THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

INTEGRITY

NOVEMBER 2009 EXAMINATIONS
(PROFESSIONAL)

PART 2

FINANCIAL ACCOUNTING PRACTICE
(Paper 2.1)

Attempt ALL Questions

TIME ALLOWED: 3 HOURS

QUESTION 1

The Chief Finance Officer of Pramsoman Company Ltd submitted the draft Financial Statements for 2008 financial year to the Executive Committee for preliminary discussions:

i) Income Statement for the year ended 31st December 2008

	Notes	2008 GH¢'000	2007 GH¢'000
Turnover		35,500	30,000
Cost of sales		(15,700)	(14,000)
Gross profit		19,800	16,000
Admin. & distribution costs		(5,800)	(5,000)
Net operating profit		14,000	11,000
Other income		300	200
Net profit before interest & tax		14,300	11,200
Interest charges		(700)	(500)
Profit before taxation		13,600	10,700
Taxation		(3,200)	(2,500)
Net profit after taxation		10,400	8,200

ii) Statement of changes in Equity for the year ended 31st December 2008

	Ordinary Shares GH¢'000	Preference Shares GH¢'000	Share Deals GH¢000	Revaluation Reserve GH¢'000	Income Surplus GH¢'000
Balance at 1/1/08	12,500	2,800	-	-	7,300
Share issue for cash	2,400	-	-	-	-
Bonus issue	500	-	-	-	(500)
Redemption	-	(2,800)	-	-	-
Reissue of treasury shares	-	-	300	-	-
Profit for the year	-	-	-	-	10,400
Dividend	-	-	-	-	(2,000)
Revaluation surplus	-	-	-	700	-
Balance 31/12/08	15,400	-	300	700	15,200

iii) Balance Sheet as at 31st December 2008

	Notes	2008 GH¢'000	2007 GH¢'000
Non-Current Assets:			
Property, Plant and Equipment		27,500	20,000
Current Assets:			
Inventory		14,000	15,500
Trade receivables		13,000	11,000
Investments		9,500	-
Bank		600	1,200
Cash		100	1,100
		37,200	28,800
Current Liabilities		(24,900)	(17,200)
Net Current Assets		12,300	11,600
Non-Current Liabilities:			
Obligation under finance lease		(5,000)	(4,200)
Loan stocks		(2,000)	(4,000)
Deferred tax provision		(1,200)	(800)
		(8,200)	(9,000)
NET ASSETS		31,600	22,600
Financed by:			
Ordinary Shares		15,400	12,500
Preference Shares		-	2,800
Share Deals		300	-
Revaluation Reserves (Capital Surplus)		700	-
Income Surplus		15,200	7,300
		31,600	22,600

iv) Notes to the Financial Statements:

a) During the year, Pramsoman Company Ltd issued shares for cash incurring issue costs of GH¢100,000. Subsequent to this, a bonus issue was made from the income surplus. In September 2008, the entity decided to purchase and cancel all of its preference shares for GH¢2,800,000. The issue cost has been charged to the income statement as part of the administration expenses.

b) Tangible non-current assets include certain properties which were revalued during the year. Assets capitalised under finance lease agreements during the year amounted to GH¢2,800,000. Disposal of assets having a net book value of GH¢1,900,000 realised GH¢2,200,000. The gain is dealt with in the income statement as "other income". Depreciation for the year charged to the income statement was GH¢3,800,000.

c) All the short term investments of GH¢9,500,000 fall within the definition of cash equivalents.

d) Current liabilities can be further analysed as follows:

	31 December 2008 GH¢'000	31 December 2007 GH¢'000
Bank overdrafts	800	2,000
Obligation under finance lease	500	300
Trade payables	21,200	12,700
Corporate tax	1,700	1,200
Dividends	400	800
Interest payable	300	200
	24,900	17,200

e) Part of the loan stocks were redeemed at par during the year.

f) Interest on finance lease of GH¢300 is included in the interest charge in the income statement.

During the preliminary discussions, the Chief Executive Officer was unhappy about the financial statements. He was particularly worried about the liquidity position and did not understand why inspite of profit of GH¢10,400,000, cash should reduce from GH¢2,100,000 in 2007 to GH¢600,000 in 2008. He suspected impropriety on the part of the Chief Finance Officer and the accounting staff.

You are required as the Financial Accountant of Pramsoman Company Ltd to:

(a) (i) Prepare a Cash flow Statement for the year ended 31 December 2008 in compliance with IAS 7 "Cash Flow Statement" together with accompanying notes to allay the fears and suspicion of the Chief Executive Officer.

(16 marks)

(ii) Comment briefly on the cash position of the company as indicated by the Cash Flow Statements.

(4 marks)

(Total: 20 marks)

QUESTION 2

In order to build the capacity to compete with the big firms in Ghana, two medium sized practices, Quality Service Chartered Accountants (QS) and Prestige Assurance Chartered Accountants (PA) agreed to merge their practices with effect from 1st January 2009. The financial positions of the two firms as at 31 December 2008 were as follows:

QS Chartered Accountants:
Balance Sheet as at 31 December 2008

	GH¢'000	GH¢'000
Business premises		7,000
Office equipment		1,000
Receivables from clients		4,000
Work-in-progress unbilled		1,600
Prepayments		100
Cash and cash equivalents		400
		14,100
Financed by:		
Partners Capital Accounts:		
Adom	4,800	
Boafo	3,200	
Nhyira	2,600	
		10,600
Partners' Current Accounts:		
Adom	200	
Boafo	120	
Nhyira	80	
		400
Loan from Adom		2,000
Creditors and accrued expenses		1,100
		14,100

PA Chartered Accountants:
Balance Sheet as at 31 December 2008

	GH¢'000	GH¢'000
Office equipment		1,200
Receivables from clients		2,800
Work-in progress unbilled		1,200
Prepayments		40
Cash and cash equivalents		600
		5,840

Financed by:

Partners Capital Accounts:

Dzibodi	3,200	
Esinam	1,800	5,000
Creditors and accrued expenses		840
		5,840

The profit sharing agreements between the partners of the two firms had been as follows:

	QS Chartered Accountants		PA Chartered Accountants
Adom	40%	Dzibodi	60%
Boafo	40%	Esinam	40%
Nhyira	20%		

As part of the merger process, the partners of the two firms agreed that the fair values of the tangible assets approximate their book values. They further agreed to value each firm to have a net worth equal to two years' purchase of weighted average profit for the three immediate past years.

The profits earned for the past three years were as follows:

		QS GH¢'000	PA GH¢'000	Weights
Year ended 31 December	2006	9,000	4,000	1
	2007	10,500	5,500	2
	2008	14,000	3,000	3

Profits in the merged firm are to be shared as follows:

Adom	25%
Boafo	20%
Nhyira	20%
Dzibodi	20%
Esinam	15%

The merged entity is to be known as Excellent Chartered Accountants.

The goodwill resulting from the new valuations is to be written off from the books of Excellent Chartered Accountants immediately.

You are required to:

i) Determine the amount of Goodwill attributable to each of the two firms. ***(8 marks)***

ii) Prepare the Partners Capital Accounts to determine the initial capital of each of them as partners of Excellent Chartered Accountants.

(*5 marks*)

iii) Draw up the initial balance sheet of Excellent Chartered Accountants.

(*7 marks*)

(Total: 20 marks)

QUESTION 3

a) At a recent meeting of the Board of Joe Ltd, concerns were raised that the company might be over trading.

Extracts from the financial statements of Joe Ltd are as follows:

Income statements for the years ended 31 December:

	2008	2007
	GH¢	GH¢
Turnover	8,300	6,638
Cost of sales	4,900	3,720
Gross profit	3,400	2,918
Administration and distribution expenses	2,700	2,318
	700	600
Interest	125	100
Profit before tax	575	500

Balance sheets extracts as at 31 December:

	2008	2007
	GH¢	GH¢
Property, Plant & Equipment	1,650	1,500
Current Assets		
Inventory	3,200	2,700
Trade receivables	2,750	2,000
Total assets	7,600	6,200
Equity and Liability		
Ordinary shares	400	400
Retained earnings	1,400	1,300
	1,800	1,700

Liabilities		
Trade payables	2,550	1,800
Bank overdraft	2,750	2,300
Other liabilities	500	400
	5,800	4,500
Total equity and liabilities	7,600	6,200

You are required to:

Write a report to the Board of Joe Ltd that analyses the concerns that the company is overtrading. (Attach relevant ratio).

(15 marks)

b) i. State **four (4)** reasons underlying the establishment of the District Assemblies Common Fund.

(4 marks)

ii. Explain the **four (4)** main factors considered in the sharing formula for administering the District Assemblies Common Fund.

(6 marks)

(Total: 25 marks)

QUESTION 4

The proprietress of Travelsafe Transport Services (TTS), Mrs Veronica Owusu, in her quest to expand her fleet of vehicles in the midst of liquidity difficulties, decided to acquire a new bus under a lease arrangement from Augustine Automobile Company (AAC). The lease arrangement commenced on 1st July 2008.

The cost of the vehicle to AAC was GH¢64,000 and the listed cash selling price was GH¢70,000.

The lease arrangement required four annual rental payments in advance of GH¢20,000 each commencing 1st July 2008. The implicit interest rate is 10% per annum. AAC incurred an expenditure of GH¢100 in respect of professional advice on the lease agreement.

The vehicle is estimated to be used for four years after which it would be scrapped at nil value.

Both TTS and AAC prepare accounts to 31 December. Veronica and the Accountant of AAC are unable to reach a consensus as to whether the agreement constitutes a finance lease or an operating lease.

Required:

(a) With reference to IAS 11 "Leases", outline any **four (4)** indications/factors that characterise a lease agreement as a finance lease.

(4 marks)

(b) Prepare extracts of TTC's Income Statement for the year ended 31 December 2008 and Statement of Financial Position (Balance Sheet) as at 31 December 2008 on the assumption that the agreement is

i) a finance lease

(6 marks)

ii) an operating lease

(2 marks)

(c) Prepare extracts of AAC's Income Statement for the year ended 31 December 2008 on the premise that the agreement is a finance lease.

(3 marks)

(Total: 15 marks)

QUESTION 5

a) On 1 January 2005 QRS Company bought machinery at a cost of GH¢80,000. It is the policy of the company to depreciate the machinery at the rate of 25% on straight line basis.

In accordance with tax laws of the country in which QRS Company is domiciled, capital allowance is granted at the rate of 40% per annum, straight line (40% in 2005, 40% in 2006 and 20% in 2007).

Assume that:

i) The only difference for tax purpose is the adjustment for the asset above.

ii) The applicable corporate tax rate is 30%.

You are required to:

Write up the deferred tax account under the Full Provision Method for all the relevant years.

(6 marks)

b) As a general rule, assets should not be carried at amounts greater than those expected to be realised from their sale or use. Outline **five (5)** principal situations in which net realisable value of inventory is likely to be less than cost.

(5 marks)

c) In accordance with IAS 8 "Accounting policies, changes in Accounting Estimates and Errors" outline the **three (3)** conditions under which a change in accounting policy is required/permitted.

(3 marks)

d) ABC company acquired a gari processing machine in January 2006 for an amount of GH¢30,000 and adopted a depreciation policy of 20% per annum on straight line basis. The expected output of the machine was estimated as follows:

Year	Output (bags)
2006	5000
2007	4000
2008	3000
2009	2000
2010	1000

At the commencement of 2008 financial year, the directors realised that using "production units" as basis of depreciation will result in more appropriate presentation than the straight line. They therefore changed the depreciation policy from "straight line" to "production units".

The retained profits balance brought forward from31st December 2007 was GH¢25,000.

Required:

Show how the effect of the change in accounting policy should be reflected in the prior year's figures as well as the relevant extracts in the 2008 Income Statement and Balance Sheet.

(6 marks)

(Total: 20 marks)