Financial Accounting I

1st Year Examination

August 2011

Paper, Solutions & Examiner's Report

NOTES TO USERS ABOUT THESE SOLUTIONS

The solutions in this document are published by Accounting Technicians Ireland. They are intended to provide guidance to students and their teachers regarding possible answers to questions in our examinations.

Although they are published by us, we do not necessarily endorse these solutions or agree with the views expressed by their authors.

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 2011

Paper : FINANCIAL ACCOUNTING I

Tuesday 16th August 2011 - 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 S. Sage, a sole trader, on 31 December 2010:

	£/€	£/€
Buildings	220,400	
Accumulated depreciation on buildings		44,080
Fixtures, fittings and computers at cost	80,040	
Accumulated depreciation on fixtures, fittings and computers		19,980
Inventory as at 1/1/2010	21,050	
Receivables and payables	140,540	129,880
Bank		8,140
Petty cash	430	
PRSI and VAT liability		17,980
Purchases and sales	302,910	547,890
Returns	3,330	2,120
Discounts		4,140
Postage and stationary	1,230	
Advertising and distribution	7,900	
Carriage inwards	6,720	
Power	4,570	
Telephone and internet	7,990	
Insurance	12,600	
Rent received		25,000
Bank interest and charges	2,275	
Wages and salaries	80,990	
Allowance for receivables 1/1/2010		8,130
Irrecoverable debts recovered		840
Drawings	7,550	
Capital		92,345
	900,525	**900,525**

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

1. The inventory count as at 31 December 2010 showed the following information. Based on this information the value of closing inventory to be incorporated into the financial statements must be calculated.

Product	Quantity	Cost per unit	Sales Price per unit	Costs to Sell per unit
	in Units	£/€	£/€	£/€
A1	750	5.20	5.10	0.20
B2	6,060	3.15	3.75	0.80
C3	4,000	0.90	1.00	-

QUESTION 1 *(Cont'd)*

2. During 2010 S. Sage took the following for personal use:
- £/€9,500 in inventory items;
- £/€4,100 from the bank.

In addition, one third of the insurance costs above relate to S. Sage's personal insurance.

3. S. Sage carries out her business in a large building. A portion of this building is surplus to her requirements and is let out to a tenant. As at 31 December 2010, the tenant owes rental payments for November and December 2010 amounting to £/€5,000 in total. This has not been accounted for.

4. £/€3,140 is to be written off as an irrecoverable debt. S. Sage has examined the receivables listing and has determined that the allowance for receivables is appropriate and need not be adjusted.

5. Allowances to be made for depreciation as follows:

Buildings..	3% straight line
Fixtures, fittings and computers......	15% reducing balance

The depreciation policy is to charge a full year of depreciation in the year of acquisition and none in the year of sale/disposal.

6. A bank statement received in December 2010 showed bank interest and charges of £/€120 relating to November 2010.

7. £/€650 of advertising relates to an advertising campaign which is due to run in 2011 and therefore S. Sage considers that the amount should be considered as a prepayment.

You are required to prepare:

a) The income statement for the year ended 31 December 2010.

10 Marks

b) The statement of financial position as at that date.

8 Marks

Presentation and format.

2 Marks

Total 20 Marks

QUESTION 2 *(Compulsory)*

Part A
Outline your understanding, with the use of relevant examples, of capital and revenue expenditure.

4 Marks

Part B
On 1 January 2010 N. Nutmeg's books and records contained the following balances:

	€/£
Motor vehicles at cost	75,400
Accumulated depreciation motor vehicles	47,850

During 2010 the following occurred:

- On 1 February 2010 motor vehicle C was traded in against a new motor vehicle D.
- Motor vehicle C had been purchased on 1 September 2006 for €/£40,000.
- N. Nutmeg wrote a cheque for €/£20,000 for motor vehicle D, on the date of purchase the list price of motor vehicle D was €/£35,700.
- The year end of the business is 31 December 2010.

Motor vehicles are depreciated at 20% per annum on the straight line basis from the month of purchase to the month of sale.

You are required to:

i). Prepare the motor vehicles at cost account.

2 Marks

ii). Prepare the motor vehicles accumulated depreciation account for the year ended 31 December 2010.

3 Marks

iii). Prepare the disposal account for motor vehicle C.

2 Marks

Part C
The following information relates to the payroll costs for, C. Cinnamon, a sole trader for the month of December 2010.

- Gross wages and salaries €/£40,000;
- Employers PRSI/Social Insurance €/£5,000;
- Net wages and salaries €/£29,000;
- Balances owed to the revenue authority was paid on 31 December 2010.

Note: The difference between gross and net wages and salaries relates only to salary taxes and employees PRSI/ social insurance.

QUESTION 2 *(Cont'd)*

You are required to:

Prepare appropriate journal entries to record the:

i) Wages expense in the books and records of C. Cinnamon. **3 Marks**

ii) Payment of wages through the bank. **2 Marks**

iii) Payment of PAYE/PRSI to the Revenue authority. **2 Marks**

Presentation and format (relating to all parts of the question) **2 Marks**

Total 20 Marks

QUESTION 3 *(Compulsory)*

On 7 January 2011, F. Fennell received her bank statements for the month ended 31 December 2010. The bank statement showed a balance of €/£23,575 (overdraft) as at 31 December while the cash book showed a balance of €/£41,540 (credit) as at the date. On examination of the cash book and the bank statement the following were discovered:

1. A dishonoured cheque of €/£1,540 had been recorded as cash receipts, in error, in the cash book;
2. Bank charges of €/£65 had not been recorded in the cash book;
3. F. Fennell has an approved overdraft level of €/£20,000 from her bank. The bank statement contains a penalty of €/£200 as F. Fennell exceeded the approved overdraft level. This has not been recorded in the cash book;
4. A cheque of €100 to replenish the petty cash tin, was recorded in the bank account but omitted from the cash book;
5. Cash receipts of €/£4,700 were posted as cash payments of €/£7,400 in the cash book;
6. On 17th December F. Fennell lodged cash of €/£610 to her bank personal account. This was lodged to the business bank account in error by the bank;
7. Standing orders of €/£770 had not been posted to the cash book;
8. Receivables of €/£4,350 were lodged directly to the bank account. No record had been made of this in the cash book;
9. Lodgements of €/£4,190, lodged to the bank account on 31 December 2010, had not been credited by the bank;
10. The following cheques, drawn on the bank account, had not been presented to the bank for payment as at 31 December 2010:

Cheque Number	Date Cheque was Written	€/£
No: 1425	24 June 2010	925
No: 2651	11 November 2010	1,025
No: 3001	28 December 2010	5,240
No: 3010	31 December 2010	2,120

QUESTION 3 *(Cont'd)*

You are required to:

a) Prepare the adjusted cash book for the month of December 2010.

10 Marks

b) Prepare a statement on 31 December 2010, reconciling the adjusted cash book with the bank statement balance.

5 Marks

c) Explain, in report format, two reasons for preparing bank reconciliation on a regular basis.

3 Marks

Presentation and format.

2 Marks

Total 20 Marks

SECTION B

Answer any TWO of the three questions in this Section

QUESTION 4

The following opening balances were extracted from the books of C. Coriander on 1 November 2010:

	Debit €/£	Credit €/£
Non Current Assets	98,550	
Receivables	11,200	
Bank		7,250
VAT		1,730
Payables		5,400
Electricity Due		940
Capital		94,430
	109,750	109,750

The following transaction took place for the month of November 2010:

Nov, 2 Purchased goods on credit at a cost of €/£7,200 plus VAT of 15%;

Nov, 5 Sold goods on credit for €/£6,000 plus VAT of 15%;

Nov, 7 Receivables paid €/£4,500 by cheque. The payment was after a 10% discount had been allowed;

Nov, 10 Paid €/£2,000 in VAT by cheque;

Nov, 14 Purchased goods at a cost of €/£5,000 plus VAT of 15%, paid for these by cheque;

Nov, 19 Payables of €/£6,000 were paid by cheque. An additional discount of 5% was received due to the prompt payment;

Nov, 21 The outstanding balance owed on electricity was paid by cheque;

Nov, 24 Sold goods for cash for €/£2,200 plus VAT of 15%;

Nov, 27 Paid wages and salaries of €/£700 by cheque;

Nov, 30 Purchased non current asset of €/£4,000 by cheque.

QUESTION 4 *(Cont'd)*

You are required to:

a) Enter the opening balances in T Accounts.

3 Marks

b) Write up the original books of entry for November 2010 and post the balances to the ledger.

12 Marks

c) Balance the ledger accounts as at 30 November 2010.

2 Marks

d) Extract the trial balance as at 30 November 2010.

3 Marks
Total 20 Marks

QUESTION 5

Part A

A business can be carried out through the medium of a sole trader, partnership or limited company. For each of these business types:

- Write a brief note explaining each business type;
- Outline two advantages of carrying out business through each business type;
- Outline one disadvantages of carrying out business through each business type.

12 Marks

Part B

Provide a definition of accounting.

2 Marks

Part C

One aim of the accounting process is to communicate financial information. Outline the information provided by the Income Statement and the Statement of Financial Position.

6 Marks
Total 20 Marks

QUESTION 6

Part A

The total sales figure of T. Thyme is made up of both cash sales and credit sales. T. Thyme did not maintain proper books and records for the year ended 31 December 2010, but T. Thyme is in a position to provide you with the following information:

Credit Sales

Credit sales are made to larger corporate businesses. The following information is available for receivables for the year ended 31 December 2010.

	€/£
Receivables 1/1/10	77,210
Receivables 31/12/10	81,101
Interest charged to customer on overdue balances	4,230
Sales returns	36,000
Irrecoverable debts written off	4,210
Discounts allowed	730
Contra entry with payables	110
Cash received from credit customers	174,620

Cash Sales

Cash sales relate to sales made in T. Thyme's shop. The following information relates cash movements in T. Thyme's shop for the year ended 31 December 2010:

	€/£
Cash float 1/1/10	250
Cash float 31/12/2010	300
Sundry expenses paid in cash from the shop till	2,050
Cash lodged to the business bank account from the shop till	74,640
Drawings in cash from the shop till	1,670

You are required to:

i. Calculate the total sales figure for T. Thyme for the year ended 31 December 2010.

12 Marks

ii. Outline in brief, the accounting principle/rule that allows for the calculation of the missing figures in part (i).

2 Marks

Part B

The following information is available for a business that did not maintain proper books and records for the year to 31 December 2010. He is only able to provide you with the following information:

	£/€
Purchases	204,200
Inventory as at 1 January 2010	64,250
Closing inventory as at 31 December 2010	59,110
Standard mark – up on cost of sales	15%

QUESTION 6 *(Cont'd)*

You are required to:

With the aid of a trading account, calculate the sales figure for the business.

6 Marks
Total 20 Marks

1st Year Examination: August 2011

Financial Accounting I

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.

Suggested Solution 1

S. Sage

Income statement for the year ended 31 December 2010

		€/£	**€/£**
Sales			547,890
Sales returns			(3,330)
Net sales			544,560
Cost of sales			
Opening inventory		21,050	
Purchases	293,410		
Purchases returns	(2,120)	291,290	
Carriage inwards		6,720	
		319,060	
Less closing inventory		(25,152)	
Cost of sales			(293,908)
Gross Profit			250,652
Discount received			4,140
Rent received and receivable			30,000
Less Expenses			
Postage and stationary		1,230	
Insurance		8,400	
Wages and salaries		80,990	
Telephone and internet		7,990	
Depreciation of buildings		6,612	
Depreciation of fixtures, fittings and computers		9,009	
Advertising and distribution		7,250	
Irrecoverable debts		3,140	
Irrecoverable debts recovered		(840)	
Bank charges		2,395	
Power		4,570	
Total expenses			(130,746)
Operating Profit			154,046

Suggested Solution One *(Cont'd)*

S. Sage
Statement of financial position as at 31 December 2010

	2010 €/£	2010 €/£	2010 €/£
Non-current assets			
Buildings	220,400	(50,692)	169,708
Fixtures, fittings and computers	80,040	(28,989)	51,051
			220,759
Current assets			
Closing inventory		25,152	
Receivables	137,400		
Allowances for receivables	(8,130)	129,270	
Other debtors		5,000	
Cash		430	
Prepayments		650	
			160,502
Total assets			**381,261**
Equity and Liabilities			
Equity			
Capital		92,345	
Profit for 2010		154,046	
Accumulated profits		246,391	
Drawings		(25,350)	
			221,041
Current liabilities			
Payables		129,880	
PRSI and VAT		17,980	
Bank overdraft		12,360	
			160,220
Total Equity and Liabilities			**381,261**

Solution One *(Cont'd)*

Workings
Working 1

Product	Quantity	Cost per unit	Sales Price per unit	Costs to Sell per unit	NRV
	in Units	£/€	£/€	£/€	£/€
A1	750	5.20	5.10	0.20	4.9
B2	6,060	3.15	3.75	0.80	2.95
C3	4,000	0.90	1.00	-	1.00

Lower of Cost and NRV

Product	Quantity	Lower of Cost and NRV			Valuation
	in Units	£/€			
A1	750	4.90	*	=	3,675
B2	6,060	2.95	*	=	17,877
C3	4,000	0.90	*	=	3,600
				Total	**25,152**

Workings 2

	€/£
Purchases	302,910
Drawings	(9,500)
Restated purchases	293,410

	€/£
Bank	(8,140)
Bank Charges	(120)
Drawings	(4,100)
Restated bank	(12,360)

Insurance
€/£12,600/3 = €/£4,200 - drawings

	€/£
Drawings as per TB	7,550
Purchases	9,500
Bank	4,100
Insurance	4,200
Restated drawings	25,350

Workings 3

	€/£
Rent received	25,000
November/December due	5,000
	30,000

Solution One *(Cont'd)*

Workings 4

	€/£
Receivables	140,540
Irrecoverable debts	(3,140)
	137,400

Workings 5

Buildings at cost

	€/£
Buildings as per TB	220,400
Annual depreciation – 3% SL	3%
	6,612

Fixtures, fitting and computers

	€/£
Fixtures, fitting and computer	80,040
Accumulated depreciation	(19,980
	60,060
Annual depreciation – 15% RB	15%
	9,009

Workings 6

	€/£
Advertising as per TB	7,900
Prepayments	(650)
	7,250

Workings 7

	€/£
Bank charges as per TB	2,275
Accruals	120
	2,395

Suggested Solution 2

Part A

Capital Expenditure: this is expenditure on goods that will last for more than one year and are not bought for resale but to be used by the business to help generate sales. Examples include premises, equipment, delivery vans etc. That is capital expenditure is expenditure on non-current assets or the repayment of loans.

Revenue (Current) Expenditure: this is expenditure on goods that will be used up within one year and are not bought for resale. They relate to the day-to-day running of the business and are incurred in the for the purpose of the trade of the business. Examples include wages, rent, rates, telephone etc.

Part B

Motor Vehicles at Cost Account

Date	Details	€/£	Date	Details	€/£
1/1/10	Balance c/d	75,400	1/2/10	Disposal	40,000
1/2/10	Cheque additions	20,000			
1/2/10	Trade-in additions	15,700			
			31/12/10	Balance	71,100
		111,100			111,100
1/1/2011	Balance	71,100			

Motor Vehicles Accumulated Depreciation Account

Date	Details	€/£	Date	Details	€/£
1/2/2010	Disposal	27,334	1/1/10	Balance c/d	47,850
31/12/10	Balance b/d	34,808	31/12/10	Income statement	14,292
		62,141			62,142
			1/1/2011	Balance c/d	34,808

Motor Vehicles C Disposal Account

Date	Details	€/£	Date	Details	€/£
1/2/10	Cost	40,000	1/2/10	Accumulated Depreciation	27,334
	Income statement	3,034	1/2/10	Trade in	15,700
		43,034			43,034

Suggested Solution 2 *(Cont'd)*

Motor Vehicle C Depreciation Calculation:

	€/£						€/£
2006	40,000	*	20%	*	4/12	=	2,667
2007	40,000	*	20%	*	1	=	8,000
2008	40,000	*	20%	*	1	=	8,000
2009	40,000	*	20%	*	1	=	8,000
2010	40,000	*	20%	*	1/12	=	<u>667</u>
							27,334

Motor Vehicle C Depreciation Calculation:

	€/£						€/£
Continuing	35,400	*	20%	*	1	=	7,080
Disposed of MV	40,000	*	20%	*	1/12	=	667
Addition	35,700	*	20%	*	11/12	=	<u>6,545</u>
							14,292

Suggested Solution 2 *(Cont'd)*

Part C

		Debit €/£	Credit €/£
1.			
Dr	Wages and salaries – income statement	40,000	
Dr	Employers PRSI	5,000	
Cr	Paye/prsi		16,000
Cr	Net wages		29,000
	Being the posting of wages and salaries		
2.			
Dr	Net wages	29,000	
Cr	Bank		29,000
	Being the payment of wages and salaries		
3.			
Dr	Paye/prsi	16,000	
Cr	Bank		16,000
	Being the payment of paye/prsi to the revenue authority		

Suggestion Solution 3

Part A

Bank Account/Cash Book

	€/£		€/£
		Balance	41,540
		Error 1	3,080
Error 5	12,100	Error 2 - Bank Charges	65
Write back of 1425	925	Error 3 – Bank Penalties	200
Credit transfer	4,350	Error 4	100
		Error 7	770
		Reissue of cheque 1425	925
Balance	29,305		
	46,680		46,680
		Balance	29,305

Part B

Bank Reconciliation as at 31 December 2010

		€/£
Balance per bank		(23,575)
Correction of bank error		(610)
Add outstanding Lodgement		4,190
Less O/S Cheques		
2651	1,025	
3001	5,240	
3010	2,120	
Reissued Cheque	925	(9,310)
Balance		(29,305)

Note: No marks were awarded for the reissue of the stale cheque (1425) as this was no specifically required by the question. If the stale cheque (1425) was not reissued the corrected balance on the Bank Account/Cash Book and corrected balance as per the bank reconciliation would have been €28,380 (overdrawn). Both solutions were awarded equal marks.

Suggestion Solution 3 *(Cont'd)*

Part C

To: Whom it May Concern
From: An Accounting Technician
Subject: Importance of Preparing Control Accounts
Date: 18/8/2011

I have been asked to prepare a report outlining the importance of regular preparation of bank reconciliations:

- Identification of errors, such errors may have been made either by the bank, the company or both. For example a business may have omitted to post receipts from receivables.

- 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

Suggestion Solution 4

Part B

Purchases Book

Date	Analysis	Total	Net	VAT
		€/£	€/£	€/£
02-Nov	Goods for resale	8,280	7,200	1,080
		8,280	7,200	1,080

Sales Book

Date	Analysis	Total	Net	VAT
		€/£	€/£	€/£
5-Dec	Sale of goods	6,900	6,000	900
		6,900	6,000	900

Cheque Payments Book

Date	Analysis	Total	Expenses	Non current Assets	Purchases	Payables	Wages	VAT	Memo Discount Received
		€/£	€/£	€/£	€/£	€/£	€/£	€/£	€/£
30-Nov	Non current asset	4,000		4,000					
14-Nov	Goods for resale	5,750			5,000			750	
21-Nov	Electricity	940	940						
19-Nov	Payables	6,000				6,000			300
27-Nov	Wages	700					700		
10-Nov	VAT	2,000						2,000	
		19,390	940	4,000	5,000	6,000	700	2,750	300

Cash Receipts & Lodgements book

Date	Analysis	Total	Receivables	Sales	VAT	Discount Received (Memo)
		€/£	€/£	€/£	€/£	€/£
7-Nov	Receivables	4,500	4,500			500
24-Nov	Sales	2,530		2,200	330	
		7,030	4,500	2,200	330	500

Suggest Solution Four *(Cont'd)*

Part A and C

Non Current Assets A/C

	€/£		€/£
Balance b/d	98,550		
Cheque payments book	4,000	Balance c/d	102,550
	102,550		102,550
Balance b/d	102,550		

Bank A/C

	€/£		€/£
		Balance b/d	7,250
Cash receipts book	7,030	Cheque payments book	19,390
Balance c/d	19,610		
	26,640		26,640
		Balance b/d	19,610

Payables A/C

	€/£		€/£
Cheque payments book	6,000	Balance b/d	5,400
Discount received	300	Purchases book	8,280
Balance c/d	7,380		
	13,680		13,680
		Balance b/d	7,380

Receivables A/C

	€/£		€/£
Balance b/d	11,200	Cash receipts book	4,500
Sales book	6,900	Discount allowed	500
		Balance c/d	13,100
	18,100		18,100
Balance b/d	13,100		

Capital A/C

	€/£		€/£
		Balance	94,430

Suggest Solution Four *(Cont'd)*

VAT

	€/£		**€/£**
Purchases book	1,080	Balance b/d	1,730
Cheque payments book	2,750	Sales book	900
		Cash receipts	330
		Balance c/d	870
	3,830		3,830
Balance	870		

Suggested Solution Four *(Cont'd)*

Electricity Due

	€/£		€/£
Cheque payments book	940	Balance b/d	940
	940		940

Discount Allowed

	€/£		€/£
Receivables	500		

Discount Received

	€/£		€/£
		Payables	300

Wages

	€/£		€/£
Cheque payments book	700		

Sales Account

	€/£		€/£
Balance c/d	8,200	Sales book	6,000
		Sales for cash	2,200
	8,200		8,200
		Balance b/d	8,200

Purchases Account

	€/£		€/£
Purchases book	7,200	Balance c/d	12,200
Cheque payments book	5,000		
	12,200		12,200
Balance b/d	12,200		

Suggest Solution Four *(Cont'd)*

Part D

C. Coriander
Trial Balance at 30 November 2010

	Debit	Credit
	€/£	**€/£**
Bank		19,610
Payables		7,380
Receivables	13,100	
Non current assets	102,550	
Capital		94,430
VAT	870	
Sales		8,200
Purchases	12,200	
Discount allowed	500	
Discount received		300
Wages	700	
	129,920	129,920

Suggested Solution 5

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 usually 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.

Like sole traders, the partners of a partnerships also have unlimited liability.

Suggested Solution 5 *(Cont'd)*

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 (Companies House) 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 company's legislation, namely the Companies Acts in Ireland and the UK.

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.

Suggested Solution 5 *(Cont'd)*

Advantages of a Partnership Business (Any Two)

- The burden and risks of ownership are shared;
- Instead of having to offer a comprehensive range of services as a sole trader would, partners can specialise. For example in firms of solicitors some solicitors specialise in family law and others in corporate take-overs etc.;
- Partnerships can usually raise more capital than a sole trader, thereby facilitating expansion;
- A silent partner who does not take an active part in the running of the business can enjoy limited liability;
- Like sole traders partnerships are set up with comparative ease – with few administrative burdens imposed on a partnership by law, accounting standards or stock exchange regulations;
- Did not bear any of the cost associated with the transition to international accounting standards;
- Similar to a sole trader business, the partners of a partnership are usually directly involved in the running of the business and will therefore 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 partners in a partnership should be completely aware of how the resources of the business are being managed. There is no division between management and ownership.

Advantages of a Limited Company (Any Two)

- All owners (shareholders) enjoy limited liability;
- Limited companies because of their size can usually 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 corporate profits.

Suggested Solution 5 *(Cont'd)*

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?

Disadvantages of a Partnership (Any One)

- Have to share the profits.
- Less control of the business for the individual.
- Disputes over workload.
- Problems if partners disagree over the direction of the business.

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
- The day-to-day running of the business is delegated to directors and managers. Therefore the shareholders of a company tend to have less information about the company they own than the directors and managers of the business who run the business for them.

Suggested Solution Five *(Cont'd)*

Part B

Accounting can be defined as the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.

Part C

The Income Statement

The income statement is fundamentally a listing of all income and all expenses for the year. Taking expenses from income gives the profit that the business earned for the year. Therefore the income statement is year specific – just looking at the accounting year or period in question.

By examining income statements year on year a business can gain information about whether sales and expenses are increasing or decreasing and how they are moving in relation to each other. For example in any year if sales were to fall while at the same time expenses increase – the information would be captured in the income statement and action could be taken.

Also the income statement divides the cost of producing/purchasing a good/service from the cost of administration and selling expenses within the business. The information can be useful when businesses are examining costs.

The Statement of Financial Position

The statement of financial position is fundamentally a listing of all the assets of a business and all the liabilities of a business. By subtracting these assets from liabilities we arrive at the net worth of the business. The statement of financial position is a snap shot pictures of a business at a point in time – usually the end of the financial year. It is different to the income statement in this regard – the income statement spans the full financial year.

Assets and liabilities are both categories into long term and short term assets and liabilities in the statement of financial position. Short term is considered to be less than one year. By examining the assets of a business in relation to the associated liabilities the statement of financial positions helps to show how financially strong (or otherwise) a business is.

Suggested Solution 6

Part A
(i)
Total sales = credit sales + cash sales = €293,741

Cash sales can be calculated using the movement through the cash in till account
Credit sales can be calculated using a receivables account

Cash in Tills

	€/£		€/£
Balance b/d	250	Sundry expenses	2,050
Cash Sales	**78,410**	Cash lodged to bank	74,640
		Drawings	1,670
		Balance	300
	78,660		78,660
Balance	300		

Receivables Control A/C

	€/£		€/£
Balance b/d	77,210	Irrecoverable debts	4,210
Sales	**215,331**	Sales returns	36,000
Interest charged on overdue accounts	4,230	Discounts allowed	730
		Contra	110
		Cash receipts credit customers	174,620
		Balance c/d	81,101
	296,771		296,771
Balance b/d	81,101		

(ii)

The incomplete records technique used above relies upon T Accounts balancing. T Accounts will always balance because the debit entries will always equal the credit entries. This is the case due to the dual aspect concept. The dual aspect concept states that every transaction should have a two sided effect, one debit, one credit and these must have the same value. In the question above all entries on one side were known and therefore the total of the T account was known. The total of one side of the T Account must equal the total on the other side of the T Account and therefore the missing figure can be derived.

Suggested Solution 6 *(Cont'd)*

Part B

	€/£	€/£
Sales (115%)		240,741
Cost of sales		
Opening inventory	64,250	
Purchases	204,200	
	268,450	
Less closing inventory	(59,110)	
Cost of sales (100%)		(209,340)
Gross Profit (15%)		31,401

1st Year Examination: August 2011

Financial Accounting I

Examiner's Report

General
The overall standard of answers varied widely.

Candidates seemed to find the double entry questions, such as question 2 and 4, very difficult. These two questions were very poorly answered by the majority of candidates.

Many candidates did not attempt all parts of all questions, this made achieving a passing mark for the question and paper overall significantly more difficult. Some candidates attempted the same part of the same question several times and then ran out of time and did not complete the entire paper.

The general presentation of papers was better than in the summer sitting. However a significant minority of students are still not taking the time to organise their answer booklets and ensure that questions were in the correct order. The main areas of weakness for these candidates were as follows:

- Poor handwriting, particularly in theory questions;
- Excessive use of abbreviations and text speak;
- No workings presented (for such candidates significant marks were lost as a result);
- Workings not referenced in answers and all working completed together at the end of the answer book.

Question 1
This question was generally candidates' best question. The following points are made:

- Identification of sales returns and purchase returns was better than in the summer sitting but still remained an issue for some candidates.
- Candidates struggled with the valuation of closing inventory. This was very disappointing as it has been identified as an issue in prior sittings.
- Candidates did not, in the main, know how to deal with the drawings of inventory items.
- Candidates knew that the rent receivable should be included in the income statement as other income however they were unable to deal with the associated adjustment.
- A significant minority of candidates did not know how to deal with the year end VAT liability.
- Calculation and treatment of depreciation remains an issue for many candidates.
- Very disappointingly a significant number of candidates still cannot deal with allowances for receivables and irrecoverable debts.

Question 2
Most candidates answered part A of this question well.

Part B was answered poorly by many students. A significant minority did not even prepare T accounts. Other areas of difficulty were dealing with the part exchange, depreciation workings and basic bookkeeping errors which were made by some candidates.

Part C was extremely poorly answered:

- Many candidates did not even attempt this portion of the question;
- Many candidates did not prepare journal entries, instead T Accounts were prepared;
- Those that did prepare journal entries, did not, in the main include narratives with those journals;
- Many candidates simply did not know how to deal with wages and salaries in sufficient detail.

Question 3
This question was reasonably well answered with most candidates achieving a passing grade for the question. However the following points are made:

- Many candidates did not know how to deal with the dishonoured cheque;
- Many candidates did not deal with the cash receipts recorded as cash payments;
- Most candidates did not realise that a cheque was six months old and therefore stale.

In part C many students did not present the answer in report format as requested by the question and as a result lost these “easy” marks.

Question 4
This question was poorly answered. The main issues were as follows:

- Many candidates did not know how to prepare books of prime entry;
- Some candidates had significant issues in simply not knowing how to post transactions to T Accounts from the books of prime entry;
- Many candidates did not even bother finishing the question and did not prepare a trial balance;
- The presentation of the question was very poor from some candidates.

Question 5
Nearly all candidates attempted this question. In general it was the best answered question from section B of the paper. Parts A and B were generally well answered. Part C was poorly answered by many candidates.

Question 6
This question was not popular among candidates. However those that attempted it generally did well.

Part A (i) was reasonably well answered by most candidates. Some candidates are choosing not to attempt this question via T accounts but simply to list items and add or subtract as appropriate. While there is nothing wrong per say with this approach candidates that attempted the question in this manner performed significantly worse than those who used T account. The approach seemed to confuse the candidates that used it.

Part A (ii) was very poorly answered.

The most common mistake in part B was that candidates became confused between mark-up and margin.