Accounting Technicians Ireland

Financial Accounting

1st Year Examination

August 2013

Paper, Solutions & Examiner's Report

Professional. Practical. Proven.

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There are often many possible approaches to the solution of questions in professional examinations. It should not be assumed that the approach adopted in these solutions is the ideal or the one preferred by us. Alternative answers will be marked on their own merits.

This publication is intended to serve as an educational aid. For this reason, the published solutions will often be significantly longer than would be expected of a candidate in an examination. This will be particularly the case where discursive answers are involved.

Accounting Technicians Ireland

First Year Examination: Autumn 2013

Paper : FINANCIAL ACCOUNTING

Tuesday 20th August 2013 - 9.30 a.m. to 12.30 p.m.

INSTRUCTIONS TO CANDIDATES

PLEASE READ CAREFULLY

Candidates must indicate clearly whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

In this examination paper the €/£ symbol may be understood and used by candidates in Northern Ireland to indicate the UK pound sterling and by candidates in the Republic of Ireland to indicate the Euro.

Answer ALL THREE questions in Section A and TWO of the three questions in Section B. If more than TWO questions is answered in Section B, then only the first two questions, in the order filed, will be corrected.

Candidates should allocate their time carefully.

All workings should be shown.

All figures should be labelled as appropriate e.g. £s, €s, units, etc.

Answers should be illustrated with examples, where appropriate.

Candidates may ignore any VAT implications to transactions throughout this paper unless the question specifically instructs them to do otherwise.

Question 1 begins on Page 2 overleaf.

Note:
This paper uses both the language of International Accounting Standards (I.A.S's) and Financial Reporting Standards (F.R.S's) where appropriate (e.g. Receivables/Debtors). Examinees are permitted to use either terminology when preparing financial statements but the use of the language of the International Accounting Standards (e.g. Receivables rather than Debtors) is preferred.

SECTION A

Answer ALL THREE QUESTIONS (Compulsory) in this Section

QUESTION 1 *(Compulsory)*

The following trial balance was extracted from the books of N. Trust, a sole trader, on 31 December 2012:

	€/£	**€/£**
Buildings	313,500	
Accumulated depreciation on buildings		105,900
Computers and equipment at cost	77,400	
Accumulated depreciation on computers and equipment		32,450
Inventory as at 1/1/2012	37,780	
Receivables and payables	165,790	154,110
Bank		17,010
Cash in tills	650	
PRSI/NIC liability		13,410
Purchases and sales	295,410	505,140
Returns		7,620
Discounts	6,750	3,740
Stationary and administration	3,170	
Carriage outwards and advertising	11,890	
Carriage inwards	3,220	
Light and heat	2,010	
Internet and communications	9,700	
Insurance	30,150	
Bank interest	475	
Wages and salaries	86,150	
Allowance for receivables 1/1/2012		4,140
Irrecoverable debts	6,740	
Irrecoverable debts recovered		1,440
Suspense	1,250	
Drawings	16,090	
Accumulated profit and loss		78,950
Capital		144,215
	1,068,125	**1,068,125**

The following information, which has *not* been accounted for above, is also available:

1. The inventory count as at 31 December 2012 showed 21,250 units of closing inventory. Each unit of inventory is valued at €/£1.30.

2. During 2012 N. Trust took goods to the value of €/£310 per month for his personal use.

3. N. Trust has carried out a review of his receivables balance as at 31 December 2012. He considers that a further €/£11,450 of receivables should be written off as irrecoverable and that the closing allowance for receivables should be set at 10% of the final receivable balance.

4. Insurance is paid annually in advance on 30 September. Insurance for the year ended 30 September 2013 of €/£16,500 was paid on 30 September 2012.

QUESTION 1 (Cont'd)

5. Allowances to be made for depreciation as follows:

Buildings..	2% straight line
Computers and equipment................	10% reducing balance

6. The balance in the suspense account relates solely to a payment to a supplier that was incorrectly treated. The entry in the bank account was correct but no other entry was made.

You are required to prepare:

a) The Statement of Profit and Loss for the year ended 31 December 2012.

12 Marks

b) The Statement of Financial Position as at that date.

8 Marks

Total 20 Marks

QUESTION 2 *(Compulsory)*

Part A
G. Masala is a sole trader who sells some goods on credit. G. Masala did not maintain proper books and records for the year ended 31 December 2012, but G. Masala is in a position to provide you with the following information which all relates to credit customers:

	€/£
Receivables 1/1/2012	51,750
Receivables 31/12/2012	49,650
Allowance for receivables 1/1/2012	4,150
Sales returns	12,410
Irrecoverable debts written off	11,970
Discounts allowed	1,030
Contra entry with payables	650
Cash received from credit customers	104,740

You are required to calculate the credit sales of G. Masala for the year ended 31 December 2012

7 Marks

Part B
G. Masala realises that she has not kept strong internal controls over the business's cash. She suspects an employee is stealing cash from the business. G. Masala is able to provide you with the following information in relation to the cash movements of the business for the year ended 31 December 2012:

	€/£
Cash float 1/1/2012	1,050
Cash float 31/12/2012	3,650
Sundry expenses paid from cash	12,950
Cash lodged to the business bank account from cash sales	84,190
Cash sales	104,710
Drawings in cash from the shop till	915

You are required to advise G. Masala as to whether it appears likely that an employee is stealing cash or not and the amount of cash that appears to have been stolen.

7 Marks

Part C
Outline your understanding of the concepts of mark-up and margin.

3 Marks

Part D
N. Gavin is a sole trader who sells one product. The cost of the product is €/£12. N. Gavin is considering setting a mark-up of 25% on the good.

Calculate the selling price of the product if a mark-up of 25% is applied and calculate the profit margin at this selling price.

3 Marks
Total 20 Marks

QUESTION 3 ***(Compulsory)***

On 5 January 2013, T. Turmeric received her bank statements for the month ended 31 December 2012. bank statement showed a balance of €/£11,060 (overdraft) as at 31 December while the cash book showed a balance of €/£23,648 (credit) as at the date. On examination of the cash book and the bank statement the following were discovered:

1. Bank charges of €/£165 had not been recorded in the cash book;

2. A dishonoured cheque of €/£2,256 from a receivable, had been recorded as cash receipts, in error, in the cash book;

3. The bank has debited the bank account (statement) in error with €/£500 that relates to another customer;

4. A payment of €/£1,450 on 27 December 2012 had not been processed by the bank and had not been paid out as T. Turmeric had exceeded her overdraft limit. This payment had been posted to the cash book on 27 December;

5. The bank statement shows a penalty of €/£250 for exceeding the approved overdraft level. This has not been recorded in the cash book;

6. A cheque of €/£125 to pay sundry expenses, was recorded in the bank account but omitted from the cash book;

7. Cash receipts of €/£3,700 were posted as cash payments of €/£7,300 in the cash book;

8. On 27^{th} December T. Turmeric lodged cash of €/£110 to her personal bank account. This was lodged to the business bank account in error by the bank;

9. Standing orders and direct debits of €/£1,090 had not been posted to the cash book;

10. Receivables of €/£2,900 were lodged directly to the bank account. No record had been made of this in the cash book;

11. Lodgements of €/£3,790, lodged to the bank account on 31 December 2012, had not been credited by the bank;

12. The following cheques, drawn on the bank account, had not been presented to the bank for payment as at 31 December 2012:

Cheque Number	**Date Cheque was Written**	**€/£**
No: 676	17 October 2012	925
No: 701	30 December 2012	6,010
No: 703	31 December 2012	625

You are required to:

a) Prepare the adjusted cash book for the month of December 2012.

10 Marks

b) Prepare a statement on 31 December 2012, reconciling the adjusted cash book with the bank statement balance.

6 Marks

c) Explain, in report format, <u>two</u> reasons for preparing bank reconciliations on a regular basis.

<u>4</u> Marks
Total <u>20</u> Marks

SECTION B

Answer any TWO of the three questions in this Section

QUESTION 4

Part A

Outline your understanding of the accruals concept.

3 Marks

Discuss the implications the accruals concept has on the treatment of closing inventory in the financial statements of a business.

3 Marks

Part B

i. Write a brief note on the following terms as they relate to inventory valuation in the financial statements:

- Cost.
- Net realisable value (NRV).

4 Marks

C. Cumin manufactures and sells three products: Products Alpha, Beta and Gamma. The following information is available for the year ended 31 December 2012 (on a per unit basis):

Inventory Item	Costs Incurred	Cost to Complete	Sales Price	Costs to Sell	Units in Inventory
	€/£	€/£	€/£	€/£	
Alpha	5.50	1.25	14.25	2.30	1,000
Beta	6.25	Nil	6.50	0.50	2,500
Gamma	2.75	4.10	7.10	1.20	950

ii. State the principle used to value inventory items for inclusion in the financial statements of a business.

1 Mark

iii. Calculate the total value of inventory for inclusion in the financial statements of C. Cumin.

6 Marks

Part C

Valuing inventory appropriately has an important impact upon the financial statements of an entity. Outline the affect on the Statement of Profit and Loss and Statement of Financial Position if closing inventory is *over-valued.*

3 Marks
Total 20 Marks

QUESTION 5

Part A

Outline your understanding of the role played by the books of prime entry in the financial accounting system. Provide an example of a book of prime entry and outline the information contained in that book of prime entry.

3 Marks

Part B

Outline your understanding of how the VAT system operates.

(Note: knowledge of VAT rates is not expected).

4 Marks

Part C

You are given the following information for K. Finnan, a sole trader registered for VAT for the month of December 2012:

- Sales on credit for the month of December 2012 amounted to €/£92,200 net of VAT, €/£106,030 gross;
- Sales returns (all credit) for the month of December 2012 amounted to €/£8,900 net of VAT, €/£10,235 gross;
- Purchases on credit for the month of December 2012 amounted to €/£63,500 net of VAT, €/£73,025 gross;
- Purchases returns (all credit) for the month of December 2012 amounted to €/£4,700 net of VAT, €/£5,405 gross;
- K. Finnan pays €/£8,500 in VAT to the Collector General monthly by direct debit on the 14th of every month.

The VAT liability of K. Finnan as at 1 December 2012 was €/£10,125.

You are required to:
Prepare the appropriate T accounts to record the above entries for the month of December 2012, including the VAT T account.

8 Marks

Part D

Outline your understanding of the imprest system as it relates to petty cash.

2 Marks

Given the following information, calculate the cash replenishment required for the month of February 2013.

	€/£
Imprest cash float	350
Postage stamps	22
Taxi receipts	32
Cleaner	120
Flowers for retirement party	45
Credit sales posted to the sales day book	900
Cake for retirement party	30

3 Marks
Total 20 Marks

QUESTION 6

Part A

A business can be run through one of three possible mediums: sole trader, partnership and limited company. Provide a description of each of these business types.

6 Marks

Outline two advantages and one disadvantage of conducting business as a sole trader and a limited company.

6 Marks

Part B

An accounting technician within an organisation has many roles. State any four of these.

4 Marks

Part C

At the heart of accounting is the concept of accountability. For both a public limited company and a charity provide an example of the following:

i. An organisational objective,
ii. To whom the organisation is accountable and why.

4 Marks
Total 20 Marks

1st Year Examination: August 2013

Financial Accounting

Suggested Solutions

Students please note: These are suggested solutions only; alternative answers may also be deemed to be correct and will be marked on their own merits.

Solution One

				Marks Allocated
N. Trust				
Statement of profit and loss for the year ended 31 December 2012				**½ for title**
		€/£	**€/£**	
Sales			505,140	**½ mark**
Cost of sales				
Opening inventory		37,780		**¼ mark**
Purchases	291,690			**½ mark**
Purchases returns	(7,620)	284,070		**½ mark**
Carriage inwards		3,220		**¼ mark**
		325,070		
Less closing inventory		(27,625)		**1 mark**
Cost of sales			(297,445)	
Gross Profit			207,695	
Discount received			3,740	**½ mark**
Less Expenses				
Stationary and administration		3,170		**¼ mark**
Carriage outwards and advertising		11,890		**½ mark**
Insurance		17,775		**½ mark**
Light and heat		2,010		**¼ mark**
Wages and salaries		86,150		**¼ mark**
Discount allowed		6,750		**½ mark**
Internet and communication		9,700		**¼ mark**
Depreciation of buildings		6,270		**1 mark**
Depreciation of computer and equipment		4,495		**1 mark**
Increase in the allowance		11,294		**1 mark**
Irrecoverable debts recovered		(1,440)		**½ mark**
Irrecoverable debts		18,190		**1½ marks**
Bank interest		475		**½ mark**
Total expenses			(176,729)	
Operating profit			34,706	

Solution One *(Cont'd)*

N. Trust
Statement of financial position as at 31 December 2012

	2012 €/£	2012 €/£	2012 €/£	Mar… Allocat… ½ for title
Non-current assets				
Buildings	313,500	(112,170)	201,330	
Computers and equipment	77,400	(36,945)	40,455	½ mark
			241,785	
Current assets				
Closing inventory		27,625		
Receivables	154,340			1 mark
Closing allowance	(15,434)	138,906		½ mark
Prepayments		12,375		½ mark
Cash		650		
			179,556	
Total assets			**421,341**	
Equity and Liabilities				
Equity				
Capital		144,215		
Accumulated losses		78,950		½ mark
Profits 2012		34,706		½ mark
Accumulated profits		257,871		
Drawings		(19,810)		1½ mark
			238,061	
Current liabilities				
Payables		152,860		1½ mark
Bank O/D		17,010		½ mark
PRSI/NIC		13,410		½ mark
			183,280	
Total Equity and Liabilities			**421,341**	

Workings

Workings 1

Closing inventory quantity	21,250
Value per unit	1.30
Closing inventory	27,625

Workings 2

	€/£
Drawings as per TB	16,090
Drawings of inventory	3,720
Restated drawings	19,810

	€/£
Purchases as per TB	295,410
Drawings	(3,720)
Restated purchases	291,690

Solution One *(Cont'd)*

Workings 3

	€/£
Receivables as per TB	165,790
Additional irrecoverable debt	(11,450)
Re-stated receivables	154,340
Closing allowance 10%	10%
	15,434
Opening allowance	(4,140)
Increase in the allowance	11,294

	€/£
Irrecoverable debts as per TB	6,740
Additional irrecoverable debts	11,450
	18,190

Workings 4

	€/£
Insurance as per TB	30,150
Prepayments	(12,375)
Restated insurance	17,775

€/£16,500 / 12 * 9 = €/£12,375

Workings 5

Buildings	€/£
Cost of buildings	313,500
Depreciation 2%	6,270

Computers and equipment

	€/£
Cost	77,400
Accumulated depreciation	(32,450)
	44,950
Deprecation	10%
Annual depreciation	4,495

Workings 6

Payables as per TB	154,110
Error	(1,250)
Restated payables	152,860

Solution Two

Part A

Receivables Control A/C

		€/£		**€/£**	
½ mark	Balance b/d	51,750	Sales returns	12,410	**1 mark**
	Credit Sales	**128,700**	Cash received	104,740	**1 mark**
			Irrecoverable debts	11,970	**1 mark**
			Contra	650	**1 mark**
			Discounts allowed	1,030	**1 mark**
			Balance c/d	49,650	**½ mark**
		180,450		180,450	
	Balance b/d	49,650			

1 mark for not including the allowance for receivable as at 1/1/2012 in the receivables control account

Part B

Cash Book

		€/£		**€/£**	
1 mark	Balance b/d	1,050	Sundry expenses	12,950	**1 mark**
1 mark	Cash sales	104,710	Cash lodged to bank	84,190	**1 mark**
			Drawings in cash from till	915	**1 mark**
			Potential missing cash	**4,055**	
			Balance c/d	3,650	**1 mark**
		105,760		105,760	
	Balance b/d	3,650			

1 mark for stating that it is likely an employee is stealing and for the figure (even if the figure is incorrect)

Part C

Mark-up and margin are measures that businesses use to set and manage prices to maximise profitability. Mark-up is the amount added to the cost of a product or service to arrive at a price, thus the mark-up percentage is the margin divided by the cost price and expressed as a percentage. The gross margin is the difference between cost and the selling price, thus the gross margin percentage is the margin divided by the sales price and expressed as a percentage.

[1 ½ marks each explanation, max 3 marks]

Part D

Mark-up Calculation

	€/£	**Marks Allocated**
Cost of product	12	
Mark-up of 25%	25%	
Mark-up	3	**½ mark**
	12	
Sales price with 25% mark-up	15	**1 mark**
Margin	**€/£**	
Sales price with 25% mark-up	15	
Cost of product	(12)	**½ mark**
Margin	3	

Solution 2 *(Cont'd)*

Margin	3	*	100%	= 20%	A… 1 m…
Sales price	15				

Solution Three

Part A

Bank Account/Cash Book

		€/£		€/£	
			Balance	23,648	**1 mark**
			Bank charges	165	**1 mark**
1 mark	Failed payment	1,450	Dishonoured cheque	4,512	**1.5 marks**
1.5 marks	Error 7	11,000	O/D Penalty	250	**1 mark**
1 mark	Direct lodgement	2,900	Omitted cheque	125	**1 mark**
	Balance	14,440	DD & SO	1,090	**1 mark**
		29,790		29,790	
			Balance	14,440	

Part B

			€/£	
Bank Reconciliation as at 31 December 2012				**½ mark for title**
Balance per bank			(11,060)	**1 mark**
Add outstanding lodgement			3,790	**1 mark**
Banking error			500	**1 mark**
Banking error			(110)	**1 mark**
Less O/S Cheques				
	676	925		
	701	6,010		
	703	625		
			(7,560)	**1 ½ marks (½ mark each)**
Balance			(14,440)	

Marks

Solution 3 *(Cont'd)*

Part C

To: Whom it May Concern
From: An Accounting Technician
Subject: Importance of Preparing Bank reconciliations
Date: 20/8/2013

I have been asked to prepare a report outlining the importance of regular preparation of bank reconciliations. It is important for all businesses to prepare regular bank reconciliations for the following reasons:

- Preparation of regular bank reconciliations will help to identify errors, such errors may have been made either by the bank, the sole trader or both. For example a business may have omitted to post receipts from customers.
- Preparation of bank reconciliation will also highlight items such as bank interest, charges, standing orders, direct debits and dishonoured cheques. These will be known by the bank but not identified by a business until it receives the bank statement and prepares the bank reconciliation.

Should you have any further queries please feel free to contact me.
An Accountant Technician

Solution Four **Marks Allocated**

Part A

Income is recognised in the financial statements as it is earned, not when the cash is received. Expenditure is recognised as it is incurred, not when it is paid for. When income is incurred over time (e.g. rental/interest income) or expenditures are time-based (e.g. rent payments), the income and expenditure recognised in the income statement should relate to the time period, not to the receipts and payments of cash. The accruals concept gives rise to accruals and prepayment in the accounts of businesses.

3 marks

The accrual concept requires that the cost of inventory items is charged to the Statement of Profit and Loss in the period in which this is sold. Thus the cost of inventory is match with the sales revenue generated from the inventory. This will normally lead to two adjustments being made to the cost of purchases for the period.

- Items of inventory bought in a previous period but sold in this period.
- Items of inventory purchased in this period but which remain unsold as at the end of this period.

The accruals concepts means that the cost of inventory items not sold at the end of the accounting period is not included in the Statement of Profit and Loss (it is deducted from purchases and opening inventory to calculate cost of sales in the trading account) and instead it is treated as an asset of the business and is recorded as a current asset.

3 marks

Part B

(i)

<u>Cost</u>

Cost includes all the expenditure incurred in bringing the product or service to its present location and condition. This includes either the cost of purchase – materials costs, import duties, freight, less trade discounts (a discount for buying in bulk or being a regular customer) or the cost of conversion – this includes direct costs, such as direct material, direct labour and direct expense plus production overheads for e.g. factory rent and rates. **2 marks**

<u>Net realisable value (NRV)</u>

NRV is the revenue expected to be earned in the future when the goods are sold, less any further costs (including selling costs) that need to be incurred. Thus NRV is the selling price, less trade discounts, all further costs to completion and all marketing, selling and distribution costs. **2 marks**

(ii)

Inventory is valued at the lower of cost and NRV. **1 mark**

(iii)

Inventory Item	**Costs Incurred €/£**
Alpha	5.50
Beta	6.25
Gamma	2.75

Inventory Item	**Sales Price €/£**		**Cost to Complete €/£**		**Costs to Sell €/£**		**NRV €/£**	
Alpha	14.25	-	1.25	-	2.30	=	10.70	**1 mark**
Beta	6.50	-	Nil	-	0.50	=	6.00	**1 mark**
Gamma	7.10	-	4.10	-	1.20	=	1.8	**1 mark**

Marks Allocated

Solution Four *(Cont'd)*

Inventory Item	**Total Cost €/£**	**NRV €/£**	**Valuation €/£**		**Units of Inventory**	**Valuation €/£**	
Alpha	5.50	10.70	5.5	*	1,000	5,500	
Beta	6.25	6.00	6.00	*	2,500	15,000	**1**
Gamma	2.75	1.8	1.8	*	950	1,710	**1 ma**
						22,210	

Part C

When closing inventory is over-valued it means that it is included in the financial statements at a value that is greater than its true value. This means that in the Statement of Profit and Loss the value of closing inventory deducted from the cost of sales is over-stated, this in turns means that the cost of goods available for sale is under-stated and therefore profits are over-stated.

In the Statement of Financial Position the value of closing inventory in current assets is over-stated and therefore assets are over-stated.

3 marks

Solution Five arks ated

Part A

One of the primary purposes of financial accounting is to record, summarise and classify information arising from transactions the business has entered into with other parties. However, if ledgers were updated each time a transaction occurred, the ledger accounts would quickly become cluttered and errors may be made. Therefore, all transactions are initially recorded in a book of prime entry and then posted in summary to the ledger accounts. This ensures that detailed information is captured on every transaction in the books of prime entry and yet the ledger accounts do not become cluttered.

Book of Prime Entry	**Transaction**
Sales day book	Credit sales
Sales returns day book	Returns of goods sold on credit
Purchases day book	Credit purchases
Purchases returns day book	Returns of goods bought on credit
Cash book	All bank transactions
Petty cash book	All small cash transactions
The journal	All transactions not recorded in any other book of prime entry

2 marks for explanation

1 mark for any example

Part B

VAT or valued added tax is a tax levied on the sales of all businesses. VAT is collected by businesses and remitted to the Revenue Authority on a regular basis. A business must charge VAT on all vatable sales but is allowed to reclaim VAT on purchases. Thus businesses only remit the balance to the Revenue Authority. Where the VAT paid on purchases is greater than the VAT levied on sales a business can claim a refund of the difference between VAT on purchases and VAT on sales from the Revenue Authority. Therefore in the year-end Statement of Financial Position the VAT balance will usually be a liability representing funds owed to the Revenue Authority but may also be a asset representing a refund due by the Revenue Authority to the business.

Where a business is registered for VAT, VAT should not appear in the Statement of Profit and Loss of the business as it is neither income nor an expense of the business. The business is simply a collection vehicle for the Revenue Authority. **4 marks**

Part C

Sales A/C

	€		€
Balance c/d	92,200	Receivables	92,200
	92,200		92,200
		Balance b/d	92,200

½ mark

Solution Five *(Cont'd)*

Receivables A/C

Marks Allocated					Marks ...d
½ mark	Sales	106,030	Sales returns	10,235	
			Balance c/d	95,795	
		106,030		106,030	
	Balance b/d	95,795			

Sales Returns A/C

Marks Allocated					Marks
		€		€	
½ mark	Receivables	8,900	Balance c/d	8,900	
		8,900		8,900	
	Balance b/d	8,900			

Payables A/C

Marks Allocated					Marks
		€		€	
½ mark	Purchases returns	5,405	Purchases	73,025	½ mark
	Balance c/d	67,620			
		73,025		73,025	
			Balance b/d	67,620	

Purchases A/C

Marks Allocated					Marks
		€		€	
½ mark	Payables	63,500	Balance c/d	63,500	
		63,500		63,500	
	Balance b/d	63,500			

Purchases Returns A/C

Marks Allocated					Marks
		€		€	
	Balance c/d	4,700	Payables	4,700	½ mark
		4,700		4,700	
			Balance b/d	4,700	

VAT Control

Marks Allocated					Marks
		€		€	
			Balance b/d	10,125	½ mark
½ mark	VAT on purchases	9,525	VAT on sales	13,830	½ mark
½ mark	VAT on sales returns	1,335	VAT on purchases returns	705	½ mark
¼ mark	Bank	8,500			
	Balance c/d	5,300			
		24,660		24,660	
			Balance b/d	5,300	

Bank A/C

Marks Allocated					Marks
		€		€	
			VAT direct debit	8,500	¼ mark 1 mark for balancing

Solution Five *(Cont'd)* arks cated

Part D

Under the imprest system a cash float is set for pretty cash – say €/£300. As cash is paid out of petty cash it is replaced with receipts for the items purchased. At all times remaining petty cash plus receipts in the petty cash tin will equal the cash float. At the end of the month funds from the bank account are transferred into petty cash to bring the balance of cash back up to the float. At this point the expenses associated with the receipts are posted to the ledgers of the business.

2 marks

Cash replenishment required for the month of February 2013:

	€/£	
Imprest cash float	350	**¼ mark**
Postage stamps	(22)	**½ mark**
Taxi receipts	(32)	**½ mark**
Cleaner	(120)	**½ mark**
Flowers for retirement party	(45)	**½ mark**
Cake for retirement party	(30)	**½ mark**
Cash balance at month end	**101**	
Cash replenishment required	**249**	**¼ mark**

Marks Allocated

Solution Six

Part A

A business can be carried out through one of the business types: sole trader, partnership and limited company

Sole Trader

The term sole trader relates to ownership, in that one person owns the business entity. This type of business entity is often quite small. There are no formal procedures required to set up a sole trader business. In addition the sole trader can decide how the business is going to be run and is free to dissolve or sell the business at any time.

Both in the UK and Ireland the sole trader and the business are not recognised as separate legal entities. Because of this sole traders have unlimited liability. Unlimited liability means that there is no distinction between the sole trader's personal wealth and that of the business.

Partnerships

Partnerships are entities where ownership is divided between at least two people. Usually partnerships have no more than twenty individual partners. Like sole traders partnerships tend to be small in size, exceptions to this include accounting and solicitor partnerships, these often have more than twenty partners.

A partnership is normally set up using a Deed of Partnership. This contains:

- Amount of capital each partnership should provide (i.e. starting capital).
- How profits and losses should be divided.
- How many votes each partner has (usually based on the proportion of capital invested).
- Rules on how to take on new partners.
- How the partnership is brought to an end, or how a partner leaves.

In the absence of this deed of partnership, the Partnership Act of 1890 (amended in 1907) will apply to avoid any disputes in the future.

Limited Company

The name limited company is derived from the fact that the owners (shareholders) of a limited company enjoy limited liability. The number of owners (shareholders) in a limited company however, is potentially unlimited. Because of this they tend to be quite large.

A limited company has a separate legal existence to that of its owners. A direct consequence of this is that the owners of limited companies have limited liability. This means that the owners (shareholders) are only required to finance the business up to a certain point. This point is the shareholder's share capital i.e. the quantity of money each shareholder has invested in the business through purchasing shares.

The distinguishing factor that differentiates a limited company from a sole trader and a partnership is that a limited company has to prepare annual "statutory accounts"; this is the price to be paid for the benefit of limited liability. Limited companies must produce such accounts annually and may have to appoint an independent person to audit and report on them depending on certain size criteria. Once prepared, a copy of the accounts must be sent to the Registrar of Companies which maintains a separate file for every company. The file for any company can be inspected at the Companies Registration Office for a nominal fee by a member of the general public. This is why the statutory accounts are often referred to as the published accounts.

Limited companies are governed very tightly by legislation, namely the Companies Acts.

2 marks each (Max 6 marks)

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Solution Six *(Cont'd)*

Advantages of a Sole Trader Business (Any Two)

- With one owner the sole trader does not have to worry about setting up in business with an unsuitable partner;
- A sole trader is free to make decisions and run the business as he/she sees fit without having to take the opinions of others on board;
- A sole trader does not have to split the rewards of the business with others;
- The comparative ease with which the business is set up and run – there are few administrative burdens imposed on sole traders by law, there is no requirement to produce final accounts, have them audited or present them at an annual meeting;
- Did not bear any of the cost associated with the transition to international accounting standards;
- Because a sole trader is usually directly involved in the running of the business he/she will not have to spend resources finding a suitable management team to delegate the running of the day-to-day activities of the business to;
- As owner/manager of the business a sole trader is completely aware of how the resources of the business are being managed. There is no division between management and ownership. Not so with a limited company where the financial statements are the shareholders prime source of information as to how the assets of the company are being managed and how the company is performing.

Any 2 advantag 1 mark each

Advantages of a Limited Company (Any two)

- All owners (shareholders) enjoy limited liability;
- Limited companies because of their size can raise large quantities of capital. Such capital requirements are required for expansion abroad for example. Thus limited companies tend to be better positioned to take advantage of business opportunities which may arise;
- The burden of the day-to-day running of the company is delegated;
- A shareholder in a public limited company can easily sell his/her holding in one company and reinvest in another public limited company if he/she so chooses. This flexibility allows shareholders to manage their portfolio efficiently;
- In recent times restriction on capital flows between countries has largely been removed, allowing individuals to purchases the shares of foreign public limited companies. Such international diversification can insulate shareholders against the effects of the domestic business cycle;
- In the Republic of Ireland the current favourable corporation tax rate versus personal income tax rates and the consequential shielding of business profits.

Any 2 advantages – 1 mark each

Disadvantages of Being a Sole Trader (Any One)

- Unlimited Liability – A sole trader is liable for any debts that the business incurs. This means that any money that the owner has put into the business could be lost, but most importantly, if the business continues to incur further costs then the owner has to pay these as well. In some cases they may have to sell some of their own possessions to pay suppliers, etc. Such a risk often puts potential sole traders off setting up businesses, and also makes them consider the other forms of business structure.
- As a result of the sole trader and the business being the same legal form, the sole trader is taxed based on income tax not corporation tax. Corporation rate tax rates are more favourable than income tax rates.
- Can be difficult to raise finance. Because they are small, bank may not lend large sums of money to sole traders who may be unable to avail of other forms of long-term finance unless they change their ownership status.
- Can be difficult to enjoy economies of scale, i.e. lower cost per unit due to higher levels of production. A sole trader, for instance, may not be able to buy in bulk and enjoy the same discounts as larger businesses.
- There is a problem of continuity if the sole trader retires or dies – what happens to the business?

Any 1 disadvantage – 1 mark

Disadvantages of Limited Company (Any One)

- Costly and complicated to set up as a company
- Lack of privacy of information due to filing requirement with CRO/Companies House

Any 1 disadvantage – 1 mark

Solution Six *(Cont'd)*

…arks
…cated

Part B

The accountant's role in the organisation can be analysed as follows:

1. Preparation and presentation of timely accurate financial/management accounts to management to help management interpret the financial information.
2. Identification of areas of inefficiency and wastages of resources in the business.
3. Treasury functions: The accountant also plays the role of treasury functions in such a way that they raise finance, cash management, etc.
4. Setting up an effective system of internal and accounting controls.
5. Preparation of feasibility reports: These reports assist management in assessing the viability/profitability or otherwise proposed capital expenditure such as the opening of a new factory or branch.
6. Investigation of the performance/operations of competing business organisations to assist management in policy formulation.
7. Investigation of fraud within the organisation, this is a key role of the accountant in preparation of an audit at year-end.

1 ma… (Max 4… marks)

(Other relevant comments will be marked on their merit)

Part C

Organisation	**Objective**	**Accountable to**
Public limited company	Making a profit/ creation of shareholder wealth	Shareholders
Charities	Achievement of charitable aims or maximise spending on activities	Charity trustees or Donor

1 mark for each point

(Max 4 marks)

1st Year Examination: August 2013

Financial Accounting

Examiner's Report

Statistical Analysis – By Question						
Question No.	1	2	3	4	5	6
Average Mark (%)	64%	65%	56%	36%	53%	66%
Nos. Attempting	249	242	246	169	143	190

Statistical Analysis - Overall	
Pass Rate	75%
Average Mark	57%
Range of Marks	**Nos. of Students**
0-39	33
40-49	30
50-59	61
60-69	68
70 and over	59
Total No. Sitting Exam	**251**
Total Absent	72
Total Approved Absent	11
Total No. Applied for Exam	334

General Comments

The overall standard of answers was generally good. Most candidates are now attempting the required number of questions, which is very welcome.

The general presentation of scripts was acceptable. The majority of candidates are now filing question parts together. The main areas of weakness around presentation are as follows:

- Poor and untidy handwriting
- No workings presented for some questions
- Workings presented all combined in the rough work section of the paper – despite the answer book explicitly stating not to do this

Question 1

A Statement of Profit and Loss and Statement of Financial Position question. This question was generally reasonably well answered.

While answers were generally good the following were common mistakes/comments:

- Many candidates struggled with the treatment of drawings and the PRSI/NIC liability. These items were incorrectly included in the Statement of Profit and Loss.
- The adjustments for irrecoverable debts and the allowance for receivables also proved challenging for some candidates.

- The Statement of Financial Position was poorly answered in some papers -candidates were to what items should be included in current assets and liabilities. In particular many treated overdraft as an asset.
- Some candidates failed to use correct titles on both statements.

Question 2
An incomplete record question

Parts A and B were well answered by most candidates. However those candidates who failed to use the T account format often presented very poorly organised and unstructured answers.

Parts C and D most candidates were not able to clearly distinguish between mark up and margin.

Question 3
A bank reconciliation question
Many candidates had clearly not studied/revised/practiced bank reconciliation statements. While candidates were able to answer the theory part of the question (and therefore pick up some marks), they were not able to prepare either the adjusted cash book (part A) or the bank reconciliation (part B).

Very few candidates obtained the format marks for properly labeling the bank reconciliation.

Question 4
An inventory question

Candidates were very poor on calculating cost and NRV of inventory. A good number of candidates confused NRV with NBV and discussed depreciation. A few more did understand NRV but were not able to apply it correctly/at all to the calculation. While a lot of candidates attempted the question, this was the most poorly answered question, certainly in section B.

In part C it was very disappointing that so few candidates appreciated the impact of overvalued inventory on the financial statements. From a technique perspective the failure to clearly label the parts of the question and lack of workings restricted ability to award effort/approach marks.

Question 5
A bookkeeping question

Reasonable attempts were made to all parts of the question. For part B candidates were well able to discuss what VAT is, but did not appreciate that it was being discussed on a financial accounting paper and did not relate it in any way to the impact on the accounts.

A minority of candidates presented T accounts with just numbers on the debit/credit side of the account without any narrative thus limiting the ability of the examiner to award marks.

Question 6
A theory question on business entities

A very popular question that was well answered, this question gave many candidates a chance to pick up marks. One area of weakness was when discussing limited companies a lot of candidates did not understand the difference between shareholders and directors.

In parts B and C there was some confusion between the accountant technician's role and the ethical principles.