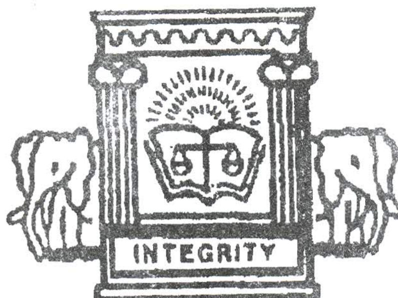
THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)



NOVEMBER 2005 EXAMINATIONS
(PROFESSIONAL)

PART 2

FINANCIAL ACCOUNTING PRACTICE
(Paper 2.1)

Answer <u>ALL</u> Questions

TIME ALLOWED: 3 HOURS

QUESTION 1

a. Outline the procedure for dissolving a moribund partnership firm in line with section 52 of the Incorporated Private Partnership Act , 1962 (Act 152).

(4 marks)

b. Two accountancy firms, AVD and Co Chartered Accountants (with Aba, Victor and Dzibodi as partners) and EC and Co Chartered Accountants (with Edward and Comfort as partners) agreed to merge their practices effective 1 January, 2005. Both firms balanced their books and made up their accounts to 31 December 2004. Their balance sheets are as follows:

	AVD	EC
	¢m	¢m
Land and Buildings	35,000	
Equipment	5,000	6,000
Debtors	28,000	20,000
Prepayments	400	200
Bank and cash	2,000	3,000
	70,400	29,200
Capital Account: Aba	24,000	
Victor	16,000	
Dzibodi	13,000	
Edward		16,000
Comfort		9,000
Current Account: Aba	1,000	
Victor	600	
Dzibodi	300	
Edward		500
Comfort		400
Loan from Aba	10,000	
Creditors	5,000	3,000
Accruals	500	300
	70,400	29,200

The profit and loss sharing ratio of A,V and D is 2:2:1 respectively and that of E and C is 3:2 respectively. AVD partnership agreement allows for 10% interest on capital per annum and that of EV allows annual salaries as follows: Edward ¢5,000,000 and Comfort ¢4,000,000.

The tangible fixed assets of both firms are to be revalued at 1 January 2005 as follows:

	AVD	EC
	¢m	¢m
Land and buildings	54,100	
Equipment	6,000	8,100

The premises of EC are rented and will be given up after the merger. All other identifiable assets will be taken over at book values.

The total value of each of the existing firms at 31st December 2004 are to be computed at the present values of their projected net cash flows for the three years ending 31st December 2007 which are as follows:

		AVD	EC
		¢m	¢m
Year ending 31 December	2005	50,000	20,000
	2006	55,000	25,000
	2007	22,675	17,781

The above projections are based on the assumptions that the two firms are not merged and that the cash flows are received at the end of the year. The cost of capital of both firms is 15% per annum.

The discounting factor at the rate of 15% per annum are as follows

Year		
	1	0.870
	2	0.756
	3	0.658

Profits and losses are to be shared in the new firm as follows: A25%; V20%; D20%; E20% and C15%. The loan from Aba is to be recognized as a liability of the new firm.

Goodwill is not to be maintained in the books of the new firm and current accounts balances are to be transferred to the capital accounts.

Required:

i. Determine the revaluation surplus/deficit and its apportionment (2 marks)

ii. Determine the Goodwill attributable to the firms arising from the amalgamation. (6 marks)

iii. Write up the Partners' Capital Accounts showing the closing balances to be transferred to the opening balance sheet. (3 marks)

iv. Prepare the balance sheet of the new firm, AVDEC & Co, as at 1 January 2005. (5 marks)

(Total 20 marks)

QUESTION 2

Quality Builders Friend Limited (QBF Ltd) has been in business for many years selling building materials like tiles, cement, iron rods and roofing sheets . It sometimes undertakes minor construction works for some customers. There has not been any change in business activity since its incorporation. The following is a summary of its account balances at 30th September 2005:

	¢m	¢m
Sales		112,000
Stocks in trade at 1/10/04	6,290	
Purchase of goods	46,170	
Wages and Salaries	17,345	
Distribution costs	5,620	
Administrative expenses	8,200	
Non- Executive Directors' allowance	90	
Interest expense	100	
Interim ordinary dividend	2,000	
Tangible fixed assets	58,340	
Government Capital grant		
(relating to Tangible fixed assets)		2,000
Depreciation of Tangible fixed assets		3,900
Intangible fixed assets,	18,750	
Amortization of Intangible fixed assets		7,500
Net surplus on the sale of fixed assets		900
Research and development cost	2,250	
Construction contract balance		700
Trade receivable/ payable	8,400	7,030
Long term investment - 15% Bonds (2003 – 2010)	7,000	
Bond interest- net receipt		945
Tax	425	
Cash and bank	3,400	
Stated Capital (80 million shares)		40,000
Income Surplus at 1 / 10 / 04		9,405
	184,380	184,380

The following information is relevant:

i. Tangible fixed assets are depreciated at 20% on the cost of assets owned at the year end. The government grant was received during the current year. QBF Ltd discloses capital grants as deferred income in its balance sheet. Intangible assets represent software and brands that were all purchased on 1st October 2002 and are being amortized over five years.

On 1 January 2005 QBF Ltd sold a redundant fixed asset which cost ¢2,000 million and a written down value of ¢400 million for cash consideration of ¢1,300 million

ii. The research and development costs relate to a single project to develop a new technology of producing tiles locally . This was completed during the current year. Full details of its cost are:

	Research	Development
	¢m	¢m
Year to 30 September 2003	2,250	nil
Year to 30 September 2004	1,400	1,200
Year to 30 September 2005	600	1,650

Prior to the current year, the company wrote off all research and development costs as and when incurred. At the beginning of the current year, the directors became confident of the profitable outcome of the project and they wish to comply with GNABS 13 . The auditors are satisfied that the expenditure now meets the criteria for asset recognition in GNABS 13. Production of the new tile started after the completion of its research and development and is expected to last for five years. A full year's amortization is to be calculated in the current year.

iii. The accountant of QBF Ltd was unsure how to record the transactions relating to a construction contract. The figure in the list of account balances represents progress billings received of ¢2,700 million less the costs incurred to date of ¢2,000 million. The following details have been obtained:

	¢ million
Contract Price (fixed)	5,000
Cost incurred to date	2,000
Estimated additional cost to complete	1,000
Progress Billings	3,000

There is a 10% retention from progress billings.

The company believes that the outcome of this contract can be estimated reliably. The contract is 60% complete .

The billed contract revenue and its related cost of sales are not included in the list of balances given (in the Trial Balance above).

iv. Withholding tax on investment income is 10% and has been deducted at source from the bond interest received. Investment income is to be shown gross in the income statement. Tax deducted at source is treated as final tax on investment income.

The balance on taxation account of ¢425 million is made up as follows:

Tax provision for the year to 30 September 2004	¢4,250 million
Agreed with Internal Revenue Service and paid	¢4,675 million
	¢4,25 million

The provision of income tax on operating profit (including profit/loss on fixed asset disposal) for the year to 30 September 2005 is at the rate of 30%.

v. A final dividend of ¢60 per ordinary share has been proposed.

vi. Stocks in trade on 30th September 2005 were ¢5,500 million.

vii. Two Non-Executive Directors on an annual allowance of ¢30 million each have their terms of office ending on 30th September 2005 and are eligible for re-election.

viii. The external auditors, PFF Chartered Accountants are to be re-appointed during the shareholders meeting. Their fee for the year ended 30th September 2005 agreed at ¢100 million is outstanding.

Required:

Prepare in a form suitable for publication, and in compliance with relevant accounting standards and Companies Code, 1963 (Act 179):

a) Profit and Loss Account and Income Surplus Account of QBF Ltd for the year ended 30 September 2005 (9 marks)

b) Balance Sheet as at 30 September 2005 (8 marks)

c) Notes to the financial statements in respect of ***five accounting policies*** **and a** ***fixed assets (tangible and intangible) schedule*** (8 marks)

d) An appropriate Directors' Report to the financial statements of QBF Ltd (that accords with the minimum content requirements prescribed by Section 132 of the Ghana Companies Code). (5 marks)

(Total 30 marks)

QUESTION 3

You are the financial analyst of your company, a firm in the engineering industry. The Directors of your company , ABC company, are interested in the impact of price changes on the performance of their business and have adopted the practice of including current cost accounts (using the real terms system) alongside the historical cost accounts in the published financial statements. Extracts from the published financial statements for the year ended 31st December, 2004 are given below:

PROFIT AND LOSS ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2004

	Historical Cost	**Current Cost**
	¢m	¢m
Sales	30,000	30,000
Operating costs (note 1)	16,000	19,000
Operating profit	14,000	11,000
Interest payable	2,000	2,000
Profit before Tax	12,000	9,000
Taxation	3,500	3,500
Profit after tax	8,500	5,500
Holding gains arising during the year	-	*3,500*
Inflation adjustment to shareholders' fund	-	*(2,000)*
Real gains	-	1,500
Profit for the year	8,500	7,000
Dividends	7,000	7,000
Retained profit	1,500	-

BALANCE SHEET AS AT 31 DECEMBER 2004	¢m	¢m
Tangible fixed assets	20,000	24,000
Current Assets(note 2)	16,000	19,000
Current Liabilities	(10,000)	(10,000)
Loans	(15,000)	(15,000)
	11,000	18,000
Shareholders Fund	11,000	18,000

Notes

1 **Operating costs**		
Cost of sales(excluding depreciation)	8,000	10,000
Depreciation	5,000	6,000
Other operating costs	3,000	3,000
	16,000	19,000
2 **Current Assets**		
Stocks	6,000	9,000
Debtors	9,000	9,000
Cash	1,000	1,000
	16,000	19,000

Required

a) Compute (under both conventions) three accounting ratios for ABC Co. which differ under the two conventions (6 marks)

b) Explain, for each ratio you have computed, the reason why the current cost elements included in the ratio differ from the historical cost element. (6 marks)

c) Outline any three (3) limitations of accounting ratios based on historic cost accounts (3 marks)

(Total 15 marks)

QUESTION 4

a) With specific reference to GNABS 13 *'Accounting for Research and Development Cost'*, outline **five** criteria that must be satisfied before development costs of a project can be capitalized and recognized as an asset. (5 marks)

b) KK Ltd bought a piece of machinery on 1 January 2001 from PPP Heavy Machinery Ltd for ¢2,000 million. The initial estimated useful life of the machinery was ten years (straight line). On 1 January 2003, the machinery was revalued at ¢1,800 million with the initial estimated life remaining unchanged.
On 1 January 2004, this asset was sold to a competitor GGB Ltd for ¢1,600 million

Required:

Draft the relevant extracts (in respect of the machinery) of the Income Statement for each of the years ended 31 December 2002, 2003 and 2004 and the balance Sheet as at 31st December 2002, 2003 and 2004 (5 marks)

c. **i)** Discuss the typical budgetary control procedures employed by public sector directors in ensuring that expenditures are kept within budget (4 marks)

ii) Different public sector organizations adopt different accounting practices/techniques. These include(but not limited to)

- Cash Accounting
- Commitment Accounting, and
- Fund Accounting

Required:

Explain each of these accounting techniques/ practices. (6 marks)

(Total 20 marks)

QUESTION 5

a) FE Enterprise wishes to penetrate into the fixed asset consumer goods market by introducing either credit sales scheme or hire purchase scheme to meet the fixed asset consumer goods requirement of civil servants. The Proprietor, Mr. Fawzy, is however not clear about the distinctive tenets of these two schemes to enable him take a decision on what to introduce. He has approached you for advice.

Required:

Explain to Mr Fawzy the difference between "Hire Purchase Sale" transaction and "Credit Sale" transaction. (5 marks)

b) Fawzy Enterprise (FE) started business on 1 January 2004 mainly to sell TV sets of a standard type (Sharp 21') to civil servants on hire purchase terms. The total amount, including interest payable for each Set is ¢3,000,000. Customers are expected to pay an initial deposit of ¢600,000 followed by twenty four monthly installments of ¢100,000 each. FE purchases his stocks from QQ Electronics at a unit cost of ¢2,000,000 Prices remained unchanged throughout 2004. The following trial balance was extracted from the books of FE as on 31 December 2004:

	¢' million	¢'million
Capital		2,000
Fixed Assets	200	
Drawings	80	
Bank Overdraft		192
Creditors		532
Purchases	3,600	
Cash collected from customers		1,530
Bank interest	8	
Wages and salaries	256	
General operating expenses	110	
	4,254	4,254

For the first year of operation, (year ended 31 December 2004,) 1,700 sets were sold. It is the policy of FE to take credit for profits (including interest) in proportion to the cash collected from customers . Fixed assets are depreciated at the rate of 10% on cost.

Required:

Prepare the Hire Purchase trading account and profit and loss account for the year ended 31 December 2004 and a balance sheet as at 31 December 2004. (10 marks)

(Total 15 marks)