1. (a) Under accruals-basis accounting, accountants frequently make the following FIVE categories of adjusting journal entries at the end of each accounting period: Deferred expenses (prepaid expenses); Deferred revenues (unearned revenue); Accrued expenses (accrued liabilities); Accrued revenues (accrued assets); Estimated expenses (e.g., depreciation, allowance for uncollectible accounts)

   (i) Write short notes on the process involved in recording adjusting journal entries for any THREE of the five categories of items listed above. **[ 9 marks]**

   (ii) Explain how the adjusting journal entries listed above are related to the accruals and matching concepts. **[ 7 marks]**

   (b) Internal controls promote accurate information, help an organization ensure compliance with applicable laws and regulations and safeguard organizational assets. As a result, internal controls are important even in small businesses.

   List and briefly describe FIVE internal control practices relating to cash, which would be carried out even in a small business having little opportunity for the separation of duties. **[10 marks]**

   (c) While listening to the evening news recently your friend Jack heard a report about a decision taken by the local accountancy profession to implement accounting standards in your country. Jack firmly believes in the free market system and thinks that the decision to introduce accounting standards is a useless and undesirable infringement on the right of firms to choose the accounting policies that are most appropriate to their individual circumstances.

   Briefly describe THREE ways in which accounting standards benefit the following persons.

   (i) Those who prepare financial statements for publication

   (ii) The users of published financial statements **[ 9 marks]**

**Total 35 marks**

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2. Bravo and Rampaul are partners in a partnership trading as B & R Distributors. This partnership is located in Westmoreland, Jamaica. The business has been trading successfully for more than fifteen years and with the increased activity in the surrounding area the partners are eager to expand the business. There are a number of options that are available to the partners. These options include admitting additional partners or incorporation. Bravo and Rampaul have been reading about the different types of business entities as well as the Companies' Act and the legislation relating to partnership. In order for the partners to come to an agreement on the new form the business should take, they are collecting data and will be meeting with a consultant to determine the best route for the business.

The partners have extracted the adjusted trial balance of B & R Distributors as at December 31, 2005. The trial balance presented below indicates the account balances at December 31, 2005.

| Account Title | Debit | Credit |
|---|---|---|
| Cash | $21 620 | |
| Accounts receivable (net) | 84 000 | |
| Inventory | 29 360 | |
| Prepaid expenses | 3 900 | |
| Equipment | 98 000 | |
| Accumulated depreciation | | $ 18 000 |
| Notes payable (due in 2 years) | | 9 600 |
| Accounts payable | | 38 520 |
| Accrued expenses | | 2 880 |
| Bravo, capital (beginning of year) | | 70 000 |
| Bravo, drawings | 10 080 | |
| Rampaul, capital (beginning of year) | | 60 000 |
| Rampaul, drawings | 7 200 | |
| Sales | | 648 960 |
| Purchases | 389 800 | |
| Selling expenses | 112 380 | |
| Administrative expenses | 91 620 | |
| **Totals** | **$847 960** | **$847 960** |

The company uses a periodic inventory system. The physical inventory at the end of the year was $38 200. The partnership agreement provides that partners are allowed 10 per cent interest on invested capital as of the beginning of the year. The residual net income and any bonuses on the admission of new partners are to be divided equally.

(i) Prepare the income statement for B & R Distributors for the year ending December 31, 2005. (Include the appropriation of profits between the partners.) **[ 8 marks]**

(ii) Prepare a statement of changes in the partners' capital for the current year. **[ 3 marks]**

The expansion of B & R Distributors requires injection of capital from investors. The first option available to B & R Distributors is the admission of a new partner.

B & R Distributors approached Zandolie, a sole proprietor in a neighbouring town, to acquire a one-third share of the partnership for $70 000 in cash and other assets. Zandolie, who has been experiencing some minor health problems, views the offer as an excellent opportunity and is eager to join the partnership.

Zandolie offers to contribute the following assets and liabilities to the partnership:

| | |
|---|---|
| Cash | $10 000 |
| Equipment | 85 000 |
| Current liabilities | 25 000 |

The above figures reflect the fair market value of the assets and liabilities of Zandolie.

The partners are examining the proposal and would like to know the effect of the admission of Zandolie on their respective capital balances. The partners are aware that they could admit the partner using the bonus method or the goodwill method. They are currently considering admission of Zandolie using the bonus method.

(iii) Compute the bonus attributable to Bravo and Rampaul upon the admission of Zandolie to the partnership. **[ 8 marks]**

(iv) Prepare a balance sheet for the partnership immediately following the admission of Zandolie. **[12 marks]**

Having completed the calculation pertaining to changes in their respective capitals as a result of admitting Zandolie using the bonus method, the partners are considering the option of incorporating the business and selling shares to members of the public. The partners need to know the advantages and disadvantages of this type of business organization.

(v) Briefly discuss TWO advantages and TWO disadvantages that would accrue to B & R Distributors if they changed from a partnership to a public company. **[ 4 marks]**

**Total 35 marks**

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3. CARICOM Company is the leading merchandiser of imported furniture in St. Kitts. The following data were taken from the records of CARICOM Company for the year ended December 31, 2005:

| | |
|---|---|
| Administrative expenses | $100 000 |
| Cost of merchandise sold | 732 000 |
| Gain on condemnation of land | 30 000 |
| Interest expense | 8 000 |
| Interest revenue | 5 000 |
| Loss on disposal of a segment of the business | 92 500 |
| Sales | 1 820 000 |
| Selling expenses | 400 000 |
| Accounts payable | 149 500 |
| Accounts receivable | 309 050 |
| Accumulated depreciation | 3 050 000 |
| Allowance for doubtful accounts | 21 500 |
| Cash | 145 500 |
| Ordinary shares $15 par (400 000 shares authorized; 152 000 shares issued) | 2 280 000 |
| Dividends: | |
| Cash dividends paid on ordinary shares | 120 000 |
| Interim cash dividends on preference shares | 25 000 |
| Stock dividends declared and distributed on ordinary shares | 60 000 |
| Dividends payable | 30 000 |
| Equipment | 9 541 050 |
| Income tax payable | 55 900 |
| Interest receivable | 2 500 |
| Merchandise inventory (December 31, 2005), at lower of cost (FIFO) or market | 425 000 |
| Notes receivable | 77 500 |
| Organization costs | 55 000 |
| Share premium /(Paid-in capital in excess of par) ordinary shares | 666 250 |
| Share premium /(Paid-in capital in excess of par) preference shares | 240 000 |
| 5 per cent preference shares $100 par (30 000 shares authorized; 15 000 shares issued) | 1 500 000 |
| Prepaid expenses | 15 900 |
| Retained earnings, January 1, 2005 | 2 548 150 |
| Treasury stock (2 000 shares of ordinary shares of $35 per share) | 70 000 |

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**Additional Information:**

The average number of common shares outstanding during 2005 was 150 000.
The directors declared the final dividend on the preference shares.
The gain on condemnation of the land is an extraordinary item.
The corporation tax rate applicable to the company is 35 per cent.

(a) Using the information provided above, prepare the following statements in a form suitable for publication (that is, the statements should comply with the minimum requirements of the International Accounting Standards):

(i) A multi-step income statement for CARICOM Company for the year ended December 31, 2005. **[10 marks]**

(ii) A statement showing the appropriation of the profits for the year ended December 31, 2005. **[ 5 marks]**

(iii) The shareholders equity section of CARICOM Company's balance sheet as at December 31, 2005. **[10 marks]**

(b) Briefly describe the purpose of the income statement and the balance sheet. **[ 4 marks]**

(c) Briefly discuss THREE limitations of financial statements as a source of information for assessing the financial condition and performance of a company. **[ 6 marks]**

**Total 35 marks**

**END OF TEST**