THE INSTITUTE OF CHARTERED ACCOUNTANTS, GHANA

NOVEMBER 2015 PROFESSIONAL EXAMINATIONS

EXAMINERS GENERAL COMMENTS

FINANCIAL REPORTING (2.1)

STANDARD OF THE PAPER

The standard of the questions fell below standard and could not be compared to those previously administered under Financial Reporting (Paper 2.1). The questions were not too involving and the volume of work required was quite minimal.

COVERAGE OF SYLLABUS

The questions covered all the relevant sections and reflected the weighting of the topics in the syllabus, and it followed a similar pattern of the previous exams, except the section on the Financial Statement Interpretation carried 20 marks instead of 15.

GENERAL PERFORMANCE

The general performance of the candidates was far below average. More than 80% of the candidates scored less than 40% of the total marks while a few candidates scored below 12%. The high performers were concentrated in Cape Coast and Kumasi. The low performers were in the other regional centres. There were no signs of copying.

The general performance showed that the background of most of the candidates entering the examinations at this level was far below standard expected and they were not really prepared for the examinations. The Institute should reconsider the exemption policy for students registering for the examinations.

NOTABLE STRENGTHS OF CANDIDATES

Candidates who prepared adequately and were ready for the examinations scored more than 50% of the total marks. A few candidates scored above 65% of the total marks.

Candidates with high understanding of the Accounting Standards scored high marks especially in question four.

WEAKNESSES OF CANDIDATES

The performance of most of the candidates showed that they were not fully prepared for the examination. They showed lack of understanding of the Accounting Standards and especially the double entry principles in questions one three and five.

The orderly and logical presentation of answers continued to be a challenge to most candidates.

A few of the candidates presented their answers without showing workings to support the final figures in the answer, resulting in the loss of vital points especially in question three on publication of Financial statement.

A few of the candidates failed to record the question numbers answered on the front cover of the answer book in chronological sequence and also on top of the page in the answer book.

QUESTION ONE

Below is the summarised draft statement of financial position of DX Ltd, a company listed on the Ghana Stock Exchange, as at 31 March, 2015:

	GHS'000	GHS'000	GHS'000
ASSETS			
Non-current Assets			
Property at valuation (land GHS20, 000; buildings GHS165, 000) (note ii)			185,000
Plant (note ii)			180,500
Financial assets at fair value through profit or loss at 1 April 2014 (note iii)			12,500
			378,000
Current assets			
Inventory		84,000	
Trade receivables (note iv)		52,200	
Bank		3,800	140,000
Total assets			**518,000**
EQUITY AND LIABILITIES			
Equity			
Stated capital			290,000
Capital surplus		18,000	
Income surplus			
- At 1 April 2014		12,300	
- For the year ended 31 March 2015		96,700	127,000
			417,000
Non-current liabilities			
Deferred tax – at 1 April 2014 (note v)			19,200
Current liabilities			81,800
Total equity and liabilities			**518,000**

The following information is relevant:

(i) DX Ltd's statement of profit or loss includes GHS8million of revenue for credit sales made on a 'sale or return' basis. At 31 March 2015, customers who had not paid for the goods, had the right to return GHS2.6million of them. DX Ltd applied a mark-up on cost of 30% on all these sales. In the past, DX Ltd's customers have sometimes returned goods under this type of agreement.

(ii) The non-current assets have not been depreciated for the year ended 31 March 2015.

DX Ltd has a policy of revaluing its land and buildings at the end of each accounting year. The values in the above statement of financial position as at 1 April 2014 when the building had a remaining life of 15 years. A qualified surveyor has valued the land and buildings at 31 March 2015 at GHS180million.

Plant is depreciated at 20% on the reducing balance basis.

(iii) The financial assets at fair value through profit or loss are held in a fund whose value changes directly in proportion to a specified market index. At 1 April 2014 the relevant index was 1,200 and at 31 March 2015 it was 1,296.

(iv) In late March 2015 the directors of DX Ltd discovered a material fraud perpetrated by the company's credit controller that had been continuing for some time. Investigations revealed that a total of GHS4million of the trade receivables as shown in the statement of financial position at 31 March 2015 had in fact been paid and the money had been stolen by the credit controller. An analysis revealed that GHS1.5million had been stolen in the year to 31 March 2014 with the rest being stolen in the current year. DX Ltd is not insured for this loss and it cannot be recovered from the credit controller, nor is it deductible for tax purpose.

(v) During the year, the company's taxable temporary differences increased by GHS10miiion of which GHS6million related to the revaluation of the property. The deferred tax relating to the remainder of the increase in the temporary differences should be taken to profit and loss. The applicable income tax rate is 20%.

(vi) The above figures do not include the estimated provision for income tax on the profit for the year ended 31 March 2015. After allowing for any adjustments required in terms (i) to (iv), the directors have estimated the provision of GHS11.4million (this is in addition to the deferred tax effects of item (v).

(vii) During the year, dividends of GHS15.5million were paid. These have been correctly accounted for in the above statement of financial position.

Required:

Taking into account any adjustments required by items (i) to (vii) above:

(a) Prepare a statement showing the recalculation of DX Ltd's profit for the year ended 31 March 2015; and

(7 marks)

(b) Redraft the statement of financial position of DX Ltd as at 31 March 2015.

(13 marks)

(Notes to the financial statements are not required). **(Total: 20 marks)**

QUESTION TWO

Kack Ltd is a listed company that assembles domestic electrical goods which it then sells to both wholesale and retail customers. Kack Ltd's management was disappointed in the company's results for the year ended 31 March 2014. In an attempt to improve performance the following measures were taken early in the year ended 31 March 2015:

A national advertising campaign was undertaken,

Rebates to all wholesale customers purchasing goods above set quantity levels were introduced,

The assembly of certain lines ceased and was replaced by bought in completed products. This allowed Kack Ltd to dispose of surplus plant.

Kack Ltd's summarised financial statements for the year ended 31 March 2015 are set out below:

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2015

	GHSm
Revenue (25% cash sales)	4,000
Cost of sales	(3,450)
Gross profit	550
Operating expenses	(370)
Operating profit	180
Profit on disposal of plant (note (i))	40
Financial charges	(20)
Profit before tax	200
Income tax expense	(50)
Profit for the year	150

STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2015

	GHSm	GHSm
Non-current Assets		
Property, Plant and equipment (note (ii))		550
Current Assets		
Inventory	250	
Trade receivables	360	
Bank	nil	610
Total Assets		**1,160**
Equity and Liabilities		
Stated capital (400m shares)		100
Income Surplus		380
		480
Non-current liabilities		
8% loan notes		200
Current liabilities		
Bank overdraft	10	
Trade payables	430	
Current tax payables	40	480
Total equity and liabilities		**1,160**

Below are ratios calculated for the year ended 31 March 2014:

Return on year end capital employed (profit before interest and tax over total assets less current liabilities)	28.1%
Net assets (equal to capital employed) turnover	4 times
Gross profit margin	17%
Net profit (before tax) margin	6.3%
Current ratio	1.6:1
Closing inventory holding period	46 days
Trade receivables' collection period	45 days
Trade payables' payment period	55 days
Dividend yield	3.75%
Dividend cover	2 times

Notes

Kack Ltd received GHS 120m from the sale of plant that had a carrying amount of GHS 80m at the date of its sale.

The market price of Kack Ltd's share throughout the year averaged GHS3.75 each.

There were no issues or redemption of shares or loans during the year.

Dividends paid during the year ended 31 March 2016 amounted to GHS 90m, maintaining the same dividend paid in the year ended 31 March 2015.

Required:

(a) Calculate ratios for the year ended 31 March, 2015 (showing your workings) for Kack Ltd, equivalent to those provided above. **(10 marks)**

(b) Analyse the financial performance and position of Kack Ltd for the year ended 31 March 2015 compared to the previous year. **(10 marks)**

(Total: 20 marks)

QUESTION THREE

(a) CL Ltd is a wholesaler and retailer of office furniture. Extracts from the company's financial statements are set out below:

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED:

	31 March 2015		**31 March 2014**	
	GHS'000	**GHS'000**	**GHS'000**	**GHS'000**
Revenue: - cash	12,800		26,500	
- credit	53,000	65,800	28,500	55,000
Cost of sales		(43,800)		(33,000)
Gross profit		22,000		22,000
Operating expenses		(11,200)		(6,920)
Finance costs: - loan notes	(380)		(180)	
- overdraft	(220)	(600)	-	(180)
Profit before tax		10,200		14,900
Income tax expense		(3,200)		(4,400)
Profit for the year		7,000		10,500
Other comprehensive income:				
Gain on property revaluation		5,000		1,200
Total comprehensive income		12,000		11,700

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2015

	Stated Capital GHS'000	**Capital Surplus GHS'000**	**Income Surplus GHS'000**	**Total**
Balances b/f	8,500	2,500	15,800	26,800
Share issue	12,900	-	-	12,900
Comprehensive Income	-	5,000	7,000	12,000
Dividends paid	-	-	(4,000)	(4,000)
Balances c/f	**21,400**	**7,500**	**18,800**	**47,700**

STATEMENTS OF FINANCIAL POSITION AS AT 31 MARCH:

	2015		2014	
	GHS'000	GHS'000	GHS'000	GHS'000
Assets				
Non-current assets (see note)				
Cost		93,500		80,000
Accumulated depreciation		(43,000)		(48,000)
		50,500		32,000
Current assets				
Inventory	5,200		4,400	
Trade receivables	7,800		2,800	
Bank	-	13,000	700	7,900
Total assets		**63,500**		**39,900**
Stated capital		21,400		8,500
Capital surplus		7,500		2,500
Income surplus		18,800		15,800
		47,700		26,800
Non-current liabilities				
10% loan notes		4,000		3.000
Current liabilities				
Bank overdraft	3,600		-	
Trade payables	4,200		4,500	
Taxation	3,000		5,300	
Warranty provision	1,000	11,800	300	10,100
		63,500		**39,900**

Note:

Non-current assets

During the year the company redesigned its display areas in all of its outlets. The previous displays had cost GHS10million and had been written down by GHS9million. There was an unexpected cost of GHS500,000 for the removal and disposal of the old display areas. Also during the year the company revalued the carrying amount of its property upwards by GHS5million and the accumulated depreciation on these properties of GHS2million was reset to zero.

All depreciation is charged to operating expenses.

Required:

Prepare a statement of cash flows for CL Ltd for the year ended 31 March 2015 in accordance with IAS 7 - Statement of Cash Flows.

(15 marks)

(b) The directors of CL Ltd are concerned at the deterioration in its bank balance and are surprised that the amount of gross profit has not increased for the year ended 31 March 2015. At the beginning of the current accounting period (i.e. on 1 April 2014), the company changed to importing its purchases from a foreign supplier because the trade prices quoted by the new supplier were consistently 10% below those of its previous supplier. However, the new supplier offered a shorter period of credit than the previous supplier (all purchases are on credit). In order to encourage higher sales, CL Ltd increased its credit period to its customers, and some of the cost savings (on trade purchases) were passed on to customers by reducing selling prices on both cash and credit sales by 5% across all products.

Required:

(i) Calculate the gross profit margin that you would have expected CL Ltd to achieve for the year ended 31 March 2015 based on the selling and purchase price changes described by the directors. **(2 marks)**

(ii) Comment on the directors' surprise at the unchanged gross profit and suggest what other factors may have affected gross profit for the year ended 31 March 2015.

(3 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Two of the enhancing qualitative characteristics of useful financial information contained in the IASB's Conceptual Framework for Financial Reporting are understandability and comparability.

Required:

Explain the meaning and purpose of the above characteristics in the context of financial reporting and discuss the role of consistency within the characteristic of comparability in relation to changes in accounting policy. **(6 marks)**

(b) LB Ltd is a construction contract company involved in building commercial properties. Its current policy for determining the percentage of completion of its contracts is based on the proportion of cost incurred to date compared to the total expected cost of the contract.

One of LB Ltd's contracts has an agreed price of GHS500million and estimated total costs of GHS400million.

The cumulative progress of this contract is:

Year ended:

	30 September 2011	**30 September 2012**
	GHSm	**GHSm**
Costs incurred	160	290
Work certified and billed	150	320
Billing received	140	300

Based on the above, LB Ltd prepared and published its financial statements for the year ended 30 September 2011. Relevant extracts are:

STATEMENT OF PROFIT OR LOSS

	GHSm
Revenue (balance)	200
Cost of sales	(160)
Profit (100 x 160/400)	40

STATEMENT OF FINANCIAL POSITION

	GHSm
Current assets	
Amounts due from customers	
Contract costs to date	160
Profit recognised	40
	200
Progress billings	(150)
	50
Contract receivables (150-140)	10

LB Ltd has received some adverse publicity in the financial press for taking its profit too early in the contract process, leading to disappointing profits in the later stages of contracts. Most of LB Ltd's competitors take profit based on the percentage of completion as determined by the work certified compared to the contract price.

Required:

(i) Assuming LB Ltd changes its method of determining the percentage of completion of contracts to that used by its competitors, and that this would represent a change in an accounting estimate, calculate equivalent extracts of profit or loss and statement of financial position for the year ended 30 September 2012. **(7 marks)**

(ii) Explain why the above represents a change in accounting estimate rather than a change in accounting policy. **(2 marks)**

(c) LB Ltd also sells building materials to other contractors from its warehouse and is considering setting up another retail branch in a different part of the country.

The directors have been told that the branch can be run directly through the head office or set up a separate entity, but are not sure how the accounting will work.

Required:
Explain to the directors how this transaction should be treated in the books of LB Ltd.

(5 marks)

(Total: 20 marks)

QUESTION FIVE

On 1 January 2012, VM Ltd acquired 18m of the equity shares of GR Ltd in a share exchange in which VM Ltd issued two new shares for every three shares it acquired in GR Ltd. This gave VM Ltd a holding of 90%. Additionally, on 31 December 2012, VM Ltd will pay the shareholders of GR Ltd GHS1.76 per share acquired. VM Ltd's cost of capital is 10% per annum.
At the date of acquisition, shares in VM Ltd and GR Ltd had market prices of GHS6.50 and GHS2.50 each respectively.

STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 30 SEPTEMBER 2012

	VM	GR
	GHS'000	GHS'000
Revenue	129,200	76,000
Cost of sales	(102,400)	(52,000)
Gross profit	26,800	24,000
Distribution costs	(3,200)	(3,600)
Administrative expenses	(7,600)	(4,800)
Investment income	1,000	-
Finance costs	(840)	-
Profit before tax	16,160	15,600
Income tax expense	(5,600)	(3,200)
Profit for the year	**10,560**	**12,400**
Equity as at 1 October 2011		
Stated capital	120,000	30,000
Income surplus	108,000	70,000

The following information is relevant:

(i) At the date of acquisition the fair values of GR Ltd's assets and liabilities were equal to their carrying amounts with the exception of two items:

1. An item of plant had a fair value of GHS3.6million above its carrying amount. The remaining life of the plant at the date of acquisition was three years. Depreciation is charged to cost of sales.

2. GR Ltd had a contingent liability which VM Ltd estimated to have a fair value of GHS900, 000. This has not changed as at 30 September 2012.

GR Ltd has not incorporated these fair value changes into its financial statements.

(ii) VM's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, GR Ltd's share price at the date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.

(iii) Sales from VM Ltd to GR Ltd throughout the year ended 30 September 2012 had consistently been GHS1.6million per month. VM Ltd made a mark-up of 25% on these sales. GR Ltd had GHS3million of these goods in inventory as at 30 September 2012.

(iv) VM Ltd's investment income is a dividend received from its investment in a 40% owned associate which it has held for several years. The underlying earnings for the associate for the year ended 30 September 2012 were GHS4million.

(v) Although GR Ltd has been profitable since its acquisition by VM Ltd, the market for GR Ltd's product has been badly hit in recent months and VM Ltd had calculated that the goodwill has been impaired by GHS4million as at 30 September 2012.

Required:

(a) Calculate the goodwill on acquisition of GR. **(5 marks)**

(b) Prepare the consolidated statement of profit or loss for VM Ltd for the year ended 30 September 2012. **(15 marks)**

(Total: 20 marks)

SUGGESTED SOLUTIONS

QUESTION ONE

(a)

DK LTD

RECACULATION OF PROFIT FOR THE YEAR ENDED 31ST DECEMBER, 2015

	GH ¢'000	**GHS' 000**
Draft retained profit per income surplus		96,700
Dividends paid		15,500
Draft profit for the year		112,200
Profit on goods on sale or return (2,600 x 30/130)		(600)
Depreciation:		
Buildings (165,000/15)	11,000	
Plant (180,500 x 20%)	36,100	
		(47,100)
Gain in investment (W3)		1,000
Current year fraud loss		(2,500)
Increase in deferred tax provision (W5)		(800)
Current year tax		(11,400)
		50,800

[7 marks]

(b)
DX LIMITED
STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2015

	GH ¢'000	GHS '000
Non-current assets		
Property (W1)		180,000
Plant (W1)		144,400
Investments (W3)		13,500
		337,900
Current assets		
Inventory (84,000 + 2,000 (W2))	86,000	
Trade receivables (W7)	45,600	
Bank	3,800	
		135,400
Total assets		**473,300**
Equity and liabilities		
Stated capital		290,000
Capital surplus (18,000 + 4,800 (W6))		22,800
Income surplus (W8)		46,100
Total equity		358,900
Non-current liabilities		
Deferred tax (19,200 + 2,000 (W5))		21,200
Current liabilities		
As per draft SFP	81,800	
Tax payable	11,400	
		93,200
Total equity and liabilities		**473,300**

Workings

1) Property, plant and equipment

	Land	Buildings	Plant	Total
	GH ¢'000	GH ¢'000	GH ¢'000	GH ¢'000
Property	20,000	165,000	180,500	365,500
Depreciation	-	(11,000)	(36,100)	(47,100)
	20,000	154,000	144,400	318,400
Revaluation	-	6,000	-	6,000
Balance c/d	**20,000**	**160,000**	**144,400**	**324,400**

2) Sale or return

	GH ¢'000	GH ¢'000
Cancel sale:		
DR Sales	2,600	
CR Receivables		2,600
Record inventories:		
DR Inventories (SFP) 2,600 x 100/130	2,000	
CR Cost of sales (closing inventories)		2,000

3) Financial assets at FV through profit or loss

	GH ¢'000
FV at year end (12,500 x 1,296/1,200)	13,500
Per draft SOFP	(12,500)
Gain – to profit or loss	1,000

4) Fraud

	GH ¢'000	GH ¢'000
DR Income surplus - prior year	1,500	
DR Current year profit	2,500	
CR Receivables		4,000

5) Deferred tax

	GH ¢'000	GH ¢'000
DR Capital surplus (6,000 x 20%)	1,200	
DR Profit or loss (tax charge) (4,000 x 20%)	800	
CR Deferred tax liability (10,000 x 20%)		2,000

6) Capital surplus

	GH ¢'000
Land and buildings at 31 March 2014	185,000
Depreciation (165,000/15)	(11,000)
	174,000
Valuation at 31 March 2015	180,000
Surplus	6,000
Deferred tax provision (6,000 x 20%)	(1,200)
Net surplus	4,800

7) Trade receivables

	GH ¢'000
Per draft SFP	52,200
Sale or return	(2,600)
Adjustment - fraud	(4,000)
	45,600

8) **Income surplus**

	GH ¢'000
B/f	12,300
Prior year adjustment	(1,500)
Total comprehensive income	50,800
Dividends paid	(15,500)
	46,100

[13 marks]

EXAMINER'S COMMENT

a) The approach to the question was below average. The recalculation of the Company's profit could have been a bonus question but majority of the candidates could not answer it. Even though, the notes to the question were not too involving. This confirms the challenges candidates have with the double entry principle.

b) The redrafting of the Statement of Financial Position could have been a give-away but it tend out to be a disaster.

QUESTION TWO

a) **Return on Capital Employed (ROCE)**
Profit before Interest and Tax / Total Assets – Total Current Liabilities
220/680×100 = 32.3%

Net assets turnover
Turnover / Net Assets
4,000/680 =5.9 times

Gross Profit Margin
Gross Profit /Turnover
550/4,000 ×100 = 13.8%

Net Profit Margin
Profit before Tax / Turnover
200/4,000 ×100 =5%

Current ratio
Current Assets / Current Liabilities
610/480 = 1.27: 1

Closing Inventory holding period
Average Inventory / Cost of Sales
250/3,450 ×365 = 26 days

Trade receivables collection period
Trade Receivable / Credit Sales x 365
360/3,000 ×365 = 44 days

Trade payables payment period

Trade Payables / Credit Purchase x 365

430/3,450 × 365 = 45 days

Dividend yield

Dividend per Share / Market Price per Share x 100

22.5/375*×100 = 6%

*__Dividend per share__

Dividend Paid / No. of Share

(90/400)/

Dividend cover

Net Profit after Tax / Dividend Paid

150/90 = 1.67 times

Earnings per Share / Dividend Per /share

[10 marks]

b) Analysis of the comparative financial performance and position of Kack for the year ended 31 March 2015.

The first thing to notice about Kack's results is that the ROCE has increased by 4.2 percentage points, from 28.1 to 32.3. On the face of it, this is impressive. However, we have to take into account the fact that the capital employed has been reduced by the plant disposal and the net profit has been increased by the profit on disposal. So the ROCE has been inflated by this transaction and we should look at what the ROCE would have been without the disposal. Taking out the disposal gives us the following ratios:

ROCE =180/ (680+80) × 100 = 23.7%

Net asset turnover = 4,000/760 = 5.3 times

Net profit margin =160/4,000 × 100 = 4%

Comparing these ratios to those for the period ended 31 March 2014 we can see that ROCE has fallen. This fall has been occasioned by the fall in the net profit margin. The asset turnover has improved on the previous year after adding back the disposal.

The net profit margin can be analysed into two factors – the gross profit margin and the level of expenses. The **gross profit percentage is 3.2 % down** on the previous year. This is probably due to the rebates offered to wholesale customers, which will have increased sales at the expense of profitability. The replacement of some production lines by bought in products will probably also have reduced profit margins. Sales may have been increased by the advertising campaign, but this has been additional expense charged against the net profit. It looks as if management have sought to boost revenue by any available means. The plant disposal has served to mask the effect on profits.

Kack's **liquidity has also declined** over the current year. The current ratio has gone down from 1.6 to 1.3. However, there has also been a sharp decline in the inventory holding period, probably due to holding less raw material for production. It could be that the finished good can be delivered direct to the wholesalers from the supplier. This will have served to reduce the current ratio. The receivables collection period has remained fairly constant but the payables payment period has gone down by 10 days. It looks as if, in return for prompt delivery, the finished goods supplier demands prompt payment. This fall in the payables period will have served to improve the current ratio. We do not have details of cash balances last year, but Kack currently has no cash in the bank and a GHS 10 m overdraft. Without the GHS 120m from the sale of plant the liquidity situation would obviously have been much worse.

The **dividend yield has increased** from 3.75% to 6 %, which looks good as far as potential investors are concerned. But we are told that the dividend amount is the same as last year. As there have been no share issues, this means that the dividend per share is the same as last year. Therefore the increase in dividend yield can only have come about through a fall in the share price. The market is not that impressed by Kack's results. At the same time the dividend cover has declined. Do the same dividend has been paid on less profit (last year's dividend cover was 2.0, so profit must have been GHS 180m). Management decided it was important to maintain the dividend, but this was not sufficient to hold the share price up.

To conclude, we can say that **Kack's position and performance is down** on the previous year and any apparent improvement is due to the disposal of plant.

[10 marks]

EXAMINER'S COMMENT

a) The question followed a similar pattern in previous exams. It is therefore not surprising when most candidates scored high marks while it was the reverse to most of the candidates who did not know. By stating the formula in computing ratios provides evidence that the candidate knows what he is about. A few candidates failed to state the formula and therefore lost vital points.

b) The analysis of the financial Performance of the Company was poorly handled as most candidates wrote on the Industry performance instead of the trend analysis.

QUESTION THREE

(a) CL Ltd

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 MARCH 2015

	GH ¢'000	GH ¢'000
Cash flows from operating activities		
Profit before tax	10,200	
Depreciation (W2)	6,000	
Loss on disposal of displays (W3)	1,500	
Interest expense	600	
	18,300	
Increase in warranty provision (1,000 – 300)	700	
Increase in inventories (5,200 – 4,400)	(800)	
Increase in receivables (7,800 – 2,800)	(5,000)	
Decrease in trade payables (4,500 – 4,200)	(300)	
Cash generated from operations	12,900	
Interest paid	(600)	
Income tax paid (W4)	(5,500)	
Net cash from operating activities		6,800
Cash flows from investing activities		
Purchase of property, plant and equipment (W1)	(20,500)	
Cost of disposal of property, plant and equipment	(500)	
Net cash used in investing activities		(21,000)
Cash flows from financing activities		
Share issue	12,900	
Loan note issue (4,000 – 3,000)	1,000	
Equity dividends paid	(4,000)	
Net cash from financing activities		9,900
Net decrease in cash and cash equivalents		(4,300)
Cash and cash equivalents at beginning of period		700
Cash and cash equivalents at end of period		**(3,600)**

Workings

1) **NON-CURRENT ASSETS – COST**

	GH ¢'000		GH ¢'000
Balance b/f	80,000	W/off old displays	10,000
Revaluation (5,000 – 2,000)	3,000		
Purchases (bal)	20,500	Balance c/f	93,500
	103,500		103,500

2) **NON-CURRENT ASSESTS - DEPRECIATION**

	GH ¢'000		GH ¢'000
W/off on disposal	9,000	Balance b/f	48,000
Revaluation adjustment	2,000		
Balance c/f	43,000	Charge in year (bal)	6,000
	54,000		54,000

3) **NON-CURRENT ASSESTS – DISPOSAL**

	GH ¢'000		GH ¢'000
Cost	10,000	Acc depreciation	9,000
Cost of disposal	500	Loss of disposal	1,500
	10,500		10,500

4) **INCOME TAX PAYABLE**

	GH ¢'000		GH ¢'000
Tax paid (bal)	5,500	Balance b/f	5,300
Balance c/f	3,000	Charge for year	3,200
	8,500		8,500

[15 marks]

(i) Taking the figures for the year ended 31 March 2014 and applying the 10% reduction in purchase costs and the 5% discount to customers, the directors would have expected the gross profit to be as follows:

	GH ¢'000
Revenue (55,000 x 95%)	52,250
Cost of sales (33,000 x 90%)	(29,700)
Gross profit	**22,550**
Gross profit % (22,550 / 52,250 x 100)	43.2%

The actual gross profit % for the year ended 31 March 2015 is:
(22,000/65,800 x 100) 33.4%

[2 marks]

(ii) The directors should not be surprised at the unchanged gross profit as cost of sales has increased by the same amount as revenue, wiping out any possible increase in gross profit. In fact the actual gross profit margin has fallen from 40% in 2014 to 33.4% in 2015, so despite the 10% reduction in the cost of purchases the company was trading less profitably.

Possible reasons for this could be:

- Shipping costs involved in importing goods having to be borne by the recipient;
- Import duties Currency exchange losses, perhaps exacerbated by having to pay within a shorter period. Inventory losses – uninsured damage, obsolescence etc;
- Selling a larger proportion of goods on which the gross profit % is lower than the average mark-up. Perhaps sales or special offers to customers, which will have to lower the average mark-up. The foreign supplier may have increased his prices at some point during the year;
- Also there may have been changes in accounting policy during the year – perhaps depreciation or distribution costs which were treated as expenses in 2014 and have been charged to cost of sales in 2015. If this has happened it will require retrospective restatement so that 2014 and 2015 can be correctly compared.

[3 marks]

EXAMINER'S COMMENT

This was a straight forward question on the preparation of a Cash Flow Statement. The performance was abysmal as most of the candidates could not prepare it. A few also messed up as they could not differentiate between operating, investing and financing activities.

QUESTION FOUR

(a) Understandability

Financial information is intended to **assist users in making economic decisions**. For this purpose it is important that financial information is presented in a form which users can understand. However, this does not mean that complex matters which some users may find difficult to understand, and which some **directors may like an excuse to exclude**, should be left out of financial statements. Reports from which data has been excluded could be incomplete and misleading. The Conceptual Framework states that users can be assumed to have reasonable knowledge of business and economic activities and be prepared to review and analyze the information diligently.

[2.5 marks]

Comparability

In understanding the financial performance of an entity, users will want to compare its results with those of **other entities in the same sector** and with its own results for previous periods. The concept of comparability is therefore very important. Comparison between entities is made more possible by IFRSs in which most allowed alternatives have been removed and by the requirement to disclose accounting policies. So if two entities have applied different accounting policies users can be aware of that and allow for it.

Comparing an entity's results with its performance in prior years requires the application of consistency. An entity should treat financial items and transactions in a consistent manner from year to year, by applying the same accounting policies. Where there is a change of accounting policy from one year to the next, the comparative information must be restated to show what the results for the previous year would have been if the new accounting policy had been applied. The statement of changes in equity also shows the effect on the previous year's equity balances of the change of accounting policy. The user is therefore able to adjust for the change of accounting policy and observe the changes in underlying performances.

[3.5 marks]

(b) (i) Based on value of work certified, the contract is 64% complete ((320 / 500) x 100) at 30 September 2012. Extracts for 2012 are:

LB LTD

STATEMENT OF PROFIT OR LOSS (EXTRACTS) FOR THE YEAR ENDED 30TH SEPTEMBER, 2012

	GH¢ million
Revenue ((500 x 64%) – 200)	120
Cost of sales ((400 x 64%) – 160)	(96)
Profit ((100 x 64%) – 40)	24

LB LTD

STATEMENT OF FINANCIAL POSITION (EXTRACTS)AS AT 30TH SEPTEMBER, 2012

	GH¢ million
Current assets	
Amounts due from customers	
Contract costs to date	290
Profit recognized (100 x 64%)	64
	354
Progress billings	(320)
	34
Contract receivables (320 – 300)	20

[7 marks]

(ii) Accounting policies are the **rules, principles and practices** adopted by an entity in preparing its financial statements. They should be **based upon IFRSs** or other financial reporting standards.

Accounting estimates are the **measurements and valuations** arrived at by an entity in applying accounting policies to specific items and transactions.

In the case of LB Ltd, the accounting policy is in accordance with IAS 11 Construction Contracts. Revenue and costs are recognized according to the **stage of completion** of the contract. LB's current means of estimating the stage of completion is based on proportion of cost to date to total cost.

Although the question refers to it as LB's 'current policy', this is an **accounting estimate**, because it is LB's method of applying the accounting policy. A different measurement basis, based on the same accounting policy, is to estimate stage of completion based on the value of work certified. In transferring from one to the other, LB is making a **change of accounting estimate**.

[2 marks]

(c) If a branch is accounted for through the head office, tight control can be maintained. Inventory is normally transferred to the branch at selling price and the following accounts are maintained in the head office ledger:

- Branch inventory control account – goods transferred recorded at selling price
- Branch mark-up account
- Goods sent to branch account – goods transferred recorded at cost price

The branch inventory account will be debited when goods are sent to the branch and credited when they are sold. At the end of the period, after adjusting for unsold inventory, the mark-up account will show the gross profit of the branch.
Under this system, branch expenses are usually paid centrally from head office.

A branch which is set up as a separate entity will keep its own full accounting records and pay its own expenses. Initial assets will be transferred to the branch from head office and transactions between the branch and the head office will go through a **branch current account** in the head office ledger, representing net investment in the branch, and a **head office current account** in the branch ledger, representing the capital provided by head office. At the end of the period these two accounts will be reconciled.

Goods will be transferred to the branch at cost or at a small mark-up, so that the branch can add its own mark-up. At the end of the period adjustments will have to be made for any goods or cash in transit and for any unrealized profit in inventory, where goods have been transferred to the branch at an amount above cost price.

[5 marks]

EXAMINER'S COMMENT

a) Only a few candidates were able to explain the meaning and purpose of qualitative characteristics of useful financial information of understandability and Comparability as contained in IASB's Conceptual Framework for Financial Reporting.

b) i) This section of the question on preparation Extracts Statements of Profit or Loss and Financial Position was a disaster and only a few candidates attempted the question satisfactorily.

ii) Most candidates could not explain the difference between Accounting Policy and Estimates and let alone relate it to the Contract Accounts in the question.

c) Most of the candidates could relate the question to both dependent and independent branches. Majority of them presented their answers on dependent branches controlled from Head office.

QUESTION FIVE

(a) Goodwill at acquisition

	GH ¢'000
Considered transferred	
Stated capital (12m x GH¢6.50)	78,000
Deferred consideration (18m x GH¢1.76 x 1/1.1)	28,800
	106,800
Fair value of NCI (2m x GH¢2.5)	5,000
	111,800
Fair value of assets	
Stated capital	30,000
Income surplus (70,000 +(12,400 x 3/12))	73,100
Fair value adjustments to plant	3,600
Contingent liability	(900)
	(105,800)
Goodwill	**6,000**

[5 marks]

(b) VM LTD GROUP – CONSOLIDATED STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 30 SEPTEMBER 2002

	GH ¢'000
Revenue (129,200 + (76,000 x 9/12) – 14,400 (**W2**))	171,800
Cost of sales (102,400 + (52,000 x 9/12) -14,400 + 600 (W2) + 900 (**W3)**)	(128,500)
Gross profit	43,300
Distribution costs (3,200 + (3,600 x 9/12))	(5,900)
Administrative expenses (7,600 + (4,800 x 9/12) + 4,000 (goodwill impairment))	(15,200)
Finance costs (**W4**)	(3,000)
Share of profit of associate (4,000 x 40%)	1,600
Profit before tax	20,800
Income tax expense (5,600 + (3,200 x 9/12))	(8,000)
Profit for the year	**12,800**
Profit attributable to	
Owners of the parent (β)	12,360
Non-controlling interest (**W5)**	440
	12,800

<u>Workings</u>

1) Group structure

VM → 90%

GR → 10%

1 Jan 2002 Mid-year acquisition, nine months before year end

2) Intragroup trading

	GH ¢'000	GH ¢'000
Intragroup trading (1,600 x 9 months)		
DEBIT Revenue	14,400	
CREDIT Cost of sales		14,400
PURP (3,000 X 25/125)		
DEBIT Cost sales	600	
CREDIT Group inventory (SFP)		600

3) Fair value adjustment

	Acquisition	Movement	Year end
	GH ¢'000	GH ¢'000	GH ¢'000
Plant	3,600	(900)*	2,700
*(3,600 / 3) x 9/12			

4) Finance costs

	GH ¢'000
VM per statement of profit or loss	840
Unwinding of discount on deferred consideration:	
((28,800 x 10%) x 9/12)	2,160
	3,000

5) Non-controlling interest

	GH ¢'000
Profit for the year (12,400 x 9/12)	9,300
Depreciation on fair value adjustment (W3)	(900)
Goodwill impairment	(4,000)
	4,400
Non-controlling share 10%	400

15 marks

Alternative Solution to Q 5

VM Ltd.

Workings.

1) **Group structure**

VM	⟶	90%
GR	⟶	10%
		100

1 Jan 2002 Mid-year acquisition, nine months before year end

2) **GR Ltd.** (Subsidiary's) Net Assets @ Acquisition

	GH ¢'000
Stated Capital	30,000
Income Surplus	73,000
Fair Value Adjustment (Plant)	3,600
Contingent liability	900
	105,800

3) **GR Ltd.** (Subsidiary's) Income Surplus @ Acquisition

	GH ¢'000
Income Surplus b/fwd	70,000
Add: Pre-Acquisition Profits (3/12x12,400)	3,100
	73, 100

		GH ¢'000
4)	Depreciation (Plant) (3600/3)x3/12	900

5) Cost of Sale

	GH ¢'000
VAN Ltd	102,400
GR Ltd	39,000
Intra Group Trading (1,600 x 9)	(14,000)
PURP (3000 x25/125)	600
Depreciation (W4)	900
	128,500

6) R Ltd Statement of Profit or Loss

	GH ¢'000
NCI Share of Subsidiary Profit as given and time apportioned (0.1 x12,400 x9/12)	930
NCI Share of:	
Depreciation (0.1 x 900)	(90)
Impairment (0.1 x 4000)	(400)
	440

a)

VM LTD

Goodwill Calculation	GH ¢'000
Fair Value of Purchase Consideration	
Shares (18,000 x 2/3) x GH¢ 6.5	78,000
Deferred Consideration (18,000 x GH¢ 1.76) /1.1	28,000
	106,800
Add: Fare Value of NCI @ Acquisition	
[(18,000 / 0.9) x0.1] x GH¢2.5	5,000
	111,800
Less: Fair Value of Subsidiary's Net Assets @ Acquisition W2	105,800
	6,000

VM LIMITED

CONSOLIDATED STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 30TH SEPTEMBER 2012

	GH ¢'000	GH ¢'000
Revenue (129,200 + (76,000 x 9/12) -14,400		171,800
Less: Cost of Sales (W5)		128,500
Gross Profit		43,300
Distribution Costs (3,200 + (3,600 x 9/12)		(5,900)
Administration Expenses (7,600 + (4,800 x9/12) +4,000		(15,200)
Income from Associates (4,000 x 0.4)		1,600
Finance Cost (840 + (28,800 x 0.1 x 9/12))		(3,000)
Profit before Tax		20,800
Income Tax Expense (5,600 + (3,200 x9/12)		(8,000)
Profit for the year		**12,800**
Profit for the year attributable to :		
Parent (Balancing figure)		12,360
NCI (W 6)		440
		12,800

EXAMINER'S COMMENT

The approach to the question was above average. Even then, a few candidates proved that they were not prepared for the examination. Most Candidates could not relate the date of acquisition to be able to apportion the income and expenses between the parent and the subsidiary. A few also failed to apportion the shareholding structure between the parent and subsidiary correctly.

a) Most of the candidates could not calculate the Goodwill, as they had challenge with computation of the Fair Value of Assets of the subsidiary.

b) The approach to the question on the Consolidated Statement of Profit or Loss was above average. Even then, a few candidates proved that they were not prepared for the examination. It is important for candidates to show detail workings to support their final figures in the Consolidated Statement.