Accounting Technicians Ireland

Financial Accounting

1st Year Examination

May 2014

Exam 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: Summer 2014

Paper: FINANCIAL ACCOUNTING

Tuesday 13th May 2014 - 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 the € symbol 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 the language of International Accounting Standards (I.A.S). Examinees are permitted to use either I.A.S or Financial Reporting Standards (F.R.S) 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 B. Bonsai, a sole trader, on 30 September 2013:

	Debit	**Credit**
	€/£	**€/£**
Land	198,540	
Inventory as at 1/10/2012	26,180	
Receivables and payables	61,670	57,160
Bank and cash	11,985	
PRSI/NIC liability		4,740
VAT liability		7,130
Sales and purchases	317,450	557,820
Returns	22,980	17,965
Rental costs on office space and equipment	41,840	
5% long term bank loan		151,000
Interest charged by supplier on overdue balances	1,780	
Allowances for receivables 1/10/2012		4,050
Carriage	5,780	
Discounts	2,540	1,850
Advertising and media costs	3,150	
Light and heat	6,520	
Telephone and internet	2,220	
Insurance	17,850	
Rates, water charges and refuse	7,950	
Wages and salaries	103,740	
Employers' PRSI/NIC costs	12,150	
Long term loan interest	3,050	
Irrecoverable debts	4,110	
Drawings	11,720	
Accumulated profits/losses		47,650
Capital		13,840
	863,205	**863,205**

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

1. The inventory count as at 30 September 2013 showed closing inventory valued at €/£21,540.

2. During the year to 30 September 2013 B. Bonsai took the following for personal use:
   - €/£450 in inventory items per month;
   - €/£220 from the bank per month.

3. Included in the insurance costs above is €/£14,400 which relates to the year ended 31 December 2013.

4. Telephone and internet charges are consistent at €/£222 per month. The figure included in the trial balance above does not include telephone and internet charges for August and September 2013.

5. 40% of carriage relates to carriage inwards and the remainder relates to carriage outwards.

Question 1 continues overleaf

QUESTION 1 *(Cont'd)*

6. €/£2,500 of the PRSI/NIC liability was paid on 30 September 2013 and has not been accounted for above.

7. B. Bonsai reviewed his receivable balances as at 30 September 2013 and deciding the following:
- An additional €/£2,150 of receivables balances should be written off as irrecoverable;
- The closing allowance for receivables should be set at 5% of the final receivables balance.

You are required to prepare:

a) The Statement of Profit and Loss for the year ended 30 September 2013.

11 Marks

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

9 Marks
Total 20 Marks

QUESTION 2 *(Compulsory)*

Part A
With the aid of a relevant example outline your understanding of the term non-current asset.

3 Marks

Part B
S. Cooper commenced in business as a sole trader. The following assets were purchased for use within the business:

Asset Type	Additional Comments
Computers	Computers are expected to consume economic benefit at a relatively high rate in the first years after purchase with consumption of economic benefit falling in later years.
Building	The building is expected to reduce in value evenly over its useful life.

Required:

i. Outline your understanding of the terms straight line depreciation and reducing balance depreciation as they relate to non-current assets.

4 Marks

ii. S. Cooper has requested your advice as to the most appropriate depreciation method to be applied to each of the assets outlined above. You must justify your decision in each case.

3 Marks

Part C
L. Hoff, a sole trader, decided to build a building to use within her sole trader business. The following costs were incurred:

Cost Category	**€/£**
Building materials	43,250
Delivery of building materials	1,250
Fixtures and fittings for the new building	9,940
Legal costs	2,500
Architect fees	4,100
Flowers and plants for the new building	610
Site preparation costs	1,120
Interest incurred on construction loan during the period of construction	3,580

Question 2 continues overleaf

QUESTION 2 *(Cont'd))*

Required:

i. With the aid of relevant examples outline your understanding of the terms capital expenditure and revenue expenditure.

4 Marks

ii. Calculate the cost of the building to be included within the "Buildings T Account" of L. Hoff.

4 Marks

iii. Assuming that all items were paid by cheque, prepare the journal entry required to record the addition of the building within the books and records of L. Hoff.

2 Marks
Total 20 Marks

QUESTION 3 *(Compulsory)*

COMPLETE ANY FOUR PARTS

Part A

The following receivables control account has been prepared by an inexperienced bookkeeper for the month of December 2013.

Receivables Control Account

		€/£			**€/£**
1/12/2013	Allowance for receivables	6,100	1/12/2013	Balance	25,100
	Credit sales	52,100		Contra with payables	700
	Credit sales returns	1,100			
	Discounts allowed	70			
	Cash receipts	47,460			

You are required to prepare the receivables control account for the month of December 2013 dealing appropriately with all the items above and thereby derive the receivables balance as at 31 December 2013.

5 Marks

Part B

Outline your understanding of the term "*external audit*" and explain why carrying out an external audit annually is important for many companies.

5 Marks

Part C

Outline your understanding of each of the error types below, provide an example of the error and state whether the error would leave the trial balance in balance or not.

- Error of omission
- Error of transposition
- Casting (arithmetical) error
- Error of principle
- Error of original entry

5 Marks

Question 3 continues overleaf

QUESTION 3 *(Cont'd)*

Part D

The following bank reconciliation has been prepared by an inexperienced bookkeeper for the month of December 2013.

Bank Reconciliation Statement for the month of December 2013

	€/£
Balance per bank statement (overdrawn)	41,250
Less: cheques written not presented to bank for payment	(17,120)
Less: lodgements not credited	(3,310)
Add: banking error (bank credited account in error with monies which belongs to another customer)	1,110
Favourable balance as per cash book	21,930

You are required to prepare the bank reconciliation statement for the month of December 2013 dealing appropriately with all the items above.

5 Marks

Part E

The trial balance of a sole trader failed to agree and the balance was entered into a suspense account. An examination of the books and records of the sole trader revealed the following:

- During the year, €/£2,250 interest received on favourable bank balances were correctly entered in the cash book but debited to the interest expense account.
- A payment of €/£7,100 for rent had been correctly recorded in the cash book but debited to the rent account as €/£17,000.

When these entries are corrected the trial balance will balance.

You are required to:

i. Prepare journal entries to correct the above errors. Narratives are not required.

4 Marks

ii. Hence derive the opening balance in the suspense account.

1 Mark
5 Marks

Part F

In January 2012, Meadows golf course offered a life membership subscription for €/£15,000 per member, to cover membership of the golf club for ten years starting from 2012. 50 members of the gold club took up this offer and paid in full during 2012.

You are required to:

i. Prepare the journal entries required to appropriately record the life membership in 2012. Narratives are not required.

4 Marks

ii. Prepare the journal entries required to appropriately record the life membership in 2013. Narratives are not required.

1 Mark
Total 20 Marks

SECTION B

Answer any TWO of the three questions in this Section

QUESTION 4

O. Oak manufactures and sells three products: Theta, Iota and Kappa. The following information is available for the year ended 31 December 2013 (on a per unit basis):

Inventory Item	**Costs Incurred**	**Cost to Complete**	**Sales Price**	**Costs to Sell**	**Units in Inventory**
	€/£	**€/£**	**€/£**	**€/£**	
Theta	3.15	2.75	7.85	0.90	9,750
Iota	4.75	1.60	5.75	0.75	12,080
Kappa	2.00	Nil	6.55	2.25	7,110

Required:

i. Write a brief note on any three of the following terms as they relate to inventory valuation in the financial statements:
- Cost
- Net realisable value (NRV)
- First in - first out (FIFO)
- Average cost (AVCO).

6 Marks

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 O. Oak as at 31 December 2013.

6 Marks

iv. Prepare the journal entry to record closing inventory in the financial statements of O. Oak as at 31 December 2013.

3 Marks

v. Outline the effect on the Statement of Profit and Loss and Statement of Financial Position if closing inventory is *under-valued.*

4 Marks
Total 20 Marks

QUESTION 5

Part A

Accounting concepts and conventions are of fundamental importance in the preparation of financial statements. W the aid of relevant examples, outline your understanding on *<u>any three</u>* of the following concepts/conventions.

- Accruals
- Going Concern
- Historical Cost
- Materiality
- Prudence

9 Marks

Part B

Outline your understanding of the term *"accounting policy"*.

3 Marks

The consistent application of accounting policies year on year is important to allow users of accounting information compare the financial information of an entity year on year. There are however two scenarios where an entity can change an accounting policy. State these two reasons.

2 Marks

Part C

List any four users of accounting information. Outline what information each user is interested in and why.

(Guidance: one of the four users *must* be internal to the business)

<u>6</u> Marks
Total <u>20</u> Marks

QUESTION 6

Part A

P. Plum does not maintain proper books and records. She is however able to provide you with the follow information as at 31 December 2013.

	€/£
NBV of non-current assets	95,000
Current assets	19,870
Capital as at 1 January 2013	51,770
Drawings	8,150
Current liabilities	15,650
Non-current liabilities	22,110
Capital introduced during 2013	7,100

You are required to:

i. Calculate the profit/loss figure for P. Plum for the year ended 31 December 2013.

5 Marks

ii. Outline your understanding of why the technique used in part (i) can be used to derive the profit/loss figure.

2 Marks

Part B

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

3 Marks

The following information for the year ended 31 December 2013 is available for a sole trader who does not maintain proper books and records.

Opening inventory as at 1 January 2013	€/£95,000
Closing inventory as at 31 December 2013	€/£77,870
Purchases	€/£154,140
Purchases returns	€/£19,120
Standard profit margin for 2013	30%

Using the information above, derive the sales figure (to the nearest whole number) for the year ended 31 December 2013.

5 Marks

Part C

O. Orange is a sole trader who did not maintain proper books and records for the year ended 31 December 2013. O. Orange purchases all goods on credit and is in a position to provide you with the following information which all relates to credit suppliers.

	€/£
Payables 1/1/2013	51,750
Payables 31/12/2013	49,650
Purchases returns	12,410
Discounts received	1,030
Contra entry with receivables	650
Cash paid to suppliers	104,740

You are required to calculate the credit purchases of O. Orange for the year ended 31 December 2013.

5 Marks

Total 20 Marks

1st Year Examination: May 2014

Financial Accounting

Suggested Solutions
and
Examiner's Comments

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.

Statistical Analysis – By Question						
Question No.	1	2	3	4	5	6
Average Mark (%)	72%	62%	64%	50%	48%	69%
Nos. Attempting	1148	1145	1143	954	479	810

Statistical Analysis - Overall	
Pass Rate	76.6%
Average Mark	61.4%
Range of Marks	**Nos. of Students**
0-39	171
40-49	100
50-59	209
60-69	211
70 and over	466
Total No. Sitting Exam	1157
Total Absent	337
Total Approved Absent	48
Total No. Applied for Exam	1542

General Comments:

The overall standard of answers was generally good. Most candidates are now attempting the required number of questions, which is very welcome. A small number of candidates are still completing 3 questions in section B and two questions in section A in error, therefore they were only marked out of four questions. However where questions are offering choice within the question some candidates are completing all parts of the question. Students should note that this is unnecessary and can mean that time is lost elsewhere.

Some candidates present T accounts when journals are requested in the question.

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
- In theory questions some candidates are repeating themselves in multiple paragraphs. Where shorter more concise answers would have scored the same marks.
- No workings presented for some questions
- Some candidates are making calculation errors within workings and thus presenting an incorrect figure in the solution, but all the elements of the working are correctly treated. It would appear time and examination pressure could be a factor. Where the elements of the calculation are clearly shown in the workings marks are not being deducted for this
- Workings presented all combined in the rough work section of the paper – despite the answer book explicitly stating not to do this

Examiner's Comments on Question One

This question was generally well answered.

Many candidates prepared correct calculations for trade receivables, allowance for doubtful debts, irrecoverable debts, drawings and bank correctly.

A significant number of candidates did not correctly adjust purchases for drawings. The adjustment for the insurance prepayment was not well answered with difficultly focused on the calculation of the prepayment.

Layout, presentation and workings continue to improve however candidates need to remember to title the financial statements correctly. Note that they are named correctly on the examination paper and use this to your advantage.

Solution One
B. Bonsai
Statement of Profit and loss for the year ended 30 September 2013 **0.5 marks**

	Ref to Workings	**€/£**	**€/£**	**€/£**	**Marks Allocated**
Sales				557,820	**0.5**
Sales returns				(22,980)	**0.5**
Net sales				534,840	
Cost of sales					
Opening inventory			26,180		**0.25**
Purchases	1	312,050			**1**
Purchases returns		(17,965)	294,085		**0.5**
Carriage inwards	4		2,312		**0.5**
			322,577		
Less closing inventory			(21,540)		**0.5**
Cost of sales				(301,037)	
Gross Profit				233,803	
Discount received				1,850	**0.5**
Less Expenses					
Rental costs on office space and equipment			41,840		**0.25**
Interest charged by supplier			1,780		**0.5**
Advertising and media costs			3,150		**0.25**
Insurance	2		14,250		**0.75**
Rates, water charges and refuses			7,950		**0.25**
Wages and salaries			103,740		**0.25**
Employers PRSI/NIC Costs			12,150		**0.5**
Discount allowed			2,540		**0.5**
Telephone and internet	3		2,664		**0.5**
Carriage outwards	4		3,468		**0.5**
Decrease in the allowance for receivables	5		(1,074)		**0.5**
Irrecoverable debts	5		6,260		**0.75**
Interest	6		7,550		**0.5**
Light and heat			6,520		**0.25**
Total expenses				(212,788)	
Operating profit				22,865	

Solution One *(Cont'd)*

B. Bonsai
Statement of financial position as at 30 September 2013 **0.5 marks**

Non-current assets	**Ref to Workings**	**€/£**	**€/£**	**€/£**	**Marks Allocated**
Land				198,540	**0.25**
Current assets					
Closing inventory			21,540		**0.25**
Receivables	5	59,520			**0.75**
Closing allowance	5	(2,976)	56,544		**0.5**
Insurance prepaid	2		3,600		**0.5**
Cash and bank	1		6,845		**1**
				88,529	
Total assets				**287,069**	
Equity and Liabilities					
Equity					
Capital			13,840		**0.5**
Accumulated profits			47,650		**0.25**
Profits 2013			22,865		**0.5**
Accumulated profits			84,355		
Drawings	1		(19,760)		**0.75**
				64,595	
Non-current liabilities				151,000	**0.5**
Current liabilities					
Payables			57,160		**0.5**
Telephone and internet accrual	3		444		**0.5**
Interest accrual	6		4,500		**0.5**
VAT liability			7,130		**0.5**
PRSI/NIC liability	1		2,240		**0.75**
				71,474	
Total Equity and Liabilities				**287,069**	

Workings

Working 1

	€/£
Drawings as per TB	11,720
Drawings of inventory €/£450*12	5,400
Drawings of bank €/£220*12	2,640
Restated drawings	19,760

	€/£
Bank balance as per TB	11,985
Drawings	(2,640)
PRSI/NIC payment	(2,500)
Restated bank	6,845

	€/£
PRSI/NIC liability	4,740
PRSI/NIC payment	(2,500)
Restated PRSI/NIC	2,240

	€/£
Purchases as per TB	317,450
Drawings	(5,400)
Restated purchases	312,050

Workings 2

	€/£
Insurance to 31 December 2013	14,400
Three months prepaid	3,600

	€/£
Insurance as per TB	17,850
Insurance prepaid	(3,600)
	14,250

Workings 3

	€/£
Telephone and internet as per TB	2,220
Accruals	444
Restated telephone and internet costs	2,664

Workings 4

Carriage	5,780
Carriage inwards	40%
Carriage inwards	2,312
Carriage outwards	3,468

Solution One *(Cont'd)*

Workings 5

	€/£
Receivables as per TB	61,670
Irrecoverable receivables	(2,150)
Restated receivables	59,520
Closing allowance	5%
Closing allowance	2,976
Opening allowance	4,050
Decrease in allowance	1,074
Irrecoverable debts as per TB	4,110
Irrecoverable receivables	2,150
Restated irrecoverable debts	6,260

Workings 6

	€/£
Principle value of loan	151,000
5% interest rate	5%
Annual interest	7,550
Interest paid	(3,050)
Interest Accrual	4,500

Total: 20 marks

Examiner's Comments on Question Two

The most common issue in this question was candidate's explanation of depreciation was not comprehensive enough with most simply outlining how straight line and reducing balance methods are calculated and not explaining why a particular method should be used. Many candidates confused depreciation rate and method.
Many candidates included fixtures and fittings in the capitalised cost of the building rather than treating them as a separate class of non-current asset.

Candidates' knowledge of debits and credits seems to be improving. Students should note that when asked to complete journals, it is important to include a narrative for the journal, as otherwise marks will be lost.

Part A
Non-current assets are tangible assets that are purchased to be used within the business and are not intended for resale. Examples include: machinery, buildings and delivery vans. Such assets are expected to last for longer than one year.

3 marks

Part B
(i)
Depreciation refers to the measure of wearing out and consumption in the useful economic life of a non-current asset. There are two methods of calculating depreciation: the straight line method and the reducing balance method.

Straight Line Method
Using this method the amount of depreciation charged every year is the same. It is therefore appropriate for assets were the consumption of economic benefit is relatively even over the life of the asset for example buildings.

The formula for the straight line method of depreciation is as follows:

$$\text{Depreciation Charge per Annum} = \frac{\text{Cost – Estimated Residual Value}}{\text{Expected Life of Fixed Asset}}$$

Solution Two *(Cont'd)*

Reducing Balance Method
The reducing balance method calculates the per annum depreciation charge by multiplying the net book value of the non-current asset by a fixed percentage rate. The result of using the reducing balance method is that depreciation charge is the highest in the first year after purchase and falls in each subsequent year. It is therefore appropriate for assets were the consumption of economic benefit is relatively high in first years after purchase and reduces thereafter for example motor vehicles.

The formula for the reducing balance method of depreciation is as follows:
Depreciation Charge per Annum = NBV of non-current asset * Depreciation % Rate

4 marks

(ii)
Whether the straight line or reducing balance method of depreciation is chosen depends upon how the asset is expected to consume economic benefit. The method used should approximate how the asset is expected to consume economic benefit. Where assets are expected to consume economic benefit evenly over the life of the asset the straight line method is normally considered appropriate. Thus using the straight line method for the building would appear appropriate.

Using the reducing balance method means that the depreciation charged is the highest in the first year after purchase and falls in each subsequent year. Thus using the reducing balance method for computers would appear appropriate.

3 marks

Part C
(i)
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 for the purpose of the trade of the business. Examples include wages, rent, rates, telephone etc.

4 marks

(ii)

Capitalised costs	**€/£**	**Marks Allocated**
Building materials	43,250	**0.5**
Deliver of building materials	1,250	**0.5**
Legal costs	2,500	**0.5**
Architect fees	4,100	**0.5**
Site preparation costs	1,120	**0.5**
Interest incurred on construction loan during the period of construction	3,580	**0.5**
	55,800	

0.5 marks each for excluding Fixtures and Fittings and Flowers and Plants

(iii)

	Dr	Cr	Marks Allocated
	€/£	€/£	
Buildings at cost	55,800		0.75
Bank		55,800	0.75
Being the recognition of buildings built			0.5

Total: 20 marks

Examiner Comments on Question Three

Part A - well answered by most candidates. Some candidates incorrectly included the allowance for receivables.
Part B - answers here were mixed. Some candidates identified the issue of a conflict of interest between directors and shareholders, however many did not. Some candidates mentioned that companies are required to have their financial statements audited by an external audit, however many did not.
Part C – answers were mixed. Candidates tended to get mixed up in the explanations and some did not identify the impact on the trial balance or did not include an example.
Part D - well answered, although some candidates did not deal with the overdrawn balance correctly.
Part E - most students identified the correct adjustment for rent, but many did not adjust the interest correctly. Many stated the numerical balance for the suspense account but did not state whether it was a Dr or a Cr and therefore lost marks.
Part F - generally poorly answered. Very few candidates achieved full marks when they answered this part of question 3.

In general parts C, E and F were the least popular choices. Some weaker candidates attempted all parts of the question and wasted valuable time.

Solution Three

Part A

Receivables Control A/C

Marks Allocated		€/£		€/£	Marks Allocated
0.5	Balance b/d	25,100	Sales returns	1,100	0.75
0.75	Sales	52,100	Cash received	47,460	0.75
			Contra	700	0.75
			Discounts allowed	70	0.75
			Balance c/d	27,870	
		77,200		77,200	
0.25	Balance b/d	27,870			

0.5 marks for excluding allowances for receivables.

Part B

In many jurisdictions companies are required to produce annual financial statements and have them audited by an external auditor. The need for auditing is derived from the need for trust/confidence in the information in the annual financial statements. This is because in many large companies the owners of the company are not the same as the directors of the company.

Directors are appointed by the shareholders to act on their behalf and have a fiduciary duty (must act in good faith). Directors are responsible for stewardship of assets but also are required to prepare regular reports on the effectiveness of that stewardship. Hence a conflict of interest arises and an independent expert is employed to check the accuracy of this report.

An annual external audit is where an independent firm of accountants examines the books, records and financial statements produced by the directors to assess whether they are true and fair.

5 marks

Solution Three *(Cont'd)*

Part C

Error of omission is where a transaction is completely omitted from the books. The trial balance will re balance. For example an electricity bill left in filing tray and not entered in the books and records.

Error of transposition this is where there is a debit and a credit entry but they are not the same. The trial balanc will not balance. For example a sale of €/£750 posted as €/£570 in one account.

Casting error this is where a numerical error has occurred in the balancing process. The trial balance will not balance. For example the total in the receivables control account added up as €/£14,000 when the correct figure if the addition were correct is €/£14,750.

Error of principle is where an item is entered into the wrong class of accounts. The trial balance will remain in balance. For example building repairs debited to buildings at cost T Account as opposed to the building repairs T Account.

Error of original entry is where the original figure used to make the double entry is incorrect. The trial balance will remain in balance. For example a credit purchase of €/£1,350 entered into the purchases day book as €/£11,350.

1 mark each for a total of 5 marks.

Part D

Bank reconciliation statement for the month of December 2013

	€/£	Marks Allocated
Balance per bank statement (overdrawn)	(41,250)	1.5
Add: lodgements not credited	3,310	1
Less: cheques written not presented to bank for payment	(17,120)	1
Less: banking error (bank credited account in error with monies which belongs to another customer)	(1,110)	1.5
Unfavourable balance as per cash book	(56,170)	

Part E

		Debit	Credit	Marks Allocated
		€/£	€/£	
Dr	Suspense	4,500		0.5
Cr	Interest received		2,250	0.75
Cr	Interest expense		2,250	0.75
Dr	Suspense	9,900		1
Cr	Rent Account		9,900	1

Suspense Account

Marks Allocated	Details	€/£	Details	€/£	Marks Allocated
0.25	Error 1	4,500	Opening balance on suspense	14,400	0.5
0.25	Error 2	9,900			
		14,400		14,400	

Solution Three *(Cont'd)*

Part F
€/£15,000 * 50 = €/£750,000 – life membership

		Debit	Credit	Marks Allocated
		€/£	**€/£**	
2012				
Dr	Bank	750,000		**1**
Cr	Life membership fund		750,000	**1**
Dr	Life membership fund	75,000		**1**
Cr	Life memberships: Statement of profit and loss		75,000	**1**
2013				
Dr	Life membership fund	75,000		**0.5**
Cr	Life memberships: Statement of profit and loss		75,000	**0.5**

Examiner Comments on Question Four

A popular question answered by the majority of candidates.

Many candidates calculated the value of inventory correctly. However, there are still a lot of candidates who clearly have not prepared for this question. Also, some candidates who were able to calculate the inventory value were unable to explain the definitions of Cost, NRV, AVCO and FIFO. Many candidates stated that FIFO applies to perishable goods in error. While some candidates provided an explanation for four terms in error
Some candidates were unable to correctly advise on the impact of undervaluing closing inventory on the statement of profit and loss. The journal piece of the question was very poorly answered.

Solution Four

(i)
Cost
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.

Net realisable value (NRV)
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.

FIFO
First-In, First-Out (FIFO) may be used to calculate the value of closing inventory and the cost of goods sold during the period. This method assumes that inventory purchased or manufactured first is sold first and newer inventory remains unsold. Thus the cost of older inventory is assigned to the cost of goods sold (Statement of profit and loss) and that of newer inventory is assigned to ending inventory (Statement of financial position). The actual flow of inventory usually will not match the first-in, first-out pattern.

AVCO
Average cost method (AVCO) calculates the cost of closing inventory and cost of goods sold for a period on the basis of weighted average cost per unit of inventory. Cost is calculated by taking the average price, calculated by dividing the total costs of purchases by the total number of units purchased.

Any 3 at 2 marks

Solution Four *(Cont'd)*

(ii)
Inventory is valued at the lower of cost and NRV.

1 m

(iii)

Inventory Item	**Costs Incurred**
	€/£
Theta	3.15
Iota	4.75
Kappa	2.00

Inventory Item	**Sales Price**		**Cost to Complete**		**Costs to Sell**		**NRV**	**Marks Allocated**
	€/£		**€/£**		**€/£**		**€/£**	
Theta	7.85	-	2.75	-	0.90	=	4.2	**1**
Iota	5.75	-	1.60	-	0.75	=	3.4	**1**
Kappa	6.55	-	Nil	-	2.25	=	4.3	**1**

Inventory Item	**Total Cost**	**NRV**	**Valuation**		**Units of Inventory**	**Valuation**	**Marks Allocated**
	€/£	**€/£**	**€/£**			**€/£**	
Theta	3.15	4.2	3.15	*	9,750	30,712.50	**1 mark**
Iota	4.75	3.4	3.4	*	12,080	41,072	**1 mark**
Kappa	2.00	4.3	2	*	7,110	14,220	**1 mark**
						86,004.50	

(iv)

		Debit	**Credit**	**Marks Allocated**
		€/£	**€/£**	
Dr	Closing inventory in the statement of financial position	86,004.50		**1.25**
Cr	Closing inventory in the statement of profit and loss		86,004.50	**1.25**
	Being the posting of the closing inventory journal			**0.5**

(v)
When closing inventory is under-valued it means that it is included in the financial statements at a value that is less 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 under-stated, this in turns means that the cost of goods available for sale is over-stated and therefore profits are under-stated.

In the Statement of Financial Position the value of closing inventory in current assets is under-stated and therefore assets are under-stated and hence the value of the entity is understated.

4 marks

Total: 20 marks

Examiner Comments on Question Five

This was probably the least popular question in section B.

Candidates appeared to answer this question because there were able to answer part C. However some candidates provided an explanation for four terms in error.
Candidates made a good attempt to answer part A. Part B was not very well answered with only a small number of candidates referring to the principles, conventions, etc. Most candidates were not able to identify two reasons for changing accounting policies.

Part C was generally well answered, with most students achieving at least 4 marks. Some candidates however failed to identify examples of the accounting information that would be required by each user. A few candidates also gave owners/shareholders/investors as different users (and these are effectively the same).

Solution Five

Part A

Accruals

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. For example the sale of a good is recognised in the financial statements when the rights and rewards of ownership have passed from the seller to the purchaser not when the cash is received.

Going Concern

Financial transactions are usually prepared on the assumptions that the business will continue in operational existence for the foreseeable future. This means that the financial statements are drawn up on the assumption that there is no intention or necessity to close down the business.

If the financial statements are not prepared on the going concern basis then they must be prepared on what is known as the break-up basis. The break-up basis reflects the following:

- Some non-current assets may be sold at less than their value on the statement of financial position, whilst a machine may have a use for specific business, it may be scrap or no use to other businesses.
- In contrast, property may be sold for a value in excess of that shown in the statement of financial position based on original cost.
- If the entire inventory is sold at once then it will not be sold for as much money as if it were sold in the normal way.
- Some receivables may decide not to pay the business if it is known the business is about to go into liquidation.

In most cases financial statements are prepared on a going concern basis unless there is evidence to the contrary.

Historical Cost

Assets are recorded at historical cost i.e. what they were bought for. Liabilities are valued at the amount initially received in exchange for the obligation. Thus the figure shown in the financial statements for an item is the value of the item when the transaction occurred, not its current market value. Historical cost has many drawbacks, a significant one being that the non-current assets of the business tend to be undervalued and therefore the statement of financial position does not show the true value of the business.

Historical cost continues to be used however for the following reasons: it is simple and cheap to apply, figures used are objective and verifiable and the lack of a sound and acceptable alternative. An example of the historical cost concept is valuing buildings at a cost price of €/£100,000 even though the current market value of the buildings is €/£250,000.

Materiality

Materiality is a threshold quality that is demanded of all information given in the financial statements. When immaterial information is given in the financial statements, the resulting clutter can impair the understandability of the other information provided.

Solution Five *(Cont'd)*

An item's size is judged in the context both of the financial statements as a whole and of the other in available to users that would affect their evaluation of the financial statements. An example of a material the value of non-current assets of €/£250,000 in the financial statement of an entity with total assets of €/£320, The non-current assets are material to the financial statements of the entity.

<u>Prudence</u>
In conditions of uncertainty, a cautious approach should be taken, so that gains and assets are not overstated and losses and liabilities are not understated. This means that:

- Sales and profit should not be included in the income statement until the cash has been received or that there is reasonable certainty that the cash will be received.
- In contrast, losses should be recognised in the income statement as soon as they are foreseen and considered reasonably certain.

An example of prudence can be seen in the allowance for receivables. As at the year end the entity does not know that receivables will not be able to pay the balances due. If it did these balances would need to be written off as irrecoverable debts. However based on past experience and knowledge of the economy the entity knows that in all probability not all receivables will be able to discharge the balances owed. The entity therefore sets up an allowance for receivables to reflect balances that the entity expects not to receive and this is deducted from receivables in the statement of financial position. Therefore the figure reported for receivables can be thought of as the funds the entity expects to receive as opposed to the total balances owed as at the year end.

3 marks each for a total of 9 marks
9 marks

Part B

Accounting policies are those principles, bases, conventions, rules and practices applied by an entity that specify how the effects of transactions and other events are to be reflected in its financial statements through: recognising, selecting measurement basis for and presenting assets, liabilities, gains, losses and changes to capital.

3 marks

Generally speaking an entity should apply its accounting policies consistently year on year in order to achieve comparability and consistency. It is appropriate to change an accounting policy for two reasons: when required by an IFRS, and when the change will result in reliable and more relevant presentation of information.

2 marks

Part C

<u>Lenders</u>
Banks who lend money to a business require information that helps them determine whether loans and interest will be paid when due. The key accounting information for lenders is therefore, cash flow and profitability of the business.

<u>Payables</u>
Suppliers and trade payables require information that helps them understand and assess the short-term liquidity of a business. Is the business able to pay short-term debt when it falls due? The key accounting information for payables is therefore cash flow and profitability.

<u>Receivables</u>
Customers require information about the ability of the business to survive and prosper. As customers of the company's products, they have a long-term interest in the company's range of products and services. They may even be dependent on the business for certain products and services. The key accounting information for receivables is therefore sales growth, new product development and investment decision.

<u>Employees</u>
Employees require information about the stability and continuing profitability of the business. They are crucially interested in information about employment prospects and the maintenance of pension funding and retirement benefits. They are also likely to be interested in the pay and benefits obtained by senior management. The key accounting information for employees is therefore revenue and profit growth, levels of investment in the business

<u>Government</u>

Many government agencies and departments are interested in accounting information. For many busi most significant one is the Revenue commissioners. Revenue needs information on business profitability i to levy and collect corporation tax, accounting information on sales and purchases is needed to verify V Added Tax (VAT) returns.

<u>Analysts</u>

Investment analysts require very detailed financial and other information in order to analyse the competitive performance of a business and its sector (only applicable for Plcs). Much of this is provided by the detailed accounting disclosures that are required by authorities such as the London Stock Exchange.

<u>Public at large</u>

Interest groups formed by various groups of individuals who have a specific interest in the activities and performance of businesses, will also require accounting information such as the environmental policies of the business.

1.5 marks each for a total of 6 marks
<u>Total: 20 marks</u>

Examiner's Comments on Question Six

A popular question in Section B

Generally this was well answered. However in part A some candidates treated capital as if it had a debit balance and added it to NCA and CA in error.

In part B a significant number of students did not apply the correct calculation to find out the sales figure, and appeared to get confused between mark up and margin when it came to application even though many had properly explained it. Students would benefit from revising this area in more detail.

Part C was generally well answered. Some weaker candidates didn't prepare the answer in T account format and may have become confused as a result.

Solution Six

Part A
(i)
Statement of financial position as at 31 December 2013

	€/£	€/£	€/£	Marks Allocated
Non-current assets			95,000	0.5
Current assets			19,870	0.75
Total assets			**114,870**	
Equity and Liabilities				
Capital 1/1/13		51,770		0.75
Capital introduced		7,100		0.75
Profits 2013		**26,390**		
		85,260		
Drawings		(8,150)		0.75
			77,110	
Non-current liabilities			22,110	0.75
Current liabilities			15,650	0.75
Total Equity and Liabilities			**114,870**	

(ii)
The profit/loss above was derived based upon the knowledge that the statement of financial position must always balance. The technique used above relies upon the dual aspect concept. The dual aspect concept states that every transaction has two equal effects. The two effects are opposite and equal, i.e. a debit and a credit. The dual aspect concept is the reason the statement of financial position balances and is the reason that assets are equal to equity and liabilities.

2 marks

Part B
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 difference between cost and the selling price 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.

3 marks

Solution Six *(cont'd)*

Statement of profit and loss for the year ended 31 December 2013

		€/£	€/£		Marks Allocated
Sales			217,357	**100%**	**1**
Cost of sales					
Opening inventory		95,000			**0.75**
Purchases	154,140				**0.75**
Purchases returns	(19,120)	135,020			**0.75**
		230,020			
Less closing inventory		(77,870)			**0.75**
Cost of sales			(152,150)	**70%**	**1**
Gross Profit			65,207	**30%**	

Part C

Payables Control Account

Marks Allocated	Date	Details	€	Date	Details	€	Marks Allocated
0.5		Purchases returns	12,410	1/1/13	Balance b/d	51,750	**0.5**
1		Discounts received	1,030		**Purchases**	**116,730**	
1		Payments to payables	104,740				
1		Contra	650				
1	31/12/13	Balance c/d	49,650				
			168,480			168,480	
				1/1/2014	Balance b/d	49,650	

Total: 20 marks