SOLUTIONS TO MAY 2018 Financial Reporting and Planning Paper

QUESTION 1(a)

ABOTREYE ENTERPRISE
CASH BUDGET
FOR THE FOUR MONTS FROM JUNE TO SEPTEMBER 2018

	JUNE GH¢	JULY GH¢	AUGUEST GH¢	SEPTEMBER GH¢
BUDGETED INFLOWS				
Collections from customers	14,850	49,695	68,862	74,652
Budgeted Outflows				
Payment for machinery	49,500	-	-	-
Direct materials cost	15,813	15,750	16,625	17,438
Direct labour cost	13,300	12,000	13,200	13,400
Variable production overheads	1,995	3,130	3,180	3,330
Fixed production overheads	825	2,475	2,475	2,475
	81,433	33,355	35,480	36,643
Budgeted Surplus/Deficit	(66,583)	16,340	33,382	38,009
Budgeted Opening Cash balance	66,000	(583)	15,757	49,139
Budgeted Closing Cash balance	(583)	15,757	49,139	87,148

WORKINGS

1. Collection form customers

	JUNE	JULY	AUGUEST	SEPTEMBER	OCTOBER
Sales units	2,600	2,900	3,300	3,300	3,500
	GH¢	GH¢	GH¢	GH¢	GH¢
Sales value	66,000	74,200	82,500	82,500	90,000
Collection from customers					
1st month – 25%	16,500	18,550	20,625	20,625	
Less Cash discount @ 10%	(1,650)	(1,855)	(2,063)	(2,063)	
Net Collections for 1st month	14,850	16,695	18,562	18,562	
2nd Month – 50%	-	33,000	37,100	41,250	
3rd Month – 20%	-	-	13,200	14,840	
Total Collections	14,850	49,695	68,862	74,652	

2. Computation of Costs

(a) Production units:	JUNE	JULY	AUGUEST	SEPTEMBER	OCTOBER
	Units	Units	Units	Units	Units
Sales Units	2,600	2,900	3,300	3,300	3,500
June's production	2,600	-	-	-	-
75% of month's sales	-	2,175	2,475	2,475	2,620
25% of following month's	725	825	825	875	1,000
Total Production for month	3,325	3,000	3,300	3,350	3,620
(b) Direct material cost					
Production Units	3,325	3,000	3,300	3,500	3,625
	¢	¢	¢	¢	¢
Materials Cost @¢5.00	16,625	15,000	16,500	16,750	18,125
Purchases of materials:					
Month of Production	8,313	7,500	8,250	8,375	9,063
Next Month's Production	7,500	8,250	8,375	9,063	
Total purchases of motor	15,813	15,750	16,625	17,438	
(c) Direct wages @¢4.00	13,300	12,000	13,200	13,400	
Variable production Overheads @¢1.00	3,325	3,000	3,300	3,350	3,620
Month of production 60%	1,995	1,800	1,980	2,010	217
Following month 40%	-	1,330	1,200	1,320	
(d) Payments for variable Production overhead	1,995	3,130	3,180	3,330	
Fixed Production overheads	3,300	3,300	3,300	3,300	
Month of production – 25%	825	825	825		
Following month – 50%	-	1,650	1,650	1,650	
Payment of fixed prod. overheads	825	2,475	2,475	2,475	

QUESTION 1 (a) (ii)

The cash budget indicates that the company will be having surplus balances throughout except for the month of June, 2018.

To be able to purchase a new machine in October 2018, Abotreye Enterprise needs to consider borrowing about GH¢63,000.00 to add to its cash balance of GH¢87,000. This is based on the assumption October 2018 will generate sufficient funds to take care of itself.

QUESTION 1(b)

(a) Cost of inventories 1,200,000

Cost of inventories		1,200,000
Profit margin	$\frac{33.33333}{100 - 33.333} \times 1{,}200$	600,000
Estimated Sales Value of Inventories		1,800,000

Price Reduction by 60%

New Sales value = 40% of 1,800,000

= 720,000

Cost of inventories	1,200,000
Net Realizable value	720,000
Impairment loss of inventories	480,000

Biegya Ltd should charge GH¢480,000 as part of the cost of sales to reflect inventory impairment and reduce the cost of inventories in the balance sheet from GH¢1,200,000 to GH¢720,000

(b) The declaration of one of Biegya Ltd's customers bankrupt in March 2018 is an adjusting event in line with IAS 10: events after the reporting period.

GH¢800,000 of the receivables outstanding is no longer recoverable and should be written off as bad debts in the profit or loss statement and only GH¢150,000 shown as receivables in the statement of financial position relating to 31/12/2017.

(c) The decision of the court to award damages against Biegya Ltd for breach of contract is an adjusting event, the appeal notwithstanding.

Biegya Ltd should recognize a provision for legal damages as an expense for GH¢120,000 in the statement of profit or loss and also as a liability in the statement of financial position as t 31/12/2017.

(d) The issue of redeemable preferential shares characterizes the financial instrument as debt.

The dividend thereon of ¢48,000 should therefore be treated as interest expense in the income statement and the amount of capital of ¢400,000 reversed from stated capital and rather included in debt.

The dividend should also be reversed from the statement of changes in equity into the income statement.

QUESTION 2
SUFFER TO GAIN LTD
STATEMENT OF PROFIT OR LOSS

FOR THE YEAR ENDED 31ST MARCH, 2018	GH¢000
Turnover	224,000
Cost of Sales	(156,346)
Gross Profit	67,694
Other Income	2,400
Selling and Distribution Expenses	(11,240)
Administrative Expenses	(17,980)
Interest expenses	(200)
Profit before tax	40,674
Tax expenses	(10,700)
Profit after tax	29,974

SUFFER TO GAIN LTD
STATEMENT OF INCOME SURPLUS
FOR THE YEAR ENDED 31/03/2018

Balance b/f	24,100
Profit for the year	29,974
	54,074
Interim dividend paid	(4,000)
Balance c/f	50,074

SUFFER TO GAIN LTD
STATEMENT OF FINANCIAL POSITION
AS AT 31ST MARCH, 2018

Non-current assets	82,344
Property, Plant & Equipment	20,640
Intangible assets	102,984
Current Assets	
Inventories	11,000
Receivables	16,800
Investments	14,000
Cash & Bank	11,450
	53,250
Total assets	156,234
Equity: Stated Capital	
320,000,000 ordinary shares @¢0.25	80,000
Income surplus	50,074
Total Equity	130,074
Non-current liabilities	
Deferred Tax	14,500
Current liabilities	
Trade payables	10,260
Overdraft	1,400

	11,660
Total Equity and Liabilities … … …	156,234

WORKINGS

COST OF SALES

Opening stock … … … … …	12,580
Purchases … … … … …	92,340
Closing stock … … … … …	(11,000)
Wages … … … … …	34,690
Depreciation & Amortisation	
Property, Plant & Equipment	
20% of 112,680 … … … …	22,536
Amortization of Intangibles … … …	660
Assets (22,500 – 5yrs)… … … …	4,500
	156,306
Other Income:	
Investment Income … … … …	600
Gain on foreign exchange transactions …	1,800
	2,400
Administrative Expenses … … …	21,280
Development Expenditure … … …	(3,300)
	17,980
Tax expenses	
Per draft financial statement … … …	10,000
Deferred tax at end (25% of 58m)	15,500
Opening deferred tax	13,800
Deferred tax expenses	700

Non-current assets schedule

	Property, Plant & Equipment	Intangible Assets	
Cost	112,680		25,800
Depreciation:			
Balance b/f	7,800		
Charge for year	22,536	(4,500+660)	5,160
	30,336		5,160
Net book value	82,344		20,640

QUESTION 3

Valuation of Zamsi Bank Ltd	GH¢000
Loans and advances	3,340
(8,350 @ 40%)	

Investments (6,500 – 100)	6,400
Deposits (18,875 + 1,600)	(20,475)
Property, Plant & Equipment (4,325 – 500 + 15,000)	18,825
Cash and Balances with other banks (3,125 – 1,200)	1,925
Other assets (2,125 – 900)	1,225
Other Liabilities	(5,500)
Total value of Zamsi Ltd	5,740

Price per share $\frac{5,740,000}{200,000}$ =¢28.7

Therefore, value of 75% of the shares

75% of 200,000 shares @¢287= GH¢4,305,000

(a) Situations where the use of the Net Assets approach for valuation is appropriate.

i) Where a business takes over the assets and liabilities of another
ii) Acquisition of majority interest in another
iii) Acquisition of another company that has substantial assets backing for its operations for example, the acquisition of a manufacturing concern
iv) Where the fair value of assets are easily obtainable in the market – there is an active market for all assets.

(b) Weakness inherent in the net assets approach to business valuation:

i) Where the acquisition is in respect of a non-controlling interest
ii) Earnings is a better reflection of the expected benefits for investors rather than assets
iii) Where there is no active market for most of the assets

QUESTION 4

Workings

Selling Price/Unit	15
Variable Cost/Unit	9
Contribution/Unit	6

(a) Number of units to break even

$$\frac{\text{Fixed Cost}}{\text{Contribution/Unit}} = \frac{90{,}000}{6}$$

= 15,000 units

(b) Sales value at Break-even point

= Break – Even Units @ Selling Price

= 15,000 units @¢15

= ¢225,000

(c) Contribution/Sales ratio

$$\frac{\text{Contribution/Unit}}{\text{Selling Price}}$$

$$= \frac{6}{15} \times 100$$

= 40%

(d) Units to earn target profit of ¢30,000

$$= \frac{\text{Fixed Cost + Target Profit}}{\text{Contribution/Unit}}$$

$$= \frac{90{,}000 + 30{,}000}{6} = 20{,}000 \text{ Units}$$

(e) Amount of sales to achieve target profit of ¢35,000

$$= \frac{\text{Fixed Cost + Target Profit}}{\text{Contribution per unit}} \times \text{Selling Price}$$

$$= \frac{90{,}000\ 6 + 35{,}000}{6} \times 15$$

= ¢312,500

(f) Target sales to achieve profit after tax of ¢30,000

$$= \frac{\text{fixed Cost} + \left(\frac{\text{Target profit}}{(1 - \text{tax rates})}\right)}{\text{Contribution per unit}}$$

$$= \frac{90{,}000 + \frac{(30{,}000)}{1 - 0.25)}}{6}$$

= 21,667 units

(g) Selling Price 15
New variable cost <u>10</u>
Contribution/Unit <u>5</u>

New Fixed Cost ¢105,000

Number of units to achieve target profit of ¢30,000

$$= \frac{\text{Fixed Cost + Target Profit}}{\text{Contribution/Unit}}$$

$$= \frac{105{,}000 + 30{,}000}{5}$$

$$= \underline{27{,}000 \text{ units}}$$

<u>QUESTION 5(a)</u>

(a) Six characteristics of good financial information

The fundamental characteristics of good financial information are faithful representation and relevance. These two go to the heart of making financial statements useful.

(i) Relevance

Relevant financial information is capable of making a difference in the decision made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.

Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both. Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions. Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

The predictive value and confirmatory value of financial information are interrelated. Information that has predictive value often also has confirmatory value. For example, revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that were made in past years. The results of those comparisons can help a user to correct and improve the processes that were used to make those previous predictions.

(ii) Faithful representation

Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. To be a perfectly faithful representation, a depiction would have three characteristics. It would be *complete*, *neutral* and *free from error*. Of course, perfection is seldom, if ever, achievable. The Board's objective is to maximise those qualities to the extent possible.

A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. For example, a complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all of the assets in the group, and a description of what the numerical depiction represents (for example, original cost, adjusted cost or fair value). For some items, a complete depiction may also entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction.

A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users. Neutral information does not mean information with no purpose or no influence on behaviour. On the contrary, relevant financial information is, by definition, capable of making a difference in users' decisions.

Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate.

However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

There are other enhancing characteristics of good financial information. These contribute to increasing the usefulness of financial information.

(iii) Comparability

Users' decisions involve choosing between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another.

Consequently, information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item. A comparison requires at least two items.

Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal. Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different.

(iv) Verifiability

Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation, for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, using the first-in, first-out method).
It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information.

(v) Timeliness

Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

(vi) Understandability

Classifying, characterizing and presenting information clearly and concisely makes it *understandable*. Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading.

Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

QUESTION 5 (b)

IASB's Due Process in setting IFRS

1. **Setting the agenda**

The IASB, by developing high quality accounting standards, seeks to address a demand for high quality information that is of value to all users of financial statements. High quality information will also be of value to preparers of financial statements. The IASB evaluates the merits of adding a potential item to its agenda, also known as the work plan, mainly by reference to the needs of investors.

In setting the agenda, the IASB considers the following factors:

- the relevance of the issue to users of the information and the reliability of information that could be provided by resolving the issue;
- whether or not existing guidance is already available;
- the possibility of increasing convergence by resolving the issue;
- the quality of the standard to be developed; and
- resource constraints.

To help the IASB in considering its future agenda, its staff are asked to identify, review and raise issues that might warrant the IASB's attention. In addition, the IASB raises and discusses potential agenda items in the light of comments from other standard-setters and other interested parties, the IFRS Advisory Council and the IFRS Interpretations Committee, and staff research and other recommendations.

The IASB receives requests from constituents to interpret, review or amend existing publications. The staff consider all such requests, summarise major or common issues raised, and present them to the IASB from time to time as potential issues for inclusion in the IASB's future agenda.

2. **Planning the project**

When adding an item to its active agenda, the IASB also decides whether to:

- conduct the project alone; or
- conduct the project jointly with another standard-setter.

Similar due process is followed under both approaches.

After considering the nature of the issues and the level of interest among constituents, the IASB may establish a Consultative group at this stage. A team is selected for the project by the two most senior members of the technical staff: The Director of Technical Activities; and The Director of Research**.**

The project manager draws up a project plan under the supervision of those Directors. The team may also include members of staff from other accounting standard-setters, as deemed appropriate by the IASB.

3. Development and publication of a Discussion Paper

Although a Discussion Paper is not mandatory, the IASB normally publishes it as its first publication on any major new topic to explain the issue and solicit early comment from constituents. If the IASB decides to omit this step, it will state why.

Typically, a Discussion Paper includes:

- a comprehensive overview of the issue;
- possible approaches in addressing the issue;
- the preliminary views of the authors of the issue or the IASB; and
- an invitation to comment

This approach may differ if another accounting standard-setter develops the research paper.

Discussion Papers may result either from:

- a research project being conducted by another accounting standard-setter; or
- as the first stage of an active agenda project carried out by the IASB.

In the first case, the Discussion Paper is drafted by another standard-setter and published by the IASB. Issues related to the Discussion Paper are discussed in IASB meetings, and publication of such a paper requires a simple majority vote by the IASB.

If the Discussion Paper includes the preliminary views of other authors, the IASB reviews the draft Discussion Paper to ensure that its analysis is an appropriate basis on which to invite public comments.

For Discussion Papers on agenda items that are under the IASB's direction, or include its preliminary views, the IASB develops the paper or its views on the basis of analysis drawn from staff research and recommendations, as well as suggestions made by the IFRS Advisory Council, Consultative groups and standard-setters and presentations from invited parties. All discussions of technical issues related to the draft paper take place in public sessions.

4. Development and publication of an Exposure Draft

Publication of an Exposure Draft is a mandatory step in due process. Irrespective of whether the IASB has published a Discussion Paper, an Exposure Draft is the IASB's main vehicle for consulting the public. Unlike a Discussion Paper, an Exposure Draft sets out a specific proposal in the form of a proposed Standard (or amendment to an existing Standard).

The development of an Exposure Draft begins with the IASB considering:

- issues on the basis of staff research and recommendations;

- comments received on any Discussion Paper; and
- suggestions made by the IFRS Advisory Council, Consultative Groups and accounting standard-setters, and arising from public education sessions.

After resolving issues at its meetings, the IASB instructs the staff to draft the Exposure Draft. When the draft has been completed, and the IASB has balloted on it, the IASB publishes it for public comment**.**

The length of time that the comment period is open varies, however for major projects the IASB will normally allow a period of at least 120 days for comments. The comment period on draft IFRIC Interpretations is usually 60 days, but may be less in urgent cases.

5. Development and publication of an IFRS

The development of an IFRS is carried out during IASB meetings, when the IASB considers the comments received on the Exposure Draft. After resolving issues arising from the Exposure Draft, the IASB considers whether it should expose its revised proposals for public comment**,** for example by publishing a second Exposure Draft. In considering the need for re-exposure, the IASB:

- identifies substantial issues that emerged during the comment period on the Exposure Draft that it had not previously considered;
- assesses the evidence that it has considered;
- evaluates whether it has sufficiently understood the issues and actively sought the views of constituents; and
- considers whether the various viewpoints were aired in the Exposure Draft and adequately discussed and reviewed in the basis for conclusions.

Drafting the IFRS

The IASB's decision on whether to publish its revised proposals for another round of comments is made in an IASB meeting. If the IASB decides that re-exposure is necessary, the due process to be followed is the same as for the first Exposure Draft**.** When the IASB is satisfied that it has reached a conclusion on the issues arising from the Exposure Draft, it instructs the staff to draft the IFRS.

Pre-ballot draft

A pre-ballot draft is usually subject to external review, normally by the IFRIC. Shortly before the IASB ballots the Standard, a near-final draft is posted on eIFRS**.** Finally, after the due process is completed, all outstanding issues are resolved, and the IASB members have balloted in favour of publication, the IFRS is issued.

6. Procedures after an IFRS is issued

After an IFRS is issued, the staff and the IASB members hold regular meetings with interested parties, including other standard-setting bodies, to help understand unanticipated issues related to the practical implementation and potential impact of its proposals. The IFRS Foundation also fosters educational activities to ensure consistency in the application of IFRSs. After a suitable time, the IASB may consider initiating studies in the light of:

- its review of the IFRS's application;
- changes in the financial reporting environment and regulatory requirements; and
- comments by the IFRS Advisory Council, the IFRS Interpretations Committee, standard-setters and constituents about the quality of the IFRS.

Those studies may result in items being added to the IASB's work plan.

QUESTION 6

(a) Corporate governance relates to the processes by which corporate entities are managed to ensure that they deliver their objective of optimizing shareholder wealth and value.
Such processes include:
- The composition of the board
- Board processes
- Financial reporting processes
- Accountability mechanisms and transparency
- Due process for decision making
- Internal control systems

(b) Internal control systems are checks and balances put in place to safe-guard the integrity of management processes and resources of an organisation.

Internal control systems are the policies and procedures adopted by management of an institution to assist in the achievement of objectives including:
- Adherence to policies
- Safe guarding of assets
- Prevention and detection of errors and fraud
- Ensuring completeness and accuracy of records
- Timely preparation of financial statements.

Control environment relate to the overall attitude, awareness and actions of management regarding internal controls and their importance. Control environment encompass
- Management style
- Corporate culture
- Corporate values
- Corporate philosophy

- Organizational culture
- Personnel policies and procedures

Internal control procedures include

- Authorization procedures
- Procedures for accurate recording of financial transactions
- Approval and control processes
- Processes put in place for checking arithmetical accuracy of records
- Reconciliation processes and systems
- Comparing internal data with external data
- Mechanisms for limiting direct physical access to records
- Procedures for segregation of duties

Types of controls include:

- Preventive controls
- Detective controls
- Corrective controls

(c) Importance of internal control and risk management towards sustainability of corporate organizations

- To ensure policy compliance
- To proactively deal with risks before they crystalize
- To avoid needless losses
- Ensure reliable financial information that faithfully represent what is purported to have transpired
- Lead to more informed decision making
- Ensure that plans become reality
- Prevent fraud and corruption