**INSTITUTE OF CHARTERED ACCOUNTANTS - GHANA**

**Sample Question And Answers**

**Questions**

1. Odwira Ltd operates in the mining industry with a financial year end 31 December, 2020. On 1 January, 2020, Odwira Ltd began to lease a group of machines that were used in the production process. The lease was for five years, and the total annual rental (payable in arrears) was GH¢8 million. The lessor paid GH¢30 million for the machines on 31 December 2019. The lessor has advised Odwira Ltd that the interest rate implicit in the lease can be taken as 10%. The estimated useful economic life of the machines were five years.

**Required:**

In accordance with IFRS 16: Leases, show the accounting treatment of the above

Transaction. **(MAY 2021)**

1. The **Conceptual Framework for Financial Reporting** identifies faithful representation as a fundamental qualitative characteristic of useful financial information.

**Required:**

Distinguish between **fundamental** and **enhancing** qualitative characteristics. **(MAY 2021)**

1. BeGreen Ltd (BeGreen) is an agro-processing company which reports under International Financial Reporting Standards (IFRSs) and prepares its financial statements up to 31 December each year. The company intends to comply fully with **IAS 12 Income Taxes** by introducing deferred tax in its financial statements.

On 1 January 2020, the company acquired an item of plant which cost GH¢750,000 and has a useful life of 5 years with no residual value. BeGreen enjoys capital allowance at the rate of 30%. Revenue generated by using the plant is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes. BeGreen estimates current tax provision for the year to 31 December 2020 at GH¢10,125. The tax rate of BeGreen is 25%.

**Required:**

1. In accordance with **IAS 12: Income Taxes**, explain the amounts to be reported in the Statement of Financial Position and Statement of Profit or Loss for the year ended 31 December 2020.

(5 marks)

1. ii) Explain the term **temporary difference** and state **ONE (1)** circumstance in which temporary difference may arise. (2 marks)

**(APRIL 2022)**

1. Kundugu Ltd (Kundugu) is a manufacturing company located in the Savannah Region. The reporting date of Kundugu is 31 December and the company reports under International Financial Reporting Standards (IFRSs). Kundugu intends to expand its production to take advantage of emerging economic activities in the new region.

On 1 January 2020, the company entered into a lease agreement for a production equipment which has a useful economic life of 8 years. The lease term is for four years and Kundugu agrees to pay annual rent of GH¢50,000 commencing on 1 January 2020 and annually thereafter. The interest rate implicit in the lease is 7.5% and the lessee's incremental borrowing rate is 10%. The present value of lease payments not yet paid on 1 January 2020 is GH¢130,026. Kundugu paid legal fees of GH¢1,000 to set up the lease.

**Required:**

Prepare extracts for the Statement of Financial Position and Statement of Profit or Loss for 2020 and 2021, showing how Kundugu should account for this transaction. (6 marks)

**(APRIL 2022)**

1. The IASB's Conceptual Framework identifies, among others, the qualitative characteristics of relevance, faithful representation, comparability and understandability.

**Required:**

Justify with an example each how the qualitative characteristics will apply to the treatment of tangible non-current assets. (10 marks)

**(APRIL 2022)**

1. Banda Ltd (Banda) incurred the following borrowing costs during the financial year-end 31 December 2022:

**GH¢**

Overdraft interest 14,400

Foreign currency loan interest (correctly translated into GH¢) 100,800

Foreign currency exchange differences on equity 168,000

In addition, a three-year fixed rate GH¢2.4 million loan was borrowed on 1 January 2022 at 6.5%. A loan set-up fee (transaction costs) of GH¢24,000 was incurred. This increased the effective interest rate on the loan to 6.88%.

**Required:**

In accordance with **IAS 23: Borrowing Costs**, calculate the maximum amount that could potentially be capitalised as borrowing costs for the year-end 31 December 2022 (assuming an asset was being financed using all available finance). (5 marks) **(NOVEMBER 2023)**

1. Fugu Ltd (Fugu) operates in the automobile industry. The following transaction relates to Fugu for the year-end 31 July 2023. On August 1, 2022, Fugu entered into a ten-year lease, agreeing to pay GH¢3 million annually in arrears in exchange for the use of a building. The present value of the minimum lease payments was GH¢20.13 million at 1 August 2022, and the useful economic life of the building was 50 years. Fugu’s cost of capital is 8%.

**Required:**

In accordance with **IFRS 16: Leases** show the financial reporting treatment of the above transactions in the financial statements of Fugu for the year ended 31 July 2023. (5 marks) **(NOVEMBER 2023)**

1. The Financial Accountant of Abodie Ltd is finalising the financial statements of Abodie Ltd for the year ended 31 August 2021. The following items are being considered for deferred tax purpose:

• At year end, Abodie Ltd's property, plant & equipment had tax base and carrying value of GH¢72 million and GH¢95 million respectively.

• The company's provision for decontamination costs was GH¢11 million (appropriately discounted) at the year end. Decontamination costs are tax deductible when paid.

• The company had inventory with carrying value of GH¢24 million. This did not agree with the tax base because of GH¢3 million write-down for obsolete items. Tax relief is only granted for inventories upon sale.

• The company incurred GH¢15 million in respect of new software development during the year which was capitalised and will be amortised over the next 5 years. Full year’s charge is required in the first year of completion or purchase. This cost was deducted in the current year for tax purposes. The company is liable for income tax at 30%.

**Required:**

Compute the company's deferred tax liability at 31 December 2021. **(6 marks) (MARCH 2023)**

1. The Conceptual Framework for Financial Reporting identifies faithful representation as a fundamental qualitative characteristic of useful financial information.

**Required:**

Explain why faithful representation is important. (5 marks) **(MARCH 2023)**

1. Comparability is one of the enhancing qualitative characteristics of useful financial information. Comparability improves usefulness of financial statements and it is achieved by consistency.

**Required:**

Explain the role of consistency in relation to changes in accounting policy and the need for comparability. (5 marks) **(MARCH 2023)**

**Solutions**

1. Leased asset

GH¢’000

Cost 30,320

Charge for the year (6,064)

24,256

The lessee is required under IFRS 16 to recognise a right-of-use asset and a corresponding liability. Accordingly, GH¢30.320 million is to be included both as asset and lease liability on initial recognition. The lease liability is treated as shown below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Year ended** | **Opening balance** | **Finance cost** | **Finance cost** | **Closing balance** |
|  | **GH¢’000** | **GH¢’000** | **GH¢’000** | **GH¢’000** |
| 31-Dec-2020 | 30,320 | 3,032 | (8,000) | 25,352 |
| 31-Dec-2021 | 25,350 | 2,535 | (8,000) | 19,887 |

The statement of profit or loss in the first year will include a finance cost of GH¢3.032million with a depreciation charge of GH¢6.064 million.

The statement of financial position will include closing lease liability in the current year, GH¢25.352 million, of which GH¢19.887 million is a non-current liability and GH¢5.465 million is a current liability. The right of use asset of GH¢30.320 million will be depreciated over five years (GH¢30.320 ÷ 5 years) = GH¢6.064 million. Therefore, the asset will be recognised in the statement of financial position at GH¢24.256 million (.i.e. GH¢30.320 – 6.064) million.

**Alternatively**, the current lease liability GH¢5.465 million (GH¢8 millionGH¢2.535) million) and the non-current lease obligation is GH¢19. 887 million (GH¢25.352 million- GH¢19.887 million).

Workings: Lease liability = 3.971 x GH¢8 million) = 30.320 million Or

|  |  |  |  |
| --- | --- | --- | --- |
| Year | Rent GH¢million | DCF | PV GH¢million |
| 1 | 8 | 0.909 | 7.272 |
| 2 | 8 | 0.826 | 6.608 |
| 3 | 8 | 0.751 | 6.008 |
| 4 | 8 | 0.683 | 5.464 |
| 5 | 8 | 0621 | 4.968 |
| 9 |  |  | **30.320** |
|  |  |  |  |

1. The **Conceptual Framework for Financial Reporting** implies that the two fundamental qualitative characteristics (relevance and faithful representation) are vital as, without them, financial statements would not be useful, in fact, they may be misleading. As the name suggests, the four enhancing qualitative characteristics (comparability, verifiability, timeliness and understandability) improve the usefulness of the financial information. Thus financial information which is not relevant or does not give a faithful representation is not useful (and worse, it may be misleading);

Financial information which does not possess the enhancing characteristics can still be useful, but not as useful as if it did possess them. For financial statements to be useful to users (such as investors or loan providers), they must present financial information faithfully, i.e. financial information must faithfully represent the economic phenomena which it purports to represent (e.g. in some cases it may be necessary to treat a sale and repurchase agreement as an in-substance (secured) loan rather than as a sale and subsequent repurchase).

Faithfully represented information should be complete, neutral and free from error. The substance is not identified as a separate characteristic because the IASB says it is implied in a faithful representation such that faithful representation is only possible if transactions and economic phenomena are accounted for according to their substance and economic reality.

1. **Statement of Financial Position**

BeGreen Ltd should recognise Non-current liability (deferred tax) of GH¢18,750 and a current liability (current tax) of GH¢10,125. **(1 mark)**

**Statement of Profit or Loss**

Recognise income tax expense of GH¢28,875 (i.e. GH¢10,125 + GH¢18,750) **(1 mark)**

**W1**

**Carrying amount of plant GH¢**

Cost at 31/12/20 750,000

Depreciation (750,000/5yrs) (150,000)

Carrying amount at 31-12-20 600,000 **(1 mark)**

**W2**

**Tax base of plant GH¢**

Cost at 31/12/20 750,000

Capital allowance (750,000 x 30%) (225,000)

Tax base at 31-12-20 525,000 **(1 mark)**

**W2 Temporary difference** GH¢

Carrying amount 600,000

Tax base (525,000)

Taxable temporary difference 75,000

Therefore, deferred tax (temporary dif. x tax rate) (25% x GH¢75,000) = GH¢18,750 **(1 mark)**

**Journal Entry DR CR**

GH¢ GH¢

Debit Income tax expense 18,750

Credit Deferred Tax liability 18,750

**Temporary differences**

IAS 12 defines temporary differences as the difference between the tax base of an asset or liability and its carrying amount in the statement of financial position. Temporary differences may arise in the following circumstances:

• Accounting depreciation does not equal tax-allowable depreciation (capital allowances).

• An item of income or expense is included in the accounting profit in one period but included in the taxable profit in another. For example, capitalized development costs are amortised over several years in the financial statements, but tax relief is given as the costs are incurred (on a cash basis).

• A right of use asset and lease liability may be recognised under IFRS 16 with the lease payments being a chargeable deduction in the period paid under the tax legislation of the relevant jurisdiction (meaning that the asset and liability would not be recognised under the tax rules).

**Explanation: 1 mark**

**Example: 1 mark**

1. Kundugu Ltd

**Kundugu Ltd**

**Statements of financial position extract as at 31st December 2020**

**ASSETS** **2021 2020**

**Non-current asset GHS GHS**

Right-of-use asset 181,026 181,026

Accumulated Depreciation (45,257) (90,514)

135,769 90,512

**Non-current liabilities**

Lease liability 89,778 46,511

**Current liabilities**

Capital sum 40,248 43,267

Finance Charge 9,752 6,733

**50,000** **50,000**

**Kundugu Ltd**

**Statements of financial profit or loss extract for the year ended 31st December 2020**

**2021 2020**

**Expenses GHS GHS**

Depreciation (181,026/4) (45,257) (45,257)

Finance costs (9,752) (6,733)

**WI Lease liability**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| year | Balance @ start | Lease payments | Liability for the year | Implicit interest @7.5% | Balance at end |
| 2020 | 130,026 | 0 | 130,026 | 9,752 | 139,778 |
| 2021 | 139,778 | (50,000) | 89,778 | 6,733 | 96,511 |
| 2022 | 96,511 | (50,000) | 46,511 | 3,488 | 50,000 |
| 2023 | 50,000 | (50,000) | 0 | 0 | 0 |

**W2 Right of use asset**

Lease liability @ start 130,026

Lease payment at 1 January 2020 50,000

Initial direct cost 1,000

181,026

Annual depreciation = GHS181,026 ÷ 4 years GHS 45,257

1. Qualitative characteristics as applicable to tangibles non-current assets illustrated by IAS 16; **Relevance**

The choice of the revaluation model as a measurement model in IAS 16 provides relevant information by showing up-to-date values. This will help give an indication as to what the entity's underlying assets are worth. Revaluations should be applied to all assets in a class, not just those with positive changes.

**Faithful representation**

Although the revaluation model gives relevant information this information is generally seen to be a less faithful representation than the cost model – the other measurement model allowed by IAS 16. The cost model is based on historic costs which are not the most relevant costs on which to base future decisions. However, historic cost is based on fact, so can claim to represent that which it purports to represent. The recognition criteria of IAS 16, setting out what may be recognised as part of the cost of an item of property, plant and equipment also aids verifiability of the resultant figure.

**Comparability**

The standard 'rules' laid down in IAS 16 mean that the financial statements of different companies can be compared as they have been prepared on the same basis. IAS 16 also facilitates comparability between companies by requiring the disclosure of accounting policies (in accordance with IAS 8) in respect of, for example, depreciation methods and measurement bases. It also requires the disclosure of both carried forward and brought forward figures, aiding comparability between this year and the previous year. IAS 16 allows comparability between the cost and the revaluation model (for example to facilitate comparison between two companies who have adopted different models) by requiring equivalent cost information to be disclosed under the revaluation model. It also requires disclosures (in accordance with IAS 8) of the effect of a change in an accounting estimate such as useful lives or depreciation rates. This facilitates comparison.

**Understandability**

To improve understandability IAS 16 requires disclosures to be given by each class of property, plant and equipment so it will be clear what types of asset have been purchased during the year and what types of assets have been sold. If this information was merged over one class, it would be less understandable. The format of the property, plant and equipment 'table' also aids understandability (with the movement on each class of assets clearly set out) and the disclosure of depreciation policies aids an understanding of asset lives.

**(4 points @ 2.5 marks each = 10 marks)**

1. **Maximum amount to capitalise (IAS 23 para 6):**

**GH¢’000**

Overdraft 14.4

Foreign currency loan interest 100.8

Foreign currency exchange differences on equity -

Effective interest on loan ((2,400 – 24) x 6.88%) 163.44

**278.64** **(5 marks)**

1. **Leases**

**Fugu Ltd**

**Statement of financial position as at 31 July 2023**

Right-of-use Asset **GH¢’000**

Cost 20,130.0

Depreciation (2,013.0)

Carrying amount **18,117.0**

Liability (See working below):

Non-current liability 17,239.6

Current liability 1,500.8

Total liability **18,740.4**

**Fugu Ltd**

**Statement of profit or loss for the year ended 31 July 2023**

Operating costs: **GH¢'000**

Depreciation (2,013)

Finance costs:

Interest on lease (1,610.4)

**Working: Lease schedule for payments in arrears**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Year** | **Opening balance** | **Interest @ 8%** | **Payments** | **Closing Balance** |
| **2023** | 20,130.0 | 1,610.4 | (3,000.0) | 18,740.4 |
| **2024** | 18,740.4 | 1,499.2 | (3,000.0) | 17,239.6 |

1. **Tax**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Carrying amount | Tax base | Taxable/ (deductible) Temporary difference | Deferred tax @ 30% |
|  | GH¢000 | GH¢000 | GH¢000 | GH¢000 |
| Property, plant and equipment | 95,000 | 72,000 | 23,000 | 6,900 |
| Provision for contamination | (11,000) | **0** | (11,000) | (3,300) |
| Inventory | 24,000 | 27,000 | (3,000) | (900) |
| Development | 12,000 | **0** | 12,000 | 3.600 |
| **Total** | **120,000** | **99,000** | **21,000** | **6.300** |

**Deferred tax liability (net) is GH¢6.3 million.**

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Therefore, financial information which is not relevant or does not give a faithful representation is not useful (and worse, it may possibly be misleading); however, financial information which does not possess the enhancing characteristics can still be useful, but not as useful as if it did possess them. In order for financial statements to be useful to users (such as investors or loan providers), they must present financial information faithfully, i.e., financial information must faithfully represent the economic phenomena which it purports to represent (e.g., in some cases it may be necessary to treat a sale and repurchase agreement as an insubstance (secured) loan rather than as a sale and subsequent repurchase).

Faithfully represented information should be complete, neutral and free from error. Substance is not identified as a separate characteristic because the IASB says it is implied in faithful representation such that faithful representation is only possible if transactions and economic phenomena are accounted for according to their substance and economic reality.

1. The main objective of financial statements is to provide information that is useful to a wide range of users for the purpose of making economic decisions. Therefore, it is important that the activities and events of the entity, as expressed within the financial statements, are understood by users, meaning that their usefulness and relevance is maximised. This can present management with a problem because clearly not all users have the same (financial) abilities and knowledge. For understandability, management are allowed to assume users do have a reasonable knowledge of accounting and business and are prepared to study the financial statements diligently. Importantly, this characteristic cannot be used by management to avoid disclosing complex information that may be relevant in user decision-making.

However, management must recognise that too much or overly complex disclosure can obscure the more important aspects of an entity’s performance, i.e., important information should not be ‘buried’ in the detail of unfathomable information. Comparability is the main tool by which users can assess the performance of an entity. This can be done through trend analysis of the same entity’s financial statements over time (say five years), or by comparing one entity with other (suitable) entities (or business sector averages) for the same time period. This means that the measurement and disclosure (classification) of like transactions should be consistent over time for the same entity, and (ideally) between different entities. Consistency and comparability are facilitated by the existence and disclosure of accounting policies.

The above illustrates the close correlation between comparability and consistency. However, it is not always possible for an entity to apply the same accounting policies every year; sometimes they have to change (e.g., because of a new accounting standard or a change in legislation). Similarly, it is not practical for accounting standards to require all entities to adopt the same accounting policies. Thus, if an entity does change an accounting policy, this breaks the principle of consistency. In such circumstances, IFRSs normally require that any reported comparatives (previous year’s financial statements) are restated as if the new policy had been in force when those statements were originally reported. In this way, although there has been a change of policy, comparability has been maintained.

It is more difficult to address the issue of consistency across entities; as already stated, accounting standards cannot prescribe the use of the same policy for all entities (this would be uniformity). However, accounting standards do prohibit certain accounting treatments (considered inappropriate or inferior) and they do require entities to disclose their accounting policies, such that users become aware of differences between entities, and this may allow them to make value adjustments when comparing entities using different policies.