THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Foundation Examinations Autumn 2009

September 11, 2009

INTRODUCTION TO FINANCIAL ACCOUNTING (MARKS 100)

Module B **(3 hours)**

Q.1 (a) Briefly explain the term 'substance over form' and give an appropriate example. **(03)**

(b) Identify whether the following statements are true or false and give brief reasons to support your conclusion:

(i) The concept of separate entity is not applicable to a partnership.
(ii) Revenue is not recognized in the period in which it is received.
(iii) In case of fixed assets, fair value is always greater than the historical cost.
(iv) According to IAS-2, inventories may be valued using LIFO, FIFO or weighted average method.
(v) According to IAS-2, inventory is valued on the basis of cost or current replacement cost, whichever is less.
(vi) Running finance is a short term liability although it may not be paid in full for many years.
(vii) Closing stock does not appear in the pre-closing trial balance but appears in the post-closing trial balance.
(viii) The concept of going concern supposes that the life of business entity will be more than 15 years.
(ix) When the provision for bad debts is based on age analysis, the opening balance of provision for doubtful debts is not taken into consideration.
(x) Net realizable value of inventories is equal to selling price.
(xi) In a partnership, profit is always shared in the ratio of capital introduced by each partner.
(xii) The 'prudence' concept allows a business to build substantially higher reserves/provisions than are actually required. **(12)**

Q.2 The trial balance prepared by A.A. Enterprise showed a difference of Rs. 47,090 which was put on the credit side of a suspense account. An investigation disclosed that:

(i) The total of purchase return day book amounting to Rs. 16,160 had not been posted to the ledger.
(ii) Discount received amounting to Rs. 11,320 had been debited to discount allowed account.
(iii) The sales account had been added short by Rs. 10,000.
(iv) An asset bought four years ago for Rs. 7,000 and depreciated to Rs. 1,200 had been sold for Rs. 1,500 at the beginning of the year. The receipt of cash has been posted in the bank book but corresponding entries have not been recorded.
(v) A credit sale of Rs. 1,470 had been credited to the customer's account as Rs. 1,740.
A bad debt of Rs. 1,560 has to be written off. Provision for doubtful debts is to be maintained at 10% of debtors. Debtors appearing in the trial balance are Rs. 23,390 and the provision for bad debts account shows a credit balance of Rs. 2,320.
(vi) A sub-total of Rs. 29,830 on the list of closing stock had been carried over as Rs. 29,380 and another sheet had been overcast by Rs. 1,000.

Required:
Pass rectification/adjustment entries to correct the above errors. ***(Narrations are not required)*** **(11)**

Q.3 Shafiq Ahmad is in the business of sun-flower oil. He expanded his business considerably during the year ended June 30, 2009 but did not maintain proper books of account. He has now extracted the following details from a register maintained at the business premises:

Summary of receipts and payments

	Rupees
Receipts:	
Additional capital injected	1,000,000
From debtors	4,713,750
From insurance company for damaged stock	30,000
Cost of transportation recovered from customers	200,000
Payments:	
Landlord	192,000
Salaries	248,000
Fuel and maintenance of delivery trucks	224,000
Miscellaneous office expenses	112,000
Personal income-tax	50,000
Transfer to 12% fixed deposit (on Feb. 1, 2009)	200,000
Suppliers	3,200,000
Cost of transportation paid to suppliers	250,000
Purchase of truck and initial repair thereof	360,000

From the income tax file for year ended June 30, 2008, he determined the following balances:

	Rupees
Capital	497,300
Creditors for oil purchases	1,200,000
Creditors for expenses: - Rent for June 2008	16,000
- Salaries	4,000
Cash and bank	75,000
Debtors	160,000
Provision for bad debts	48,000
Stock of oil (1,250 tins)	1,250,000
Furniture	30,000
Accumulated depreciation on furniture	5,700
Delivery trucks	400,000
Accumulated depreciation on trucks	144,000

On scrutiny of the other records, he was able to gather the following information:

(i) 2,800 tins of oil were sold during the year at Rs. 2,000 each.
(ii) 3,000 tins were purchased during the year at Rs. 1,200 each. 50 tins were damaged in transit against which insurance claim of Rs. 30,000 was received. The damaged tins were sold for Rs. 15,000 and the amount is included in receipt from debtors. Two tins were withdrawn for personal use and ten tins were gifted to a charity.
(iii) 50 tins were declared unfit for health, by the quality inspection department and could either be sold at Rs. 1,000 each or reprocessed by a third party, at a further cost of Rs. 900 each. A decision in this regard has not been made so far.
(iv) A second-hand delivery truck costing Rs. 300,000 was purchased on April 1, 2009 by paying cash. Rs. 60,000 were spent to bring it in proper operating condition.
(v) Rs. 10,000 were paid for registration of the truck and a fee of Rs. 18,000 was paid for obtaining fitness certificate which is valid for three years. These amounts are included in fuel and maintenance expenses shown above.
(vi) Debtors amounting to Rs. 60,000 were written off during the year. Bad debts are estimated at 2% of sales.
(vii) Depreciation is charged from the date of purchase. The rate of depreciation is 10% and 20% of WDV on furniture and delivery trucks respectively.
(viii) Stock is valued on weighted average basis.

Required:
(a) Trading & profit and loss account for the year ended June 30, 2009.
(b) Balance sheet as at June 30, 2009. **(25)**

Q.4 P, Q and R are partners sharing profit in the ratio of their capitals. Their balance sheet at June 30, 2009 was as follows:

Balance Sheet
At June 30, 2009

			Rupees			**Rupees**
Creditors and accrued expenses			485,000	Cash in hand		65,000
Loan from Q			625,000	Cash at bank		450,000
Capitals:	P	640,000		Investments (market value 435,000)		300,000
	Q	320,000		Debtors	400,000	
	R	480,000	1,440,000	Less: Provision	60,000	340,000
				Stocks		500,000
				Land and building		450,000
				Motor cars		350,000
				Equipments		95,000
			2,550,000			2,550,000

On July 1, 2009 R retired and his share was ascertained after taking into account the following:

(i) Provision against debtors and stocks was adjusted at 10% and 5% respectively.
(ii) The investments were revalued according to market. Of these, investments costing Rs. 180,000 were taken over by R at their market value of Rs. 160,000.
(iii) A motor car having a book value of Rs. 150,000 was taken over by R for Rs. 200,000.
(iv) R's share of goodwill was agreed at Rs. 216,000.

Thereafter, S was admitted as a partner on the basis of the adjusted balance sheet. He was given one-fourth share in the profits and he brought proportionate share of capital and goodwill. The basis of valuation of goodwill for the purpose of admission of S as a partner was the same as at the time of R's retirement.

Required:
Prepare capital accounts of the partners in columnar form and the balance sheet of the firm as at July 1, 2009 after the admission of S, assuming that goodwill is not retained in the books of account. **(18)**

Q.5 Khan Limited closes its accounts on June 30 each year. The company was unable to take stock of physical inventory until July 14, 2009 on which date the physical inventory was valued at Rs. 185,000. The following details are available in respect of the period July 1 to July 14, 2009:

(i) Payments against purchases amounted to Rs. 48,000 and included:
- Rs. 5,000 in respect of goods received on June 28, 2009;
- Rs. 6,000 in respect of goods received on July 18, 2009;
- Rs. 2,000 in respect of goods received and returned to supplier on the same date i.e. July 7, 2009.

(ii) Collection against sales amounted to Rs. 60,000 and included:
- Rs. 1,500 in respect of goods which left the warehouse on June 29, 2009;
- Rs. 2,800 in respect of goods which were not dispatched until July 15, 2009;
- Rs. 760 in respect of goods invoiced and dispatched on July 10, 2009 but returned by the customers on July 12. These were included in the stock taken on July 14, 2009.

(iii) The rate of gross profit is 25% of selling price with the exception of an isolated purchase on July 7, 2009 of 100 similar articles. Of these, 60 units were sold on July 10, 2009 for Rs. 7,500. Payment against purchase of these articles and the sale proceeds as referred above are included in purchases and sales referred to in para (i) and (ii) respectively.

(iv) Goods costing Rs. 6,000 were purchased on June 28 but remained unpaid till July 24, 2009.

(v) An invoice amounting to Rs. 10,000 was raised on July 9, 2009 but remained uncollected till July 14, 2009.

(vi) An item costing Rs. 9,000 which had been purchased on June 25, 2009 was damaged on July 4, 2009. It can be repaired at a cost of Rs. 1,000 and sold for Rs. 7,000 and has been taken in stock at its net realizable value.

(vii) Stock count sheets prepared on July 14, 2009 showed the following discrepancies:
- A page total of Rs. 5,000 had been carried to the summary as Rs. 6,000.
- The total of another page had been undercast by Rs. 200.

(viii) Included in the physical count were goods costing Rs. 2,200 which were held on behalf of a supplier.

Required:
Determine the amount of stock required to be disclosed in the financial statements as at June 30, 2009. **(15)**

Q.6 The accountant of Aslam, Bashir & Company, a partnership concern, has finalized the draft financial statements for the year ended June 30, 2009. Mr. Bashir is not satisfied with the fixed assets reported in the above financial statements and have asked you to review the same.

The details of fixed assets appearing in the financial statements are as follows:

	Useful life (Years)	-------------------- Rupees --------------------			
		2009	**2008**	**2009**	**2008**
		Cost		**Accumulated Depreciation**	
Land		5,000,000	5,000,000	-	-
Building	20	7,250,000	7,000,000	4,562,500	4,200,000
Plant & Machinery	15	11,910,000	10,000,000	3,994,000	3,200,000
Furniture and Fixtures	10	3,075,000	3,000,000	2,257,500	1,950,000

Depreciation is provided on straight line basis from the date of purchase to the date of sale.

An analysis of the working papers has revealed that the details of additions/deletions to fixed assets are as follows:

(i) In January 2009, Rs. 200,000 were spent on the extension of the underground water tank and Rs. 50,000 were spent on fumigation of the entire building.

(ii) On March 31, 2009 a generator which had completed five years of its life was replaced by another generator. The cost of new generator was Rs. 2,000,000 whereas the supplier allowed 10% of the cost of the old generator as trade-in-allowance. As a result, the company made a payment of Rs. 1,910,000 only.

(iii) On July 1, 2008 fully depreciated furniture costing Rs. 400,000 was repaired at a cost of Rs. 75,000. It is expected that the repairs would allow the furniture to be used for the next five years.

Required:
Prepare necessary journal entries to record the required corrections. **(16)**

(THE END)