SOLUTION: FINANCIAL ACCOUNTING PRACTICE NOV 2007

QUESTION 1

John, Mikel and Obi
Revaluation Account

	GH¢		GH¢
Office Equipment	4,680	Land & Buildings	29,250
Stock	5,850	Sundry Creditors	3,510
Provision for Bad debts	1,690	* Goodwill	219,960
Capitals:			
John	120,250		
Mikel	72,150		
Obi	48,100		
	252,720		252,720

Capital Accounts

	GH¢ John	GH¢ Mikel	GH¢ Obi		GH¢ John	GH¢ Mikel	GH¢ Obi
Goodwill	44,460	105,300	70,200	Per Balance Sheet	175,500	81,900	58,500
Motor Vehicle	7,540	-	-	Revaluation A/c	120,250	72,150	48,100
Office Equipment	12,870	-	-	Bank (3:2)	-	78,000	52,000
Bank	130,000	-	-				
Loan A/c	100,880						
c/f		126,750	88,400				
	295,750	232,050	158,600		295,750	232,050	158,600

An alternative is to credit the Goodwill directly to the capital accounts of the partners in accordance with Profit/Loss sharing ratio.

Mikel and Obi Partnership
Balance sheet as at 31st December 2007

FIXED ASSETS	GH¢	GH¢	GH¢
Land and Buildings			146,250
Office Equipment			29,250
Motor Vehicles			11,180
			186,680
CURRENT ASSETS			
Stocks		73,710	
Debtors	80,730		
Less Provisions	1,690	79,040	
Bank		66,690	219,440
			406,120
Capitals:		126,750	
Mikel		88,400	215,150
Obi			
Long term loan-John			135,980
Sundry Creditors			54,990
			406,120

Land and Buildings

	GH¢		GH¢
Per Bal Sheet	117,000	Bal c/d	146,250
Rev. A/c	29,250		
	146,250		146,250
Bal	146,250		

Office Equipment

	GH¢		GH¢
Per Bal Sheet	46,800	Rev A/c	4,680
		Bal c/d	42,120
	46,800		46,800
Bal b/f	42,120	Capital: John	12,870
		Bal c/d	29,250
	42,120		42,120

Stock

	GH¢		GH¢
Per Bal Sheet	79,560	Rev. A/c	146,250
		Bal c/d	73,710
	79,560		79,560

Sundry Creditors

	GH¢		GH¢
Rev. A/c	3,510	Per Bal Sheet	58,500
Bal c/f	54,990		
	58,500		58,500

Goodwill Account

	GH¢		GH¢
Rev. A/c	219,960	Capital:	
		John	44,460
		Mikel	105,300
		Obi	70,200
	219,960		219,960

Motor Vehicles

	GH¢		GH¢
Per Bal Sheet	18,720	Capital John	7,540
		Bal c/d	11,180
	18,720		18,720

Bank Account

	GH¢		GH¢
Per Bal Sheet	66,690		
Capital:		Capital:	
Mikel	78,000	John	130,000
Obi	52,000	Bal c/d	66,690
	196,690		196,690

Loan Account - John

	GH¢		GH¢
Bal b/f	135,980	Per Bal Sheet	35,100
		Capital A/c	100,880
	135,980		135,980

QUESTION 2

(a)

Abigail Company Ltd

Profit and Loss Account for the year ended 31st December 2006

	Note	GH¢	GH¢
Sales			2,925,900
Cost of sale			(1,785,897)
Gross profit			1,140,003
Selling, general & Admin Expenses	2		(979,311)
Impairment of trade Investment			57,000)
Net Profit before Interest Tax			(103,692)
Interest charging (15,000 + 5,244)			(20,244)
Net Profit before Tax			83,448
Taxation (1,000 + 200)	3		(1,200)
Net Profit after tax			82,248

Income Surplus Account for the year ended 31st December 2006

		Note	GH¢
Bal b/f			65,103
Profit for the year			82,248
			147,351
Transfer to Capital Surplus			(15,000)
Dividend:	Preference		(4,200)
	Ordinary		(19,500)
Balance			108,651

Abigail Company Ltd
Balance sheet as at 31st December 2006

	Note	GH¢	GH¢
Fixed Assets			681,000
Trade Investment	4		15,000
			696,000
Current Asset			
Stock		252,526	
Debtors (Net)		440,073	
Prepayments		30,002	
		722,601	
Current Liabilities			
Creditors		371,022	
Accrued Interest		7,500	
Taxation		300	
Bank overdraft		354,528	
Dividends Payable (2,100 + 19,500)		21,600	
		754,950	
Net Current Liabilities			(32,349)
			663,651
10% Debenture (2004 – 2010)			(150,000)
NET ASSETS			513,651
Financed by:			
Stated capital			360,000
Capital surplus	5		45,000
Income surplus			108,651
Shareholders Fund			513,651

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting Policies

The following accounting policies have been adopted and consistently applied in preparing the financial statements:

a. Basis of Accounts

The financial statements have been prepared on historic cost basis.

b. Fixed Assets and Depreciation

Fixed assets are depreciated over the estimated useful life. The rates applicable are as follows:

Plant & Machinery	-	10% on cost
Buildings	-	2% on cost
Motor Vehicles	-	25% on written down value

c. Stocks

Stocks are valued at lower of cost or net realizable value.

d. Debtors

Debtors are stated net of provision for doubtful debts.

e. Investments

Investments are stated in the balance sheet at cost less recognized impairment

2. Net operating profit

This is stated after charging the following:

	GH¢
Depreciation	24,000
Auditors Fee	3,000
Directors Remuneration	181,500
Impairment loss on Investment	57,000

3. Taxation Schedule

	As at 1/1	Charge for the year	Payments during year	As at 31/12
Prior to 2006	600	-	(1,500)	(900)
2006	-	1,200	-	1,200
	600	1,200	(1,500	300

4. Fixed Assets Schedule

	Land and Buildings	Plant & Machinery	Motor Vehicle	Total
	GH¢	GH¢	GH¢	GH¢
Cost/Valuation				
Balance at 1/1/06	-	105,000	54,000	159,000
Additions	600,000	30,000	-	630,000
Balance at 31/12/06	600,00	135,000	54,000	789,000
Depreciation				
Balance at 1/1/06	-	60,000	24,000	84,000
Charge for the year	3,000	13,500	7,500	24,000
Balance at 31/12/06	3,000	73,500	31,500	108,000
N B V At 31/12/06	597,000	61,500	55,500	681,000

5. Stated Capital

	GH¢
Preference shares	60,000
Ordinary shares	300,000
	360,000

All issued shares are fully paid for and there is no treasury share.

Workings

Selling, General & Admin Expenses

Selling expenses	120,000
Admin expenses	644,052
Inc. provision for doubtful debts	6,759
Directors' Remuneration	181,500
Audit fees	3,000
Depreciation	
Plant and Machinery	13,500
Buildings	3,000
Motor vehicles	7,500
	979,311

Workings

Administrative Expenses	649,296
Balance as per Trial Balance	(5,244)
Less Interest on overdraft	644,052

Depreciation	
Buildings (2% x 150,000)	3,000
Plant & Machinery (10% x 135,000)	13,500
Motor vehicle {25% x (54,000 – 24,000)}	7,500

Provision for Doubtful Debts	
New provision (1% x 2,025,900)	29,259
Old provision (as per Trial Balance)	(22,500)
Increase in Provision	(6,759

(b) Except in a winding up, a Company shall not pay a dividend to its shareholders r make any return or distribution of any of its assets to its shareholders unless:

i. The Company is able after such payment, return or distribution, to pay its debts as they fall due.

ii. The amount or value of such payment, return or distribution does not exceed its Income Surplus immediately prior to making such payments, returns or distribution.

QUESTION 3

GOD FIRST CHEMICAL STORE

(i) Creditors

	2006	2005
Acid Test Ratio		
Current Asset – Stocks : 1	123,845 : 1	131,790 : 1
Current Liabilities	107,020	92,890
	1.16:1	1.42: 1
Current Ratio		
Current Assets : 1	250,975 : 1	232,945 : 1
Current Liabilities	107,020	92,890
	2.34:1	2.51:1

(ii) Management

	2006	2005
Return on Capital Employed		
Net Profit Margin	46,900 x 100%	41,810 x 100%
Total Capital Employed	283,000	245,540
	16.6%	17%
Assets Turnover		
Sales	1,323,130 x 100%	1,101,965 x 100%
Capital employed	283,000	245,540
	4.7%	4.5%

Shareholders

	2006	2005
Earnings per share		
Earnings	¢(46,900 – 21,900 – 5,000)	¢(41,810 – 18,210 – 5,000)
No. of Shares	10,000	10,000
	¢20,000	¢18,600
	10,000	10,000
	¢2	¢1.86
Dividend Cover		
Earnings	¢20,000	¢18,600
Dividend paid	¢7,500	¢7,000
	2.7 times	2.7 times

Brief Comments on the Changes in Ratio

The fall in both the Acid test and the Current Ratio indicates a decline in the liquidity position of the company. This is not necessarily dangerous, but does warrant further investigation, for example by comparison with industrial averages.

Return on total funds has fallen slightly. Computation of the secondary ratio shows a slight rise in asset turnover and a slight fall in the net profit percentage, suggesting sales may have been accompanied by a rise in expenses.

Earning per share has increased, not because of increase in the return on capital but because of the increase in the total resources employed. Dividend cover is constant, and the level of cover is reasonable.

Existing gearing

	Existing	Proposed
Ordinary Shares	25,000	25,000
Add New Issue	-	12,000
Income Surplus	73,815	73,815
	98,815	110,815
Deferred Tax	27,165	27,165
10% Debenture	50,000	50,000
Convertible debenture	-	16,000
	77,165	93,165
Gearing	$\frac{77,165}{98,815} \times 100\%$	$\frac{93,165}{110,815} \times 100\%$
	78%	84%

The new issues (Debentures Stocks and ordinary shares) will make the capital structure more geared/leverage towards debt financing and therefore worsen the financial risk exposure of the company.

QUESTION 4

(a) The principal situations in which net realizable value is likely to be lower than cost include:

- (i) a major increase in cost with no compensating increase in selling price
- (ii) a significant fall in selling price
- (iii) physical deterioration of stock
- (iv) obsolescence of products
- (v) a deliberate marketing strategy, to manufacture and sell particular products at a loss
- (vi) defective products resulting from errors in production process.

(b) The most obvious circumstances in which impairment review becomes necessary include:

- (i) where any part of the company's business operations begins to make a loss.
- (ii) a significant fall in the asset market value
- (iii) physical damage to or obsolescence of a fixed asset
- (iv) a significant re-organisation of business operations.
- (c) the loss of key employees
- (d) a significant increase in market interest rates.

(c)

(i) Warrants

These are authorisation processes, which make moneys available to spending organizations. They can be provisional, general and specific warrants.

(ii) Financial Encumbrances

These are documents that are used for the release of funds by the treasury to spending organisations. They are to be prepared by the vote controller on the basis of their budgeted allocations. They authorise funds to be spent by spending officers or the Accountant. Servicing treasuries certify such FE's which are often prepared in quadruplicate and distributed as follows:

(a) Original to Paying Treasury
(b) Duplicate to the Vote Controller
(c) Triplicate to Spending Officer
(d) Quadruplicate kept by Certifying Treasury.

(iii) Drawing Limits

This is a control measure which limits spending organizations to the approved appropriated moneys available to him. It establishes a limit up to which the Treasury Officer can issue cheque on a bank for the organization.

In principle the Controller and Accountant General advises the treasury officers of their drawing limits each quarter with copies of such advice to the Bank of Ghana and Local Commercial Banks. The drawing limits is covered by the total amount of FES.

(iv) Expenditure Authorisation

This is an Authorisation that the Accountant General gives to the treasury to request the treasury officer to release additional funds to a spending officer who applies for such additional funds.

An expenditure authorization form is then issued to the treasury from the Accountant General specifying the amount to be released to the spending officer. It should be noted that these additional funds are not outside the drawing limit or that within FES.

(d) (i) Similarities between private and public sector accounting:

- They are integral parts of the economic system and use similar resources in executing their purposes.
- Financial management systems are similar. Both have information systems.
- Cost analysis and control and evaluation techniques are unavoidable to ensure economy efficiency and effectiveness.

- They produce in some cases similar goods and services.

(ii) Differences

- Objectives
- Source of financial resources
- Pricing of goods and services
- Transferability of ownership
- Resource contributors and recipients of goods and services
- Policies and operating decisions.

QUESTION 5

(a) (i) It is certain contractual revenue can be measured reliably;

(ii) It is certain that the enterprise will receive the contract revenue;

(iii) Both the costs to complete the contract and the stage of contract completion at the balance sheet date can be measured reliably; and

(iv) The costs attributable to the contract can be clearly identified so that actual costs incurred can be compared with prior estimates.

(b) CONTRACT ACCOUNT

(i)

	GH¢'000		GH¢'000
Material	90	Materials returned	5
Labour	35	Material on site	19
Depreciation –Truck	100	Material transferred	6
Sub-contract	70	Cost of sales	206
		WIP c/d	59
	295		295

CONTRACT PROFIT AND LOSS ACCOUNT

	GH¢'000		GH¢'000
Cost of sales	206	Turnover	280
Profit	74		
	280		280

(ii)

CONTRACT DEBTOR'S ACCOUNT

	GH¢'000		GH¢'000
Turnover	280	Bank	224
		Balance c/d	56
	280		280

(iii) Work-in-progress

	GH¢
Cost to date	265
Profit taken	74
	339
Less work certified	280
Work-in-progress	59

Workings

COMPUTATION OF PERCENTAGE OF COMPLETION

	GH¢
TURNOVER (Value of work completed)	280,000
CONTRACT PRICE	700,000

Percentage of completion $\frac{280,000 \times 100}{700,000} = \underline{40\%}$

COMPUTATION OF TOTAL ESTIMATED COST
(and "Cost of sales")

	GH¢	GH¢
Cost to date		265,000
Add:		
Materials on site	19	
	80	99,000
Further Depreciation		150,000
Estimated further cost to completion		514,000
COST OF SALES (514,000 X 40%)		205,600