

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL ONE

FINANCIAL ACCOUNTING – PAPER 1

MONDAY, 16 JUNE 2008

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Attempt all questions in Sections **A** and **B**, any **two** questions from Section **C** and any **one** from Section **D**.
3. Section **A** has **twenty** compulsory multiple-choice questions each carrying 1 mark.
4. Section **B** has **one** compulsory question carrying 30 marks.
5. Section **C** has **three** and only **two** questions are to be attempted. Each question carries 20 marks.
6. Section **D** has **two** questions and only **one** question is to be attempted. Each question carries 10 marks.
7. Please read further instructions on the answer book.

SECTION A**Question 1**

- (i) Which of the following equations are **NOT** true?
- (i) Assets - Liabilities + Owners' Equity = Zero.
 - (ii) Assets = Liabilities + Owners' Equity.
 - (iii) Assets - Liabilities = Owners' Equity.
 - (iv) Assets - Owners' Equity = Liabilities.
 - (v) Assets + Liabilities = Owners' Equity.
- (a) (ii) and (iii).
 - (b) (i) and (v).
 - (c) (iii) and (iv).
 - (d) (ii) and (iv).
- (ii) The nature of an asset is best described as:
- (a) Something with physical form that is valued at cost in the accounting records.
 - (b) An economic resource owned by a business and expected to benefit future operations.
 - (c) An economic resource representing cash or the right to receive cash in the near future.
 - (d) Something owned by a business that has a ready market value.
- (iii) XYZ Ltd, a newly formed company, incurred the following costs related to land and building:
- Plan approval fees for the building Shs 4 Million.
 - Title search fees Shs 20,000.
 - Cash paid for land with a building to be demolished Shs 230 million.
 - Excavation for construction of basement of new building Shs 36 million.
 - Removal of old building Shs 34 million less salvage of Shs 9 million = Shs 25 million.
- At what amount should XYZ Ltd record the land only?
- (a) Shs 304,020,000.
 - (b) Shs 295,020,000.
 - (c) Shs 264,020,000.
 - (d) Shs 255,020,000.

- (iv) A material overstatement in closing inventory was discovered after the financial statements of a company were finalised. What effect did this error have on the financial statements?

	Current assets	Gross profit
(a)	Understated	Overstated
(b)	Overstated	Overstated
(c)	Understated	Understated
(d)	Overstated	Understated

- (v) In the annual report, where would a financial statement reader find out if the company's financial statements give a fair depiction of its financial position and operating results?

- (a) Notes to the financial statements.
- (b) Balance sheet and income statement.
- (c) Management discussion and analysis section.
- (d) Auditor's report.

- (vi) A company normally sells its products for Shs 20,000 per unit, which includes a profit margin of 25%. However, the selling price has fallen to Shs 15,000 per unit. The company's current inventory consists of 200 units purchased at Shs 16,000 per unit. Replacement cost has now fallen to Shs 13,000 per unit. Calculate the value of inventory at the lower of cost or market value.

- (a) Shs 3,200,000.
- (b) Shs 2,600,000.
- (c) Shs 3,000,000.
- (d) Shs 4,000,000.

- (vii) A company purchased a plant on 1 January 2006 for Shs 540,000,000 and has a salvage value of Shs 40,000,000. Depreciation is provided for at the rate of 20% per annum using the reducing balance method.

Compute its depreciation expense for the year ended 31 December 2007.

- (a) Shs 80,000,000.
- (b) Shs 86,400,000.
- (c) Shs 100,000,000.
- (d) Shs 108,000,000.

- (viii) Which of the following statements concerning the similarities between a general partnership and a company is correct?
- (a) Company shareholders and general partners have limited personal liability.
 - (b) Companies and general partnerships have perpetual existence.
 - (c) Companies and general partnerships can declare bankruptcy.
 - (d) Companies and general partnerships are recognized taxpayers by Uganda Revenue Authority.
- (ix) A bank reconciliation is performed in order to:
- (a) verify the accuracy of the company's recorded cash balance.
 - (b) ensure that all bank loans have been properly accounted for.
 - (c) verify that all cash disbursements are for a legitimate business purpose.
 - (d) verify that only authorized personnel signed the disbursement cheques.
- (x) A company opened a fixed deposit account with its bankers on 1 June 2007. It was agreed that interest payment dates be 1 April and 1 October each year. Interest income for the year ended 31 December 2007 was for a period of :
- (a) 3 months.
 - (b) 4 months.
 - (c) 6 months.
 - (d) 7 months.
- (xi) The double entry principle states that:
- (a) for every debit there is an equal credit.
 - (b) total assets must match total liabilities and owners' equity.
 - (c) expenses should be recognized in the same accounting period in which they generated revenue.
 - (d) total debits equal total credits.
- (xii) Which of the following statements regarding receivables is true?
- (a) A receivable arises when a company buys goods or services from another party on credit.
 - (b) Accounts receivable are more formal than notes receivable.
 - (c) Accounts receivable are often called trade receivables.
 - (d) Accounts receivable is a miscellaneous category that may include loans to employees.

- (xiii) A company has been unable to collect an account receivable of Shs 1,000,000 and writes it off by reducing the provision for doubtful debts account. What entry must be made when the debtor eventually pays the entire Shs 1,000,000?
- (a) Debit bad debts recovered account Shs 1,000,000
Credit accounts receivable account Shs 1,000,000.
 - (b) Debit accounts receivable account Shs 1,000,000
Credit provision for doubtful debts account Shs 1,000,000.
 - (c) Debit cash account Shs 1,000,000
Credit accounts receivable account Shs 1,000,000.
 - (d) Both (b) and (c) are required.
- (xiv) XYZ Ltd had the following information for the year ended 30 June 2008:
- Opening inventory Shs 400,000
Purchases Shs 990,000
Closing inventory Shs 350,000
- The gross profit as a percentage of sales is always 20%.
- Based on these figures, what is the sales revenue for the year?
- (a) Shs 1,248,000
 - (b) Shs 1,300,000
 - (c) Shs 1,040,000
 - (d) Shs 1,740,000
- (xv) Which of the following is a summary of the transactions in partnership dissolution?
- (a) Gains and losses on the sale of assets are divided pro rata to capital balances and the final cash payment to the partners is based on the profit and loss sharing ratios.
 - (b) Gains and losses on the sale of assets are divided according to the profit and loss sharing ratios and the final cash payment to the partners is pro rata to the capital balances.
 - (c) Gains and losses on the sale of assets and the final cash payment to the partners are divided according to the profit and loss sharing ratios.
 - (d) Gains on the sale of assets and final cash payment to the partners are pro rata to the capital balances and losses divided according to the profit and loss sharing ratios.

- (xvi) Financial statements are prepared:
- (a) only for publicly owned business organizations.
 - (b) for companies, but not for sole proprietorships or partnerships.
 - (c) primarily for the benefit of persons outside of the business organization.
 - (d) in either monetary or non-monetary terms, depending upon the need of the decision maker(s).
- (xvii) The matching principle:
- (a) applies only to situations in which a cash payment occurs before an expense is recognized.
 - (b) applies only to situations in which a cash receipt occurs before revenue is recognized.
 - (c) is used in accrual accounting to determine the proper period for recognition of expenses and revenues.
 - (d) is used in double entry to determine the proper period in which to recognize revenue.
- (xviii) In preparing a company's cash flow statement, which, if any, of the following items could form part of the calculation of cash flow from financing activities?
- (a) Bonus issue of shares.
 - (b) Dividends received.
 - (c) Proceeds from sale of premises.
 - (d) Rights issue of shares.
- (xix) Which of the following is an underlying assumption?
- (a) Consistency concept.
 - (b) Historical cost concept.
 - (c) Going concern concept.
 - (d) Prudence concept.
- (xx) Which of the following combinations gives the four principal qualitative characteristics of financial statements?
- (a) Understandability, reliability, relevance, comparability.
 - (b) Understandability, prudence, relevance, comparability.
 - (c) Understandability, reliability, relevance, materiality.
 - (d) Completeness, reliability, relevance, comparability.

SECTION B**Question 2**

Moses owns a small business and keeps all the accounting records himself on a computer using basic accounting software. He does not understand financial statements and therefore never uses this part of the software. He does, however, regularly print out the analysis of the receipts and payments in and out of his bank account. Unfortunately, his software was corrupted and lost all the data. Moses has now approached you to prepare the accounts for him from the available records.

He has provided you with the balance sheet as at 31 May 2007, the previous year end set out below.

Balance Sheet as at 31 May 2007

	Shs '000'	Shs '000'	Shs '000'
Non-current assets (Net book value)			
Office equipment		30,000	
Furniture		<u>15,000</u>	45,000
Current assets			
Bank		600	
Trade receivables	11,400		
Less provision	<u>600</u>	10,800	
Insurance prepaid		1,800	
Inventory		<u>7,200</u>	<u>20,400</u>
Total Assets			<u>65,400</u>
Liabilities and owner's equity.			
Current liabilities			
Trade payables		9,600	
Accrued electricity bill		<u>600</u>	10,200
Long-term liabilities			
10% Loan			6,000
Owner's equity			
Capital			<u>49,200</u>
Total liabilities and owner's equity			<u>65,400</u>

You also obtained the following information:

- 1 The following payments appeared on the bank statement for the year ended 31 May 2008:

Particulars	Shs '000	Remarks
Payments to suppliers	81,000	Moses takes a cash discount of 10% on invoice amount on all payments to suppliers.
Water and electricity	9,000	Shs 800,000 for May 2008 was paid on 10 June 2008.
New equipment	7,200	
General expenses	4,800	
Insurance	1,800	Includes a prepayment of Shs 600,000.
Stationery & printing	5,400	
Loan interest	300	Shs 300,000 was paid on 1 June 2008.
Drawings	12,000	Moses also took goods from the business worth Shs 1,200,000.

- 2 The following receipts appeared on the bank statement for the year ended 31 May 2008:

	Shs '000
Receipts from sales	129,000
Sale of old equipment	1,200

- 3 The following relate to cheques dated before 31 May 2008 but not presented by that date:

	Shs '000
General expenses	360
Stationery & printing	180

- 4 At 31 May 2008 the following balances were also available:

	Shs '000	
Trade receivables	12,600	Excludes bad debts of Shs 1,200,000
Trade payables	10,800	
Inventory	6,000	

- 5 You also establish the following information:

- (i) The net book value of the old equipment which was sold was Shs 1,800,000.

- (ii) Depreciation is charged on the net book value at the year end:
- | | |
|------------------|-----|
| Office equipment | 25% |
| Furniture | 20% |
- (iii) A general provision is made for doubtful debts of 5% of trade receivables.

Required:

- (a) Prepare Moses' income statement for the year ended 31 May 2008.
(18 marks)
- (b) Prepare Moses' balance sheet as at 31 May 2008.
(10 marks)
- (c) After Moses' financial statements had been prepared, Moses is surprised that the Shs 1,200,000 he received when he sold his old computer does not appear in the financial statements. Explain to Moses why Shs 1,200,000 does not appear in the financial statements.
(2 marks)
(Total 30 marks)

SECTION C

Question 3

You have been provided with the following trial balance as at 31 May 2008 for XYZ Ltd.

	Dr Shs '000	Cr Shs '000
Bank	150,000	
Inventory 1 June 2007	3,600,000	
General expenses	1,800,000	
Electricity	270,000	
Marketing and advertising expenses	744,000	
Salaries	1,470,000	
Buildings at cost	15,000,000	
Motor vehicles at cost	480,000	
Plant and equipment at cost	2,100,000	
Accumulated profits 1 June 2007		840,000
Trade receivables	1,314,000	
Purchases	6,600,000	
Loan interest paid	90,000	
5% Loan		1,800,000
Revenue		17,628,000
Discounts received		450,000
Trade payables		1,500,000
Shs 1,000 ordinary shares		4,500,000
Accumulated depreciation 1 June 2007		
Buildings		6,000,000
Motor vehicles		180,000
Plant and equipment	-	720,000
Total	<u>33,618,000</u>	<u>33,618,000</u>

The following notes are relevant:

1. Inventory at 31 May 2008 was valued at Shs 2,400,000,000.
2. Marketing and advertising expenses include Shs 18,000,000 paid in advance for a marketing campaign scheduled to begin in June 2008.
3. There were salaries outstanding of Shs 30,000,000 for the year ended 31 May 2008.
4. A customer ceased trading owing the company Shs 114,000,000. The debt is not expected to be recovered.
5. An allowance for doubtful debts is to be established at 5% of trade receivables.

6. Depreciation is to be provided for as follows:
- (i) Buildings at 5% per annum on their original cost.
 - (ii) Motor vehicles at 25% per annum of their written down value.
 - (iii) Plant and equipment at 20% per annum of their written down value.
7. The audit fee is estimated to be Shs 60,000,000.

Required:

- (a) Prepare the income statement for XYZ Ltd for the year ended 31 May 2008.
(10 marks)
- (b) Prepare the balance sheet for XYZ Ltd as at 31 May 2008.
(7 marks)
- (c) Briefly explain the purpose of providing for depreciation and identify the factors to be taken into account when deciding on which depreciation method to use.
(3 marks)
- (Total 20 marks)**

Question 4

Rocky Ltd's balance sheets as at 31 December 2006 and 2007, and its income statement for the year ended 31 December 2007 are shown below.

Rocky Ltd issued no new ordinary shares during the year.

During 2007 Rocky Ltd spent Shs 87 million on non-current assets additions. There were no non-current assets disposals during the year ended 31 December 2007.

Balance sheets	2007	2006
	Shs million	Shs million
Non- current assets	<u>811</u>	<u>826</u>
Current assets		
Inventories	45	53
Trade receivables	172	160
Prepayments	17	21
Cash and bank	<u>7</u>	<u>3</u>
	<u>241</u>	<u>237</u>
Total assets	<u>1,052</u>	<u>1,063</u>
Current liabilities		
Overdraft	11	10
Trade payables	39	51
Accruals	24	20
Dividends	78	65
Taxation	<u>47</u>	<u>30</u>
	<u>199</u>	<u>176</u>
Long-term liabilities		
Bank loan	<u>195</u>	<u>325</u>
Capital & reserves		
Share capital	260	260
Share premium	52	52
Revaluation reserve	90	90
Retained profits	<u>256</u>	<u>160</u>
	<u>658</u>	<u>562</u>
Total capital & liabilities	<u>1,052</u>	<u>1,063</u>

Income statement	Shs million
Turnover	810
Cost of sales	<u>(459)</u>
Gross profit	351
Distribution and administrative costs	<u>(131)</u>
	220
Other operating income	<u>17</u>
Operating profit	237
Interest receivable	<u>18</u>
	255
Interest payable	<u>(34)</u>
Profit before tax	221
Tax on profit from ordinary activities	<u>(47)</u>
Profit from ordinary activities after tax	174
Retained profit 1 January 2007	<u>160</u>
	334
Proposed dividends	<u>(78)</u>
Retained profit 31 December 2007	<u>256</u>

Required:

In accordance with **IAS 7**: Cash Flow Statements, prepare a cash flow statement with supporting schedules for Rocky Ltd for the year ended 31 December 2007 using the indirect method.

(20 marks)**Question 5**

On 31 May 2008 the bank column of Goodman Ltd's cash book showed a debit balance of Shs. 3,000,000. The monthly bank statement written up to 31 May 2008 showed a credit balance of Shs. 5,161,000. On checking the cash book with the bank statement, it was discovered that the following transactions had not been entered in the cashbook:

1. Dividends of Shs. 480,000 had been paid directly from the bank.
2. A VAT refund of Shs. 520,000 had been collected by the bank.
3. Bank interest of Shs. 160,000 had been credited to the bank statement.
4. Bank charges of Shs. 60,000 had been debited on the bank statement.
5. A direct debit of Shs. 140,000 for professional subscription had been paid by the bank.
6. A standing order of Shs. 400,000 for loan repayment had been paid by the bank.
7. The deposit account balance of Shs. 2,800,000 had been transferred into the entity's current account.

8. A cheque received from Mr. Lawrence Tugume, and credited in the bank statement has now been dishonoured and debited in the bank statement on 30 May 2008. The only entry for this cheque in the cash book is the receipt on 5 May 2008 of Shs. 290,000.
9. A further check revealed the following items:
- Cheque No. 100190 for Shs. 150,000 had been recorded twice as a credit in the cash book.
 - Cheque No. 100199 for Shs 310,000 in favour of Mr. Mukwano had been correctly recorded in the bank statement but included in the cash book as Shs. 301,000.
 - Two cheques drawn in favour of Mr. Kodere Shs. 250,000 and Mr. Hamling Shs. 560,000 had been entered in the cash book but had not yet been presented for payment.
 - Cash and cheques amounting Shs. 900,000 had been paid into the bank on 31 May 2008 but were not credited by the bank until 2 June 2008.

Required:

- (a) Starting with a debit balance of Shs. 3,000,000, bring the cash book up to date and balance it off.
- (b) Prepare a bank reconciliation statement for May 2008.

(15 marks)

(5 marks)

(Total 20 marks)

SECTION D

Question 6

- (a) What is the importance of regulating financial reporting?
(3 marks)
 - (b) Give **three** different forms of financial reporting regulation you know.
(3 marks)
 - (c) Briefly explain any **four** steps the International Accounting Standards Board (IASB) goes through when setting a standard.
(4 marks)
- (Total 10 marks)**

Question 7

- (a) Briefly explain **three** types of errors that may be revealed by extraction of a trial balance.
(3 marks)
 - (b) Identify any **five** potential users of financial statements giving a brief example of each group's information needs.
(5 marks)
 - (c) Explain how the liability of a limited company differs from the liability of a sole trader, in respect of amounts owed to others?
(2 marks)
- (Total 10 marks)**