1. (a) Briefly explain the THREE primary objectives of financial reporting by business organizations as specified in the International Accounting Standards. **[6 marks]**

   (b) List the EIGHT steps in the Accounting Cycle (Process). **[12 marks]**

   (c) The table below presents a number of accounting procedures and practices in Chavez Corporation. Each item listed violates an accounting assumption, principle, information characteristic, or modifying convention.

Item Number	Item Description
1.	An officer of Chavez Corporation purchases a new home computer for personal use with the company's money, charging it to miscellaneous expenses.
2.	A machine, which cost $60 000, is reported at its current market value of $90 000.
3.	Chavez Corporation decides to establish a large loss and related liability this year because of the possibility that it may lose a pending patent infringement lawsuit. Its attorneys consider the possibility of the loss remote.
4.	Because the company's income is low this year, a switch from accelerated depreciation to straight-line depreciation is made this year.
5.	The president of Chavez Corporation believes that it is foolish to report financial information on a yearly basis. Instead, the president believes that financial information should be disclosed only when significant new information, related to the company's operations, is available.
6.	Chavez Corporation recognizes all sales revenues on a cash basis.

For EACH item identify the assumption, principle, information characteristic, or modifying convention that is being violated and state the purpose of that assumption, principle, information characteristic, or modifying convention. **[17 marks]**

Total 35 marks

Closing

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2. (a) The AMIRA Corporation is about to be audited by the Accounting firm of Ragu and Raga The corporation had dismissed its financial controller at the beginning of the last quarte and has been experiencing problems in filling the post. The corporation's chief executive officer (CEO) has asked the accounts clerk to prepare the statements for the auditing firm The accounts clerk has been with the company for only three months and has never preparec financial statements before. The auditing firm needs to have proper statements before it car commence the audit. The following is the first draft of the income statement that this poorly trained accounts clerk has prepared for the CEO.

AMIRA Corporation
Income Statement
For the Year Ended December 31, 2004

	$
Sales revenue	1 182 375
Investment revenue	19 250
Cost of merchandise sold	(340 375)
Selling expenses	(247 625)
Administrative expenses	(315 625)
Interest expense	(13 000)
Special items	
Depreciation non cash expense	(32 500)
Extraordinary item	(80 000)
Income tax liability	(51 750)
Net income	120 750

On discussion with the accounts clerk it was discovered that the following omissions were made in preparing the income statement.

- No provision was made for bad debts of $1 500.
- ✓ The ending inventory included in the cost of goods sold included goods sold to a customer on December 25, valued at $1 300 but which were still at the company on December 31.
- ✓ The administrative expenses included a $4 000 payment to an insurance company representing a payment on the CEO's personal house. The CEO had refunded the organization on December 31, but the clerk did not record the transaction.
- AMIRA Corporation has 50 000 shares of common stock outstanding and is subject to income tax at a rate of 30 per cent on all aspects of its operations. The company declared a dividend of 15 cents per share.

Prepare a multiple-step income statement for 2004 for the AMIRA Corporation.

[15 marks]

(Ensure that both the format and terminology in the statement are consistent with International Accounting Standards.)

(b) The accounts clerk of the AMIRA Corporation also prepared the following balance sheet as at December 31, 2004.

AMIRA Corporation
Balance Sheet
For the year just finish December 31, 2004

Assets	$	Liabilities and Capital	$
Cash	18 000	Accounts payable	25 000
Marketable securities	27 000	Reserve for income taxes	34 000
Accounts receivable	75 000	Advanced payments by customers	3 500
Merchandise inventory	60 000	Bonds payable	120 000
Supplies inventory	3 000	Capital stock	225 000
Shares in another company	60 000	Reserve for depreciation	60 000
Unsold shares	75 000	Cash dividends declared	7 500
Building and land	213 000		475 000
Deferred charges	6 000		
Other assets	54 000	Earned surplus	116 000
	591 000	Total	591 000

While reviewing the balance sheet you realize that it contains several errors including misclassification of items, lack of adequate disclosure and poor terminology. In addition, from discussions with the accounts clerk, it was discovered that

- the bonds payable are due in 2010
- shares in the subsidiary represents shares purchased as a long term investments
- the item, 'Deferred charges,' represents the share premium account
- 'Other assets' represents the cash surrender value of an insurance policy
- the building has a historical cost of $163 000 and the land $50 000. The market values of these are now $450 000 for the building and $150 000 for the land.
- the item unsold shares represent the balance of the authorized share capital that has not been sold
- the earned surplus is a balancing figure that has been used in place of retained earnings
- the company has in its authorized capital 100 000, 8 per cent preference shares with a par value of $5 that have not been issued as yet
- capital stock refers to 45,000 ordinary shares

Prepare the corrected balance sheet of AMIRA Corporation as at December 31, 2004. The balance sheet should be presented in good form using the International Accounting Standards. **[20 marks]**

Total 35 marks

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3. The financial statements of Brown Sugar Outfitters Inc. for the financial year 2004 are presented below.

Brown Sugar Outfitters Inc.
Income Statement
For the Year Ended December 31, 2004

		$	$
Sales			490 000
Less:	Cost of goods sold		(210 000)
Gross profit			280 000
Less:	Selling and administrative expenses	195 000	
	Depreciation expense	15 000	
	Interest expense	1 000	(211 000)
			69 000
Less:	Loss on sale of machinery		(3 000)
Income before taxes			66 000
Less:	Income tax expense		(22 000)
Net Income			44 000

Brown Sugar Outfitters Inc.
Balance Sheet
As at year ended December 31, 2004

Assets

	2004 $	2003 $
Cash	5 000	45 000
Accounts receivable (net)	52 000	37 000
Inventory	41 000	25 000
Machinery (net)	60 000	60 000
Total assets	158 000	167 000

Liabilities & Stockholders' Equity

	$	$
Accounts payable	27 000	64 000
Long-term note payable	5 000	20 000
Common stock, $5 par value	5 000	4 000
Paid-in capital in excess of par value	20 000	16 000
Retained earnings	101 000	63 000
Total liabilities and stockholders' equity	158 000	167 000

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(a) The following additional information also applies to Brown Sugar Outfitters Inc.

1. Common stock (200 shares) was sold for $25 per share in the middle of 2004.

2. Dividends of $6 per share were declared and paid in late 2004.

3. Machinery that cost $20 000 and that has a book value of $13 000 was sold for $10 000 cash. New machinery was purchased for $28 000 cash.

4. The note payable relates to a borrowing transaction.

Using the indirect method, prepare a Statement of Cash Flows for Brown Sugar Outfitters Inc. for the year ended December 31, 2004. **[20 marks]**

(b) An independent review of the financial statements of Brown Sugar Outfitters Inc. for the year ended December 31, 2004, revealed the following items:

1. On December 15, 2004, an explosion occurred at the Diego Martin factory of the company. Ten people were injured, and five houses located close to the factory were severely damaged. Although no lawsuits had been filed by the end of the year, management anticipates future court appearances and several out-of-court settlements. The company was not insured for the casualty.

2. Brown Sugar Outfitters Inc. was sued in February for discriminatory hiring practices. Its lawyers have indicated that the plaintiffs have a strong case and would likely win the suit. Although the suit was for $100 000, it would probably be settled for $40 000.

Describe the accounting treatment for contingent liabilities. **[4 marks]**

(c) Outline how the TWO independent situations in (a) above should be treated in the December 31, 2004, financial statements of Brown Sugar Outfitters Inc. **[5 marks]**

(d) On July 1, 2005, Brown Sugar Outfitters Inc. borrowed $225 000 as a long-term loan. The terms of the loan require that Brown Sugar pay interest and $75 000 of principal on July 1, 2006, 2007, and 2008. The unpaid balance of the loan accrues interest at the rate of 10 per cent per year. Brown Sugar Outfitters Inc. has a December 31 year-end.

Compute Brown Sugar Outfitters Inc.'s accrued interest as of December 31, 2005. **[2 marks]**

(e) Prepare the balance sheet extract to show the appropriate disclosure for the accrued interest and the current and long-term portions of the outstanding debt as of December 31, 2005. **[4 marks]**

Total 35 marks

END OF TEST