INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

NOVEMBER 2010 EXAMINATIONS
(PROFESSIONAL)

PART 4

ADVANCED FINANCIAL REPORTING
(Paper 4.1)

Attempt ALL Questions

TIME ALLOWED:

Reading & Planning	-	**15 Minutes**
Working	-	**3 Hours**

QUESTION 1

The following consolidated cash flow statement was prepared for Fofie Group of Companies for the year ended December 31, 2009.

FOFIE GROUP OF COMPANIES
CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2009

	GHS	GHS
Operating Cash Flows:		
Net profit before tax		2,533,200
Adjustment for depreciation		850,000
		3,383,200
Movements in working capital items		991,800
Interest received	130,000	
Interest paid	(45,000)	
Non controlling interest	(200,000)	
Taxation	155,000	40,000
Net cash flow from operating activities		4,415,000
Investing cash flows:		
Purchase of property, plant and equipment	(1,900,000)	
Disposals and transfers of properties at carrying value	7,925,000	
Disposal of subsidiary	(125,000)	
Purchase of interest in joint venture	(1,125,000)	
Net cash from investing activities		4,775,000
Financing cash flows:		
Repayment of borrowed funds	(3,000,000)	
Proceeds from issue of shares	2,285,000	
Net cash flow from financing activities		(715,000)
Increase in cash and cash equivalents		8,475,000

Cash and cash equivalents at the end of 2009 and 2008 are made up as follows:

	2009 GHS	2008 GHS
Cash on hand	5,600	2,500
Balance with Big Bank Ghana Limited	6,096,000	5,523,600
Balance with Lucky Ghana Limited	(560,000)	210,500
91 day Treasury bills	9,884,800	8,750,000
Cash and cash equivalents	15,426,400	14,486,600

The accountant could not reconcile the increase of GHS8,475,000 shown in the above cash flow statement with the actual increase in cash and cash equivalents of GHS939,800 derived from the opening and closing balances.

Further enquiries revealed that:

i. Fofie Group disposed off a subsidiary company, Aseda Limited on June 1, 2009. The sale of Aseda Limited resulted in a loss of GHS125,000 made up as follows:

	GHS
Sale proceeds: Ordinary shares	1,500,000
Cash	375,000
	1,875,000
80% of net assets sold	(1,680,000)
Goodwill	(320,000)
Loss on disposal	(125,000)

The Statement of Financial Position of Aseda Limited as at June 1, 2009 is presented below:

	GHS	GHS
Non-Current Assets: Valuation		1,700,000
Depreciation		(150,000)
		1,550,000
Current Assets:		
Inventories	300,000	
Trade receivables	200,000	
Other receivables	50,000	
Cash in hand	40,000	
Bank	610,000	
	1,200,000	
Creditors: amounts falling due within one year:		
Trade Payables	450,000	
Other payables	75,000	
Taxation	125,000	
	650,000	
Net Current Assets		550,000
		2,100,000
Stated Capital		500,000
Capital Surplus		600,200
Income Surplus		999,800
		2,100,000

The accountant simply included the loss on sale in the cash flow statement without any further adjustments in respect of the sale of the subsidiary.

ii. During 2009, Fofie Group transferred some of its tangible assets to New Limited, a newly incorporated company which is jointly owned with another company. The statement of financial position of Fofie Group as at December 31, 2009 contain the sum of GHS1,500,000 as investment in New Limited. This is made up of:

	GHS
Purchase cost: Property transferred	1,000,000
Cash	125,000
	1,125,000
Dividend received	(50,000)
Profit for the year on joint venture after tax	275,000
Revaluation of property	150,000
Closing balance per statement of financial position – New Limited	1,500,000

The entire amount of GHS1,125,000 incurred in acquiring New Limited has been included in the cash flow statement shown above.

iii. The amount of GHS155,000 shown in the cash flow statement in respect of taxation is the difference between the opening and closing balances on the taxation account. Tax charged in the statement of comprehensive income for 2009 is GHS955,000 and comprised:

	GHS
Corporate tax for 2009	979,500
Overprovision for 2008	(124,500)
Taxation related to the joint venture	100,000
	955,000

iv. The non-controlling interest figure in the cash flow statement comprised the difference between the opening and closing statement of financial position totals. The profit attributable to the non-controlling interest for the year was GHS375,000.

v. Included in the cash flow figure for the disposal of properties is the sale and leaseback of some land and buildings. The sale proceeds of the land and buildings were GHS5,000,000 payable in 2010 at an interest of 15% per annum. The total gain on the sale of properties including the land and buildings was GHS600,000.

vi. Some properties of Fofie Group were revalued in 2009 resulting in a revaluation surplus of GHS115,000. This revaluation surplus was not taken into account in preparing the cash flow statement.

vii. In preparing the consolidated statement of comprehensive income, interest receivable credited amounted to GHS135,000 and interest payable charged was GHS95,000.

Required:

Prepare a revised Consolidated Cash Flow Statement for Fofie Group of Companies for the year ended December 31, 2009.

25 marks

QUESTION 2

(a) Tasty Breweries Limited operates in the Pito brewery industry. The industry has become quite unstable due to influx of many companies and this is making survival rather difficult. The trial balance of Tasty Breweries Limited for the year ended 30/9/10 is as follows:

TASTY BREWERIES LIMITED
TRIAL BALANCE AS AT 30^{TH} SEPTEMBER, 2010

	DR GHS	CR GHS
Property, plant & equipment (net)	330,500	
Intangible assets	23,400	
Purchases	460,690	
Sales		750,490
Inventory	40,100	
Receivables/payables	73,200	69,500
Bank & cash	29,700	
Selling, general & administrative expenses	100,800	
12% Medium-Term facility		24,000
Sated capital		50,000
Capital surplus		78,200
Income surplus		86,200
	1,058,390	1,058,390

Additional Information:

i. Profits accrue evenly throughout the year

ii. Sales and purchases include VAT/NHIL at 15%

iii. Corporate tax rate for the year is 25%

iv. Inventory at 30/9/2010 is GHS48,260.

v. The industry has established that a company with a Z-score of 1.81 or less is very likely to become bankrupt within six months from the date of the relevant financial statements.

vi. The industry Z-score is calculated as $Z = 0.012X_1 + 0.014X_2 + 0.33X_3 + 0.066X_4 + 0.999X_5$ where:

X_1 = net working capital/total assets (%)
X_2 = retained earnings/total assets (%)
X_3 = profit before interest and tax/total assets (%)
X_4 = market value of equity/book value of total debt securities (%)
X_5 = sales/total assets (%)

vii. The market value of equity is calculated using a PE ratio of 3.5 applied to earnings before tax.

Required:

Advise whether Tasty Breweries Limited is likely to collapse in the next six months from 30th September, 2010 using the Altman's Z-score.

(*15 marks*)

(b) There is general agreement that profit is a residual available for distribution once provision has been made for maintaining the value of capital. Differences begin to emerge when discussions turn to the consideration of the meaning of capital maintenance.

Required:

Identify and explain any **four (4)** concepts of capital maintenance and the accounting systems that use each of them.

(*8 marks*)

(c) "Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contribution from equity participants" IAS 18 (paragraph 7), ***Revenue Recognition***

Required:

State **four (4)** conditions under which revenue may be recognized from sale of goods; and **three (3)** conditions under which the outcome of a transaction involving the rendering of service can be estimated reliably.

(*7 marks*)
(Total: 30 marks)

QUESTION 3

The business of SOS Television Limited which hit the airwaves in 2002, has been making losses since 2004.

The statement of financial position as at 31st March 2010 was as follows:

ASSETS	GHS	GHS
Non-Current Assets		
Patents and copyrights		300,000
Land and buildings (NBV)		800,000
Plant and machinery (NBV)		600,000
		1,700,000

	GHS	GHS
Current Assets		
Inventories		500,000
Trade and other receivables		500,000
Bank		150,000
Investments (Cost)		400,000
		1,550,000
Total Assets		3,250,000
Financed by:		
Stated capital:		
150,000 Ordinary shares		1,500,000
20% 70,000 cumulative preference shares		700,000
Income surplus		(300,000)
		1,900,000
Non-current Liabilities		
15% Debentures		500,000
Current Liabilities		
Interest on debentures		75,000
Trade payables		375,000
Provision for business restructuring		200,000
Provision for legal damage & claims		50,000
Provision for warranties		150,000
		850,000
Equity and liabilities		3,250,000

The following scheme of reconstruction was approved by all parties as well as the High Court with the exception of one ordinary shareholder.

i. The preference shares were to be reduced to GHS7.5 per share and arrears in dividend thereof for three years were to be cancelled.

ii. The ordinary shares were to be reduced to GHS5.00 per share.

iii. The fair values of the assets were to be taken at:

	GHS
Patents	Nil
Land and buildings	900,000
Plant and machinery	300,000
Investments	300,000
Inventories	420,000
Trade and other receivables	280,000

iv. The balance on the Income surplus is to be eliminated.

v. The liability for legal damages and claims was to be settled for GHS40,000 and the provision for warranty reduced to GHS110,000.

vi. The accrued debenture interest was to be paid in cash.

vii. Investment with a carrying amount of GH210,000 were to be sold for cash at that value in desperation to strengthen the working capital position of the business.

viii. The amount set aside for business restructuring was to be eliminated

ix. The High Court directed payment of GHS1,000 to the member who opposed the scheme for 100 ordinary shares held by her. Mr. Sokpoti, a director of the company, offered to take over the shares.

The following additional information is relevant:

SOS Television Limited carried on trading from 1st April, 2010 to 30th September, 2010 which resulted in the following changes in assets and liabilities:

	Increase by GHS	Decrease by GHS
Bank and cash	40,000	-
Inventories	50,000	-
Trade and other receivables	80,000	-
Trade payables	-	20,000

Plant and machinery is depreciated at 10% per annum and no depreciation is provided on land and buildings.

The half year debenture interest has not been paid.

Required:

(a) Prepare the Capital Reduction Account as at 31 March 2010.

(*4 marks*)

(b) Prepare the statement of financial position as at 1st October 2010.

(*11 marks*)

(Total: 15 marks)

QUESTION 4

Dawa Ltd processes shea nut into shea butter for export. The directors have decided to list the company on the Ghana Stock Exchange in order to raise additional capital for a major expansion programme.

A five year summary

A summary of financial statements for the past five years is provided below:

Financial position as at 30th September 2010

	2010 GHS'000	2009 GHS'000	2008 GHS'000	2007 GHS'000	2004 GHS'000
Stated capital	5,000	5,000	5,000	5,000	5,000
Income surplus	15,000	13,000	11,000	10,000	8,000
Long term loan	4,000	6,000	7,000	5,000	5,000
Deferred tax	250	350	450	350	400
	24,250	24,350	23,450	20,350	18,400
Property, plant & equipment	10,000	8,000	6,000	5,000	4,500
Trade investment	6,000	7,000	5,000	4,000	3,500
Net current assets	8,250	9,350	12,450	11,350	10,400
	24,250	24,350	23,450	20,350	18,400
(Extracts) from Statement of Comprehensive Income					
Turnover	25,000	20,000	18,000	17,500	14,000
Profit before tax	8,000	6,000	4,000	3,500	3,000
tax	2,000	1,600	1,200	1,000	800
Dividend	4,000	3,500	2,800	2,700	2,500

Additional Information:

(i) The replacement cost of the plant is GHS5,000,000 but its current realizable value is GHS3,000,000. The book value of the plant is GHS4,000,000.

(ii) An amount of GHS2,000,000 of stock is obsolete and can be sold for GHS500,000 as scrap

(iii) Information obtained from the Graphic Business indicates that Sugar Limited's market price per share is quoted at GHS20 with earnings per share of GHS2.00. Sugar Limited is in the same industry as Dawa Limited.

(iv) The cost of capital of Dawa Ltd is estimated at 20%.

(v) The stated capital of Dawa Ltd comprised 5,000,000 ordinary share of no par value issued at GHS1.00 per share.

Required:

(a) Estimate the value per share of Dawa Ltd using: net assets (going concern), Earnings Yield, and Dividend Yield methods of valuation.

(10 marks)

(b) State any **six (6)** items that would be required to prepare the accountant's report to be included in the offer for sale documents.

(3 marks)

(c) Hook Ltd has offered to take over Dawa Ltd.

Suggest any **four (4)** factors that the owners of Dawa Ltd may consider in fixing realistic price for the shares of Dawa Ltd.

(2 marks)
(Total: 15 marks)

QUESTION 5

Savannah Limited was incorporated some years ago to process raw shea-nuts into shea-butter for export as raw material for the manufacture of cosmetics. So far, a total of five (5) production lines have been identified as projects for research and development. An extract of the Research & Development Account for the year-ended 30th June, 2010 was as follows:

Project	Balance on 1/7/09 GHS	Expenditure during year GHS	Balance on 30/6/10 GHS
1	46,500	-	46,500
2	27,480	-	27,480
3	36,000	4,000	40,000
4	18,950	21,050	40,000
5	-	32,400	32,400
	128,930	57,450	186,380

Additional Information:

i. Project 1 was completed in August 2009 and sales revenue was first generated on 1/10/09.

ii. Project 2 was completed on 1/7/07 at a cost of GHS45,850 and is being amortised in accordance with the company's policy.

iii. Project 3 was abandoned during the year ended 30/6/10 because a competitor had successfully launched a new product.

iv. Project 4 is still on-going and it meets the criteria for capitalization as per IAS 38 "Intangible Assets". However, sales of the product are yet to begin.

v. Project 5 was commenced in November 2009 and completed in early June 2010 but sales revenue is expected to begin on 1/7/10.

vi. The company's policy is to capitalize research and development expenditure meeting the conditions set out in IAS 38 "Intangible Assets" and to amortise it over five years on a straight line basis beginning when sales revenue is first generated from the development project.

vii. Amortization is apportioned on a time proportion basis.

viii. General research expenditure incurred during the year totaled GHS22,220.

***Required*:**

(a) State the criteria which must be met under IAS 38 "Intangible Assets" for development expenditure to be capitalized.

(***6 marks***)

(b) Determine the amounts to be included in the Statement of Comprehensive Income for Research & Development Expenditure for the year ended 30 June, 2010 and in the Statement of Financial Position for the Intangible Assets for Savannah Limited as at that date.

(***6 marks***)

(c) Clearly distinguish between the cost and revaluation models of measuring Intangible Assets.

(***3 marks***)

(Total: 15 marks)