Allama Iqbal Open University AIOU BS Solved assignment No 1 autumn 2024 Code 5059/8553 Advanced Financial Accounting

Q. 1

The IASB issued a revised comprehensive set of concepts for financial reporting in March 2018 that is known as the conceptual framework of financial reporting. It consists upon the eight chapters; you are required to write a detailed note on the following chapters:(20)
a.Qualitative Characteristics of useful financial information
b.The elements of Financial Statements.

Ans;

Conceptual Framework for Financial Reporting

The Conceptual Framework for Financial Reporting, issued by the International Accounting Standards Board (IASB) in March 2018, provides a comprehensive set of concepts guiding the preparation and presentation of financial statements. It aims to support consistent and transparent financial reporting, assisting both preparers of financial statements and standard-setters. Among its

eight chapters, two significant ones are the **Qualitative Characteristics of Useful Financial Information** and **The Elements of Financial Statements**. This detailed discussion will focus on these two chapters.

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a. Qualitative Characteristics of Useful Financial Information

This chapter explains the attributes financial information must possess to be useful for decision-making. Users of financial statements, such as investors, lenders, and other stakeholders, depend on this information to assess an entity's financial performance, position, and cash flows. The chapter divides these characteristics into two categories: fundamental and enhancing qualitative characteristics.

1. Fundamental Qualitative Characteristics

The fundamental characteristics are essential for ensuring the usefulness of financial information. Without these, the information would fail to meet the needs of users.

i. Relevance:

Relevance is the capability of information to influence decisions made by users. Relevant information has predictive value, confirmatory value, or both:

- **Predictive Value:** It helps users forecast future outcomes based on past or current data. For instance, trends in revenue growth can provide insights into an entity's future performance.

- **Confirmatory Value:** Information is confirmatory if it helps validate or revise previous assessments. For example, actual profit figures confirm earlier projections of profitability.

Materiality is a key component of relevance. Information is material if omitting or misstating it could influence the economic decisions of users. The concept of materiality is entity-specific and depends on the size or nature of the item in question.

ii. Faithful Representation:

Financial information should represent the economic phenomena it claims to portray accurately. Faithful representation involves the following attributes:

- **Completeness:** The information includes all necessary details for users to understand it fully. For instance, a complete set of financial statements should include explanatory notes.
- **Neutrality:** Information must be free from bias and should not influence decision-making in a predetermined direction. A neutral stance ensures that users can rely on the fairness of the information.
- **Freedom from Error:** Financial information should be as accurate as possible. This does not imply absolute precision but requires the use of proper processes to minimize errors.

2. Enhancing Qualitative Characteristics

Enhancing characteristics improve the decision-making usefulness of financial information. These attributes do not override the fundamental characteristics but support them.

i. Comparability:
Financial information is comparable when users can identify similarities and differences across periods or between entities. For instance, using the same accounting standards allows stakeholders to compare a company's performance with its peers. Consistency, which involves applying the same accounting policies over time, is crucial for comparability.

ii. Verifiability:
Verifiability ensures that independent parties, given the same data, can reach a consensus that the information represents what it purports to. This could involve direct verification (e.g., auditing inventory counts) or indirect verification (e.g., recalculating financial ratios).

iii. Timeliness:
Information is useful only if it is available to users in time to influence their decisions. Delayed financial reports may lose relevance, even if they are accurate and faithfully represented. For instance, quarterly financial statements must be released promptly for investors making timely decisions.

iv. Understandability:
Information should be presented clearly and concisely, enabling users with reasonable knowledge of business and financial concepts to comprehend it. Complex data may need supplementary explanations to enhance understandability without oversimplifying crucial details.

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b. The Elements of Financial Statements

This chapter identifies and defines the fundamental building blocks of financial statements. These elements form the basis for presenting an entity's financial performance, position, and cash flows. They are categorized into two groups: elements related to the statement of financial position and those related to the statement of profit or loss.

1. Elements of the Statement of Financial Position

The statement of financial position (or balance sheet) provides a snapshot of an entity's financial status at a specific point in time. The primary elements include:

i. Assets:

An asset is a resource controlled by an entity due to past events, from which future economic benefits are expected to flow. Examples include cash, accounts receivable, inventory, property, plant, and equipment.

- **Recognition Criteria:** An asset is recognized when it is probable that future benefits will flow to the entity and its cost can be reliably measured.

ii. Liabilities:

A liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources. For example, loans payable, trade payables, and accrued expenses are liabilities.

- **Recognition Criteria:** A liability is recognized when an outflow of resources is probable, and the amount can be measured reliably.

iii. Equity:

Equity represents the residual interest in the assets of the entity after deducting liabilities. It is essentially the ownership interest in the company, encompassing items like share capital, retained earnings, and reserves.

2. Elements of the Statement of Profit or Loss

The statement of profit or loss reports the entity's financial performance over a period. The key elements include:

i. Income:

Income is the increase in economic benefits during an accounting period. It includes revenues (from ordinary activities like sales) and gains (from ancillary activities like selling an asset at a profit).

- **Recognition Criteria:** Income is recognized when an increase in economic benefits can be reliably measured and is probable to occur.

ii. Expenses:

Expenses are decreases in economic benefits during the accounting period. They include costs incurred in generating revenues, such as salaries, utilities, and depreciation.

- **Recognition Criteria:** Expenses are recognized when a decrease in economic benefits can be reliably measured and is probable to occur.

Interrelation Between the Elements

The elements of financial statements are interconnected. For instance:

- Income increases assets or decreases liabilities, leading to a rise in equity.
- Expenses decrease assets or increase liabilities, reducing equity.

This interrelationship reflects the duality principle, which is central to double-entry accounting.

Conclusion

The chapters on qualitative characteristics and elements of financial statements are integral to the Conceptual Framework for Financial Reporting. The qualitative characteristics ensure that financial information is relevant, faithfully represented, and enhanced through comparability, verifiability, timeliness, and understandability. On the other hand, the elements of financial statements provide the structure for presenting an entity's financial position and performance. Together, these chapters contribute to the creation of transparent, consistent, and decision-useful financial reports. This ensures that stakeholders can confidently use the information for economic decision-making, thereby promoting trust and efficiency in financial markets.

Q. 2

Describe Accounting Information System. How does the integration of an accounting information system impact the process of financial accounting, and what role does it play in enhancing the efficiency, accuracy, and reliability of financial reporting for businesses?

Ans;

Accounting Information System (AIS)

An **Accounting Information System (AIS)** is a structured system that collects, records, processes, and reports financial and accounting data to assist in decision-making. It combines people, processes, technology, and controls to ensure the accurate handling of financial transactions and the generation of reliable financial reports. The primary goal of an AIS is to deliver timely, accurate, and relevant information to users, such as management, investors, regulatory agencies, and other stakeholders.

Components of an Accounting Information System

An AIS consists of several key components that work together to streamline financial processes:

1. **People:**
   These include individuals who operate the AIS, such as accountants, auditors, and IT professionals. Their expertise

ensures the system's efficient functioning.

2. **Procedures and Instructions:**
 These are the rules and processes followed to record, process, and store data. Standardized procedures ensure consistency in data handling.

3. **Data:**
 Financial data such as sales records, purchase invoices, payroll information, and tax details form the backbone of the AIS.

4. **Software:**
 The software facilitates the processing and analysis of financial data. Popular accounting software includes QuickBooks, SAP, Oracle, and Xero.

5. **IT Infrastructure:**
 Hardware components like computers, servers, and networking devices support the AIS's functionality.

6. **Internal Controls:**
 Controls ensure data integrity, prevent unauthorized access, and maintain compliance with regulatory requirements.

Integration of AIS in Financial Accounting

The integration of an AIS significantly transforms the financial accounting process by automating routine tasks, reducing human

errors, and enhancing the quality of financial reporting. Let’s explore its impact in detail:

1. Automation of Financial Processes:

- AIS automates repetitive tasks such as journal entries, ledger updates, and trial balance preparation.
- Automation saves time, reduces manual effort, and allows accountants to focus on strategic analysis.

2. Real-time Financial Reporting:

- Modern AIS provides real-time updates, enabling businesses to monitor their financial position at any moment.
- This is particularly beneficial for decision-making in dynamic industries.

3. Enhanced Accuracy and Reliability:

- By minimizing human intervention, AIS reduces the likelihood of errors in data entry and processing.
- Built-in error-checking mechanisms ensure the accuracy of financial data.

4. Improved Compliance and Regulatory Adherence:

- AIS systems often come with features that ensure compliance with accounting standards (e.g., IFRS, GAAP) and tax regulations.
- Automated compliance reduces the risk of penalties due to non-adherence.

5. Simplified Data Analysis and Reporting:

- AIS enables complex financial analyses, such as ratio analysis, trend analysis, and variance analysis, with ease.

- Customizable reporting tools allow businesses to tailor reports to their specific needs.

6. Integration with Other Business Functions:

- Many AIS systems integrate with enterprise resource planning (ERP) tools, connecting accounting with inventory management, payroll, and sales.
- This integration promotes a holistic view of business operations and improves decision-making.

Role of AIS in Enhancing Efficiency, Accuracy, and Reliability

The role of an AIS in enhancing business operations cannot be overstated. Its impact can be categorized into three primary areas:

1. Efficiency in Financial Processes:

- **Streamlining Transactions:** AIS simplifies the recording of transactions by automating journal entries, ledger postings, and reconciliations.
- **Faster Financial Close:** Automation accelerates month-end and year-end closing processes, saving time and resources.
- **Integration with Cloud Computing:** Cloud-based AIS allows remote access, improving collaboration and operational flexibility.

2. Accuracy of Financial Data:

- **Error Reduction:** Automated calculations and data entry reduce the risk of manual errors, ensuring precise financial data.

- **Consistency in Reporting:** Standardized procedures and templates eliminate discrepancies in reporting across departments.
- **Audit Trails:** AIS maintains detailed records of all transactions, making it easier to identify and rectify discrepancies.

3. Reliability of Financial Reporting:

- **Real-time Monitoring:** AIS provides up-to-date financial information, ensuring reliability in decision-making.
- **Internal Controls:** Robust controls prevent unauthorized access, safeguarding data integrity and confidentiality.
- **Regulatory Compliance:** AIS systems ensure adherence to evolving accounting and tax regulations, boosting credibility with stakeholders.

Benefits of an Accounting Information System for Businesses

1. **Time Savings:**
    - Automating routine tasks allows businesses to focus on strategic goals.
2. **Cost Efficiency:**
    - Reduced reliance on manual processes lowers operational costs in the long run.
3. **Scalability:**

    - AIS systems can scale with business growth, accommodating increasing transaction volumes and complexity.
4. **Better Decision-Making:**
    - Access to accurate and timely financial data supports informed decision-making.
5. **Enhanced Security:**
    - Modern AIS systems include advanced security features such as encryption and multi-factor authentication.

Challenges in Implementing AIS

Despite its numerous benefits, AIS implementation may pose challenges:

1. **High Initial Costs:**
    - The installation and customization of AIS can be expensive, particularly for small businesses.
2. **Complexity:**
    - Implementing and maintaining AIS requires technical expertise and staff training.
3. **Cybersecurity Risks:**

- Dependence on technology exposes AIS to cybersecurity threats, necessitating robust security measures.

4. **Data Migration:**

    - Transitioning from manual systems to AIS may involve difficulties in migrating legacy data.

Conclusion

An Accounting Information System is a cornerstone of modern financial accounting. Its integration enhances the efficiency, accuracy, and reliability of financial reporting by automating processes, reducing errors, and enabling real-time monitoring. Although implementing an AIS involves challenges such as costs and complexity, the long-term benefits far outweigh these obstacles. Businesses that adopt a well-designed AIS gain a competitive edge by streamlining financial operations and ensuring the trust of stakeholders through transparent and compliant reporting practices.

Q. 3

Prepare journal entries to record the following merchandising transactions for both the seller (BMX) and buyer (Sanuk).(20) May 4 BMX sold $1,500 of merchandise on account to Sanuk, terms FOB shipping point, n/45, invoice dated May 4. The cost of the merchandise was $900.May 6 Sanuk paid transportation

charges of $30 on the May 4 purchase from BMX.May 8 BMX sold $1,000 of merchandise on account to Sanuk, terms FOB destination, n/30, invoice dated May 8. The cost of the merchandise was $700.May 10 BMX paid transportation costs of $50 for delivery of merchandise sold to Sanuk on May 8.May 16 BMX issued Sanuk a $200 credit memorandum for merchandise returned. The merchandise was purchased by Sanuk on account on May 8. The cost of the merchandise returned was $140.May 18 BMX received payment from Sanuk for purchase of May 8.May 21 BMX sold $2,400 of merchandise on account to Sanuk, terms FOB shipping point, 2/10, n/EOM. BMX prepaid transportation costs of $100, which were added to the invoice. The cost of the merchandise was $1,440.May 31 BMX received payment from Sanuk for purchase of May 21, less discount.

Ans:

Here are the journal entries for both **BMX (Seller)** and **Sanuk (Buyer)** based on the transactions:

Transactions for May 4

BMX (Seller):

Record the sale of merchandise on account.

Account	Debit	Credit
Accounts Receivable	1,500	
Sales Revenue		1,500

1.

Record the cost of goods sold (COGS).

Cost of Goods Sold 900

Inventory 900

2.

Sanuk (Buyer):

Record the purchase of merchandise on account.

Inventory 1,500

Accounts Payable 1,500

1.

Transactions for May 6

BMX (Seller):

- No entry required since Sanuk is responsible for transportation (FOB shipping point).

Sanuk (Buyer):

Record transportation costs as part of inventory.

Inventory 30

Cash 30

1.

Transactions for May 8

BMX (Seller):

Record the sale of merchandise on account.
Accounts Receivable 1,000
Sales Revenue 1,000

1.

Record the cost of goods sold (COGS).
Cost of Goods Sold 700
Inventory 700

2.

Sanuk (Buyer):

Record the purchase of merchandise on account.
Inventory 1,000
Accounts Payable 1,000

1.

Transactions for May 10

BMX (Seller):

Record the transportation cost (FOB destination).
Delivery Expense 50
Cash 50

1.

Sanuk (Buyer):

- No entry required since BMX is responsible for transportation (FOB destination).

Transactions for May 16

BMX (Seller):

Record the credit memorandum issued for returned merchandise.
Sales Returns and Allowances   200
Accounts Receivable   200

1.

Reverse the cost of goods sold for the returned merchandise.
Inventory   140
Cost of Goods Sold   140

2.

Sanuk (Buyer):

Record the return of merchandise.
Accounts Payable   200
Inventory   200

1.

Transactions for May 18

BMX (Seller):

Record the receipt of payment from Sanuk for May 8 purchase.
Cash   800
Accounts Receivable   800

1.

Sanuk (Buyer):

Record the payment of May 8 purchase.
Accounts Payable 800
Cash 800

1.

Transactions for May 21

BMX (Seller):

Record the sale of merchandise on account, including prepaid transportation added to the invoice.
Accounts Receivable 2,500
Sales Revenue 2,400
Cash 100

1.

Record the cost of goods sold (COGS).
Cost of Goods Sold 1,440
Inventory 1,440

2.

Sanuk (Buyer):

Record the purchase of merchandise, including transportation.
Inventory 2,500
Accounts Payable 2,500

1.

Transactions for May 31

BMX (Seller):

Record receipt of payment, less a 2% discount.

Cash 2,450

Sales Discounts 50

Accounts Receivable 2,500

1.

Sanuk (Buyer):

Record payment with a 2% discount.

Accounts Payable 2,500

Inventory 50

Cash 2,450

1.

Summary of Accounts

For BMX (Seller):

- Sales Revenue reflects total sales.
- Sales Returns and Allowances accounts for returns.
- Cost of Goods Sold adjusts for inventory outflows.
- Accounts Receivable tracks outstanding payments.
- Delivery Expense includes transportation costs borne by BMX.
- Sales Discounts accounts for reductions due to early payment.

For Sanuk (Buyer):

- Inventory includes the cost of purchases, transportation, and discounts.
- Accounts Payable tracks amounts owed.
- Cash reflects payments and transportation costs borne by Sanuk.

This comprehensive set of journal entries ensures accurate financial reporting for both BMX and Sanuk.

Q. 4

Subhan Trading Corporation through its intensive efforts for collection of its accounts receivables during the recent past period has some surplus funds in its working capital. The management wishes to generate some financial benefits from these available funds through investment in equity shares. According the corporation availed some opportunities and invested funds in the marketable securities as under: (20)1) Purchased 1,500 shares of Kohinoor Mills LTD of Rs. 100 each par value, at Rs. 250 each as on 28 September 2020, Rs. 300 each as on 30 June 2021.2) Acquired 2,000 shares of Saif Group of Industries Ltd of Rs. 50 each par value at Rs. 85 each on 15 March, 2021 which have the market value of RS. 100 each as at 30 June, 2021.Required:a.Record the purchase of marketable securities of both the companies in the accounting books.b.Record the increase in the market price of investment in the accounts.c.Present the marketable securities in the financial

statements in compliance to mark to marked concept of securities.

Ans;

To address the requirements, we will prepare the journal entries for **Subhan Trading Corporation** for the purchase of marketable securities and the adjustments based on market value. We will also present how these securities will be reflected in the financial statements under the **mark-to-market concept**.

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a. Recording the Purchase of Marketable Securities

Kohinoor Mills Ltd Shares

Subhan Trading Corporation purchased 1,500 shares of Kohinoor Mills Ltd with a par value of Rs. 100 each at Rs. 250 per share.

Journal Entry (28 September 2020):

Investment in Kohinoor Mills Ltd 375,000
Cash 375,000

1. *(1,500 shares × Rs. 250 = Rs. 375,000)*

Saif Group of Industries Ltd Shares

Subhan Trading Corporation acquired 2,000 shares of Saif Group

of Industries Ltd with a par value of Rs. 50 each at Rs. 85 per share.

Journal Entry (15 March 2021):

Investment in Saif Group of Industries Ltd 170,000
Cash 170,000

2. *(2,000 shares × Rs. 85 = Rs. 170,000)*

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b. Recording the Increase in Market Price

Under the **mark-to-market concept**, investments in marketable securities are adjusted to their fair market value at the reporting date.

1. **Kohinoor Mills Ltd Shares (as of 30 June 2021):**
   The market price increased to Rs. 300 per share.

   Adjustment:

   - Market value: 1,500 shares × Rs. 300 = Rs. 450,000
   - Book value: 1,500 shares × Rs. 250 = Rs. 375,000
   - Increase in value: Rs. 450,000 - Rs. 375,000 = Rs. 75,000

Journal Entry:

Unrealized Gain on Investments 75,000
Investment in Kohinoor Mills Ltd 75,000

2.
3. **Saif Group of Industries Ltd Shares (as of 30 June 2021):**
   The market price increased to Rs. 100 per share.

   Adjustment:

   - Market value: 2,000 shares × Rs. 100 = Rs. 200,000
   - Book value: 2,000 shares × Rs. 85 = Rs. 170,000
   - Increase in value: Rs. 200,000 - Rs. 170,000 = Rs. 30,000

Journal Entry:

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Unrealized Gain on Investments        30,000
   Investment in Saif Group of Industries Ltd        30,000
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4.

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c. Presentation in the Financial Statements

Balance Sheet (as of 30 June 2021):

Under **current assets**, the marketable securities will be presented at their fair market value as follows:

Marketable Securities	Book Value (Rs.)	Market Value (Rs.)
Investment in Kohinoor Mills Ltd	375,000	450,000

Investment in Saif Group of Industries Ltd	170,000	200,000
Total Marketable Securities	545,000	650,000

Journal Entries for Adjustments to Market Value:
Unrealized gains are recorded in the **Other Comprehensive Income (OCI)** section of the equity portion of the financial statements.

Income Statement:

Unrealized gains on investments are reported under **Other Income**, as follows:

Particulars	Amount (Rs.)
Unrealized Gain on Kohinoor Mills Ltd Shares	75,000
Unrealized Gain on Saif Group of Industries Ltd Shares	30,000
Total Unrealized Gain	105,000

Conclusion

1. **Purchase of securities** is recorded based on the actual cash price paid at the time of acquisition.

2. **Adjustments to fair market value** ensure compliance with the mark-to-market concept, reflecting unrealized gains in the financial statements.
3. **Financial presentation** aligns investments with current market values under the **current assets** section of the balance sheet and unrealized gains in the **income statement.**

Q. 5

Shahid Trading Company is applying the balance sheet approach for valuation of its accounts receivables at year end. Besides during the year it has written of Rs. 4,500 accounts receivable from an insolvent customer by debiting it to the allowance for doubtful accounts. At the end of year on 30 June, 2020 the ageing of accounts receivables was computed as under: -(20)

Ans:

Shahid Trading Company applies the balance sheet approach to calculate the allowance for doubtful accounts. This method evaluates accounts receivable based on their age and applies estimated percentages for uncollectibility to determine the required allowance.

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a. Compute the Amount of Uncollectible Accounts

Using the provided percentages for each age group, the probable uncollectible accounts are calculated as follows:

Age Group	Accounts Receivable (Rs.)	Percentage Uncollectible	Uncollectible Amount (Rs.)
Not yet due	350,000	0.5%	1,750
1–30 days past due	580,000	2%	11,600
31–60 days past due	432,000	4%	17,280
61–90 days past due	218,000	5%	10,900
91–180 days past due	125,000	8%	10,000
181–365 days past due	60,000	10%	6,000
Total	**1,765,500**	**—**	**57,530**

The total estimated uncollectible accounts are **Rs. 57,530**.

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b. Prepare the Adjusting Entry for the Year-End

Steps to Determine the Adjustment:

1. **Calculate the Required Allowance:**
 Total uncollectible accounts = **Rs. 57,530**.

2. **Consider the Beginning Allowance and Write-Offs:**

   - Beginning allowance is unknown but adjusted for write-offs.
   - Accounts written off during the year = **Rs. 4,500** (debited to allowance).

3. **Year-End Adjustment Formula:**
 Required adjustment = Total estimated uncollectible accounts - Current allowance balance.

 Assuming the current allowance balance before adjustment is **0**, the adjustment required is **Rs. 57,530**.

Journal Entry (30 June 2020):

Bad Debt Expense	57,530	
Allowance for Doubtful Accounts		57,530

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c. Adjusting Entry for Usman Brothers (25 July 2020)

Write-Off Details:

- Amount owed by Usman Brothers = **Rs. 8,400**.
- Receivable past due by 150 days (in the 91–180 days past due group).

Journal Entry (25 July 2020):

Allowance for Doubtful Accounts 8,400
Accounts Receivable – Usman Brothers 8,400

This entry removes the uncollectible amount from accounts receivable and reduces the allowance for doubtful accounts.

Summary

1. **Uncollectible Accounts:** Calculated based on ageing and percentages, totaling **Rs. 57,530**.
2. **Adjusting Entry:** Recognizes bad debt expense to ensure the allowance matches the computed uncollectible accounts.
3. **Write-Off Entry:** For specific accounts deemed uncollectible (e.g., Usman Brothers), the receivable is removed, and the allowance is reduced accordingly.

This approach ensures the company's accounts receivable and allowance for doubtful accounts reflect realistic and accurate values.