1. (a) Distinguish between the criteria for recognizing

    (i) revenues

    (ii) expenses

    under the **cash basis** and under the **accrual basis** of accounting. **[10 marks]**

   (b) The International Accounting Standards Board's conceptual framework of accounting identifies **relevance**, **reliability**, **comparability** and **consistency** as important qualitative characteristics of accounting information.

    Explain EACH of these qualitative characteristics of accounting information. **[15 marks]**

   (c) Briefly contrast the role of internal auditors and external auditors with reference to EACH of the features listed below:

    (i) What or who determines the scope of their work

    (ii) The period of time for which they are usually appointed

    (iii) What or whom they are usually required to be independent of

    (iv) Whether they are usually responsible for the prevention and detection of fraud

    (v) The standards which generally guide their work. **[10 marks]**

Total 35 marks

2. Marlene Henkle Inc was incorporated in St. Barths on January 1, 2004. The company issued $95 000 in $5 stated value ordinary shares. The company is proposing to expand operations into St. Friendly. In order to raise the needed funds for expansion, two options are available: either issue bonds or convert the private company into a public company.

(a) Briefly outline TWO similarities and THREE differences between a public company and a private company. **[5 marks]**

(b) The directors of the company have decided to form a public company. A trainee accountant has prepared the following financial statements and additional notes to be included in the prospectus.

Statement of Operations for 2006

Revenues	**$**
Gross sales	1 044 300
Less returns and allowances	(56 200)
Net sales	988 100
Dividends received and purchase discounts[1]	30 250
Recoveries of accounts written off	13 850
Total revenues	1 032 200
Costs and expenses	
Cost of goods sold	425 900
Salaries	60 500
Rent	19 100
Freight in and freight out[2]	3 400
Bad debt expense	24 000
Transfers[3]	38 000
Total expenses	570 900
Income before extraordinary items	461 300
Extraordinary items[4]	196 900
Net income	264 400
Earned surplus beginning of year	310 700
	575 100
Corporation tax[5]	115 020
Dividends	21 900
Earned surplus end of year	438 180

GO ON TO THE NEXT PAGE

Balance Sheet for 2006

Assets	**$**	**Liabilities and equities**	**$**
Cash in hand	3 460	Accounts payable	22 460
Cash at bank	48 600	Unpaid taxes	14 000
Accounts receivable	25 000	Unpaid rent 2006	1 580
Merchandise inventory	120 000	Mortgage payable[8]	200 000
Supplies inventory	4 000	Bonds payable[9]	56 000
Investments[6]	250 000	Capital shares issued	95 000
Property[7]	285 000	Reserves[10]	78 800
Plant and equipment	160 000	Earned surplus	438 180
Goodwill	17 960	Cash dividends declared	8 000
Total	914 020	Total	914 020

Notes:

1. Dividends received from investment in associated company $10 000 and purchase discounts $20 250.
2. Freight in $1 400 and freight out $2 000.
3. Transfer represents depreciation - expenses on plant and equipment of $24 000 and buildings of $14 000.
4. Extraordinary items:
   (a) Loss due to Hurricane Ivan $176 900
   (b) Loss due to obsolete inventory $20 000
5. Corporation tax rate is 20 per cent.
6. Investments:
   (a) Marketable securities $28 000
   (b) Long-term investment $222 000
7. Property includes the land $110 000 and building $175 000.
8. Mortgage payable is $25 000 due in 2007.
9. Bonds payable are 5-year bonds.
10. Reserves include the accumulated depreciation figure of $38 000 and share premium of $40 800.

Please note:

The company had paid corporation tax in the amount of $100 020 based on its calculation of the profit before tax. A recalculation of the net income before tax by the Inland Revenue Department shows that the company has prepaid corporation taxes of $48 140 instead of unpaid taxes of $14 000.

Prepare an income statement and a balance sheet for MHI for the year ending December 31, 2006 using International Accounting Standards. **[30 marks]**

Total 35 marks

GO ON TO THE NEXT PAGE

3. RAB and Associates have been contracted to finalize the accounts of Anguilla Company for the year ending December 31, 2006. After several meetings, the company has agreed to the following Income Statement and Balance Sheet.

Anguilla Company
Income Statement
For the year ending December 31, 2006

	$
Sales (net)	6 438 507
Cost of goods sold	(5 102 977)
Gross profit	1 335 530
Selling and administrative expenses	(855 809)
Interest expense	(34 436)
Depreciation expense	(104 614)
Income before taxes	340 671
Income tax expense	(135 500)
Net Income	205 171

Anguilla Company
Comparative Balance Sheets
As at December 31, 2006

Assets	**2006** $	**2005** $
Current assets		
Cash	6 804	428
Accounts receivable (net)	97 106	76 961
Inventories	844 539	673 606
Prepaid expenses	9 401	16 684
Total current assets	957 850	767 679
Plant and equipment, at cost	1 446 896	1 094 804
Less: Accumulated depreciation	(407 641)	(303 027)
Total assets	1 997 105	1 559 456
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable – trade	343 163	290 064
Accrued expenses	184 017	138 921
Accrued interest payable	1 067	3 394
Income taxes payable	37 390	42 958
Total current liabilities	565 637	475 337
Long-term loan	504 913	415 561
Total liabilities	1 070 550	890 898
Shareholders' equity		
Common stock	263 155	162 298
Retained earnings	663 400	506 260
Total shareholders' equity	926 555	668 558
Total liabilities and shareholders' equity	1 997 105	1 559 456

GO ON TO THE NEXT PAGE

RAB and Associates also assembled the following information:

1. Cash dividends declared and paid during 2006 were $48 031.

2. No long-term assets were disposed of in 2006.

(a) Prepare a statement of cash flows for Anguilla Company for the year ending December 31, 2006 in a form suitable for publication. **[20 marks]**

(b) Tom recently accepted a very lucrative voluntary separation package from his employer. He is considering investing part of the money received in the stock of Sangre Grande Manufacturing Company. The company is listed on the Eastern Caribbean Stock Exchange (ECSE).

The following ratios relating to operations of Sangre Grande Manufacturing Company during the three-year period January 2004 to December 31, 2006, were presented on the website of the ECSE:

Sangre Grande Manufacturing Company
Comparative Financial Ratios

Ratio	**2006**	**2005**	**2004**
Current ratio	2.5:1	1.8:1	1.7:1
Quick ratio	0.95:1	1.1:1	1.3:1
Inventory turnover	4.9 times	5.0 times	5.2 times
Accounts receivable turnover	57 days	55 days	50 days
Debt to asset ratio	51.2%	54.3%	55.8%
Times interest earned	2.2 times	1.9 times	1.89 times
Gross profit margin	28%	27.5%	27.5%
Net profit margin	1.3%	1.0%	0.9%
Dividend payout ratio	57.14%	64.52%	72.73%
Return on assets	1.8%	1.5%	1.3%
Return on capital employed	3.4%	3.3%	3.1%
Price/earnings ratio	34.5 times	38.7 times	33.5 times
Dividend per share	$2.00	$2.00	$2.00
Earnings per share	$3.50	$3.10	$2.75

Write a report to Tom informing him of the performance of the company from an investor's perspective. Your report must address FOUR key aspects of the company's performance: **liquidity, activity, solvency** and **profitability.** **[15 marks]**

Total 35 marks

END OF TEST