THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

INTEGRITY

NOVEMBER 2008 EXAMINATIONS
(PROFESSIONAL)

PART 2

FINANCIAL ACCOUNTING PRACTICE
(Paper 2.1)

Attempt ALL Questions

TIME ALLOWED: 3 HOURS

QUESTION 1

A) The main objective of the Medium Term Expenditure Framework (MTEF) is to improve the planning and budgeting of public expenditures to enhance fiscal policy formulation and implementation.

Required:

i) Outline any **five (5)** features of the Medium Term Expenditure Framework.

(5 marks)

ii) Explain any **five (5)** sources of financing for public sector organizations.

(5 marks)

B) The financial statements of Sombo Ltd for the year ended 31/12/07 are set out below:

Income statement for the year ended 31^{st} December 2007

	GH¢
Turnover	960,550
Cost of sales	(620,400)
Gross profit	340,150
Selling, Gen & Admin Expenses (excluding depreciation)	(149,450)
Depreciation	(25,600)
Interest	(35,000)
Profit before tax	130,100
Tax	(36,428)
Profit after tax	93,672

Balance Sheet as at 31^{st} December 2007

	GH¢	GH¢
Property, Plant & Equipment		330,250
Current Assets		
Inventories	90,600	
Trade Receivables	55,500	
Call account	40,000	
Cash	35,000	
	221,100	
Current Liabilities		
Trade payables	65,250	
Net Current Assets		155,850
		486,100

Financed By:	
Stated capital	100,000
Income surplus	136,100
	236,100
14% Loan	250,000
	486,100

Industry Average Ratios

Net profit on sales	15%
ROCE	25%
Average collection period	20 days
Fixed assets turnover	8 times
Assets turnover	4 times
Quick ratio	1:1
Current ratio	2:1
Times interest earned	8 times
Dividend cover	8 times
Debt to total assets	20%
Stock turnover	10 times
Gearing ratio	20%

Additional information:

i) The company's shares were issued many years ago at GH¢1 per share. The shares are now selling on the Ghana Stock Exchange at GH¢5.50/share.

ii) At the AGM held recently, the shareholders approved dividends of GH¢0.15 for the year ended 31st December 2007.

Required:

Comment appropriately on the performance of Sombo Ltd for the year ended 31st December 2007.

(15 marks)

Total: 25 marks

QUESTION 2

The trial balance extracted below is from the books of Go Ye Faithful Company Ltd, a trading and distribution company.

<u>Trial Balance as at 31st December 2007</u>

	DR	CR
	GH¢	GH¢
Lease Rental Payment	1,000	
Computers & Accessories	25,800	17,200
Furniture & Equipment	20,260	6,950
Motor Vehicles	234,500	73,000
Plant & Machinery	26,780	5,570
Office Premises	52,050	23,300
Stock – 1st Jan. 2007	226,090	-
Cash at bank	15,350	-
Cash on hand	1,630	-
Bank overdraft	-	294,700
Trade Debtors & Creditors	444,100	564,660
Investments	91,880	-
Stated Capital	-	30,000
Prepayments & Accruals	31,510	301,130
Purchases & sales	2,244,500	2,440,380
investment Income	-	13,430
Income Surplus 1/1/07	-	298,260
Selling, General & Administrative Expenses	588,400	-
Taxation: Bal b/f: 2005	22,990	-
2006	19,030	-
Payment on A/c: 2006	10,710	-
2007	12,000	-
	4,068,580	4,068,580

<u>Additional information:</u>

(i) Depreciation is provided on a straight-line basis at rates calculated to write-off the cost of each fixed asset over its estimated useful life:

Computers & Accessories	-	20%
Furniture & Equipment	-	10%
Motor Vehicles	-	10%
Plant & Machinery	-	10%
Office premises	-	2%

<u>Note</u>: Depreciation charges are to be included in Selling, General and Administrative Expenses.

(ii) Stock on hand at the end of the year cost GH¢658,970. Its net realisable value is estimated at GH¢660,000.

(iii) Included in Selling, General and Administrative Expenses is Bad Debts of GH¢11,620. A final meeting of the Credit Control Committee for the year reviewed the declared debt downwards by GH¢5,200.

(iv) A tax audit carried out for the assessment years 2005 and 2006, revealed an additional tax liability of GH¢10,710 for 2006. The audit closed the assessment for the respective years, thereupon all balances are to be transferred. The current corporate tax rate is 25%.

(v) During the year, acquisitions of Furniture & Equipment of GH¢39,502 was made. This is already included in trial balance for the year ended 31st December 2007.

(vi) The lease payment of GH¢1,000 was made on 31st December 2007 and was in respect of a finance lease arrangement for the use of a plant which had a fair value of GH¢3,000 at the inception of the lease on 1st January 2007. The lease arrangement covered 4 years commencing 1 January 2007 and provided for annual rental payment of GH¢1,000 payable in arrears on 31st December. By policy, Go Ye Faithful depreciates the leased plant over the lease period and allocates the finance charge using the sum of the years' digit method.

(vii) Included in the selling, general and administrative expenses figure in the Trial Balance is Wages, Salaries and other employee benefits figure of GH¢180,000.

(viii) The stated capital consists of ordinary shares issued at 50 pesewas per share at incorporation. In November 2007, the Directors declared an interim dividend of 20 pesewas per share and notified the shareholders. Dividend warrant and payment to shareholders had however not been effected by 31 December 2007.

You are required to prepare for Go Ye Faithful Co Ltd in accordance with International Financial Reporting Standards (IFRS), the following financial statements.

a) An Income Statement and Income Surplus Account for the year ended 31 December 2007. ***(7 marks)***

b) A Balance Sheet as at 31st December 2007. ***(7 marks)***

c) Taxation Schedule and Property, Plant and Equipment Schedule. ***(6 marks)***

d) Value Added Statement for the year ended 31 December 2007. ***(5 marks)***

Total: 25 marks

QUESTION 3

The directors of a company are considering its draft financial statements for the year ended September 30, 2008. It was discovered that the following issues are unresolved:

(i) One of the company's buildings was destroyed in a flood in October 2008. The estimated value of the building was GH¢400,000 but it was insured for only GH¢300,000. The company's going concern status is not jeopardized. The directors are unsure what adjustments, if any, should be made.

(ii) The company usually gives warranties on its products at the time of sale, undertaking to repair or replace any defective item without any charge to the customer. Some of the directors are of the opinion that a provision should be made for estimated warranty liabilities at September 30, 2008 based on sales to that date. Other directors argue that the expense of warranty should be borne in the period in which it is incurred.

(iii) Some stock items which had cost GH¢120,000 and were included in closing stock at September 30, 2008 were subsequently sold for GH¢80,000 after it was found to have deteriorated whilst in stock.

The directors are unsure how to treat the transaction in the final accounts.

(iv) The company had supplied goods worth GH¢100,000 to a customer on a "Sale or Return" basis in September 2008. The transaction was included as a credit sale in the accounting records. A profit of GH¢20,000 was provided for on this transaction.

In October 2008, the customer returned all the items in good condition, before the expiration of the right of return period.

You are required to advise the Board of Directors as to the correct treatment of each of the transactions in i – iv in line with relevant Accounting standards. State the effect, if any, on the Profit and Loss Account and the Balance Sheet.

15 marks

QUESTION 4

The partnerships of Black, White and Green (Black & Co) and Friday and Sunday (FS & Co) decided to amalgamate to form a new firm, Black Day & Co from 1st July 2008. The balance sheets of the two firms as at 30 June 2008, after preparing half year accounts to that date, are provided below:

	Black & Co.	FS & Co.
	GH¢	GH¢
Capital Accounts:		
Black	250,000	-
White	150,000	-
Green	120,000	-
Friday	-	200,000
Sunday	-	200,000

Current Accounts:		
Black	56,000	-
White	(43,000)	-
Green	26,000	-
Friday	-	(12,000)
Sunday	-	6,300
Loan from Green	100,000	-
Bank	-	10,600
Creditors & accruals	23,000	49,000
	682,000	453,900
Goodwill	34,000	-
Motor vehicles	330,000	260,500
Furniture & fittings	89,000	82,000
Equipment	75,000	63,000
Stocks	13,000	11,000
Debtors	24,000	34,000
Prepayments	8,000	600
Life Assurance Policy	35,000	-
Bank	71,800	-
Cash in hand	2,200	2,800
	682,000	453,900

Additional information:

(i) Following the decision to amalgamate with FS & Co, Green resigned from Black & Co on 30th June 2008. In order to ascertain his interest in the firm, assets were revalued as follows:

	GH¢
Motor vehicles	400,000
Furniture & fittings	60,000
Equipment	120,000
Stocks	10,000

Prepaid expenses are to be written off and 50% of debtors are considered to be bad. Goodwill is to be written off. The life assurance policy matured and the insurance company paid GH¢50,000. Green’s loan was repaid to him immediately and his remaining interest in the firm was purchased by Black and White personally in equal proportions.

(ii) Black Day and Co assumed responsibility of the creditors of Black & Co and agreed to take over assets at the following values:

	Black & Co	FS & Co
	GH¢	GH¢
Motor vehicles	380,000	300,000
Furniture & fittings	56,000	70,000
Equipment	100,000	80,000
Stocks	10,000	8,000
Debtors	12,000	20,000

(iii) Prepaid expenses in the books of each firm are to be written off.

(iv) Profit and loss sharing ratios were:

	Black & Co	FS & Co
Black	4/10	
White	3/10	
Green	3/10	
Friday		3/5
Sunday		2/5

(v) Black, White, Friday and Sunday agreed to share profits and losses in the ratio 3:3:2:2 respectively in the new firm.

(vi) Bankers of FS & Co, upon hearing of the impending merger, threatened to sell the company's assets pledged as collateral for the overdraft. Creditors of FS & Co also demanded immediate settlement of the amount owed them in full. Friday and Sunday brought fresh cash of GH¢30,000 each to settle these liabilities.

(vii) The capital of the new firm was to be GH¢1,200,000 to be contributed in the agreed profit and loss sharing ratios, any surplus or deficit being transferred to the current accounts of partners.

You are required to prepare:

a. Revaluation Account and Capital Accounts to record the transactions relating to Green's retirement.

b. Realization, capital and Bank Accounts to record transactions relating to the amalgamation.

c. Balance Sheet of Black Day & Co as at 1st July 2008.

20 marks

QUESTION 5

Godson trading Enterprise (GTE) sells Washing Machines to public servants for cash and on hire purchase terms.

The hire purchase contract requires customers to pay a deposit of one-fifth of the hire purchase selling price and the balance paid in four equal instalments at 3 months intervals. The first instalment becomes payable three months after the hire purchase agreement is signed.

The cash selling price is fixed at a profit mark up of 50% and the hire purchase selling price is fixed at 80% profit mark up.
The entity's policy on hire purchase sale profit recognition is to make provision against the profit included in the hire purchase debtors not yet due.

The trial balance extracted from the books of the entity as at 31 December 2007 was as follows:

	GH¢
Debits	
General expenses	130,000
Cash and cash equivalence	6,208
Hire Purchase debtors 1 January 2007	2,268
Property, Plant and Equipment (Net Book Value) 1st January 2007	55,000
Purchases	342,000
Trading Inventories: 1 January 2007	15,000
	550,476
Credit balances	
Capital Introduced	75,000
Cash received from Hire Purchase customers	315,468
Cash sales	71,000
Retained Profit 1 January 2007	8,000
Provision for unrealized profit 1 January 2007	1,008
Trade Payable	80,000
	550,476

The following information is relevant for the preparation of the financial statements for the year.

i) Hire purchase sales for the year amounted to GH¢540,000.

ii) In September 2007, the entity repossessed some goods which had been sold earlier in the year. The goods were purchased by GTE for GH¢3,000 and the unpaid instalments on them amounted to GH¢3,240. They were taken back into stock at a value of GH¢2,500. In November 2007 they were sold on cash terms for GH¢3,500.

iii) Depreciation for property, plant and equipment is to be charged at 20% per annum 0reducing balance basis.

Required:

As the accountant of GTE, prepare the Income Statement for year ended 31 December 2007 and a balance sheet as at 31 December 2007.

15 marks