1 COMPANY FINAL ACCOUNT

Objectives

At the end of this chapter, students should be able to:

- Explain the uses of Profit and Loss Appropriation account;
- Identify items in the Profit and Loss Appropriation accounts;
- Explain the following: interim and final, dividend, reserves, preliminary expenses;
- Prepare the Profit and Loss Appropriation account;
- Prepare a limited liability company's balance sheet.

1.1 Introduction

The trading account of a company is not different from the trading account of any other business. The profit and loss appropriation account, however, contains certain items which would not be found in the profit and loss account of a sole trader nor the profit and loss appropriation account of a partnership.

Some of these items include:

1. Directors' remuneration
2. Interest and debenture (loans)
3. Dividends paid
4. Auditor's fees
5. Taxation
6. Capital and General Reserves

Note: Salaries of management are expenses to the company because they are hired personnels.

1.2 Uses of a Profit and Loss Appropriation Account

An appropriation account is used to show how profit or loss transferred from profit and loss account is distributed to various reserves and provisions of funds. Provisions and reserves are known as retained earnings. They are authorised by the board of directors for specific purposes such as, capital and general reserves, provision for company taxes, provision for dividends, formation expenses (written-off) known as preliminary expenses. Appropriations are also frequently made for such purposes as sinking funds, contingencies and the reacquisition of debenture, to pay bonus shares and gratuity.

The balance of unappropriated profits are added to undistributed profit at the end of every business operation while the appropriation amounts are shown under separate headings in the balance sheet. The appropriation account of a company
is used for distribution of dividends, reserves and unappropriated profits.

1.3 Appropriation Items

The net profit of a company is carried down to the second section of the profit and loss account termed the profit and loss appropriation account which contains the disposal of net profit which the first section made available for distribution.
Examples are amounts written: off, goodwill, preliminary expenses, reserves etc. These are discussed below.

1. Amounts written-off

In order to ensure that the balance sheet of a company presents the true financial position, the review of sundry debtors account must be done. This will disclose that certain debts are bad debts which are irrecoverable. Such bad debts are written off the book of accounts, either before or at the end of the trading period. Bad debts are losses and must be charged against the profit and loss account.

2. Goodwill

This occurs when a newly-established business takes over and pays for an old business place with the expectation that old customers will continue to patronise it owing to established reputation, monopoly and environmental issues to make
profits. Goodwill is an asset in monetary value, determined by how much one is prepared to pay over and above the net value in anticipation of future profits.

3. Preliminary Expenses

These are expenses incurred on incorporation of companies and issue of shares. They are usually written-off against profits by installments over a period of three to five years.

4. Amount Transferred to Reserve

Allocations or appropriation of profit for general or particular purposes e.g bonus, dividends.

5. Bonuses

These are substantial amounts of accumulated, undistributed profit and loss account. They are bonus shares or script issued to existing shareholders.

6. Dividends

These are a part of company's profit that is divided among the shareholders.

1.4 Preparation of Profit and Loss Appropriation Account

The purpose of the appropriation account is to show how profit or loss transferred from the profit and loss account is distributed to various reserves and provision funds. These are reserves which are authorised by the board of directors. These
provisions and reserves are also known as retained earnings even though they are earmarked for specific purposes such as capital and general reserves, provision for dividend, formation expenses (written-off) known as preliminary expenses. In addition, appropriations are frequently made for such purposes as sinking funds, contingencies and the requisition of debenture, to pay bonus, shares and gratuity. The balance of unappropriated profit is added to undistributed profit at the end of every business operation while the appropriation amounts are shown under separate heading in the balance sheet.

Interim dividend

Interim dividend is a part-payment of the total sum of dividends due to shareholders. A company which is financially healthy every year can declare dividend to be paid to shareholders in two installments for one reason or the other. We indicated before that profit or loss appropriation is to show how profits or losses transferred from the profit and loss account are allocated or appropriated to various classes of fund reserves in accordance with legal requirements or as a result of authorisation by the board of directors. In other words, it is within the power of the board of directors to decide on a number
of appropriations to be made from undistributed profits (retained earnings) account and the purposes. The preparation of an appropriation account for a company is a little different from that of a partnership. The appropriation account for partners shows the allocation of profits among individual partners, while that of a company shows distribution of dividends, reserves, and unappropriated profits.

Example 1.1

MAX 1, a manufacturing company, with authorised share capital of N1,000,000 issued and paid-up capital of N700,000 ordinary shares had a net income of N240,000 from trade in December 31st , 2009.
Prepare the appropriation account for the year ended
December 31, 2009 making such adjustment as you consider required by the following:
(i) A general reserves of N20,000 is to be created
(ii) Provision for the dividend on ordinary shares N12,000
(iii) Retained earnings January 1, 2009
(iv) Goodwill N10,000 to be written-off
(v) The Board of Directors in the general meeting approved the provision of N30,000 for plant expansion
(vi) A sum of N49,000 was allocated for payment of bonuses and gratuity.

Solution

Max 1 Manufacturing Limited

Profit and Loss Appropriation Account for the year ended

	₦ K		₦ K
General reserve	20,000.00	Net Profit from Trading	240,000.00
Dividend on ordinary share	12,000.00		
Goodwill written off	10,000.00		
Plant expansion	30,000.00		
Bonus & Gratuity	49,000.00		
(Retained profit) bal c/d	119,000.00		
	240,000.00		240,000.00

Example 1.2

Abegunde Nigeria Ltd submitted its trial balance as at 31st December, 2009 for preparation of its final accounts share

	₦ K	₦ K
80,000 ordinary		
Shares at ₦1.00 each		80,000.00
Share Premium		20,000.00
Freehold Premises	40,000.00	
Motor Vehicle (cost)	96,000.00	
Director's salary	17,000.00	
Sales	781,220.00	
Purchases	602,840.00	
Stock-in-trade 1/12/2009	53,900.00	

General Expenses	121,200.00	
Profit and Loss account Dec. 2009		14,342.00
Wages and salaries	78,960.00	
Light and heating	92,000.00	
Bank balance	28,976.00	
Cash at bank	10,000.00	
Motor delivery expenses	2,600.00	
Rates and insurance	2,736.00	
Debtors	79,760.00	
Creditors		49,320.00
Discount allowed	9,560.00	
Discount received	5,880.00	
Bad debts	1,140.00	
Provision for bad debts 31st Dec 2009		440.00
	951,212.00	911,212.00

You are given the following additional information:

1. Closing stock (31st Dec, 2009) N25,219
2. Prepayment of rates and insurance to 31st Dec, 2009 N380
3. Bad debts provision increased to N680
4. Provision for depreciation on motor vehicles at 20% per annum on cost
5. Directors recommended a dividend of 10%
6. Outstanding motor expenses as at 31st Dec. 2009 was N224

Prepare a profit and loss account for the year ended 31 stDecember, 2009.

Example 1.3

Using the data in example 1.2, prepare the appropriation account of Abegunde Nig. Ltd for the year ended 31st Dec., 2009.

Abegunde Nigeria Limited

Profit & Loss Appropriation Account for the year ended 2009

	#		#
Director's salary	17,000.00	Net profit from previous year	14,352.00
Provision for dividend	5,974.00	Net profit from P&L	59,658.00
Unappropriated profit	51,136.00		
	74,110.00		74,110.00

Solution 1.2

Abegunde Nigeria Limited

	#		#
Opening stock 1/1/2009	26,950.00	Sales	781,220.00
Purchases	301,420.00		
Goods available	328,370.00		
Less closing stock	25,219.00		
Cost of goods sold	303,151.00		
Gross profit c/d	478,069.00		
	781,220.00		781,220.00

Profit and Loss Account for the year ended 31st December,2009

Expenditures:				
General expenses		23,120.00	Gross profit b/d	174,918.00
Lighting and heating		920.00		
Delivery van expenses		1,300.00		
Add accrued	2,600.00	2,824.00		
Rates and Insurance		1,368.00		
Less Prepaid	380.00	2,356.00		
Discount allowed		9,560.00		
Bad debts		1,140.00		
Bad debts provision (Additional)		240.00		
Motor vehicle		1,920.00		
Depreciation		59,758.00		
Net profit		180,798.00		180,798.00

Use the data from page 7 before the balance sheet.

Layout of the company Balance Sheet.

Balance Sheet as at 31st December 2009

Capita	₦	₦	Fixed Asset	₦	₦	₦
Authorised shares:						
Cost Dep. NB						
Preference shares		xx	Land	xx	xx	
Ordinary shares		xx	Plant	xx	xx	xx
		xx	Buildings	xx	xx	xx
Issued and fully paid:			Equipment	xx	xx	
Preference share		xx	Fixture & Fittings	xx	xx	xx
Ordinary share	xx	xx			xx	xx

[redacted]

			Other Assets:			
			Investment		x	xx
Revenue Reserve		xx	Current Assets:			
General Reserve		xx	Stock: W I P	xx		
Premium Account	xx		Finished goods		xx	xx
Profit and Loss Debtors						xx
Account	xx	xx	Prepayments			xx
Undistributed						
Profit		xx	Cash in bank			
Long term Liabilities:			Cash in hand			xx
Debenture		xx				
Motgages	xx					
Government loan	xx	xx				
Motgages	xx					
Government	xx	xx				
Current Liabilities:						
Accrued wages	xx					
Salaries	xx					
Creditors	xx					
Note payable	xx					
	xx					xx

Fig. 1.1 The format of a company's Balance Sheet

N.B AD = Average Depreciation

ABV = Average Book Value

Preparation of the Balance Sheet

In our previous lesson on sole proprietorship and partnership, students were shown how assets and liabilities are usually classified and grouped under headings in the balance sheet. The disclosure of the items are highly emphasized in the Companies Act of 1990.

The act stipulates particular items to be disclosed, namely: the Statement of Accounting Standards (SAS) published by the Nigerian Accounting Standard Board, (NASB), which requires classification of items into specific classes. The liabilities consist of capital reserves, long-term loan, and current liabilities, while the assets are divided into fictitious, fixed, others, and current assets. The liabilities are on the left hand side while the assets are on the right hand side of the balance sheet. The proforma of balance sheet in fig.1.1 shows the classification of the items as required by the Companies Act of 1990.

Example 1.4

Using the data in example 1.2, prepare the balance sheet of Abegunde Nig. Ltd. as at 31st December, 2009.

Abegunde Nigeria Limited

Balance Sheet As At 31st December 2009

Capital:			Fixed Assets			
Authorized & Issued Capital			Freehold premises		20,000	80,000
Ordinary share atmotor Vehicle		4,800				
N1.00 each		80,000.00	Depreciation	960	3,840	23,840
Share Premium	20,000,00	100,000				
Net profit previous year		14,353.00	Current Assets			
			Stock		25,219	
Unappropriated profit			Cash at bank		14,488	
Profit		36,784.00	Cash at hand		50	
Appropriated			Prepaid Insurance		190	
Profit-Dividend	5,874.00	56,110.00	Debtors	39,880		
			Less prov.	340	3 9,540	79,487
Current Liabilities:						
Creditors	49,320.00					
Accrued:						
Motor Vehicle	224.00	49,544				
		103,327				103,327

1.1 Analysis and Interpretation

The present classification of final accounts of companies always facilitates their analysis and interpretation. The final accounts must satisfy the needs of final users, such users include management, government agents, tax authorities,

labour union, bankers, creditors, investors and suppliers. The information which is of primary concern to the owners of the business and the outsiders is the business solvency that is, its ability to meet current obligations to creditors, investors, suppliers and the organization itself.In determining a business.

solvency, special ratio and measurement called accounting ratio are used.

1. Primary ratio:

There is a difference of opinion among authorities over what exactly the primary ratio is. Several interpretations are available, but among them the most widely acceptable are:

i. It is the ratio of net profit to the paid-up capital. If this statement is accepted, the primary ratio is calculated as:

$$\frac{\text{Net profit}}{\text{Paid-up capital}} \times 100$$

ii. It is the ratio of net profit to equity.

Equity is the total of ordinary shares capital and retained earnings (reserves). If this statement is accepted, primary ratio is calculated as:

$$\frac{\text{Net profit}}{\text{Paid-up ordinary shares + Reserves}} \times 100$$

This definition of the primary ratio is the most generally accepted.

iii. It is the ratio of net profit before interest on long-term liabilities to capital employed. Capital employed is the total of equity and long-term liabilities. Going by this, the primary ratio is:

$$\frac{\text{Net profit before interest on long-term liabilities}}{\text{Equity + long-term liabilities}} \times \frac{100}{1}$$

2. Accounting Ratio for Assessment of Solvency Position of a Business:

i. Working Capital: $\frac{\text{Excess of current asset}}{\text{Over current liabilities}}$

ii. Working Capital Ratio: $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

(It is used as a comparative ratio not as a percentage)

iii. Quick Asset Ratio or Acid ratio

Quick Asset = Current liabilities (Quick assets include cash in hand, cash at bank, short term investments and good debtors). Quick assets ratio = Current Asset Stock/Current liabilities

iv. Solvency level is expressed as percentage of current asset that would need to be liquidated to meet all Current liabilities. Current assets to current liabilities ratios is an important ratio that determines the immediate solvency of any business.

3. Current Ratio or Working Capital Ratio:

Current ratio is obtained by taking total current asset and divide by total current liabilities. This gives the ratio of current assets to current liabilities. This ratio is usually referred to as the current ratio, the working capital ratio or the banker's ratio. The current ratio measures the ability of a business concern to meet its

current obligations. For trading or manufacturing business, a ratio less than 2 to 1 is regarded as unsatisfactory.

4. Various Stock Ratios

(a) Average stock

(i) When opening and closing stocks are given:

(b) Average stock = Opening stock + Closing stock

(ii) When cost of sales and rate of stock turn over are given

$$\text{Average} = \frac{\text{Cost of sales}}{\text{Rate of stock turn}}$$

(c) Rate of stock turnover

When cost of sales and average stock are given:

$$\text{Rate of stock turnover} = \frac{\text{Cost of Sales}}{\text{Average stock}}$$

(d) Opening Stock:

(i) When closing stock, cost of sales and purchases are given:

Opening stock = (cost of sales + closing stock) purchases

(ii) When average stock and opening stock are given:

Closing stock = (Average Stock x 2) + opening stock

(i) When closing stock, cost of sales and purchases are given:

Opening stock = (cost of sales + closing stock) purchases

(ii) When average stock and opening stock are given:

Closing stock = (Average Stock x 2) opening stock

5. Cost of Sales

(a) When opening stock, closing stock and purchases are given:

Cost of Sales = (opening stock + purchases) closing stock

(b) When sales and gross profit margin (or mark up) are given.

Cost of Sales = Sales-Gross Profit

(c) When average stock and rate of stock turn are given:

Cost of sales = Average stock x Rate of Stock Turn.

1.5 Summary

- Final accounts are also called financial statements which refer to two major financial reports that the public is usually anxious to see. These are the profit and loss account and the balance sheet.
- Trading, profit and loss account are also called revenue statements and income statements respectively while the balance sheet is also called statement of financial position or statement of financial condition; a balance sheet is a photograph of the financial status of a firm at an particular period.
- The purpose of appropriation account is to show how profits transferred from the profit and loss statement/account are distributed to various appropriated or reserves accounts.

- Interim payment of dividend is a part of the total dividend declared and approved for payment to be made at the end of each company's fiscal year.
- The asset side of the liabilities are the claims against the assets.
- The ownership equity section is the excess of the asset over the liabilities.
- The liabilities measure the interest or ownership of the creditors including suppliers in the total assets.
- In company accounts, the ownership equity is also called shareholder's equity or capital.
- Shareholder's equity is divided into two sections, namely; direct investment capital stock and the Reserves which include retained earnings.
- A balance sheet can be prepared in either T-form or vertical form.
- A balance sheet is usually classified as current or short term items and non-current or long-term items.
- There is a difference between preparation of a sole proprietorship.s capital section of the balance sheet and that of the limited liability companies.
- In presenting the shareholders equity section in the balance sheet, there should be distinction between capital invested in the normal process of buying shares and that acquired through accumulation of earnings.
- In reporting paid-in capital in the balance sheet, we should be showed capital and retained earnings (capital) separately.
- The share premium should also be indicated in the balance sheet as paid-in capital while the discounted shares should be indicated too.
- In determining a business solvency, special ratios and measurements called accounting ratios are used. Examples are primary ratio, accounting ratio for assessment of solvency position of a business, current ratio or working capital ratio, stock ratios and cost of sales.

1.6 Revision Questions

1. The profit of a company is always shared in the form of:
(A) commission
(B) salaries
(C) interest
(D) dividend

2. In the final accounts of a company, the purpose of the appropriation account is to show
(A) whether the company has made a gross profit or gross loss
(B) whether the company has made a net profit or net loss
(C) how dividends are shared to shareholders
(D) how profit transferred from profit or loss account are distributed to various reserves.

3. In companies account, trading, profit and loss account is called?
(A) shareholder's account
(B) appropriation account
(C) income statement account
4. The following are the examples of intangible fixed assets except ___________.

(A) fitting
(B) goodwill
(C) patent law
(D) trademark

5. The excess of any provision made on either depreciation renewal or diminition value of asset is known as _____________.
(A) appropriated earnings
(B) retained earning
(C) reserves
(D) profits

6. (a) What is the main purpose of a balance sheet?
(b) Give an example of a balance sheet equation in accounting form.

7. Briefly explain the purpose of:
(a) Profit or Loss appropriation Accounts
(b) Preliminary Expenses
(c) Reserves

8. Explain the following terms:
(a) Interim and final dividends
(b) Preliminary expenses
(c) Reserves

9. The authorised capital of Ibukun Olu Ltd which commenced business on 1 January 2009 is N120,000 made up of N20,000 made up of 6% preference shares of N1.00 each and 100,000 ordinary shares of N1.00 each.
The following balances were extracted from the books on 31 December, 2009:

	₦
Preference share capita	20,000
Ordinary share capital	80,000
Calls in arrears	2,000
Premises (at cost)	68,000
Plant & Machinery (at cost)	30,000
Fixtures and Fittings	6,000
Provision for depreciation:	
Plant & Machinery	6,000
Fixtures & Fittings	600
Provision for bad and doubtful debts	300
Stock 31 December, 2009 7,000Debtors	6,300
Cash at bank	2,000
Cash at hand	70
Creditors	900
Profit for the year ended 31, December 2009	13,570

The directors decided to transfer 300 to reserve while 50% dividend was recommended on ordinary shares. Prepare the appropriation account and the balance sheet of

10. **Olawale Company Ltd**

Balance Sheet as at 31st December 2009

Liabilities	#	Assets	#
Trade creditors	10,500	Freehold premises	24,000
Expenses accrued	800	Plant & Machinery	10,000
Bank overdraft	2,000	Furniture & Fitting	6,000
Fixed loan	6,000	Stock20,000	
Capital Account	43,000	Debtors	14,000
		Prepayments	400

the company for the year ended 31st December, 2009 From the above balance asset, calculate the following:

(a) total capital employed

(b) fixed assets

(c) current assets

(d) current liabilities

(e) working capital

11. Prepare a properly classified balance sheet for the Uzoma Uso limited from the information that follows

Uzoma Uso Sales Limited

	₦		₦
Creditors	48,300	Preferred shares at	100
		Per share	100
Debtors	92,000		
Notes Payable	70,000	Premium on ordinary share	20,000
Accrued Expenses	4,200	Plant & Equipment	

	₦		₦
Salaries payable	3,000	Land	100,000
Miscellaneous prepaid expenses			
Cash in banks	37,000	Cash in hand	3,200
Notes receivable	21,000	Tools	12,000
Stock:		Buildings	100,000
Finished goods	39,000	Machinery	130,000

	₦		₦
Raw material	52,000	Investment in subsidiary	130,000
Goods in progress	60,000	Company	170,000
4% Bonds payable		Depreciation:	180,000
Ordinary shares at		Machinery etc	42,000
N1.00 per share		Retained earnings	200,000
		Balance previous year	9,700
		Appropriated funds	110,000
		Unappropriated:	
		Net profit	30,000