The Institute of Chartered Accountants of Pakistan

Introduction to Financial Accounting

Foundation Examination	9 March 2012
Spring 2012	100 marks - 3 hours
Module B	Additional reading time - 15 minutes

Q.1 (a) Explain the term 'prudence'. ***(03 marks)***

(b) Differentiate between cash and accrual basis of accounting. Which method would you prefer and why? ***(05 marks)***

(c) List the components of a complete set of financial statements. ***(03 marks)***

Q.2 Mr. Mubarak is a sole trader and carries on business under the name "Mubarak & Company". The balance on his cash book at 31 December 2011 did not agree with the balance as per the bank statement which shows a credit balance of Rs. 367,500.

An examination of the cash book and bank statement disclosed the following:

(i) A deposit of Rs. 49,200 made on 29 December 2011 had been credited by the bank on 1 January 2012.

(ii) Bank charges of Rs. 1,700 have not been entered in the cash book.

(iii) A debit of Rs. 4,200 appeared on the bank statement for an unpaid cheque which has been returned marked "out of date". The cheque was re-dated by his customer and paid into the bank again on 3 January 2012.

(iv) A standing order for payment of an annual subscription amounting to Rs. 1,000 has not been entered in the cash book.

(v) On 26 December 2011, Mr. Mubarak had given the cashier a cheque for Rs. 10,000 to pay into his personal account at the bank. The cashier deposited it into the business account by mistake.

(vi) On 27 December 2011, a customer had made an online transfer of Rs. 49,900 in payment against goods supplied. The advice was received and recorded in the cash book on 2 January 2012.

(vii) On 30 September 2011, Mr. Mubarak entered into a hire purchase agreement and issued a standing order to the bank to pay a sum of Rs. 2,600 on the 10th day of each month, commencing from October 2011. No entries have been made in the cash book for these payments.

(viii) A cheque for Rs. 36,400 received from Mr. Bashir had been entered twice in the cash book.

(ix) Cheques issued amounting to Rs. 467,200 had not been presented to the bank for payment until after 31 December 2011.

(x) A customer who owed Rs. 20,000 and was entitled to a cash discount of 2½% paid a cheque for the net amount on 10 December 2011. The cashier erroneously recorded the gross amount in the bank column of the cash book.

(xi) Dividend collected by the bank amounting to Rs. 12,000 has not been recorded in the cash book.

(xii) A cheque of Rs. 243,000 received from Mr. Bilal was deposited in the bank but entered in the cash book as Rs. 234,000.

Required:

(a) Prepare a bank reconciliation statement as on 31 December 2011.

(b) Prepare necessary journal entries in the books of Mubarak & Company and determine the correct cash balance that should be reported in the balance sheet. Also specify the situations in which no adjustment/entry is required. ***(13 marks)***

Q.3 The head office (HO) of a company invoices goods to its Branch at cost plus 20%. The Branch also purchases goods from local parties for which payments are made by the HO. All cash collected by the branch is banked on the same day to the credit of the HO. All expenses are paid by the HO except payments through petty cash account in which periodical transfers are made from the HO.

Following information is available in respect of the branch, for the year ended 31 December 2011:

	Rs. in '000
Cash sales	45,000
Credit sales	130,000
Direct purchase	45,000
Returns from customers	3,000
Goods sent to Branch from HO at invoice price	60,000
Amount transferred from HO for petty cash expenses	250
Bad debts	1,000
Discount to customers	2,000
Cash received from customers	125,000
Branch expenses	30,000
Petty expenses incurred by the branch	265
Balances on 1 January 2011:	
Imprest Cash	200
Sundry Debtors	25,000
Stock: Transferred from HO at invoice price	24,000
Directly purchased by branch	16,000
Stock on 31 December 2011:	
Transferred from HO at invoice price	18,000
Directly purchased by branch	12,000

Required:
Prepare Branch Account in the books of the HO for the year ended 31 December 2011 showing the profit made by the branch. ***(14 marks)***

Q.4 The trial balance of Ayub Brothers did not agree as at 31 December 2011 and the difference was carried to a suspense account. On scrutinising the books of account, the following types of errors were detected:

(i) Debtors include Rs. 15,000 which are irrecoverable and need to be written off.

(ii) Goods invoiced at Rs. 4,600 were returned by a customer. It was entered in the purchase book and posted from there to a creditor's account as Rs. 6,400.

(iii) A cheque of Rs. 8,000 received from a customer was not posted to his ledger account. Moreover, the corresponding sales invoice for Rs. 12,000 was incorrectly passed through the sales day book as Rs. 2,000.

(iv) Sales include goods sold for cash amounting to Rs. 25,000 on behalf of Mr Yasir. Ayub Brothers were entitled to a commission of 10% on the sales plus selling expenses, for which no adjustment was made. The related selling expenses amounted to Rs. 1,500.

(v) An amount of Rs. 3,800 owed by Zahid & Company for goods supplied was to be adjusted against an amount of Rs. 8,500 owed to Zahid & Company. No entry has been made in this regard.

(vi) A purchase of Rs. 15,100 was entered in the purchase day book as Rs. 1,500 and posted to the supplier's account as Rs. 5,100.

(vii) Goods invoiced at Rs. 23,000 and returned by Hamid Khan, a debtor, were entered in the purchase day book and posted therefrom to Hammad Khan, a creditor, as Rs. 32,000.

(viii) A supplier's invoice for Rs. 12,300 had been entered in the purchase day book on 28 December 2011. However, the goods were received on 2 January 2012.

(ix) Some items of furniture which stood in the books at Rs. 24,000 on 1 January 2011 were disposed of on 30 June 2011 in exchange for new furniture costing Rs. 20,800. A net invoice of Rs. 9,200 was passed through the purchase day book. Depreciation on furniture is charged at 10% on written down value.

(x) Ayub Brothers maintains a provision of 5% of the gross amount of debtors.

Required:
Prepare journal entries to rectify the errors identified above.
(Narrations are not required.) ***(21 marks)***

Q.5 Danish does not keep proper books of account due to his lack of knowledge of double entry system of accounting. He has supplied you the following information with respect to the year ended 31 December 2011 from the records kept in his diary:

(i) Receipts and payments made during the year:

	Rupees
Cash received from debtors	80,000
Discount allowed to debtors	1,400
Bad debts written off	1,800
Cash paid to creditors	63,000
Discount allowed by creditors	1,000
Sales returns	3,000
Purchases returns	2,000
Expenses paid	6,000
Drawings	5,000
Rent paid	2,500

(ii) Opening balances as on 1 January 2011:

Assets and liabilities	Rupees
Debtors	45,000
Creditors	24,000
Cash	4,500
Furniture and fixtures	15,000
Stock	25,000
Motor van	16,000

(iii) Debtors and creditors as on 31 December 2011 amounted to Rs. 48,600 and Rs. 27,000 respectively.

(iv) Outstanding expenses as on 31 December 2011 amounted to Rs. 1,200.

(v) Depreciation is charged on furniture and fixtures at the rate of 10% and on motor van at 20%.

(vi) Danish sells goods at cost plus 40% and follows a policy of maintaining a provision of 5% of the outstanding debtors.

Required:

(a) Trading and profit and loss account for the year ended 31 December 2011.

(b) Balance sheet as at 31 December 2011. ***(21 marks)***

Q.6 (a) On 1 January 2012, a company held 300 units of an item of finished goods inventory. These were valued at Rs. 22 each. During January 2012 three batches of finished goods were received into store from the production department, as follows:

Date	Units received	Production cost per unit Rupees
10-Jan	400	Rs. 23
20-Jan	400	Rs. 25
25-Jan	400	Rs. 26

Goods sold out of the inventory during January 2012 were as follows:

Date	Units sold	Sale price per unit Rupees
14-Jan	500	Rs. 31
21-Jan	500	Rs. 33
28-Jan	100	Rs. 32

Required:
Compute the cost of sales and inventory at 31 January 2012, applying the following basis of inventory valuation:
(i) FIFO (ii) Weighted Average Cost (Average is updated after every transaction).
(09 marks)

(b) The cost of inventory of Mughal Trading Corporation (MTC) based on inventory count carried out on 17 January 2012 was Rs. 675,000. These included goods costing Rs. 15,000 which were purchased in December 2011 and have a net realisable value of Rs. 12,000. During the period between 31 December 2011 and 17 January 2012, following transactions took place:

(i) Value of goods purchased amounted to Rs. 155,710.
(ii) Sale of goods amounted to Rs. 250,000. MTC normally sells goods at a mark-up of 25% of cost. However, 20% of the sales were made at a discount of 8% of the normal selling price.
(iii) Goods costing to Rs. 1990 were returned to a supplier
(iv) Goods sold to a customer on 4 January 2012 were returned on 15 January 2012.

Compute the value of inventories that should be reported in the financial statements of MTC as at 31 December 2011. ***(06 marks)***

(c) Which of the following items may be included in computing the value of inventory of finished goods manufactured by a business:

(i) raw materials
(ii) foremen's salaries
(iii) carriage inwards
(iv) carriage outwards
(v) plant depreciation
(vi) cost of storage of finished goods
(vii) abnormal waste of materials
(viii) salesmen's commission ***(02 marks)***

(d) What will be the effect of the following on cost of sales, profit and inventory:

(i) if in times of rising prices , the valuation of inventory is done on the basis of FIFO as opposed to weighted average cost method?
(ii) if an item of inventory having cost of Rs. 69,300 and net realisable value of Rs. 65,000 is omitted from original inventory count? ***(03 marks)***

(THE END)