra Ltd and Tema Ltd, in separate acquisitions. Consolidated goodwill was calculated as follows;

	Accra Ltd	**Tema Ltd**
	GH¢'000	**GH¢'000**
Purchase Consideration	24,000	9,000
Estimated fair value of net assets	(16,000)	(6,000)
Consolidated goodwill	8,000	3,000

i) A review of the fair value of each subsidiary's net assets was undertaken in June 2015. Unfortunately both companies' net assets had declined in value. The estimated value of Accra Ltd.'s net assets as at 1st July 2014 was now only GH¢15,000,000. This was due to more detailed information becoming available about the market value of its specialized properties. Tema Ltd.'s net assets were estimated to have a fair value of GH¢1,000,000 less than their carrying value. This fall was due to some physical damage occurring to its plant and machinery. **(4 marks)**

ii) AT Group Ltd has an item of earth moving plant, which is rented out to companies on short-term contracts. Its carrying value, based on depreciated historical cost is GH¢400,000. The estimated selling price of this asset is only GH¢250,000, with associated selling expenses of GH¢5,000. A recent review of its value in use based on its forecast future cash flows was estimated at GH¢500,000. Since this review was undertaken, there has been a dramatic increase in interest rates that has significantly increased the cost of capital used by AT Group Ltd to discount the future cash flows of the plant. **(6 marks)**

iii) AT Group Ltd is engaged in a research and development project to produce a new product. In the year to 30th June 2015, the company spent GH¢120,000 on research that concluded that there were sufficient grounds to carry the project on to its development stage and a further GH¢75,000 had been spent on development. At that date management having decided that they were not sufficiently confident in the ultimate profitability of the project wrote off all the expenditure to date to the income statement. In the current year further direct development costs have been incurred of GH¢80,000 and the development work is now complete with only an estimated GH¢10,000 of costs to be incurred in the future. Production is expected to commence within the next few months. Unfortunately the total trading profit from sales of the new product is not expected to be as good as market research data originally forecast and is estimated at only GH¢150,000. As the future benefits are greater than the remaining future costs, the project will be completed, but due to the overall deficit expected, the directors have again decided to write off all the development expenditure. **(5 marks)**

Required:
Advise, with numerical illustrations where possible, how the information in (i) to (iii) above would affect the preparation of AT Group Ltd.'s consolidated financial statements to 30th June 2015.

(Total: 20 marks)

QUESTION THREE

a) At a recently concluded Annual General Meeting (AGM) of a company, one of the shareholders remarked; "historical financial statements are essential in corporate reporting, particularly for compliance purposes, but it can be argued that they do not provide meaningful information. After having issued a series of environmental and then sustainability reports, it is apparent that although the numbers were allowing a true and fair review of the company's performance, operations and management they were not necessarily relevant to stakeholders. The International Integrated Reporting Council (IIRC) is calling for a shift in thinking more to the long term, to think beyond what can be measured in quantitative terms and to think about how the entity creates value for its owners" the statement concluded.

Required:
Discuss the principles and key components of the IIRC's Framework, and any concerns which could impede the Framework's suitability for assessing the prospects of an entity. **(10 marks)**

b) As a Professional Accountant, you are regarded as an expert with specialized knowledge acting ethically and influencing others to do what is right whilst working to very high standards. When confronted with an ethical challenge or dilemma in a corporate setting, Lynne Paine suggests two approaches to the management of ethical issues in organizations - the ***compliance based approach*** and the ***integrity based approach***.

Required:

i) Compare and contrast the ***compliance based approach*** and the ***integrity based approach*** in the management of ethical issues. **(6 marks)**

ii) Discuss the steps you would recommend to your company to adopt in order to sustain value creation from an ethical culture. **(4 marks)**

(Total: 20 marks)

QUESTION FOUR

a) In 2015, the shareholders of Depot Ltd decided to sell their equity stake in the company. The company is not listed and the new shareholders plan to prepare the company for listing once the acquisition was completed. The summarized financial statements of Depot Ltd for the year ended 30th June, 2015 are stated below:

Statement of Income for the year ended 30th June, 2015

	GH¢
Profit before tax	24,800,000
Taxation	(8,000,000)
Profit after tax	16,800,000
Dividends	(3,200,000)
Retained Earnings	**13,600,000**

Statement of Financial Position as at 30th June, 2015

	GH¢
Non-Current Assets	62,400,000
Current Assets	21,400,000
	83,800,000
Current Liabilities	12,800,000
Long Term Liabilities	35,000,000
	47,800,000
Net Assets	**36,000,000**
Stated Capital	20,000,000
Retained Earnings	16,000,000
	36,000,000

The following additional information is provided;

1) The discounted present value of future cash payments in respect of the long term loan is GH¢48,800,000.
2) The stated capital of Depot Ltd is made up of 25,000,000 ordinary shares of no par value.
3) Current Assets include inventory of GH¢6,600,000 representing goods received from a major supplier on "not for sale but display only" basis.
4) The fair value of the tangible non-current assets was GH¢116,000,000.

5) The profit for the current year includes VAT of 17.5% on turnover of GH¢8,500,000 being invoice amount sold to a customer.
6) The discount rate of Depot Ltd is 10% per annum.
7) Warehouse Ltd, a major competitor of Depot Ltd is listed with a P/E ratio of 9 and dividend yield of 5.2.
8) Profits after tax over the 4 years were as follows;

	GH¢
30th June 2014	12,000,000
30th June 2013	14,400,000
30th June 2012	6,400,000
30th June 2011	11,200,000

Required:
Compute the value to be placed on the ordinary shares using three methods of valuation and advise the Directors accordingly. **(15 marks)**

b) The qualitative characteristics of relevance, faithful representation and comparability identified in the **IASB's** ***Framework for the preparation and presentation of financial statements*** (**Framework**) are some of the attributes that make financial information useful to the various users of financial statements.

Required:
Discuss the concept of **relevance**, **faithful representation** and **comparability** and how they make financial information useful. **(5 marks)**
(Total: 20 marks)

QUESTION FIVE

Mion Ltd is a listed company in Ghana and operates many super markets in Ghana. During the year 2014, there was speculation in the financial press that the entity was likely to be a takeover target for larger companies in Ghana. A recent newspaper publication has suggested that the directors are unlikely to resist a takeover. The seven member board are all nearing retirement and all own significant minority shareholdings in the business.
You have been approached by a private shareholder in Mion Ltd. She is concerned that the directors have conflict of interests and that financial statements for 2014 may have been manipulated. The income statement and summarized statement of changes in equity of Mion together with comparatives for the year ended 31st December 2014 and a statement of financial position as at that date are given below:

INCOME STATEMENT FOR THE YEAR ENDED 31ST DECEMBER 2014

	2014 GH¢m	2013 GH¢m
Revenue	1,255	1,220
Cost of sales	(1,177)	(1,145)
Gross profit	78	75
Operating expenses	(21)	(29)
Profit from operations	57	46
Finance cost	(10)	(10)
Profit before tax	47	36
Income tax	(14)	(13)
Net profit	**33**	**23**

SUMMARISED STATEMENT OF CHANGES IN EQUITY

	2014 GH¢m	2013 GH¢m
Opening balance	276	261
Profit for the period	33	23
Dividends	8	8
Closing balance	**301**	**276**

STATEMENT OF FINANCIAL POSITION AS AT 31ST DECEMBER 2014

	2014 GH¢m	2013 GH¢m
NON-CURRENT ASSETS		
Property, Plant& Equipment	580	575
Goodwill	100	100
	680	675
CURRENT ASSET		
Inventory	47	46
Receivables	12	13
Cash	46	12
	105	**71**
TOTAL	**785**	**746**
EQUITY		
Share Capital	150	150
Retained Earnings	151	126
	301	**276**

NON-CURRENT LIABILITIES		
Interest-bearing borrowing	142	140
Deferred Tax	25	21
	167	**161**
CURRENT LIABILITIES		
Trade & other payables	297	273
short-term borrowing	20	36
	317	**309**
	785	**746**

The following additional information is relevant:

i) Non-current asset turnover (including both tangible and intangible non-current asset): 1.93

ii) Mion Ltd's directors have undertaken a reassessment of useful lives of non-current tangible assets during the year. In most cases they estimate that the useful lives have increased and the depreciation charges in 2014 have been adjusted accordingly.

iii) Six new stores have been opened during 2014, bringing the total to 42.

iv) Three key ratios for the supermarket sector (based on the latest available financial statement of 12 listed entities in the sector) are as follows:

- Annual sales per store: GH¢27.6m
- Gross Profit margin: 5.9%
- Net profit margin: 3.9%

Required:

a) Prepare a report and address to the investor, analyzing the performance and position of Mion Ltd based on the financial statements and supplementary information provided above. The report should also include comparisons with key sector ratios, and it should address the investor's concerns about the possible manipulation of the 2014 financial statements. **(15 marks)**

b) Evaluate with examples, the significance of each of the following to an analyst seeking to estimate the effect on future cash flows or liquidity of a company:

i) a commitment and a contingent liability. **(2 marks)**

ii) income in advance and a deposit **(1.5 marks)**

iii) an accrual and a provision **(1.5 marks)**

(5 marks)

(Total: 20 marks)

CORPORATE REPORTING SCHEME

QUESTION ONE

(a) Accounting for Investments – Avocado Group Ltd [10 marks]

Investment in Akwadu Productions (2.5 marks)

After the second acquisition on October 1, 2015, Avocado Ltd holds a total of 57% of the issued share capital of Akwadu Productions and so has control over Akwadu Productions from that date. The holding will be treated as an available for sale financial asset up to September 30, 2015. And as a subsidiary from October 1, 2015 under the provisions of IFRS 3 Business Combinations. From October 1, 2015, Avocado Ltd should be consolidated, pro-rating for three months control in the consolidated statement of comprehensive income for the year ended 31st December 2015.
In a step acquisition where control is acquired, IFRS 3 requires that the original investment is treated as being realized at its fair value. This fair value is added to the consideration paid for the controlling interest in the subsidiary and the proportionate non-controlling interest to calculate the goodwill arising on consolidation.

Investment in Akpakpa Ventures Ltd (2.5 marks)
Avocado Ltd has acquired 90% of the issued ordinary share capital of Akpakpa Ventures Ltd. Therefore it is assumed to have control of Akpakpa Ltd and should consolidate it as a subsidiary under the provisions of IFRS 10 Consolidated Financial Statements. As the subsidiary was acquired mid-year, the income, expenses and other comprehensive income should be pro-rated in the consolidated statement of profit or loss and other comprehensive income for ten months that avocado Ltd had control.

Investment in Waatre Impex Ltd (2.5 marks)
Although Akpakpa Ventures Ltd holds 65% of the issued ordinary share capital of Waatree Impex Ltd, the investment is held exclusively with a view to sale within the next four months. Therefore the holding will be included in the group's financial statements under the provisions of **IFRS 5 *Non-current assets held for sale and discontinued operations*.**
Avocado Ltd holds 90% of Akpakpa's 65% interest in Waatree Impex Ltd. As Avocado's intends to sell the investment in the next four months and is actively marketing it, the assumption must be that it meets the IFRS 5 criteria to be treated as held for sale. The assets and liabilities of Waatre Impex Ltd will be treated as held for sale. The assets and liabilities of Waatre Impex Ltd will be treated as a disposal to the group and measured at the lower of carrying amount and fair value less costs to sell. Waatre Impex Ltd will not be consolidated line by line, but rather as two single amounts, assets held for sale and liabilities held for sale. In the consolidated statement of comprehensive income, the minimum required is to show as a single line entitled to discontinued operations the

profit of Waatre Impex Ltd and any gain or loss on re-measuring the investments to fair value less costs to sell.

Investment in Akutu Brothers Ltd (2.5 marks)

Avocado Ltd holds 40% of the issued ordinary share capital of Akutu Brothers Ltd. Therefore it is assumed to be able to exercise significant influence over Akutu Brothers Ltd which should be treated as an associate under the provisions of IAS 28 Investments in Associates and Joint Ventures. Akutu Brothers Ltd will be included in the group's financial statements using equity accounting. In the consolidated statement of financial position, the investment should be measured at cost on initial recognition and then in each subsequent period the group share of Akutu Brothers Ltd.'s post-acquisition retained reserves should be added less any goodwill impairment. In the consolidated statement of comprehensive income, the group share (40%) of Akutu Brothers Ltd.'s profit and other comprehensive income should be included.

b) The amount to be capitalized to the cost price of the warehouse in 2014 can be calculated as follows:

Calculation

Specific loan	**GH¢**
GH¢800,000 x 9 % x 9/12 =	54,000
Interest earned on unused portion of loan available during the year:	
April 1 to June 30 [(800,000 – 450,000) x 3/12 x 6%]	(5,250)
July 1 to October 31 [(800,000 – 550,000) x 4/12 x6%]	(5,000)
1 November to November 30 [(800,000 – 750,000) x 1/12 x 6%]	(250)
	43,500
General pool of funds	**GH¢**
Capitalization rate is 9.58 % (**w 1)**	
Paid on January 31 (200,000 x 11/12 x 9.58%)	17,563
Paid on November 30 (200,000 x 1/12 x 9.58%)	1,597
	19,160
Total amount to be capitalized	**62,660**

Workings

1) Capitalization rate for a pool of debt	**GH¢**
Total interest payable on these borrowings:	
Bank overdraft	33,800
7 year note (9,000,000 x 10%)	900,000
	933,800
Weighted average total borrowings	
Bank overdraft	750,000
7 year note (9,000,000 x 10%)	9,000,000
	9,750,000
Capitalization rate 933,800 ÷ 9,750,000	**= 9.58%**

[10 marks]

[Total = 20 marks]

EXAMINER'S COMMENTS

Question 1 was in two parts, a) and b):

Part a) used scenarios to test treatment of various shareholdings in investees in consolidated financial statements. It was generally well answered; candidates scored a lot of marks. Nevertheless, candidates had challenges with identification and treatment of the associate company and held-for-sale assets. Only a small number of candidates were able to specifically mention ***held-for-sale asset*** **and** ***held-for-sale liability*** as line items in the Statement of Financial Position. Furthermore, some candidates simply stated that the investee should be consolidated without explaining how it should be done. Several candidates wasted time doing extensive calculations when the question clearly stated ***"Calculations are not required".***

Part b) tested the calculation of borrowing cost to be capitalised. Candidates made a good effort, but very few got ALL the calculations right. Some candidates did not understand the topic. Many candidates did not consider time apportionment of the interest. A number of them did not attempt this part.

QUESTION TWO

[a] Impairment of Assets (2 marks) and Circumstances of Impairment of Asset (3 marks)

An impairment loss arises where the carrying value of an asset, or group of assets, is higher than their recoverable amounts. In effect the standard requires that assets should not appear in a statement of financial position at a value which is higher than they are worth. The recoverable amount of an asset is defined as the higher of its net realizable value (i.e. the amount at which it can be sold for net of direct selling expenses) or its value in use (i.e. its estimated future net cash flows discounted to a present value). IAS 36 Impairment of Assets recognizes that many assets do not produce independent cash flows and therefore the value in use may have to be calculated for a group of assets – a cash generating unit.

The standard recognizes that it would be too onerous for companies to have to test for impaired assets every year and therefore only requires impairment reviews when there is some indication that impairment has occurred. The exception to this general principle is where an intangible asset has an indefinite useful or is not yet available for use, in which case an impairment review is required at least annually. This also applies to goodwill acquired in a business combination. Impairments generally arise where there has been an event or change in circumstances. It may be that something has happened to the assets themselves (e.g. physical damage) or there has been a change in the economic environment relating to the assets.

Indicators of Impairment which may be available from internal or external sources;

- Poor operating results – this could be a current operating loss or a low profit. One year's losses in itself does not necessarily mean there has been an impairment, but if this is coupled with previous losses or expected future losses then there is an indication of impairment.
- A significant decline in an asset's market value (in excess of normal depreciation through use or the passage of time) or evidence of obsolescence (through market changes or technology) or physical damage.
- Evidence of a reduction in the useful economic life or the estimated residual value of assets.
- Adverse changes in the market or economy such as the entrance of a major competitor, new statutory or regulatory rules or any indicator of value that has been used to value an asset.
- A commitment to a significant reorganization or restructuring of the business.
- Loss of key employees or major customers.
- Increases in long-term interest rates which could materially impact on value in use calculations thus affecting the recoverable amounts of assets.
- Where the carrying amount of an entity's net assets is more than its market capitalization.

[b] AT Group Ltd (15 marks)

i. On the acquisition of a subsidiary, the purchase consideration must be allocated to the fair value of its net assets with the residue being classed as goodwill (or negative goodwill if the assets have a greater fair value than the purchase consideration. IFRS 3 revised Business Combinations recognizes that it is not always possible to accurately determine the value of some assets at the date of acquisition and therefore allows a measurement period up to the end of the first full reporting period following the period of acquisition. As the revision to the value of Accra Ltd.'s assets was due to more detailed information becoming available, the fall in its asset values should be treated as an adjustment to provisional valuations made at the time of acquisition. In effect the net assets and goodwill should be restated to GH₵15,000,000 and GH₵9,000,000 respectively; the fall of GH₵1,000,000 is not an impairment loss and should not be charged to the income statement. The above assumes that the recoverable value of the company as a whole is greater than GH₵24,000,000.

The fall in value of Tema Ltd.'s assets is the result of events that occurred after the acquisition (i.e. physical damage to the plant) and this does constitute an impairment loss. The plant and machinery and machinery should be written down to its recoverable amount and the loss charged to the income statement. On the assumption that the recoverable value of the company as a whole has not fallen, goodwill will not be affected.

ii. On the basis of the original estimates, AT Group Ltd.'s earth – moving plant was not impaired, the value in use of GH₵500,000 being greater than its carrying value. However due to the dramatic increase in interest rates causing AT Group Ltd.'s cost of capital to increase, the value in use of the plant will have to be recalculated. As the discount rate has risen this will cause the value in use to fall. There is insufficient information to be able to quantify this fall. If the new discounted value is above the carrying value of GH₵400,000 there is still no impairment. If it is between GH₵245,000 and GH₵400,000, this will be the recoverable amount of the plant and it should be written down to this value. As the plant can be sold for GH₵250,000 less the selling costs of GH₵5,000; then GH₵245,000 is the least amount that the plant should be written down to even if its revised value in use is below this figure.

iii. The treatment of the research and development costs in the year to 30th June 2015 was correct due to the element of uncertainty at that date. The development costs of GH₵75,000 written off in that same period should not be capitalized at a later date even if the uncertainties leading to its original write off are favourably resolved. The treatment of the development costs in the year to 30th June 2015 is incorrect. The directors' decision to continue the development is logical as at the time of the decision the future costs are estimated at only GH₵10,000 and the future revenues are expected to be GH₵150,000. It is also true that the project is now expected to lead to an overall deficit of GH₵135,000 (120+75+80+10-150 in GH₵'000). However at 30th June 2015, the unexpensed development costs of GH₵80,000 are expected to be recovered. Provided the criteria in IAS 38 Intangible Assets are met these costs of GH₵80,000 should be recognized as an asset in the statement of financial position and matched to the future earnings of the new product. Thus, the director's logic of writing off the GH₵80,000 development costs at 30th June 2015 because of an expected overall loss is flawed. The directors do not have the choice to write off the development expenditure.

EXAMINER'S COMMENTS

Question 2 was in two parts, a) and b):

Part a) examined the determination of impairment of assets as provided in IAS 36: Impairment of Assets. It was generally well answered. However, after explaining impairment losses, many candidates did not provide circumstances that lead to impairment losses.

Part b) examined consolidation techniques under practical situations using illustrations. Answers to this part were poor, incoherent and could not explain how the information would affect the consolidated financial statements. Some candidates filled their answer sheets with figures without giving any explanation. The question gave candidates a lot of problems.

In part b) i), the first scenario, the assets of two companies were reviewed for impairment in line with IFRS 3 revised: Business Combinations. In one of the companies, the assets suffered a fall in value due to more detailed information becoming available presently but not at the date of acquisition. Such a situation required an adjustment to be made in the values of the individual assets. The fall in value of the assets did not constitute impairment and should not be charged to the income statement. In the other company, there was a physical damage to the plant after acquisition which constituted an impairment loss. Many candidates were unable to differentiate between the two circumstances.

In part b) ii), the second scenario, a dramatic increase in interest rates resulted in an increase in the cost of capital. This in turn resulted in a re-calculation of the value in use of the plant. With the figures provided in the scenario, the re-calculation of the value in use resulted in a reduction in value in use but not sufficient enough to constitute impairment. Very few candidates were able to get this correct.

In part b) iii), the third scenario, the issue was whether the directors were right in writing off ALL development expenditure under the stated circumstances. From the answers submitted, it was clear that many candidates did not know the conditions under which to write off or capitalise development expenditure. The answers appeared to be mere guesses; candidates missed out on the marks allocated to this question.

QUESTION THREE

Discuss the **principles and key components** of the IIRC's Framework, and **any concerns** which could question the Framework's suitability for assessing the prospects of an entity. **(10 marks)**

a) The International Integrated Reporting Council (IIRC) has released a framework for integrated reporting. The Framework establishes principles and concepts which govern the overall content of an integrated report. An integrated report sets out how the organization's strategy, governance, performance and prospects can lead to the creation of value. The IIRC has set out a principles-based framework rather than specifying a detailed disclosure and measurement standard. This enables each company to set out its own report rather than adopting a checklist approach. The integrated report aims to provide an insight into the company's resources and relationships, which are known as the capitals and how the company interacts with the external environment and the capitals to create value. These capitals can be financial, manufactured, intellectual, human, and social relationship, and natural capital but companies need not adopt these classifications. Integrated reporting is built around the following key components:

(i) Organizational overview and the external environment under which it operates

(ii) Governance structure and how this supports its ability to create value

(iii) Business model

(iv) Risks and opportunities and how they are dealing with them and how they affect the company's ability to create value

(v) Strategy and resource allocation

(vi) Performance and achievement of strategic objectives for the period and outcomes

(vii) Outlook and challenges facing the company and their implications

(viii) The basis of presentation needs to be determined including what matters are to be included in the integrated report and how the elements are quantified or evaluated.

The Framework does not require discrete sections to be compiled in the report but there should be a high level review to ensure that all relevant aspects are included. An integrated report should provide insight into the nature and quality of the organization's relationships with its key stakeholders, including how and to what extent the organization understands, takes into account and responds to their needs and interests. Further, the report should be consistent over time to enable comparison with other entities. The IIRC considered the nature of value and value creation. These terms can include the total of all the capitals, the benefit captured by the company, the market value or cash flows of the organization and the successful achievement of the company's objectives. However, the conclusion reached was that the Framework should not define value from any one particular perspective because value depends upon the individual company's own perspective. It can be shown through movement of capital and can be defined as value created for the company or for others. An integrated report should not attempt to quantify value as assessments of value are left to those using the report. The report does not contain a statement from those 'charged with governance' acknowledging their responsibility for the integrated report. This may undermine the reliability and credibility of the integrated report. There has been discussion about whether the Framework constitutes suitable criteria for report preparation and for assurance. There is a degree of uncertainty as to measurement standards to be used for the information reported and how a preparer can ascertain the completeness of the report. The IIRC has stated that the prescription of specific measurement methods is beyond the scope of a principles-based framework. The Framework contains information on the principles-based approach and indicates that there is a need to include quantitative indicators whenever practicable and possible. Additionally, consistency of measurement methods across different reports is of paramount importance. There is outline guidance on the selection of suitable quantitative indicators.

There are additional concerns over the ability to assess future disclosures, and there may be a need for confidence intervals to be disclosed. The preparation of an integrated report requires judgment but there is a requirement for the report to describe its basis of preparation and presentation, including the significant frameworks and methods used to quantify or evaluate material matters. Also included is the disclosure of a summary of how the company determined the materiality limits and a description of the reporting boundaries. A company should consider how to describe the disclosures without causing a significant loss of competitive advantage. The entity will consider what advantage a competitor could actually gain from information in the integrated report, and will balance this against the need for disclosure.

b)(i) Compare and contrast the **compliance based approach** and **the integrity based approach** in the management of ethical issues. **(6 marks)**

Compliance-based approach

A compliance-based approach is primarily designed to ensure that the company acts within the letter of the law and that violations are prevented, detected and punished. Some organizations faced with the legal consequences of unethical behaviour take legal precautions such as those below;

- Compliance procedures
- Audits of contracts
- Whistleblower Opportunities
- Disciplinary procedures

Corporate compliance is limited in that it refers only to the law but legal compliance is not an adequate means for addressing the full range of ethical issues that arise every day. This is especially the case where voluntary codes of conduct and self-regulation are perhaps more prevalent.

Integrity-based approach

An integrity-based approach combines a concern for the law with emphasis on managerial responsibility for ethical behaviour. Integrity strategies strive to define companies guiding values, aspirations and patterns of thought and conduct. When integrated into day-to-day operations of an organization, such strategies can help prevent damaging ethical lapses, while taping into powerful human impulses for moral thought and action. An integrity based approach to ethics treats ethics as an issue of organization culture.

Ethics management has several tasks;

- To define and give life to an organization's defining values
- To create an environment that supports ethically sound behaviour
- To instil a sense of shared accountability amongst employees

The table below indicates some of the differences between the two approaches;

Description	**Compliance-based Approach**	**Integrity-based Approach**
Ethos	Linked to external standards	Chooses ethical standards
Objective	Keep to the law	Enable legal and responsible conduct
Methods	Reduced employee discretion	Leadership, organization systems
Behavioural Assumptions	People are solitary self-interested beings	People are social beings with values
Standards	The law	Company values, aspirations
Staffing	Lawyers	Managers and lawyers
Education	The law, compliance systems	Values, the law, compliance systems
Activities	Develops standards, train and communicate, handle reports of misconduct, investigate, enforce, oversee compliance	Integrate values into company systems, provide guidance and consultation, identify and resolve problems, oversee compliance

In conclusion, mere compliance with the law is no guide to exemplary behaviour, an integrity-based approach incorporates ethics into corporate culture and systems.

(ii) Discuss the steps you would recommend to your company to adopt in order to sustain value creation from an ethical culture. **(4 marks)**

The following is a set of key actions required to help organizations maximize the value from ethical performance within an ethical culture.

- Make it a strategic priority
- Set the tone from the top
- Develop a code of ethics
- Develop and support routes to report suspected violations
- Engage and communicate
- Focus on training
- Measure effectiveness and revisit regularly

EXAMINER'S COMMENTS

Question 3 was in two parts, a) and b):

Part a) tested the principles and key components of the International Integrated Reporting Council's (IIRC) Framework. This was the most poorly answered question by candidates. Most of them understood the question to be testing on social and environmental accounting and answered in that direction.

Some candidates were totally ignorant of the subject and submitted answers like: "*it is environmental reporting to ensure they do not contaminate the environment; ensuring that they preserve the environment; sustainable measures are put in place to restore depletion of renewable resources, etc*".

For the few who tried their best, key concepts like providing information on strategy, governance, performance and prospects as well as communicating the value creation of an entity did not come out strongly enough. Scarcely did they discuss the company's resources and relationships.

Candidates spent so much energy and time pouring out all they knew about environmental reporting.

Par b) examined the difference between compliance-based approach and integrity-based approach to the management of ethical issues in an organisation. It was very badly answered as most candidates did not have any clue of what these terminologies meant. Some answers submitted were as follows:

"integrity based approach is based on the individual.

integrity based approach is based on the accounting knowledge gained by the individual. The accountants have been trained and therefore they are expected to apply their knowledge when the financial statements are prepared and presented.

the compliance based approach is developed by a lawyer while the integrity based approach is developed within the organization through sensitisation and staff participation."

Many candidates were not aware that the compliance-based approach is primarily designed to ensure that the company acts within the letter of the law and that violations are prevented, detected and punished. On the other hand, an integrity-based approach combines a concern for the law with emphasis on managerial responsibility for ethical behaviour.

QUESTION FOUR

a)

Net Assets	GHC
Fair Value of PPE	116,000,000
Adjustment in Current Assets (21,400,000 - 6,600,000)	14,800,000
	130,800,000
Value of Current & Non-Current Liabilities (12,800,000 + 48,800,000)	61,600,000
Total Net Assets	69,200,000
Total Number of Ordinary Shares	25,000,000
Value per Share (69,200,000 ÷ 25,000,000)	**2.77**
Dividend Yield	
Dividend	3,200,000
Total Number of Ordinary	25,000,000
Dividend Per Share (3,200,000 ÷ 25,000,000)	0.128
(DPS X 100) ÷ Dividend Yield	
Value per Share (0.128 X ÷ 5.2 (1.2)	**2.05**
Price / Earning	
Average Profit [(16,800-1,265)+12,000+14,400+6,400+11,200] ÷ 5	11,907,000
P/E of Warehouse	9
To obtain P/E of Depot Ltd adjust P/E Warehouse Ltd by 30% = (9 X 70%)	6.3
Value of Depot Ltd (11,907,000 X 6.3)	75,014,100
Total Number of Ordinary	25,000,000
Value per Share (75,014,100 ÷ 25,000,000)	**3.01**

b)

(i) Relevance

Information has the quality of relevance when it can influence, on a timely basis, users' economic decisions. It helps to evaluate past, present and future events by confirming or perhaps correcting past evaluations of economic events. There are many ways of interpreting and applying the concept of relevance, for example, only material information is considered relevant as, by definition, information is material only if its omission or misstatement could influence users. Another common debate regarding relevance is whether current value information is more relevant than that based on historical cost. An interesting emphasis placed on relevance within the Framework is that relevant information assists in the predictive ability of financial statements.

That is not to say the financial statements should be predictive in the sense of forecasts, but that (past) information should be presented in a manner that assists users to assess an entity's ability to take advantage of opportunities and react to adverse situations. A good example of this is the separate presentation of discontinued operations in the income statement. From this users will be better able to assess the parts of the entity that will produce future profits (continuing operations) and users can judge the merits of the discontinuation ie has the entity sold a profitable part of the business (which would lead users to question why), or has the entity acted to curtail the adverse effect of a loss making operation.

(ii) Faithful representation

The Framework states that for information to be useful it must be reliable. The quality of reliability is described as being free from material error (accurate) and a faithful representation of that which it purports to portray (i.e. the financial statements are a faithful representation of the entity's underlying transactions). There can be occasions where the legal form of a transaction can be engineered to disguise the economic reality of the transaction. A cornerstone of faithful representation is that transactions must be accounted for according to their substance (i.e. commercial intent or economic reality) rather than their legal or contrived form. To represent faithfully, information must be neutral (free from bias). Biased information attempts to influence users (perhaps to come to a predetermined decision) by the manner in which it is presented. It is recognized that financial statements cannot be absolutely accurate due to inevitable uncertainties surrounding their preparation. A typical example would be estimating the useful economic lives of non-current assets. This is addressed by the use of prudence which is the exercise of a degree of caution in matters of uncertainty. However prudence cannot be used to deliberately understate profit or create excessive provisions (this would break the neutrality principle). Reliable information must also be complete, omitted information (that should be reported) will obviously mislead users.

(iii) Comparability

Comparability is fundamental to assessing an entity's performance. Users will compare an entity's results over time and also with other similar entities. This is the principal reason why financial statements contain corresponding amounts for previous period(s). Comparability is enhanced by the use (and disclosure) of consistent accounting policies such that users can confirm that comparative information (for calculating trends) is comparable and the disclosure of accounting policies at least informs users if different entities use different policies. That said, comparability should not stand in the way of improved accounting practices (usually through new Standards); it is recognized that there are occasions where it is necessary to adopt new accounting policies if they would enhance relevance and reliability.

EXAMINER'S COMMENTS

Question 4 was in two parts, a) and b):

Part a) examined business valuation. It was generally well answered. However, it was noted that some candidates: omitted to adjust for the inventory which was not for sale but for display only; wrongly deducted dividends paid from profit after tax when computing earnings per share; used discounted cash flow method although there was not sufficient information to apply this method; divided the discounted present value of future cash payments in respect of the long term loan (GHS 48,800,000) by the number of shares and presented the result as the share price per the discounted cash flow method.

The question specifically asked candidates to advise the Directors accordingly. Nevertheless, many candidates did not and therefore lost the marks allotted to it.

Part b) tested the concept of relevance, faithful representation and comparability. It was generally well answered.

QUESTION FIVE

a) **REPORT**

To: A private shareholder

From: Management accountant

Date: 31/12/2014

Subject: Performance and position of Mion

As requested, I have analyzed the performance and position of Mion. My analysis is based on extracts from the financial statements for the year ended 31 December 2014 with comparative figures for the year ended 31 December 2013. A number of key measures have been calculated and these are set out in the attached Appendix.

SALES

The company has opened six new stores during the year. However, sales have only increased very slightly in 2014 and annual sales per store have fallen. This may be because the new stores have only opened part way through the year and have therefore not contributed a full year's revenue. Alternatively, there may have been an increase in the level of sales tax.

Annual sales per store are still above the industry average. On the face of it, this is a good sign. However, it is possible that Mion has large stores relative to the rest of the sector.

PROFITABILITY

Gross profit margin has increased very slightly during the year and this is a little above the industry average. However, although net profit margin has increased significantly during the year, this is still below the industry average. The increase in net profit margin has occurred because operating expenses have fallen by over a quarter in 2014. The operating profit margin has risen from 3.8% in 2013 to 4.5% in 2014.

Given the information available, the mostly likely cause of this fall is the increase in asset lives and the resulting reduction in the depreciation expense. As might be expected, the company has a considerable investment in property, plant & equipment and depreciation would normally be significant expense. An increase in asset is relatively unusual and it is possible the directors have used this method to deliberately improve the operating and the net profit margins. (They may have been particularly concerned that the net profit margin has obviously been well below the industry average.)

On the other hand, the directors may have carried out their review of assets lives in good faith or there could be another legitimate reason why operating expenses have fallen. For example, the 2013 figure may have been inflated by a significant "one off" expense.

It is impossible to prove that the profit figure has been manipulated on the basis of the very limited information available. Information about the reasons for the fall in operating expenses and review of asset lives and about the property, plant & equipment held by the company would be extremely useful.

OTHER MATTERS

Non-current asset turnover has improved slightly, but still below the industry average. This suggests that the company uses its asset less efficiently than others in the same sector. However, increasing the asset lives will have reduced the ratio for 2014; it is possible that the company's asset turnover would have approached the sector average had the review not been carried out. Given that six new stores have opened in 2014, it is surprising that property, plant & equipment has only increased by GHS5 million in the year. It is possible that most of the investment in new property was made during 2013.

The current ratio for both years is extremely low. Supermarkets often do have relatively low current and quick ratios, but no average figure for the industry is available, so it is difficult to tell whether this is normal for the type of operation. Short-term liquidity appears not to be a problem because the company has a positive cash balance which has increased in the year. However, the appearance of the statement of financial position suggests that this has been achieved by delaying payment to suppliers. Trade and other payables have increased by nearly 9%, while revenue and cost of sales have only increased by approximately 3%.

The debt/ equity ratio has fallen in the year and gearing does not appear to be a problem.

CONCLUSION

Mion's profit margins appear to be reasonable for a company in its industry sector. Although its net profit margin is below the industry average, this is improving. There are no apparent short-term liquidity problems.

It is possible at least some of this improvement has been achieved by deliberately reducing the operating expenses for the year. If, as seems likely, the directors wish to sell their interest in the company in the near future, improved results will help to secure a better price.

However, it is impossible to be certain that this has happened without much more detailed information about the reason for the fall in operating expenses. There may be legitimate explanation for the improvement in the company's profit margins.

APPENDIX

	2014	2013	KEY SECTOR RATIO
Annual sales per store	1255/42 =GHS29.9m	1220/36 =GHS33.9m	GHS27.6m
Gross profit margin	78/1225 X 100%=6.2%	75/1220 X 100%=6.1%	5.90%
Operating profit margin	57/1255 X 100%=4.5%	46/1220 X 100%=3.8%	-
Net profit Margin	33/1255 X 100%=2.6%	23/1220 X 100%=1.9%	3.90%
Non-current asset turnover	1255/680 1.85 times	1220/675 1.81 times	1.93 times
current ratio	105/317 =0.33:1	71/309 =0.23:1	-
Debt/Equity	142/301 X 100%=47.2%	140/276 X 100%=50.7%	-

b)

i) Commitment and contingent liability

A commitment to undertake a transaction should be backed by whether it is probable that future economic benefits will flow to/from the entity or that there is a virtual certainty of inflow/outflow of resources. Commitment usually have significant effect on the future cash flows or liquidity of an entity. For examine, if a bank issues a guarantee to its customers to purchase supplies, the bank must clearly understand that this can lead to liability which may require a provision to be made since it can affect the bank's future cash flows.

A contingent liability does not have an immediate effect on the future cash flows of an entity unless there is certainty of an obligating event. A contingent liability such as a compensation that may be paid to a customer pending a legal suit for a suspected defective product should be disclosed unless the possible outflow of resources to meet the liability is remote. If the outflow of resources is thought to be remote, no disclosure is required. If is it probable that there is an obligating event which will lead to settlement of liability, then a provision should be made for the contingent liability.

ii) Income in advance and a deposit

Income in advance emanates from contractual agreements to provide goods and services at a future date. Income in advance and deposits received have effect on future cash flows because they are recognized as liabilities until the anticipated service is rendered/goods supplied. Deposits results in inflow of resources to the entity but income in advance do not necessarily lead to cash flows.

ii) Accruals and provisions

Accruals are current obligations of an entity that will result in outflow of economic benefits when the obligation is settled. Accruals therefore have significant effect on future cash flows or liquidity of an entity. Increases in accruals may lead to inflows of cash in the short term by freeing up available funds but eventually this will lead to outflow of cash to settle the increased accruals.

A provision is a liability of an uncertainty amount and timing. A provision is treated as a liability provided it can be measured reliably and it will lead to an outflow of economic benefits. Provisions do not affect the future cash flows of an entity unless an obligating event is triggered.

EXAMINER'S COMMENTS

Question 5 was in two parts, a) and b):

Part a) tested the analysis of financial statements using ratios. It was generally well answered. However, some candidates: calculated too many ratios, most of which were not applicable in answering the question; analysed without computing or using ratios: were unable to express their thoughts clearly.

Although the question said, among others, "*address the investor's concerns about the possible manipulation of the 2014 financial statements.*" most candidates failed to take notice of this requirement and so lost valuable marks allocated for it.

Part b) tested the significance of each of the following to an analyst when estimating future cash flows or liquidity of a company: *a commitment and a contingent liability, income in advance and a deposit, an accrual and a provision*. It was not well answered. Most candidates gave general explanation of these terminologies without relating to how they impact on future cash flows or liquidity as required by the question.