CAT

Certified Accounting Technicians Examination

Stage: Level 2 L2.1

Subject Title: Financial Accounting

Examination Format Revision Pack

iCPAR
INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA
Driving Sustainable Performance

INSIDE COVER - BLANK

FINANCIAL ACCOUNTING
LEVEL 2

L2.1 EXAMINATION FORMAT REVISION QUESTIONS & SOLUTIONS

NOTES

You are required to answer Question 1. You are also required to answer any three out of Questions 2 to 5.
(If you provide answers to all of Questions 2 to 5, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first three answers to hand for Questions 2 to 5 will be marked.)

Note: Students have optional use of the Extended Trial Balance, which if used, must be included in the answer booklet.

PRO-FORMA STATEMENT OF COMPREHENSIVE INCOME BY NATURE, STATEMENT OF COMPREHENSIVE INCOME BY FUNCTION AND STATEMENT OF FINANCIAL POSITION (BALANCE SHEET) ARE PROVIDED

TIME ALLOWED:
3.5 hours, plus 10 minutes to read the paper.

INSTRUCTIONS:
During the reading time you may write notes on the examination paper but you may not commence writing in your answer book.

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

Start your answer to each question on a new page.

You are reminded that candidates are expected to pay particular attention to their communication skills and care must be taken regarding the format and literacy of the solutions. The marking system will take into account the content of the candidates' answers and the extent to which answers are supported with relevant legislation, case law or examples where appropriate.

List on the cover of each answer booklet, in the space provided, the number of each question(s) attempted.

QUESTION 1

(a) List and briefly explain five barriers to international harmonisation / convergence in financial reporting.

(10 marks)

(b) The following trial balance was extracted from the books of TT Ltd. as at 31 March 2008:

	Debit	Credit
	Rwf '000	Rwf '000
Property (Buildings) (Cost Rwf720,000,000)	600,000	
Plant and equipment (Cost Rwf600,000,000)	340,000	
Vehicles (Cost Rwf128,000,000)	94,000	
Retained earnings		227,160
Ordinary shares Rwf250 each		320,000
Share Premium account		120,000
8% Debentures		80,000
Discounts	9,200	
Returns		3,480
Inventory of Raw Mats, Stock and FG etc.	126,800	
Purchases / Sales	542,400	1,374,800
Trade accounts receivable	73,760	
Trade accounts payable		49,280
Returns	3,120	
Discounts		12,800
Provision for doubtful debts		2,240
Bank	7,040	
Ordinary dividends	7,200	
Rent and rates	55,200	
Postage and stationery	12,800	
Wages and salaries	307,200	
Motor expenses	11,040	
	2,189,760	2,189,760

The following additional information is available:

1. During the year an extension to the buildings was erected.

Materials costing Rwf12,000,000 were specially purchased for this job and in addition inventory having a selling price of Rwf12,000,000 (mark up of 50%) was used. All were put through purchases and trade accounts payable, though the special materials had not been paid for on 31 March.

2. Inventory on hand 31 March 2008: Rwf140,680,000.
3. Inventory on hand at 1 April 2007 had been overstated by Rwf8,000,000.
4. A customer has gone into liquidation and you are advised to write off the full balance owing Rwf1,760,000.
5. The provision for doubtful debts should be 5% of trade accounts receivable.
6. The annual charge for rates is Rwf24,000,000 and these are paid up to 30 June 2008.
7. Depreciation is provided on assets held at Statement of Financial Position (balance sheet) date as follows:

a) Buildings: 2% on cost.
b) Plant and machinery: 20% on cost.
c) Vehicles: 25% on written down value.

8. During the year Rwf12,000,000 was credited to sales. This had been the proceeds from the issue of 4,000 ordinary shares.
9. Dividends paid during the year were as follows:
    a. Final dividend for the year to 31 March 2007: Rwf4,000,000.
    b. Interim dividend for the year to 31 March 2008: Rwf3,200,000.
    c. The directors are considering that the final dividend for the year to 31 March 2008 will be Rwf30 per share.

REQUIRED:
Prepare, for internal use, an Statement of Comprehensive Income for the year ending 31 March 2008 and a draft Statement of Financial Position (balance sheet) as at that date. Please show all workings.

(30 Marks)
(Total: 40 marks)

QUESTION 2

Historical cost accounting has been the normal method of accounting in most countries for many years.

REQUIRED:

(a) Explain four respects in which the use of historical cost accounting may distort financial statements or their interpretation.

(12 marks)

(b) Give four reasons why historical cost accounting continues in use despite its limitations.

(8 marks)
(Total: 20 marks)

QUESTION 3

JMG Ltd is a retailer based in Kigali with a branch in Gisenyi. The following trial balances have been extracted from the books of account as at 30 June 2007:

	Kigali		Gisenyi	
	Dr	**Cr**	**Dr**	**Cr**
	Rwf m	Rwf m	Rwf m	Rwf m
Fixed assets	3,150		900	
Accumulated depreciation		1,260		270
Current a/cs	1,575			1,080
Goods sent to branch	-	3,420	3,375	
Inventory	72		180	
Capital	-	2,106		
Purchases / Sales	8,226	7,650		3,933
Provision for unrealised profit	-	36		
Provision for doubtful debts	-	45		18
Distribution expenses	720		45	
Administrative expenses	180		144	
Receivables / Payables	540	450	540	
Drawings	360		-	
Bank	144		117	
	14,967	14,967	5,301	5,301

Additional Information:
1. All goods are purchased by Kigali. Those goods sent to Gisenyi are invoiced at cost plus 25%.
2. Stocks were valued at 30 June 2007: Kigali Rwf108 m; Gisenyi Rwf135m invoice price.
3. Depreciation is to be provided for the year on fixed assets at a rate of 10% on cost.
4. The provision for doubtful debts is to be maintained at a rate of 5%.
5. As at the 30 June 2007, there was Rwf450,000,000 cash in transit from Gisenyi to Kigali. Goods invoiced at Rwf45,000,000 were in transit from Kigali to Gisenyi.

REQUIRED:

Prepare in adjacent columns: (a) the head office, (b) the branch and (c) the combined Statement of Comprehensive Incomes for the year ended 30 June 2007; and a combined Statement of Financial Position (balance sheet) as at that date.

(Total: 20 marks)

QUESTION 4

A meeting of the Directors of PEP Ltd is scheduled to discuss the following matters with a view to finalising the accounts for the year ending 31 December 2007:

(1) On the 17 January 2008 Walsh Ltd. who owed PEP Ltd Rwf50 million went into liquidation and it is expected that nothing will be recovered. The debt has been written off and charged in full in the Statement of Comprehensive Income for the year ended 31 December 2007.

(7 marks)

(2) An ex-employee of PEP Ltd has commenced proceedings against PEP for unfair dismissal. The legal advice available to PEP is that the claim is unlikely to succeed but if it does the award is likely to be Rwf150 million. The legal costs are expected to be Rwf25m even if the claim is unsuccessful. **(6 marks)**

(3) During 2006 PEP Ltd decided to enter the Far East tourist market. During 2007 a large sum was spent on investigating particular areas of this market and some proposals are at an early stage of development. Because the sums involved are large, some consider that the costs should be spread evenly over this year and the next four years. **(7 marks)**

REQUIRED:

Advise the board of PEP on the accounting treatment of these issues. Your answer should include an explanation of the provisions of the relevant accounting regulations.

(Total: 20 marks)

QUESTION 5

The following are extracts from the financial statements of FGG Ltd:

Statement of Financial Position (balance sheet)s as at 31 December

	2007		2006	
	Rwf m	Rwf m	Rwf m	Rwf m
Non-Current assets				
Deferred development expenditure		1,605		1,395
Freehold land		18,000		13,500
Plant and machinery		5,850		6,345
Investments (at cost)		3,600		3,750
		29,055		24,990
Current assets				
Inventory	10,050		8,700	
Trade Receivables	6,150		7,800	
Short term investments	1,710		840	
Cash	195		435	
	18,105		17,775	
Current Liabilities				
Trade payables	5,850		5,250	
Corporation Tax	1,275		975	
Bank overdraft	2,385		6,540	
	9,510		12,765	
Working capital		8,595		5,010
		37,650		30,000
12% Debentures 2004 – 2009		7,500		9,000
		30,150		21,000

Appropriation account for the year ended 31 December 2007

	Rwf m
Net profit before tax	2,400
Tax	900
Profit after tax	1,500
Dividends	600
Retained profit for the year	900

Notes:

1. Profit for the year is after charging:

	Rwf m
Depreciation on plant and machinery	1,155
Development expenditure	90

2. During the year plant with a net book value of Rwf750 m was sold for Rwf1,470 m. The assets had originally cost Rwf3,000 m.
3. Debentures were redeemed on 30 June 2007.
4. Dividends: Proposed at 31 Dec 2006 and paid in April 2007: Rwf450 m. Paid September 2007: Rwf150 m. Proposed at 31 Dec 2007: Rwf500 m.

REQUIRED:

Prepare a cash flow statement for FGG Ltd for the year ended 31 December 2007.

(Total: 20 marks)

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SUGGESTED SOLUTIONS

SOLUTION 1

(a) Any five of the following or similar:

(i) Different purposes of financial reporting. In some countries the purpose is solely for tax assessment, while in others is for investor decision-making.

(ii) Different legal systems. These prevent the development of certain accounting practices and restrict the options available.

(iii) Different user groups. Countries have different ideas about who the relevant user groups are and their respective importance. In the USA investor and creditor groups are given prominence, while in Europe employees enjoy a higher profile.

(iv) Needs of developing countries. Developing countries are obviously behind in the standard setting process and they need to develop the basic standards and principles already in place in most developed countries.

(v) Nationalism is demonstrated in an unwillingness to accept another country's standard.

(vi) Cultural differences result in objectives for accounting systems differing from country to country.

(vii) Unique circumstances. Some countries may be experiencing unusual circumstances which affect all aspects of everyday life and impinge on the ability of companies to produce proper reports, for example hyperinflation, civil war, currency restrictions and so on.

(viii) The lack of strong accountancy bodies. Many countries do not have strong independent accountancy or business bodies which would press for better standards and greater harmonisation.

TT Ltd

Statement of Comprehensive Income for year ended 31 March 2008

	Rwf '000	Rwf '000	Rwf '000
Revenue			1,362,800
Less returns			3,120
			1,359,680
Cost of sales			
Inventory 1/4/2007		118,800	
Purchases	522,400		
Less Returns:	3,480	518,920	
		637,720	
Inventory 31/3/2008		140,680	497,040
Gross profit			862,640
Discount received			12,800
			875,440
Provision for bad debts		1,360	
Debenture interest		6,400	
Depreciation:			
Buildings	14,800		
Plant & machinery	120,000		
Vehicles	23,500	158,300	
Discounts allowed		9,200	
Bad debts		1,760	
Rent and rates		49,200	
Postage and stationery		12,800	
Wages and salaries		307,200	
Motor expenses		11,040	557,260
			318,180
Dividends: Ordinary paid			7200
Retained			310,980
Balance c/f	227,160	8,000	219,160
Balance b/f			530,140

Statement of Financial Position at 31 March 2008

	Rwf '000	Rwf '000	Rwf '000
Non current assets	Cost	Dep'n	
Property: Buildings	740,000	134,800	605,200
Plant and equipment	600,000	380,000	220,000
Vehicles	128,000	57,500	70,500
	1,468,000	572,300	895,700
Current assets			
Inventories		140,680	
Trade and other receivables	72,000		
Provision for doubtful debts	3,600	68,400	
Bank		7,040	
Prepayment		6,000	222,120
Total assets			1,117,820
Equity and liabilities			
Ordinary shares Rwf 250 each		321,000	
Share Premium account		131,000	
Retained earnings		530,140	982,140
Long term liabilities			
8% Debentures			80,000
Current liabilities			
Trade and other payables	49,280		
Debenture interest	6,400		55,680
			1,117,820

Notes to A1 TT Ltd	*TB*			Adjustments	Statement of Comprehensive Income		Statement of Financial Position (balance sheet)	
	Dr Rwf '000	Cr Rwf '000	Note	Dr / (Cr) Rwf '000	Dr Rwf '000	Cr Rwf '000	Assets Rwf '000	Liabilities Rwf '000
Property (Buildings) (Cost Rwf720 m)	720,000			20,000			740,000	
Plant and equipment (Cost Rwf600m)	600,000						600,000	
Vehicles (CostRwf128m)	128,000						128,000	
Retained earnings		227,160	2	8,000	310,980			530,140
Dep. Property (Buildings)		120,000			14,800			134,800
Dep. Plant and equipment		260,000			120,000			380,000
Vehicles (Cost Rwf128 m)		34,000			23,500			57,500
Ordinary shares Rwf250 each		320,000		(1,000)				321,000
Share Premium account		120,000		(11,000)				131,000
8% Debentures		80,000						80,000
Discounts	9,200				9,200			
Returns		3,480				3,480		
Inventory	126,800		2	(8,000)	118,800	140,680	140,680	
Purchases	542,400		4	(20,000)	522,400			
Sales		1,374,800		12,000		1,362,800		
Trade accounts receivable	73,760				1,760		72,000	
Trade accounts payable		49,280						49,280
Returns	3,120				3,120			
Discounts		12,800				12,800		
Provision for doubtful debts		2,240			1,360			3,600
Bank	7,040						7,040	
Ordinary dividends	7,200				7,200			
Rent and rates	55,200				49,200		6,000	
Postage and stationery	12,800				12,800			
Debenture Interest					6,400			6,400
Wages and salaries	307,200				307,200			
Motor expenses	11,040				11,040			
	2,603,760	2,603,760		-	1,519,760	1,519,760	1,693,720	1,693,720

SOLUTION 2

(a)

(i) Fixed asset values are unrealistic. This is particularly marked when one looks at how property values can increase. Land and buildings stated at historical cost will be so undervalued that it could be argued that it affects the true and fair view. The sale of such property would result in a large holding gain being realized in one accounting period rather than over the period in which it was owned.

(ii) Depreciation is inadequate to finance the replacement of fixed assets. Linked with this is that the Statement of Comprehensive Income does not fully reflect the value of the asset consumed during the accounting year, thus leading to an overstatement of profits.

(iii) Holding gains on inventories are included in profit. During a period of high inflation the monetary value of inventories held may increase significantly while they are being processed. The conventions of historical cost accounting result in the realized part of the holding gain being included in profit for the year.

(iv) the true effect of inflation on capital maintenance is not shown. In effect, by failing to take this into account before calculating profit available for distribution, dividends may effectively be paid out of capital.

(b)

Despite its limitations, historical cost accounting is still used for a number of reasons:
(i) Historical cost accounts are easy to prepare and easy for users to understand. All of the ‘inflation accounts’ proposed over the last 25 years have been difficult or time consuming to prepare and difficult for users to understand.

(ii) In times of low inflation, historical cost convention costs give as true and fair a view of a company's position as any other convention. This is particularly true where fixed assets are included at valuation.

(iii) Fixed asset revaluation is allowed, reducing the problem of underestimating values.

(iv) Figures are objective and verifiable because they are tied to an actual transaction.

SOLUTION 3

JMG Ltd

Statement of Comprehensive Income for the year ended 30 June 2007

	Kigali		Gisenyi		Total	
		Rwf m		Rwf m		Rwf m
Sales		7,650		3,933		11,583
Cost of sales						
Inventory 1/7/05	72		144		216	
Purchases	8,226				8,226	
	8,298				8,442	
Goods sent to branch	(2,700)		2,700			
	5,598		2,844			
Inventory 30/6/06	144	5,454	108	2,736	252	8,190
Gross profit		2,196		1,197		3,393
Depreciation	315		90		405	
Distribution costs	720		45			
Admin. Expenses	180		144			
Bad debt provision	(18)	1,197	9	288	(9)	1,485
Net profit		999		909		1,908

Statement of Financial Position as at 30 June 2007

			Rwf m
Fixed Assets			4,050
Less depreciation			1,935
			2,115
Current Assets			
Inventory			
		252	
T. receivables	1,080		
Prov. b.d.	54	1,026	
Bank		711	
		1,989	
Current Liabilities			
T. payables		450	1,539
			3,654

			Rwf m
Capital	Balance	1/7/05	2,106
Net profit			1,908
			4,014
Drawings			
			360
			3,654

SOLUTION 4

(1) This is a 'post Statement of Financial Position (balance sheet) event' as defined in IAS 10. It is an event, either favourable or unfavourable, which occurs between the Statement of Financial Position (balance sheet) date and the date on which the financial statements are authorised for issue. They may be either adjusting or non-adjusting in nature. The IAS states that:

- An enterprise should adjust its financial statements for events after the Statement of Financial Position (balance sheet) date that provide further evidence of conditions that existed at the end of the reporting period, including events that indicate that the going concern assumption in relation to the whole or part of the enterprise is not appropriate.
- An enterprise should not adjust its financial statements for events after the Statement of Financial Position (balance sheet) date that are indicative of conditions that arose after the Statement of Financial Position (balance sheet) date;
- An enterprise should disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the enterprise's owners or others have the power to amend the financial statements after issue, the enterprise should disclose that fact; and
- An enterprise should update disclosures that relate to conditions that existed at the Statement of Financial Position (balance sheet) date in the light of any new information that it receives after the Statement of Financial Position (balance sheet) date about those conditions.

The insolvency of a debtor (trade account receivable), on the grounds that it provides additional evidence of a condition existing at the Statement of Financial Position (balance sheet) date applies here. Hence a provision for this bad debt should be made in the financial statements - *Indeed it has. It has been written off.*

(2) IAS 37 defines a contingent liability as:

- A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the enterprise’s control; or
- A present obligation that arises from past events but is not recognised because:

It is not probable that a transfer of economic benefits will be required to settle the obligation;
or
The amount of the obligation cannot be measured with sufficient reliability.

If an obligation is probable it is not a contingent liability and a provision should be made.
An entity should never recognise a contingent liability. The IAS requires a contingent liability to be disclosed unless the possibility of any outflow of economic benefits to settle it is remote.

As the claim is unlikely to succeed, the potential settlement of Rwf150 million should be not disclosed as a contingent liability. However, given that the legal costs of Rwf25million must be paid whether the claim is successful or not, this amount should be provided for in the PEP's financial statements.

(3) This proposal is not in accordance with the requirements of IAS 38 as it is a research project i.e. original and planned investigation undertaken with the prospect of gaining new scientific knowledge or understanding.
This requires research costs to be written off in full to the Statement of Comprehensive Income in the accounting period in which they are incurred. There is no scope for capitalising such costs and amortising them over a number of years unless the expenditure relates to capital expenditure on research facilities.

Development costs may only be deferred to future periods when all of the following criteria are met:

- The product or process is clearly defined and the costs attributable to the product or process can be separately identified and measured reliably
- The product or process is technically feasible
- The enterprise intends to produce and market the product or process and has the ability to do so.
- The existence of a market for the product or process or, if it is to be used internally rather than sold, its usefulness to the enterprise can be demonstrated
- Overall profit expected
- Resources exist to complete project

SOLUTION 5

FGG Ltd
Cash flow statement for the year ended 31 December 2007.

	Rwf m	Rwf m	Rwf m
Cash flows from operating activities			
Net profit before tax		3,390	
Add: Depreciation			
Buildings	1,155		
Development	90		
Profit on disposals	(720)	525	
		3,915	
Less: Increase in inventories		1,350	
		2,565	
Add: Decrease in receivables	1,650		
Increase in trade payables	600	2,250	
Cash generated from operations		4,815	
Interest received			
Interest paid		(990)	
Dividends paid		(600)	
Corporation tax paid		(600)	
Net cash flows from operating activities			2,625
Cash flows from investing activities			
Purchase of property , plant and equipment		(1,410)	
Proceeds from sale of property , plant and equipment		1,470	
Development expenditure		(300)	
Receipts from sale of investments		150	
Net cash outflow from investing activities			(90)
Cash flows from financing activities			
Issue of shares		3,750	
Debentures redeemed		(1,500)	
Purchase of short-term investments.			
Net cash from financing activities			2,250
Increase in cash and cash equivalents			4,785

Notes to the cash flow statement

Analysis of the balances of cash and cash equivalents as shown in the Statement of Financial Position (balance sheet).

	2007	2006	Change in Year
	Rwf m	Rwf m	Rwf m
Cash in hand	195	435	(240)
Overdrafts	(2,385)	(6,540)	4,155
Short term investments	1,710	840	870
	(480)	(5,265)	4,785

Marking scheme

Question 1

(a) 2 marks for each	10
(b) Notes adjustments	20
Statement of Comprehensive Income 5	
Statement of Financial Position (balance sheet) 5	
	Total 40

Question 2

(a) 4 x3	12
(b) 4 x2	8
	Total 20

Question 3

(a) 15 marks for Statement of Comprehensive Incomes 15	
(b) 5 marks for Statement of Financial Position (balance sheet) 5	
	Total 20

Question 4

(1)	7
(2)	6
(3)	7
	Total 20

Question 5

Operating activities	10
Investing activities & financing activities	10
	Total 20

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FINANCIAL ACCOUNTING

LEVEL 2

L2.1 EXAMINATION FORMAT REVISION QUESTIONS & SOLUTIONS

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List on the cover of each answer booklet, in the space provided, the number of each question(s) attempted.

QUESTION 1

(a) List and define five elements of financial statements as identified in the Framework for the Preparation and Presentation of Financial Statements.

(10 marks)

(b) The following trial balance was extracted from the books of Sligo Ltd as at 31 December 2009:

	Debit	Credit
	Rwf m	Rwf m
Retained profit	-	12,000
Ordinary shares Rwf2,500 each	-	75,000
Share premium account	-	10,000
10% Debentures 2020	-	200,000
Buildings	300,000	-
Land	50,000	-
Plant and machinery	25,000	-
Vehicles	70,000	-
Provision for depreciation:	-	-
Buildings	-	90,000
Plant and machinery	-	10,000
Vehicles	-	30,375
Discounts	2,000	2,500
Returns	3,500	4,000
Inventory	22,000	-
Purchases/revenue	225,000	427,625
Rents and rates	25,000	-
Carriage	7,000	-
Postage and stationery	4,000	-
Debenture interest paid	10,000	-
Wages and salaries	70,000	-
Bad debts	3,250	-
VAT	2,000	-
Electricity	3,000	-
Trade receivables/trade payables	74,000	42,750
Provision for doubtful debts	-	3,000
Bank	5,500	-
Interim ordinary dividends paid	6,000	-
	907,250	907,250

The following additional information is available:

1. Inventory on hand 31 December 2009 was valued at Rwf22,000,000. This includes the following items, which were valued at cost price.
(i) On 1st January 2009, Sligo Ltd purchased a machine, for the factory, at a cost of Rwf2,000,000. This has been recorded as a purchase of goods for resale in the books.
(ii) An item of inventory which was damaged during the year. This item of inventory had a cost price of Rwf1,000,000 and a net realisable value of Rwf600,000.

2. Included in revenue is an amount of Rwf25,000,000 for goods sent on approval to a customer. The mark up on these goods was 25%.

3. Carriage in the trial balance comprises carriage inwards of Rwf3,000,000, with the remainder being carriage outwards.

4. A customer has been declared bankrupt owing Rwf1,500,000. This is to be written off.

5. The provision from doubtful debts should be 5% of trade receivables.

6. Included in the revenue figure is an amount of Rwf4,000,000, which was the sales proceeds from the disposal of a motor vehicle during the year. The vehicle was purchased for Rwf10,000 during 2007.

7. Depreciation is provided on non-current assets as follows:

Buildings: 2% on cost
Plant & machinery: 20% on cost
Vehicles: 25% on written down value

A full year's depreciation is charged in the year of purchase and none in the year of sale.

8. On 20 December 2009, the Directors of Sligo Ltd proposed a final dividend of 500 francs per share. This was approved for payment at a subsequent meeting of the Board of Directors on 30 December. The ordinary dividend figure of Rwf6,000,000, in the trial balance, relates to an interim dividend that was declared and paid during 2009.

9. The debenture interest outstanding should be provided for.

10. When preparing the accounts at 31 December 2008, closing inventory was overvalued by Rwf5,000,000. This has not been corrected in the accounts.

11. At the 31 December 2009 the company had the following accruals and prepayments:

Accruals

Electricity Rwf500,000
Rates Rwf1,000,000

Prepayments

Rent Rwf5,000,000

REQUIREMENT:

Prepare, for internal use, a Statement of Comprehensive Income for the year ending 31 December 2009 and a Statement of Financial Position as at that date.

(30 marks)

(Total: 40 Marks)

QUESTION 2

You have just attended a conference on IAS 18 *Revenue*. On your return to the office, the Managing Director has asked you to prepare a report, for him, in relation to IAS 18. Your report should:

(a) State the definition of revenue. **(3 marks)**

(b) State how revenue should be measured in financial statements. **(2 marks)**

(c) Describe the conditions that should be satisfied before revenue from the sale of goods should be recognised in the financial statements. **(6 marks)**

(d) Describe how revenue from interest, royalties and dividends are recognised in financial statements. **(6 marks)**

(e) List three disclosure requirements of IAS 18. **(3 marks)**

(Total: 20 marks)

QUESTION 3

(a) In relation to IAS 10 ' *Events after the Reporting Period*" explain the following terms:

(i) Events after the reporting period

(ii) Adjusting events

(iii) Non-adjusting events **(4 marks)**

(b) In relation to IAS 37 *'Provisions, Contingent Liabilities and Contingent Assets'* define the following terms:

(i) Provision

(ii) Contingent liability

(iii) Contingent asset **(6 marks)**

(c) A meeting of the Directors of ADG Ltd is scheduled for 30 September 2010 to discuss the following matters with a view to finalising the accounts for the year ending 30 June 2010:

i. A fire occurred in one of the warehouses of ADG Ltd on 3 July 2010, destroying inventory which had a cost price of Rwf100,000 and a net realisable value of Rwf150,000.

ii. In July 2010, ADG Ltd received information that one of their largest customers had gone bankrupt. At 30 June 2010, this customer owed ADG Ltd Rwf235,000. It is anticipated that ADG Ltd will now only receive 10 cents for every Rwf1 they were owed.

iii. In July 2010, ADG Ltd sold inventory which had been in one of their warehouses for the past two years, for Rwf75,000. This had been included in the financial statements, for the year ended 30 June 2010, as its cost price of Rwf105,000.

iv. On 30 June 2010, an employee of ADG Ltd fell and injured her back at work. This employee has commenced legal action. The Solicitor for ADG Ltd informed the company on 10 August 2010, that it is probable they will be found liable and have to pay this employee Rwf33,000. The employee has worked for ADG Ltd for the past 4 years.

REQUIREMENT:
Advise the board on the accounting treatment of these issues. Your answer should give a detailed reason for the accounting treatment that you have chosen. **(10 marks)**

(Total: 20 Marks)

QUESTION 4

Tommy Norton is a retailer in Kigali with a branch in Bwakira. The following trial balances have been extracted from the books of account as at 31 December 2011:

	Kigali		Bwakira	
	Dr	Cr	Dr	Cr
	Rwf m	Rwf m	Rwf m	Rwf m
Inventory	16		40	
Capital		600		
Purchase/Revenue	1,828	1,700		884
Administrative expenses	40		42	
Trade receivables/trade payables	120	100	120	
Drawings	80			
Non Current assets	700		200	
Accumulated depreciation		280		60
Current accounts	350			240
Goods sent to branch		760	750	
Provision for unrealised profit		8		
Provision for doubtful debts		10		4
Distribution expenses	160		10	
Bank	164		26	
	3,458	3,458	1,188	1,188

Additional information:

1. All goods are purchased by Kigali. Those goods sent to Bwakira are invoiced at cost plus 25%.
2. Inventories were valued at 30 June 2010: Kigali Rwf24,000,000; Bwakira Rwf30,000,000 invoice price.
3. Depreciation is to be provided for the year on non-current assets at a rate of 10% on cost.
4. The provision for doubtful debts is to be maintained at a rate of 5%.
5. As at 30 June 2010, there was Rwf100,000,000 cash in transit from Bwakira to Kigali. Goods invoiced at Rwf10,000,000 were in transit from Kigali to Bwakira.

REQUIREMENT:

Prepare in adjacent columns: (a) the head office, (b) the branch and (c) the combined income statements for the year ended 31 December 2011; and a combined statement of financial position as at that date.

(Total: 20 Marks)

QUESTION 5

The following are extracts from the financial statements of ULS Ltd:

Statement of Financial Position as at 31 December:	2008	2009
Assets		
Non Current Assets	Rwf m	Rwf m
Land	2,000	2,400
Plant and equipment	3,400	6,700
Fixtures and fittings	2,000	2,500
	7,400	11,600
Current assets		
Inventory	1,000	1,160
Trade receivables	460	720
Cash	360	15
	1,820	1,895
Total Assets	9,220	13,495
Equity & Liabilities		
Share Capital & reserves		
Ordinary share capital	6,740	9,000
Share premium	300	600
Land Revaluation	-	400
Retained profit	940	2,104
	7,980	12,104
Non Current liabilities		
10% Debentures 2020	200	-
Current Liabilities		
Trade payables	730	900
Bank overdraft	20	131
Corporation tax	290	360
	1,040	1,391
Total Equity & liabilities	9,220	13,495

Extract of Statement of Comprehensive Income for the year ended 31 December 2009

	Rwf m
Net profit before tax	2,064
Taxation	(360)
Net profit after tax	1,704

The following additional information is provided in relation to the year ended 31 December 2009:

• Plant and machinery with a book value of Rwf400,000,000 was sold for Rwf360,000,000.
• Depreciation provided on fixtures and fittings amounted to Rwf500m and on plant and equipment amounted to Rwf900m.
• The debentures were redeemed on 31 December 2009.
• In July ULS Ltd paid an interim dividend of Rwf540m.
• No land or fixtures and fittings were disposed of during the period.

REQUIREMENT:

(a) In relation to IAS 7 explain what is meant by the term 'cash equivalents'. **(3 marks)**

(b) Describe two benefits, from an investor's perspective, of analysing the information portrayed in a cash-flow statement. **(2 marks)**

(c) Prepare for ULS Ltd, a Cash-Flow Statement for the year ended 31 December 2009, in accordance with the requirements of IAS 7. **(15 marks)**

(Total: 20 Marks)

SUGGESTED SOLUTIONS

SOLUTION 1

(a) The elements of financial statements
The elements of financial statements are the building blocks with which financial statements are constructed.

The Framework for the Preparation and Presentation of Financial Statements identifies the elements as follows:

(i) Assets: a resource controlled by an entity as a result of a past event and from which future economic benefits are expected to flow to the entity.

(ii) Liabilities: a present obligation arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits

(iii) Equity: the residual interest in the assets of an entity after deducting all its liabilities, so EQUITY = NET ASSETS = SHARE CAPITAL + RESERVES

(iv) Income: Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity

(v) Expenses: decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or increases of liabilities that result in decreases in equity

(b)

Income statement of Sligo Ltd for year ended 31 December 2009

	Rwf m	Rwf m
Revenue (w1)	398,625.00	
Returns	(3,500.00)	395,125.00
Less Cost of Sales		
Opening inventory (w8)	(17,000.00)	
Purchases (w12)	(223,000.00)	
Carriage inwards	(3,000.00)	
Returns	4,000.00	
Closing inventory (w5)	39,600.00	(199,400.00)
Gross Profit		195,725.00
loss on disposal of vehicle (w6)		(1,625.00)
Reduction in bad debt provision		625.00
Discount received		2,500.00
		197,225.00
Less Expenses		
Discount allowed	2,000.00	
Carriage outwards	4,000.00	
Postage and advertising	4,000.00	
Bad debts (w4)	4,750.00	
Electricity (w11)	3,500.00	
Rent & rates (w11)	21,000.00	
Wages and salaries	70,000.00	
Depreciation (w7)		
Buildings	6,000.00	
Motor vehicles	8,500.00	
Plant & machinery	5,400.00	
Debenture interest (w11)	20,000.00	(149,150.00)
Net profit		48,075.00

Appropriation account	Rwf m
Net profit	48,075.00
Ordinary dividends proposed (w9)	(15,000.00)
ordinary dividends paid	(6,000.00)
Retained profit b/f(w8)	7,000.00
Retained profit c/f	34,075.00

Statement of Financial Position of Sligo Ltd as at 31 December 2009

	Rwf m	Rwf m	Rwf m
Assets			
Non-Current (w7)	Cost	Dep'n	NBV
Land	50000		50,000
Buildings	300000	96,000	204,000
Motor vehicles	60000	34,500	25,500
Plant and machinery	27000	15,400	11,600
	437000	145900	291100
Current Assets			
Trade receivables (w2)	47500		
Bad debt provision (w3)	-2375	45125	
Bank		5500	
VAT		2000	
Closing inventory (w5)		39600	
Rent prepaid		5000	97225
Total Assets			388325
Equity and Liabilities			
Equity			
Ordinary share capital			75000
Share premium			10000
Retained profit			34075
			119075
Non-Current Liabilities			
10% Debentures 2020			200000
Current Liabilities			
Trade payables		42750	
Rates due		1000	
Electricity due		500	
Proposed ordinary dividend (w8)		15000	
Debenture interest due (w10)		10000	69250
Total equity and liabilities			388325

Workings

	Rwf m
1. Revenue	
As per trial balance	427,625
Less sale or return	(25,000)
Less sales proceeds	(4,000)
	398,625

2. Trade receivables

As per trial balance	74,000
Less sale or return	(25,000)
Bad debt to write off	1,500
	50,500

3. Provision for bad debts

Opening provision (trial balance)	(3,000)
Income statement	625
Required closing provision [47,500*5%]	(2,375)

4. Bad debts

As per trial balance	3,250
Bad debts to be written off (w2)	1,500
	4,750

5. Closing inventory

As per question	22,000
Sale or return	20,000
Note 1 (i) in question- machine	(2,000)
Note1 (ii) overvaluation of damaged item	(400)
	39,600

6. Profit/loss on disposal of motor vehicle

Cost price of motor sold	10,000
Dep to date on vehicle sold [2,500+ 1,875]	4,375
	5,625
Sales proceeds	4,000
Loss on disposal	(1,625)

7. Depreciation

Buildings: [300,000*2%]	6,000	(Income Statement)
Buildings: Depreciation to date [90,000 + 6,000]	96,000	(Statement of Financial Position)
Motor vehicles: [(70,000 – 10,000) – (30,375 – 4,375)]*25%	8,500	(Income Statement)
Motor vehicles: Depreciation to date [30,375 – 4,375 + 8,500]	34,500	(Statement of Financial Position)
Plant & mach: [(25,000 + 2,000)*20%]	5,400	(Income Statement)
Plant & mach: Depreciation to date [10,000 + 5,400]	15,400	(Statement of Financial Position)

8. Error from previous year	Rwf m	
Retained earning brought forward [12,000 – 5,000]	7,000	
Opening inventory [22,000 – 5,000]	17,000	
9. Ordinary Dividends		
Proposed 30,000,000 shares *Rwf500	15,000	Rwf m
10 Debenture interest		
[200,000 * 10%]	20,000	(Income Statement)
Amount paid (trial balance)	10,000	
Therefore amount due	10,000	current liability in statement of financial position)
11 Accruals/ prepayments		
Electricity		
As per Trial balance	3,000	
Amount due	500	(current liability)
	3,500	(Income Statement)
Rent/rates		
As per trial balance	25,000	
Rates due	1,000	(current liability)
Rent	(5,000)	(current asset)
	21,000	
12 Purchases		
As per trial balance	225,000	
Less machine	(2,000)	
	223,000	

SOLUTION 2

REPORT
To: Managing Director
From: Financial Accountant
<u>Re: IAS 18</u>
Date April 2009

(a) Revenue is defined as “the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than increases relating to contributions from equity participants”

(b) Revenue should be measured at the fair value of the consideration received or receivable.

(c) The following conditions should be satisfied before revenue from the sale of goods should be recognised in the financial statements:

(i) The enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods;
(ii) The enterprise retains no continuing managerial involvement, nor effective control over the goods sold;
(iii) The amount of revenue can be measured reliably;
(iv) It is probable that the economic benefits associated with the transaction will flow to the enterprise;

and

(v) The transaction costs can be measured reliably.

(d) Interest should be recognised on a time proportion basis based on the effective yield.
Royalties should be recognised on an accruals basis in accordance with the substance of the agreement.
Dividends should be recognised when the shareholder’s right to the dividend is established.

(e) Disclosure requirements of IAS 18

Accounting policy for each recognition
The amount of each significant category of revenue
The amount of revenue arising from exchanges of goods or services

Yours Sincerely

Financial Accountant

SOLUTION 3

(a)

(i) Events after the reporting period:

"Are those events, both favourable and unfavourable, that occur between the statement of financial position date and the date when the financial statements are authorised for issue."

(ii) Adjusting events:

Those that provide evidence of conditions that existed at the statement of financial position date

(iii) Non-adjusting events

Those that are indicative of conditions that arose after the statement of financial position date

(b)

(i) Provision

A provision is a liability of uncertain timing or amount.

(ii) Contingent liability

A contingent liability is a possible obligation arising from past events whose existence will only be confirmed by the occurrence of future events not wholly within the entity's control.

(iii) Contingent asset

A contingent asset is a possible asset arising from past events whose existence will only be confirmed by future events not wholly within the entities control. Contingent assets may require disclosure but should not be recognised in the accounts.

(c)

(i) This is an non-adjusting event as it occurred after the statement of financial position date. If it is material it should be disclosed in the financial statements, but it should not be recognised in the financial statements.

(ii) This is an adjusting event as it provides evidence of conditions that existed at the statement of financial position date. The company should recognise this in the accounts by debiting bad debts Rwf211,500 and crediting trade receivables Rwf211,500

(iii) This is also an adjusting event as it confirms the net realisable value of the goods that were in stock at 30 June 2010. The company will have to recognise this by reducing the value of closing inventory in the financial statements.

(iv) This is an adjusting event. As the injury took place prior to the year end it has now been confirmed that the company will probably have to pay out Rwf33,000 in compensation. The company will have to recognise a provision of Rwf33,000 in the financial statements by debiting provision expense Rwf33,000 and crediting provisions in the statement of financial position Rwf33,000.

SOLUTION 4

T. Norton
Income Statement for the 12 months ended 31 December 2011

	Kigali		Bwakira		Consolidated	
	Rwf m	Rwf m	Rwf m	Rwf m	Rwf m	Rwf m
Sales		1,700		884		2,584
Cost of sales						
Inventory 1/1/2011	16		32		48	
Purchases	1,828				1,828	
	1,844				1,876	
Goods sent to branch	(600)		600			
	1,244					
Inventory 31/12/2011	(32)	(1,212)	(24)	(608)	(56)	(1,820)
Gross profit		488		276		764
Depreciation	70		20		90	
Distribution costs	160		10		170	
Admin expenses	40		42		82	
Bad debt provision	(4)	266	2	74	(2)	340
Net profit		222		202		424

T. Norton
Statement of Financial Position as at 31 December 2011

	Rwf m	Rwf m
Non-current Assets		
Cost		900
Accumulated depreciation		(430)
		470
Current Assets		
Inventory	56	
Trade receivables	240	
Provision for bad debt	(12)	
Bank	290	574
Total Assets		1,044
Capital & liabilities		
Capital as at 1/07/09		600
Net profit		424
Drawings		(80)
		944
Current Liabilities		
Trade payables		100
Total assets and liabilities		1,044

SOLUTION 5

(a) Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(b) Analysis of a cash-flow statement allows investors to determine any solvency/liquidity issues that the company may have.
It is useful in assessing the ability of an entity to generate cash/cash equivalents and it can highlight the relationship between profit and cash-flow of an entity
(c)

ULS Ltd

Cash flow statement for the year ended 31 December 2009.

	Rwf m	Rwf m
Cash flow from operating activity		
Net profit before tax	2,064	
Add back adjustment for:		
Depreciation charges	1,400	
Interest expense	20	
Loss on sale of non-current asset	40	
Sale proceeds less NBV		
Operating profit before working capital changes	3,524	
Increase in inventories	(160)	
Increase in trade receivables	(260)	
Increase in trade payables	170	
Cash generated from operations	3,274	
Interest paid	(20)	
Income tax paid	(290)	
Net cash from operating activity		2,964
Cash flow from investing activity		
Payments to acquire tangible non-current assets	(5,600)	
Receipts from sale of tangible fixed assets	360	
Net cash used in investment activity		(5,240)
Cash flow from financing activities		
Issue of shares	2,560	
Redemption of debentures	(200)	
Dividend paid	(540)	
Net cash from financing activities		1,820
Decrease in cash in period		(456)
Cash and cash equivalent at beginning of period		340
Cash minus overdraft		
Cash and cash equivalent at end of period		(116)