SOLUTION: FINANCIAL ACCOUNTING PRACTICE NOV 2008

QUESTION 1

a) Features of MTEF

- It is designed and captured as a 3-year rolling budget, thus ensuring formal planning and giving the budget a medium term outlook.
- It reclassifies accounting heads from a wordy 9-line items into a unique 4 line items
- The concept of separate recurrent and capital expenditures has been abandoned
- It is broad-based in that it makes MDAs consider all resources available (ie expenditure to be funded by GOG, expenditures to be funded by donors, and (IGF) to enable them achieve the purpose for which they exist
- It involves strategic planning by linking MDA expenditure to the missions, objectives, output and activities of MDAs
- It links national policy objectives and priorities as contained in vision 2020 to the programmes of sector ministries.

b) Sources of Financing Public sector Organisations

(i) Pubic sector organizations, which are in the form of ministries, departments, boards, commissions, services, councils, agencies, etc, are financed with revenue accruing from various sources. Some of the common sources are:

(a) ***Budgetary allocation from revenue***: Here the department gets an allocation from central government to finance its activities. The source is centrally accrued revenue. Such allocations are by means of budgets prepared by the organization and approved by their sector ministries for the particular year before they can receive the amounts so allocated.

(b) ***Service charges (User fees)***: Some of the public sector organizations like the hospitals charge for their services and the amount so-accrued is immediately available to that organization for financing its own activities. This is obviously different from centrally allocated funds.

(c) ***Taxation and User Charges***: Another means of funding operations available to some public sector organizations is tax collected by them. The main form of tax is that levied by central government in the form of income taxes of all forms, excise duties, and other forms for taxes. Local government units fall into this category, too. They have the power to levy property rates, market tools, lorry park tolls, business operating certificates, etc.

(d) ***Loans and Grants***: These are internally and/or externally sourced loans and grants which are for specific purposes and therefore constitute funding for specific public sector organizations. They may be for specific programmes, projects, or for general developmental issues.

(e) ***Profits of Business – Type Public Sector Organisations.*** The state establishes corporations that do business (eg GNPC, STC, GBC, ECG, etc). These are therefore expected to make profits which would be a means of funding either their own expansion or for providing some other good or service for the public.

(f) ***Dividends, Interest, etc:*** The state invests by holding shares in some private or semi-public business organization and from that, dividends or interest accrue which is another source of funding the public sector.

(ii) Profitability

The gross profit % is above industry average but the net profit % is below industry average. These are signs of poor cost control on the presence of overhead costs that are not contributing to profit in any way.

Activity

Stock turnover is far below the industry average, suggesting that similar companies are doing much better. This is supported by the poor debt collection and creditor payment ratios. Debt collection is worse than industry just like payment to creditors suggesting that even though sales are not collected on time, the little that is collected is paid specially to creditors without having a chance to turn it around.

Use of Assets

Fixed assets are poorly used, showing a ratio far below the industry average and this is reflected in the return on capital employed which is also below industry average. The fixed asset base should be investigated in order to dispose of old or obsolete machinery not contributing to sales.

Liquidity

Both quick and current ratios are comparable to the industry and the company is not in any immediate danger of facing cash flow problems.

Investment

The dividend cover is just a little above industry average and encourages investors to maintain their shareholding rather than dispose of it.

Gearing

Borrowing is seriously high, it is more than two times of the industry average and is not healthy as supported by the high interest charges (26.9% of PBT) in the income account. How this borrowing is invested is not clear as fixed assets are performing poorly and stocks are also turned around poorly. Something must be done to reduce the level of borrowing.

Liability

a. Net Profit Margin $= \dfrac{\text{Profit before Interest \& Tax}}{\text{Turnover}} = \dfrac{130{,}100 + 35{,}000}{960{,}550} = 17\%$

b. ROCE $= \dfrac{\text{Profit before Interest \& Tax}}{\text{TA - CL}} = \dfrac{165{,}100}{486{,}100} = 34\%$

c. Gross Profit Margin $= \dfrac{\text{Gross Profit}}{\text{Turnover}} = \dfrac{340{,}150}{960{,}550} = 35\%$

Liquidity

a. Current Ratio $= \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{221{,}100 - 90{,}600}{65{,}250} = 3.39:1$

b. Quick Ratio $= \frac{\text{Current Assets - Inventories}}{\text{current Liabilities}} = \frac{221{,}100 - 90{,}600}{65{,}250} = 2.39:1$

Activity/Assets Utilization

a. Stock Turnover $= \frac{\text{Cost of Sales}}{\text{Inventories}} = \frac{620{,}400}{90{,}600} = 6.85$ times

b. Assets Turnovers $= \frac{\text{Turnover}}{\text{CE (TA – CL)}} = \frac{960{,}550}{486{,}100} = 1.98$ times

c. Fixed Asset, Turnover $= \frac{\text{Turnover}}{\text{Fixed Assets}} = \frac{960{,}550}{330{,}250} = 2.91$ times

d. Average Collection Days $= \frac{\text{Trade Receivables}}{\text{Turnover}} \times 365 = \frac{55{,}500}{960{,}550} \times 365 = 21$ days

e. Average Payments Days $= \frac{\text{Trade Payables}}{\text{Cost of Sales}} \times 365 = \frac{65{,}250}{620{,}400} \times 365 = 38$ days

Gearing/Leverage

a. Gearing $= \frac{\text{Long Term Debt}}{\text{Long Term Debt Equity}} = \frac{250{,}000}{250{,}000 + 236{,}100} = 51\%$

b. Times interest Earned $= \frac{\text{PBIT}}{\text{Interest Exp.}} = \frac{165{,}100}{35{,}000} = 5$ times

Investment

a. Dividend Cover $= \frac{\text{Profit after Tax}}{\text{Dividend}} = \frac{93{,}672}{15{,}000} = 6.24$ times

b. Earnings Per Share $= \frac{\text{Profit after Tax}}{\text{No. of Shares}} = \frac{93{,}672}{100{,}000} = 0.94$ shares

c. Price/Earnings Ratio $= \frac{\text{Market Price/Share}}{\text{EPS}} = \frac{5.50}{0.94} = 5.85$ times

e. Dividend Yield $= \frac{\text{Dividend per Share}}{\text{Market Price per Share}} = \frac{0.15}{5.50} = 3\%$

NB: Accept:

Assets Turnover $= \frac{960{,}000}{330{,}250 + 221{,}100} = 1.74$ times

QUESTION 2

Go Ye Faithful Company

Income Statement for the year ended 31 December 2007

	Notes	GH¢
Turnover		2,440,380
Cost of Sales		1,811,620
Gross Profit		628,760
Selling, General & Admin. Exp.		618,305
Net Operating Profit	9	10,455
Investment Income		13,430
Net profit before Interest & Tax		23,885
Finance charge		(400)
Net Profit before Tax		23,485
Taxation		(16,581)
Net profit after Tax		6,904

Income Surplus Account for the year ended 31 December 2007

	Notes	GH¢
Balance b/f		298,260
Profit for the year		6,904
		305,164
Dividend		(12,000)
Balance c/f		293,164

Balance Sheet as at 31 December 2007

	GH¢	GH¢
Non Current Assets:		
Property, Plant & Equipment		201,265
Investments		91,880
		293,145
Current Assets:		
Stocks	658,970	
Debtors	449,300	
Prepayments	31,520	
IRS – taxation	48,149	
Bank	15,350	
Cash	1,630	
	1,204,909	

Current Liabilities		
Creditors	564,660	
Accruals	301,130	
Overdraft	294,700	
Dividend	12,000	
Obligation under finance case	700	
	1,173,190	
Net Current assets		31,719
Total assets less current Liabilities		324,864
Non-Current Liabilities		(1,700)
Obligation under finance lease		323,164
Financed By:		
Stated Capital		30,000
Income Surplus		293,164
		323,164

Taxation Schedule

	Balance at 1/1/	Charge for the year	Payments	Balance at 31/12/
	GH¢	GH¢	GH¢	GH¢
Prior to 2007	(52,730)			(52,780)
2007		16,581	(12,000)	4,581
	(52,730)	16,581	(12,000)	(48,149)

Schedule of PPE

	Leased Plant	Comp & Ac	FE	MV	PM	Prem.	Total
	GH¢	GH¢	GH¢	GH¢	GH¢	GH¢	GH¢
As at 1/1/07	-	25,800	20,260	234,500	26,780	52,050	359,390
Addition	3,000						3,000
As at 31/12/07	3,000	25,800	20,260	234,500	26,780	52,050	362,390
Dep.							
As at 31/12/07	-	17,200	6,950	73,000	5,570	23,300	126,020
	750	5,760	2,026	23,450	2,678	1,041	35,105
							161,125
NBV							201,265

Workings

			GH¢	GH¢
(i)	DR	Debtors	5,200	
	CR	Selling, Gen & Adm.		5,200
(ii)	Under provision of taxation for previous years			10,710

(iii) Finance Lease

	Obligation at start GH¢	Finance charge GH¢	Payment GH¢	Obligation at close GH¢
2007	3,000	400	(1,000)	2,400
2008	2,400	300	(1,000)	1,700
2009	1,700	200	(1,000)	900
2010	900	100	(1,000)	-

(v) Interim dividend 20px 60,000 shares = GH¢12,000

(vi) Cost of Sales

Opening Stock	226,090
Purchases	2,244,500
Closing Stock	(658,970)
Cost of Sales	1,811,620

(vii) Selling, Gen & Adm. Exp

Per Trial Balance	588,400
Less bad debts adj.	(5,200)
Dep. Charge	35,105
	618,305

Value Added Statement for the year ended 31 December 2007

Turnover	2,440,380
Brought in Goods & Services	2,214,820
Value Added for Operations	225,560
Investment Income	13,430
Value Added for	238,990

Applied as to:				
Employee:				
Wages & Salaries			180,000	7,532
Providers of Capital:				
Finance charge	400		0.17	
Dividend	12,000	12,400	5.02	5.19

Government				
Corporate Tax		16,581		6.94
Retained for expansion				
Depreciation:				
Depreciation	35,105		14.68	
	(5,096)	30,009	(2.13)	12.55
		238,990		100

QUESTION 3

(i) IAS 10, events after the Balance Sheet date classifies this type of event as in the financial statements is required but there should be a note to ensure that the financial statements are not misleading. The note should state the amount of the loss and the extent of the insurance cover.

(ii) A provision should be made for the estimated amount of the liabilities under warranties as required by IAS 37, provisions, contingent liabilities and contingent assets.

The provision will appear as a liability in the balance sheet and the operating profit will be reduced by the amount of the provision.

(iii) This is an adjusting event according to IAS 10, Events after the Balance sheet date. The closing stock should be reduced by GH¢40,000 in the balance sheet and included cost of sales this reducing operating profit by this amount unless it could be shown that the deterioration had taken place after the balance sheet date.

(iv) The goods have to be treated as trading stock at September 30, 2008 applying generally accepted accounting principles. The effect on the Profit and Loss Account and balance sheet will be:

(a) Sales and trade debtors both reduced by GH¢100,000

(b) Closing stock increased by GH¢80,000

(c) Combined effect of the two adjustments is to reduce current assets and profit by GH¢20,000.

QUESTION 4

REVALUATION ACCOUNT

	¢'000		¢'000
Goodwill	34,000	Motor vehicles	70,000
F & F	29,000	Equipment	45,000
Prepayment	8,000		
Debtors	12,000		
Stock	3,000		
Capital Accounts:			
Black	11,600		
White	8,700		
Green	8,700		
	115,000		115,000

CAPITAL ACCOUNTS

	BLACK ¢'000	WHITE ¢'000	GREEN ¢'000		BLACK ¢'000	WHITE ¢'000	GREEN ¢'000
Capital				Bal b/f	250,000	15,000	120,000
Black			79,600	Revaluation	11,600	8,700	8,700
White			79,600	Life Ass. Policy	6,000	4,500	4,500
Bal c/d	347,200	242,800		Current a/c			26,000
				Capital Account	79,600	79,600	
	347,200	242,800	159,200		347,200	242,800	159,200
				Bal b/d	347,200	242,800	

REALIZATION ACCOUNT

	BLACK & CO ¢'000	FS & CO ¢'000		BLACK & CO ¢'000	FS & CO ¢'000
Motor vehicles	400,000	260,500	Motor vehicles	380,000	300,000
F & F	60,000	82,000	F & F	56,000	70,000
Equipment	120,000	63,000	Equipment	100,000	80,000
Stocks	10,000	11,000	Stocks	10,000	8,000
Debtors	12,000	34,000	Debtors	12,000	20,000
Repayments		600	Creditors		
Capital Account:			Capital Account:		
Friday		16,140	Black	25,143	
Sunday		10,760	White	18,857	
	602,000	478,000		602,000	478,000

CAPITAL ACCOUNTS

	BALCK	WHITE	FRIDAY	SUNDAY
	¢'000	¢'000	¢'000	¢'000
Bal b/f	347,200	242,800	200,000	200,000
Realization a/c	(25,143)	(18,857)	16,140	10,760
Bank			30,000	30,000
Bank	37,943	136,057		
Current Account			(6,140)	(760)
Bal c/d	360,000	360,000	240,000	240,000

BLACK ACCOUNT

	BLACK & CO	FS & CO		BLACK & CO	FS & CO
	¢'000	¢'000		¢'000	¢'000
Bal b/f	71,800		Bal b/f		10,600
Capital accounts:			Creditors		49,000
Friday		30,000	Loan – Green	100,000	
Sunday		30,000	Bal c/d	195,800	400
Capital accounts:					
Black	37,943				
White	136,057				
Sunday		0			
Life Ass. Policy	50,000				
	295,800	60,000		295,800	60,000
	591,600	120,000		591,600	120,000

BLACK DAY & CO.

BALANCE SHEET AS AT JULY 1, 2005

	¢	¢
FIXED ASSETS:		
Motor Vehicles		680,000
Furniture & Fittings		126,000
Equipment		180,000
		986,000

CURRENT ASSETS:		
Stocks	18,000	
Debtors	32,000	
Bank	196,200	
Cash in hand	5,000	
	251,200	
Less Current Liabilities	23,000	
Creditors & Accruals		228,200
		1,214,200
Capital Accounts:		
Black		360,000
White		360,000
Friday		240,000
Sunday		240,000
		1,200,000
Current Accounts:		
Black	56,000	
White	(43,000)	
Friday	(5,860)	
Sunday	7,060	14,200
		1,214,200

QUESTION 5

Income Statement for the year ended 31 December 2007

	HP	Cash Sales	Total
	¢	¢	¢
Sales (W1)	534,600	71,000	605,600
Cost of sales (W2)	(297,000)	(47,500)	(344,500)
	237,600	23,500	261,100
Provision for Unr. Profit (W3)	(98,352)	-	(98,352)
Profit on repossession (W4)	1,660	-	1,660
Gross Profit earned	140,988	23,500	164,408
General expenses			(130,000)
Depreciation			(11,000)
Net Profit			23,408

Balance Sheet as at 31 December 2007

	GH¢	GH¢	GH¢
Property, Plant & Equipment	53,000	11,000	44,000
Current Assets:			
		12,000	
Stocks (W5)			
Debtors (W3)	223,560		
Provision for unrealized profit (W3)	(99,360)	124,200	
Cash		6,208	
		142,408	
Current Liabilities			
Creditors		80,000	62,408
			106,408
Capital invested	23,408		75,000
Retained Profit			31,408
			106,408

Workings

		GH¢
(1)	HP sales as per question	540,000
	Less repossessed sales (300 x 1.8)	5,400
	Effective HP sales	534,600
(2)	Cost of sales	
	Hire purchase 534,600 / 1.8 =	297,000

Cash Sales

	Total	Regular Cash Sales	Sale of Reposse-ed goods
Sales	71,000	67,500	3,500
Cost of sales		67,500 / 1.5	2,500
	47,500	45,000	2,500

W4

Profit on repossession

	GH¢
	3,000
Cost of repossessed goods	(2,160)
Deposit and investment	(2,500)
received 5,400 – 3,240	1,660
Valuation of repossessed goods	
Profit on repossession	

W5

Valuation of Stocks

Op Stock	15,000
Purchases	342,000
Cost of sales	(345,000)
Closing stock	12,000

(3) Provision for unrealized profit

HP Debtors

Op balance	2,268
HP sales	540,000
	542,268
Cash collected from cost	(315,468)
	226,800
Less outstanding on Repossessed goods	(3,240)
	223,560

Provision for unrealized profit at 31/12/07

$$\frac{80}{180} \times 223,560 = 99,360$$

Op balance	(1,008)
Increase in provision	98,352