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CPA

Financial accounting

April 2026

Level: Foundation Level

Question 1a

 Regulation and other principles guiding the accounting profession

Explain TWO core characteristics of useful financial information.

✓ Answer for Question 1a

1. Relevance

Financial information is **relevant** if it is capable of influencing the economic decisions of users. It helps users evaluate past, present, or future events or confirm or correct previous evaluations.

Key aspects:

- **Predictive value:** Helps users predict future outcomes, such as future profits or cash flows.
- **Confirmatory value:** Confirms or changes previous expectations or assessments.
- **Materiality:** Information is material if its omission or misstatement could influence users' decisions.

Example: Reporting a significant decline in sales is relevant because it may affect investors' decisions about buying or selling shares.

2. Faithful Representation

Financial information should **faithfully represent** the economic phenomena it is intended to depict. This means the information should accurately reflect the substance of transactions and events.

A faithful representation has three qualities:

- **Complete:** Includes all information necessary for users to understand the transaction or event.
- **Neutral:** Presented without bias or manipulation to achieve a desired outcome.
- **Free from material error:** Prepared carefully and accurately, with no significant errors or omissions.

Example: Recording an asset at its correct cost and disclosing all relevant information ensures the financial statements faithfully represent the company's financial position.

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April 2026

Level: Foundation Level

Question 1b

Financial Statements of a sole trader

The following balances were extracted from the books of Upendo Traders as at 31 December 2025:

	Dr.	Cr.
	Sh."000"	**Sh."000"**
Premises	180,000	
Furniture	90,000	
Inventory (1 January 2025)	42,000	
Purchases	240,000	
Carriage inwards	8,000	
Salaries and wages	54,000	
Lighting and heating	12,000	
General expenses	18,000	
Trade receivables	60,000	
Bank	27,000	
Drawings	36,000	
Capital		250,000
Sales		480,000
Trade payables		30,000
Discounts received		7,000
	767,000	767,000

Additional information:

1. Inventory as at 31 December 2025 was valued at Sh.36,000,000
2. Salaries and wages accrued amounted to Sh.6,000,000
3. Lighting and heating prepaid amounted to Sh.2,000,000.
4. Depreciation on furniture is provided at 10% per annum.
5. Allowance for credit losses is to be maintained at 5% of trade receivables.

6. Included in general expenses is Sh.3,000,000 relating to the proprietor's personal expenses.
7. Goods costing Sh.5,000, 000 were withdrawn by the proprietor for personal use but had not been recorded.
8. Carriage inwards includes Sh.1,200,000 relating to carriage on furniture purchased during the year.

Required:

(i) Statement of profit or loss for the year ended 31 December 2025.

(ii) Statement of financial position as at 31 December 2025.

✓ Answer for Question 1b

(i) Upendo Traders

Statement of Profit or Loss for the Year Ended 31 December 2025

Details	Sh. "000"	Sh. "000"
Sales		480,000
Less: Cost of Sales		
Opening Inventory	42,000	
Add: Purchases	235,000	
Add: Carriage inwards	6,800	
Goods Available for Sale	283,800	
Less: Closing Inventory	(36,000)	(247,800)
Gross Profit		**232,200**
Add: Discounts received		7,000
Total Income		**239,200**
Less: Expenses		
Salaries and wages	60,000	
General expenses	15,000	
Lighting and heating	10,000	
Depreciation on furniture	9,120	
Allowance for credit losses	3,000	(97,120)
Net Profit		**142,080**

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Financial accounting

April 2026

Level: Foundation Level

Question 3b

Financial Statements of a partnership

Amina and Otieno are in partnership sharing profits and losses in the ratio of 3:2 respectively. Interest on capital is allowed at the rate of 10% per annum.

The following trial balance was extracted from the books of the partnership as at 31 December 2025:

	Dr	Cr
	Sh. "000"	**Sh. "000"**
Purchases	32,000	
Salaries and wages	8,000	
Rent	4,000	
General expenses	2,800	
Inventory (1 January 2025)	6,000	
Trade receivables	7,200	
Bank	31,800	
Office equipment	5,000	
Drawings - Amina	4,800	
- Otieno	3,600	
Sales		60,000
Capital - Amina		24,000
- Otieno		16,000
Trade payables		5,200
	105,200	**105,200**

Additional information:

1. Inventory as at 31 December 2025 was valued at Sh.8,400,000.

2. Partners are entitled to annual salaries as follows:
   Amina – Sh.3,000,000
   Otieno – Sh.2,400,000

3. Interest on drawings is to be charged at 5% per annum.

4. Rent amounting to Sh.400,000 was outstanding as at 31 December 2025.

5. Expected credit losses is to be set at 5% of trade receivables.

6. Included in the general expenses is Sh.200,000 relating to partners' private expenses shared equally between Amina and Otieno.

7. Office equipment is to be depreciated at 10% per annum.

Required:

(i) Statement of profit or loss and appropriation account for the year ended 31 December 2025.

(ii) Partners' capital accounts.

(iii) Statement of financial position as at 31 December 2025.

✓ Answer for Question 3b

(i) Amina and Otieno Partnership

Statement of Profit or Loss and Appropriation Account for the Year Ended 31 December 2025

Details	Sh. "000"	Sh. "000"
Sales		60,000
Less: Cost of Sales		
Opening Inventory	6,000	
Add: Purchases	32,000	
Goods Available for Sale	38,000	
Less: Closing Inventory	(8,400)	(29,600)
Gross Profit		**30,400**
Less: Expenses		
Salaries and wages	8,000	
Rent(W1)	4,400	
General expenses(W4)	2,600	
Depreciation: Office equipment(W3)	500	
Expected credit losses(W2)	360	(15,860)
Net Profit for the Year		**14,540**
Add: Interest on Drawings		
— Amina	240	
— Otieno	180	420
Total Amount for Appropriation		**14,960**

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Financial accounting

December 2022

Level: Foundation Level

Question 1b

 Correction of errors and preparing financial statements with incomplete records

Ujenzi Enterprises is a small retail firm. The trial balance of the firm failed to agree on 30 June 2022. The difference was transferred to a suspense account and financial statements prepared. On detailed review of the books, the following errors were revealed:

1. The purchases daybook had been undercast by Sh.1,200,000.
2. Purchases on credit from Demario Ltd. for Sh.600,000 had been posted to their account as Sh.6,000,000.
3. A purchase of a machine worth Sh.8,400,000 had been posted to repairs of machinery account.
4. A customer returned goods worth Sh.1,200,000. This transaction had been entered in the sales returns daybook and posted to the debit of the customer's account.
5. Sh.7,200,000 owed by Jeru Ltd., a customer, had been omitted when drawing up a schedule of debtors from the ledger.
6. A cash discount of Sh.240,000 had been correctly entered in the cashbook, but has not been posted to the customer's account.

Required:

(i) Journal entries to correct the above errors. (Narrations not required).

(ii) Suspense account duly balanced (including the opening balance).

✓ Answer for Question 1b

(i) Journal Entries to Correct Errors

No.	Details	Debit (Sh.)	Credit (Sh.)
1.	Purchases Account	1,200,000	
	Suspense Account		1,200,000
2.	Demario Ltd	5,400,000	
	Suspense		5,400,000
3.	Machinery	8,400,000	
	Repairs		8,400,000
4.	Suspense	2,400,000	
	Customer		2,400,000
5.	Suspense	240,000	
	Customer (Sales Ledger)		240,000

NOTES ON JOURNAL ENTRIES:

1. **Error 1** – Purchases daybook undercast affects trial balance; corrected by debiting Purchases and crediting Suspense.
2. **Error 2** – Creditor's account overstated by Sh.5,400,000; corrected by debiting the creditor and crediting Suspense.
3. **Error 3** – Capital expenditure incorrectly treated as revenue expenditure; correction transfers amount from Repairs to Machinery (no suspense effect).
4. **Error 4** – Sales return wrongly debited to customer; customer account needs credit of Sh.2,400,000 (to reverse wrong debit + record correct credit).
5. **Error 5** – Omission from schedule of debtors is not a ledger error; no journal entry required.

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Financial accounting

April 2024

Level: Foundation Level

Question 1a

 Regulation and other principles guiding the accounting profession

Explain the following accounting principles:

(i) Economic entity principle.

(ii) Matching principle.

✓ Answer for Question 1a

(i) Economic Entity Principle

Definition

The **Economic Entity Principle** (also called the **Business Entity Principle**) states that a business must be accounted for separately from its owners and any other entities. The business is treated as a distinct economic unit with its own financial records, completely independent of the personal finances of its owners.

Key Aspects

- **Separation of Business and Personal Transactions**: Personal expenses, assets, and liabilities of the owner(s) are not recorded in the business's books.
- **Clear Distinction**: Even in sole proprietorships where the business is not a separate legal entity, accounting treats it as separate for financial reporting.
- **Applies to All Business Structures**: Corporations, partnerships, and sole proprietorships all follow this principle.

Example

If a business owner uses business funds to pay for a personal vacation, that transaction should **not** be recorded as a business expense. It should be recorded as a **drawing** or **withdrawal** by the owner, reducing owner's equity.

Importance

- Provides clarity and accuracy in financial statements
- Prevents mixing of personal and business finances
- Essential for accurate tax reporting and legal compliance
- Enables proper assessment of business performance

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Financial accounting

April 2024

Level: Foundation Level

Question 2

 Financial Statements of a partnership

Melody and Olivia commenced a partnership business on 1 January 2023 sharing profit or loss in the ratio of 2:1 after allowing interest on the capital introduced by the partners at a rate of 10% per annum. Olivia was to receive a salary of Sh.80,000 per month starting from 1 February 2023. Melody and Olivia, have not employed a qualified accountant, hence the business lacks complete accounting records.

The following summary of the bank statements for the year ended 31 December 2023 was provided:

Receipts:		**Sh."000"**
Capital introduced	- Melody	7,000
	- Olivia	4,000
Balance of cash received from customers		25,400
Payments:	- Equipment	5,000
	- Motor vehicle	2,000
	- Furniture and fittings	750
Godown rent		750
Wages		3,544
Salary to sales team		2,400
Purchase of inventory		19,800
Rates		400
Repairs and maintenance		125
Insurance expenses		110
Motor vehicle operating expenses		373

The following cash payments were made before banking the balance of the cash received from customers:

		Sh."000"

Motor vehicle operating expenses		258
Wages		296
General administrative expenses		50
Drawings	- Melody (per week)	15
	- Olivia (per week)	12

Additional information:

1. During the year ended 31 December 2023, discount allowed to customers amounted to Sh.245,000 while discounts received from suppliers amounted to Sh.110,000.

2. As at 31 December 2023, the amounts owing to suppliers amounted to Sh.1,500,000 and the amount owing by customers was Sh.3,100,000. An amount of Sh.400,000 owing by a customer was written off.

3. As at 31 December 2023, rates and insurance prepaid amounted to Sh.50,000 and Sh.10,000 respectively.

4. Inventory was valued at Sh.2,410,000 as at 31 December 2023.

5. The go-down had been occupied since 1 January 2023 at an annual rent of Sh.1,000,000.

6. Depreciation is provided on a straight-line basis as follows:

Asset	**Rate**
Motor vehicles	20% per annum
Equipment, furniture and fittings	10% per annum

7. The partners had taken goods for their domestic use as follows:

	Sh.
Melody	100,000
Olivia	150,000

Assume a 52-week year.

Required:

(a) Partnership statement of profit or loss and appropriation account for the year ended 31 December 2023.

(b) Partners’ current accounts as at 31 December 2023.

(c) Statement of financial position as at 31 December 2023.

✓ Answer for Question 2

(a) PARTNERSHIP STATEMENT OF PROFIT OR LOSS AND APPROPRIATION ACCOUNT

For the year ended 31 December 2023

	Sh. "000"	Sh. "000"
Sales (W1)		31,153
Cost of Sales:		
Opening Inventory	0	
Purchases (21,410 – 250 drawings of goods)	21,160	
Less: Closing Inventory	(2,410)	(18,750)
Gross Profit		**12,403**
Add: Discount Received		110
Total Income		**12,513**
Expenses:		
Wages (3,544 banked + 296 cash)	3,840	
Salaries (Sales team)	2,400	
Godown Rent (Note 5)	1,000	
Rates (400 – 50 prepaid)	350	
Insurance (110 – 10 prepaid)	100	
MV Operating Expenses (373 banked + 258 cash)	631	
Repairs and Maintenance	125	
General Administrative Expenses	50	
Discount Allowed	245	

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Financial accounting

April 2024

Level: Foundation Level

Question 4

 Analyzing Financial Statements

The following are the financial statements of HMK Limited as at 31 December:

Equity and Liabilities:	**2023**	**2022**
Equity	**Sh.“000”**	**Sh.“000”**
Ordinary share capital	900,000	600,000
Share premium	210,000	90,000
Revenue reserves	246,000	84,000
Total equity and reserves	**1,356,000**	**774,000**
Non-current liabilities:		
Debentures	180,000	300,000
Bank loan	-	120,000
Total long term liabilities	**180,000**	**420,000**
Current liabilities:		
Trade payables	288,000	204,000
Proposed dividends	90,000	45,000
Corporate tax	198,000	129,000
Bank overdraft	-	84,000
	576,000	**462,000**
Total equity and liabilities	**2,112,000**	**1,656,000**
Non-current assets:		
Freehold land (Net book value)	780,000	660,000
Plant and machinery (Net book value)	582,000	450,000
Furniture and fittings (Net book value)	84,000	66,000
	1,446,000	1,176,000
Current assets:		

Inventory	306,000	222,000
Trade receivables	264,000	256,800
Short term investments	27,600	-
Cash in hand	68,400	1,200
	666,000	**480,000**
Total assets	**2,112,000**	**1,656,000**

Additional information:

1. A machinery with a net book value of Sh.12,000,000 (original cost Sh.48,000,000) was sold for Sh.18,000,000. Furniture with a net book value of Sh.18,000,000 (original cost Sh.30,000,000) was sold for Sh.13,000,000. Profits and losses on these transactions had been reported in the statement of profit or loss.

2. Corporate tax for the year ended 31 December 2023 was Sh.80,000,000.

3. The proposed dividends for the year ended 31 December 2022, were paid during the year ended 31 December 2023.

4. There was no disposal or revaluation of freehold property in the year ended 31 December 2023.

5. Interest expense charged to the statement of profit or loss for the year ended 31 December 2023 was Sh.38,400,000. Accrued interest of Sh.26,400,000 is included in the trade payables as at 31 December 2023.

6. Depreciation charged to the statement of profit or loss for the year ended 31 December 2023 was as follows:

	Sh.
Furniture and fixtures	34,000,000
Plant and machinery	58,000,000

Required:

Statement of cash flows for the year ended 31 December 2023 in accordance with International Accounting Standard (IAS) 7 “Statement of Cash Flows”.

✓ Answer for Question 4

HMK LIMITED

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2023

Cash flows from operating activities	**Sh. "000"**	**Sh. "000"**
Net profit before tax (W1)		332,000
Adjustments for:		
Depreciation (58,000 + 34,000)	92,000	
Interest expense	38,400	
Gain on sale of machinery	(6,000)	
Loss on sale of furniture	5,000	
Operating profit before working capital changes		461,400
Increase in Inventory (306,000 - 222,000)	(84,000)	
Increase in Trade Receivables (264,000 - 256,800)	(7,200)	
Increase in Trade Payables (excluding interest) (W4)	57,600	
Cash generated from operations		427,800
Interest paid (W5)	(12,000)	
Tax paid (129,000 + 80,000 - 198,000)	(11,000)	
Net cash flow from operating activities		**404,800**
Cash flows from investing activities		
Purchase of Freehold Land	(120,000)	
Purchase of Plant & Machinery (W2)	(202,000)	
Purchase of Furniture & Fittings (W2)	(70,000)	

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Financial accounting

August 2023

Level: Foundation Level

Question 2b

 The Accounting Process and Systems, Financial Statements of a sole trader

The following balances were extracted from the books of Juhudi Traders for the month of July 2023:

	Sh."000"
Debit balances: (1 July 2023) Sales ledger	1,428,000
(1 July 2023) Purchases ledger	10,500
Credit balances: (1 July 2023) Sales ledger	40,500
(1 July 2023) Purchases ledger	553,800
Discounts received	142,500
Discounts allowed	209,700
Purchases (including cash purchases of Sh.152,000)	1,334,000
Cash sales	618,000
Credit sales	2,068,200
Credit notes issued to customers	75,000
Contra settlements	36,900
Payments to trade payables	1,159,200
Interest charged by trade payables on overdue accounts	69,000
Receipts from trade receivables	1,578,000
Bad debts written off	37,200
Customer's dishonoured cheques	26,100
Interest charged on customers' overdue accounts	96,100
Debt collection expenses charged to trade receivables	10,800
Credit notes received from trade payables	26,700
Balances as at 31 July 2023:	

• Purchases ledger (Debit)	14,400
• Sales ledger (Credit)	50,700

Required:
(i) Sales ledger control account for the month ended 31 July 2023.

(ii) Purchases ledger control account for the month ended 31 July 2023.

✓ Answer for Question 2b

(i) Sales Ledger Control Account

Details	Sh. "000"	Details	Sh. "000"
Balance b/d (Opening Debit)	1,428,000	Balance b/d (Opening Credit)	40,500
Credit Sales	2,068,200	Receipts from Receivables	1,578,000
Dishonoured Cheques	26,100	Discounts Allowed	209,700
Interest on overdue accounts	96,100	Credit notes issued (Returns)	75,000
Debt collection expenses	10,800	Bad debts written off	37,200
Balance c/d (Closing Credit)*	50,700	Contra settlements	36,900
		Balance c/d (Closing Debit) [Bal. Fig]	1,702,600
Total	**3,679,900**	**Total**	**3,679,900**

Note:
Balance b/d (Aug 1 Debit) = 1,702,600
Balance b/d (Aug 1 Credit) = 50,700

(ii) Purchases Ledger Control Account

Details	Sh. "000"	Details	Sh. "000"
Balance b/d (Opening Debit)	10,500	Balance b/d (Opening Credit)	553,800
Payments to trade payables	1,159,200	Credit Purchases (W1)	1,182,000

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Financial accounting

December 2022

Level: Foundation Level

Question 1b

 Correction of errors and preparing financial statements with incomplete records

Ujenzi Enterprises is a small retail firm. The trial balance of the firm failed to agree on 30 June 2022. The difference was transferred to a suspense account and financial statements prepared. On detailed review of the books, the following errors were revealed:

1. The purchases daybook had been undercast by Sh.1,200,000.
2. Purchases on credit from Demario Ltd. for Sh.600,000 had been posted to their account as Sh.6,000,000.
3. A purchase of a machine worth Sh.8,400,000 had been posted to repairs of machinery account.
4. A customer returned goods worth Sh.1,200,000. This transaction had been entered in the sales returns daybook and posted to the debit of the customer's account.
5. Sh.7,200,000 owed by Jeru Ltd., a customer, had been omitted when drawing up a schedule of debtors from the ledger.
6. A cash discount of Sh.240,000 had been correctly entered in the cashbook, but has not been posted to the customer's account.

Required:

(i) Journal entries to correct the above errors. (Narrations not required).

(ii) Suspense account duly balanced (including the opening balance).

✓ Answer for Question 1b

(i) Journal Entries to Correct Errors

No.	Details	Debit (Sh.)	Credit (Sh.)
1.	Purchases Account	1,200,000	
	Suspense Account		1,200,000
2.	Demario Ltd	5,400,000	
	Suspense		5,400,000
3.	Machinery	8,400,000	
	Repairs		8,400,000
4.	Suspense	2,400,000	
	Customer		2,400,000
5.	Suspense	240,000	
	Customer (Sales Ledger)		240,000

NOTES ON JOURNAL ENTRIES:

1. **Error 1** – Purchases daybook undercast affects trial balance; corrected by debiting Purchases and crediting Suspense.
2. **Error 2** – Creditor's account overstated by Sh.5,400,000; corrected by debiting the creditor and crediting Suspense.
3. **Error 3** – Capital expenditure incorrectly treated as revenue expenditure; correction transfers amount from Repairs to Machinery (no suspense effect).
4. **Error 4** – Sales return wrongly debited to customer; customer account needs credit of Sh.2,400,000 (to reverse wrong debit + record correct credit).
5. **Error 5** – Omission from schedule of debtors is not a ledger error; no journal entry required.