



1. (a) **Completeness, neutrality, timeliness, understandability and verifiability** are five characteristics of financial information.

The table below lists the definitions of these characteristics with corresponding letters:

Definitions of characteristics	Letters
Accounting information must make sense to mature users who are willing to study the information.	A
Financial statements should show all aspects of the business.	B
Financial statements should be published as soon as possible after year-end.	C
Accounting information must be traceable to source documents.	D
Financial information should not favour any particular group of users.	E

List the FIVE characteristics and match EACH with the appropriate definition by selecting the correct letter from the table above.

[5 marks]

- (b) Define the term 'due process' as it relates to the development of accounting standards.

[2 marks]

- (c) You have just begun an assignment with a new company and you are discussing with the owner of the company her need for a good 'internal control' system.



Answer the following questions which were posed to you during the discussion:

- (i) What is the meaning of the term 'internal control'?
[2 marks]
 - (ii) What is the role of internal control in a business organization?
[3 marks]
 - (iii) Why are internal controls important for inventory (stock)?
[3 marks]
 - (iv) Identify TWO internal controls that should be put in place for accounts receivable (debtors).
[2 marks]
- (d) Caribbean Biscuits is a public company which has been in operation for several years. The draft financial statements of the company for the year ended June 30, 2008, showed a profit of \$172 800. The trial balance did not balance and a suspense account with a credit balance of \$6 620 was included in the Balance Sheet.

A subsequent check of the data revealed the following errors:

1. On July 1, 2007, the opening accrual of the Motor Repairs A/C of \$6 800 which represented repair bills had not been brought down. It was unpaid at June 30, 2008.

GO ON TO THE NEXT PAGE

02101020/CAPE 2009



2. Cash discount totals for June 2008 had not been posted to the Discount A/C on the subsidiary ledger.

The figures were as follows:

	\$
Discount allowed	790
Discount received	580

3. Depreciation of 'Motor vehicle' at 25 per cent was calculated for the year ended June 30, 2008 on the reducing balance and should have been calculated on the straight line basis at 25 per cent. Cost of 'Motor vehicle' was \$240 000. Net book value at July 1, 2007 was \$176 000.

4. Irrecoverable debts totalling \$16 800 are to be written off.

(i) Prepare journal entries with narratives to correct the errors above.
[16 marks]

(ii) Prepare a statement showing the necessary adjustments to the profit.
[2 marks]

Total 35 marks

2. Alfred's Beach Restaurant is located on the east coast of Sunny Island. The unadjusted trial balance at December 31, 2008 contains the items below which are listed in alphabetical order. All accounts have normal balances.

	\$
Accounts payable (trade)	56 000
Accounts receivable	48 000
Bank overdraft	14 000
Building: cost	160 000
: accumulated depreciation	16 000
Bank loan (16%)	100 000
Bad debts written off	10 000
Furniture & fittings: cost	180 000
: accumulated depreciation	86 000
Inventories	70 000
Land (valuation)	250 000
Motor vehicle: cost	80 000
: accumulated depreciation	8 000
Ordinary shares @ \$5 each	200 000
Operating expenses	360 000
Prepaid insurance	9 000
Purchases	500 000
Retained earnings	30 000
Sales	1 139 000
Salary expenses	96 000
Salaries payable	34 000
10% preference shares @ \$10 each	80 000

Additional information:

1. 30 000 ordinary shares were issued at \$5 each on January 1, 2008; this cash transaction was not reflected in the trial balance above.

GO ON TO THE NEXT PAGE
02101020/CAPE 2009



Accounting | Unit 1, Paper 02

2. Loan interest and the preferred dividend for the year were paid on December 31. An ordinary dividend of 40 cents per share was also paid on December 31; these transactions were not reflected in the trial balance above.
3. The trial balance does not reflect depreciation charges for the year. The building is depreciated over fifty years on a straight line basis. 'Motor vehicle' is depreciated at 20 per cent on a straight line basis, while 'Furniture and fittings' are depreciated on the reducing balance basis at 25 per cent.
4. At December 31, 2008, totals for closing inventory and additional expenses are as follows:

	\$
Closing inventory	40 000
Additional operating expenses owing	10 000
5. The company pays corporation tax at the rate of 30 per cent.
6. The bank loan is repayable in 7 years.

Based on the information above, prepare the following statements for the year ending December 31, 2008:

- (a) An Income Statement
[11 marks]
- (b) A classified Balance Sheet
[24 marks]

The presentation of the statements should comply with the International Accounting Standards.

Total 35 marks



3. Cheryl's Curl Up & Dye Beauty Salon has been in operation in Nevis for several years. Cheryl has expanded to sell hair products and wants to approach the bank for a loan to purchase a building. She has to prepare a statement of cash flows as part of the loan application process and has asked for your assistance in exchange for her professional services.

The following information was extracted from the books of the salon:

**Cheryl's Curl Up & Dye Beauty Salon
Comparative Balance Sheets**

	March 31,	
	2007	2008
ASSETS		
Current assets:	\$	\$
Cash	20 000	55 000
Inventory	90 000	100 000
Salon supplies	156 000	212 000
Prepaid expenses	4 000	6 000
Total current assets	270 000	373 000
Equipment (net of accumulated depreciation)	500 000	616 000
Total assets	770 000	989 000

(The Balance Sheet is continued on the next page)

GO ON TO THE NEXT PAGE
02101020/CAPE 2009





LIABILITIES & SHARE CAPITAL

Current liabilities:

Bank loan (short term)	55 000	45 000
Accounts payable	61 000	76 000
Accrued expenses	15 000	22 000
Taxes payable	19 000	11 000
	<u>150 000</u>	<u>154 000</u>

Long term liabilities:

Note payable		40 000
Bonds payable	300 000	400 000
Share capital	150 000	200 000
Retained earnings	<u>170 000</u>	<u>195 000</u>
	<u>770 000</u>	<u>989 000</u>

**Cheryl's Curl Up & Dye Beauty Salon
Income Statement
for the year ended March 31, 2008**

Revenue:	\$	\$
Net sales		900 000
Less cost of sales		<u>(500 000)</u>
Gross profit		<u>400 000</u>
Other revenue:		
Interest revenue		9 000
Gain on the sale of equipment		31 000
		<u>440 000</u>

(The Income Statement is continued on the next page)



Expenses:

Operating expenses			
(including depreciation of \$40 000)	300 000		
Interest expense	35 000		
Income tax expense	40 000	<u>375 000</u>	
Net income			<u>65 000</u>

Additional information:

1. Cheryl's equipment increased by \$116 000 during the year. An analysis of the underlying transactions indicates the following:

	\$
Purchased \$200 000 in equipment paying	
\$200 000 cash	200 000
Equipment with a book value of	
\$44 000 sold for \$75 000 cash	(44 000)
Recorded depreciation expense for the year	<u>(40 000)</u>
Net change in equipment	<u>116 000</u>

2. The company issued bonds payable for \$100 000 cash and a note payable for \$40 000 cash.
3. The company issued 1 000 shares for cash to family and friends at a price of \$50 per share.
4. Cash dividends declared and paid to shareholders amounted to \$40 000.

GO ON TO THE NEXT PAGE
02101020/CAPE 2009





- (a) Prepare a Statement of Cash Flows for 2008 showing clearly cash flows from **operating** activities, **investing** activities and **financing** activities.
[23 marks]
- (b) You are a loans officer with Third Nevis Bank. Cheryl has applied to the bank for the loan to finance her building. You have calculated the ratios below pertaining to the salon for the years 2007 and 2008 and you have obtained industry averages of the relevant ratios from the beauty salon industry.

Financial measure	Cheryl's Salon		Industry average
	2007	2008	
Liquidity			
Quick ratio	1.2 to 1	1.7 to 1	1.5 to 1
Days to sell inventory	90 days	73 days	70 days
Profitability			
Operating expense ratio	65%	60%	63%
Net income as a % of sales	15%	13%	18%

- (i) State TWO uses and TWO limitations of financial ratios.
[4 marks]
- (ii) Discuss the performance of Cheryl's Salon over 2007 and 2008 in terms of **liquidity** and **profitability** using the industry averages as benchmarks.
[8 marks]

Total 35 marks

END OF TEST
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