STRICTLY CONFIDENTIAL

THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2009 EXAMINATIONS

FOUNDATION STAGE

PAPER 1: ACCOUNTING FRAMEWORK

(DECEMBER 2009)

TIME ALLOWED : 3 HOURS

SUGGESTED SOLUTIONS

1. (a) (i) The objective of inventory control is to keep a close watch over stock levels. This involves inflows and outflows of inventory through purchases and sales. A computerized inventory control system may integrate the following modules.

- Sales order processing – useful in determining inventory levels and generating invoices.
- Purchases order processing.
- Sales ledger and purchases ledger.
- General ledger.

(ii) SITINGAWAWO DESIGNER
Destroyed Inventory

	K
Cost of sales	
9 August sales	187,200
Less: Mark-up ¼ on selling	(46,800)
Cost of sales	140,400
Goods available for sale:	
1 January: Opening inventory	36,600
9 August : Purchases	134,300
Amount available for sale	170,900
Less cost of sales	140,400
Cost of inventory destroyed	30,500

Note

(1) Mark-up on cost ⅓

Mark-up on sales = $\frac{1}{3+1} = \frac{1}{4}$

(2) Cost of sales can also be calculated as 1 + mark-up on cost

(b) (i) Under LIFO the closing inventory comprises the oldest inventory i.e. 50 units @ K5 and 100@K6 = K850

Under the First-In-First-Out method of stock valuation, stock movement follows the natural way. That is stocks are sold or used as they come in.

Closing inventory therefore comprises of the latest stock which is likely to be at the latest prices hence higher prices .
The 150 units ∴ = 150@K7 = K1,050

Under the LIFO method, stock movements are controlled by the type of storage i.e. one open –ended like bins and bags where the latest stock is used before the oldest.

Closing stock comprises of the oldest stock acquired when prices were lower.
The 150 units ∴ = 100@K76 = 600
50 5 250
K850

DATE	Opening Inventory	Purchases	Sales	Closing Inventory	LIFO Value K	FIFO Value K
Jan	-	300	200	100	500	500
Feb	100	-	50	50	250	250
April	50	400	250	200	1,150	1,200
May	200	250	300	150	850	975
June	150	200	200	150	850	1,050

2. (a)

JOURNAL ENTRIES

		Dr K	Cr K
(i)	Inventory account	1,300	
	Suspense account		1,300
(ii)	Account payable	210	
	Purchases returns		210
(iii)	Sales	1,000	
	Account receivable		1,000
(iv)	Establishment expenses	150	
	Purchases		150

(b) GONE'S CORRECTED TRIAL BALANCE AS AT 31/03/09

	K	K
Inventory at 1 April 2008	12,000	
Discount allowed	310	
Discount received		450
Provision for doubtful debts		960
Purchases	93,850	
Purchases returns		1,610
Sales		131,100
Sales returns	1,100	
Freehold property	70,000	
Provision for depreciation		3,500
Motor vehicles at cost	15,000	
Provision for depreciation		4,500
Capital		84,600
Bank	7,100	
Accounts receivables	10,300	
Accounts payables		7,390
Establishment and admin expenses	16,750	
Drawings	9,000	
Suspense account		1,300
	235,410	235,410

(c) Gone's trial balance balanced even though there were errors because of the following reasons:

(i) Compensating errors

Most of the errors had compensating wrong entries which helped to balance off.

(ii) Errors of principle

Many items were credited instead of being debited and vice versa; for example, discounts received. Provision for bad debts and depreciation were debited instead of being credited whereas inventory had been credited instead of being debited.

(iii) Closing inventory had been included in the trial balance. This is an error of principle.

(iv) Error of omission - where an item had been left out of the accounting process e.g. the inventory which was left out.

(v) Error of original entry

Where a mistake had been made at the beginning of the accounting process with both debit and credit having been similarly affected.

3. (a) (i) Bad debts are amounts receivable from customers which are definitely uncollectable. The debtor is unable to pay because of various reasons such as death, bankruptcy etc. They are specific amounts owed by specific individuals or companies. Bad debts are normal business expenses. Provisions for bad and doubtful debts are amounts set aside to cover a general loss which may occur in the future due to uncollectable debts. The amounts are not known.

(ii) Provisions for bad debts are estimates based on past experience. The provision may therefore be either:

- a percentage of outstanding debtors; or
- may depend on the age of the debt; that is debtors that are still outstanding after one year may be considered uncollectable.
- assessment of debtors who pay irregularly.

(iii) According to the prudence concept it is wise to anticipate losses and make provisions even before such losses occur. The accountant should make sure that all losses are recorded and written off as soon as they occur to avoid overstating profits, but that profits and gains should not be recorded until they are realised.

Similarly the concept of prudence supports the provision for bad debts even before the debts become bad.

(iv) Bad debts are a loss to a business hence they are written off as an expense resulting in the reduction in the profit and a reduction in the business worth.

Provision for doubtful debts are also a reduction in the anticipated profit. They reduce prospective debtors resulting in a reduction in current assets and a reduction in business worth.

(b)

PROVISION FOR BAD AND DOUBTFUL DEBTS

	K		K
31 March 2007 Bal c/d	1,500	31 March 2007 Bal b/d	950
		31 March 2007 Profit & loss	550
	1,500		1,500
31 March 2009 Bal c/d	1,900	31 March 2008 Bal b/d	1,500
		31 March 2008 P/Loss	400
	1,900		1,900
31 March 2009 Profit & loss	665	March 2008	1,900
Balance c/d	1,235		
	1,900		1,900
		31 March Bal b/d	1,235

BAD DEBTS ACCOUNT

	K		K
March 2008			
Sundry debtors	2,100	Profit & loss A/C	2,100
	2,100		2,100
March 2009			
Sundry debtors	750	Profit and Loss A/C	750
	750		750

(c)

JENNIFER K ACCOUNT

	K		K
Bad debts recovered	240	Cash	240
	240		240

B DUNCAN A/C

	K		K
Bad debts recovered	720	Cash	720
	720		720

BAD DEBTS RECOVERED A/C

	K		K
Profit & Loss	960	Jennifer K	240
		B Duncan	720
	960		960

BANK/CASH A/C

	K		
Sundry debtors	960	Bal c/d	960
	960		960
Bal b/d	960		

4. (a) Under the accruals accounting method, profit is measured as the difference between revenue earned during a given period and expenses incurred during that same period i.e.

Profit = Revenue – Expenses of a given period.

Accruals Accounting involves matching revenues and expenses so that they are attributable to the same period regardless of whether cash is paid, received or not, during that period.

This involves accounting for

- Expenses paid in advance – prepayment
- Expenses paid in arrears – owing
- Revenue received in advance.

Cash paid or received during a period may just cover the revenue earned during that particular period or expenses incurred during that same period. It may also be less than or more than the required amount so that at the end of the period there is a prepayment (asset) or amount owing in the form of expenses not paid or revenue received in advance (liability).

(b)(i) (1)

INSURANCE ACCOUNT

2008	K	2008	K
31 Dec Bank A/C	84,000	31 Dec prepaid c/d	6,800
		31 Dec Profit & Loss	77,200
	84,000		84,000

Dec 31 prepaid c/d K6,800

(2)

STATIONERY ACCOUNT

2008	K	2008	K
31 Dec Bank	37,000	1 Jan owing b/d	11,000
31 Owing c/d	24,500	31 Dec Profit & Loss	50,500
	61,500		61,500

Dec 31 owing c/d K24,500

(3) BUSINESS RATES

2008	K	2008	K
1 Jan prepaid b/d	14,000	31 Dec prepaid c/d	12,000
Dec 31 Bank	165,400	31 Dec Profit & Loss	167,400
	179,400		179,400

Dec 31 prepaid c/d K12,000

(4) WAGES ACCOUNT

2008	K	2008	K
31 Dec cash	150,000	1 Jan Accrued b/d	3,060
31 Dec Accrued c/d	4,190	31 Dec Profit & Loss	151,130
	154,190		154,190

2009
Jan 1 Accrued b/d K4,190

(5) RENT RECEIVABLE

2008	K	2008	K
31 Dec Profit & Loss	274,100	1 Jan Advance b/d	3,600
		31 Dec Bank	260,000
		31 Arrears c/d	10,500
	274,100		274,100

2009
Jan 1 Arrears b/d K10,500

(ii) BALANCE SHEET SUMMARY

CURRENT ASSETS

	K
PREPAYMENTS	
Insurance	6,800
Business rates	12,000
	18,800
ACCRUALS	
Stationery	24,500
Wages	4,190

5. (a)

MSADALIRA SUPERMARKET LTD
INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH 2009

	K
Revenue	595,000
Cost of sales	(351,000)
Gross profit	244,000
Increase in provision (W1)	(1,750)
Distribution costs (W2)	(4,750)
Administration costs (W3)	(152,300)
Finance costs	(1,600)
Sundry expenses	(45,500)
Net income for the year before tax	38,100
Provision for taxation	(18,000)
Profit after tax	20,100
Dividend: Preference dividends	(5,250)
Proposed ordinary dividend	(7,000)
Net retained income for the year	7,850
Balance of retained profit brought forward (W4)	45,450
Retained profit carried forward	53,300

WORKINGS

		K
1.	Provision for doubtful debts	
	Old provision	7,250
	New provision	9,000
	Increase in provision	1,750
2.	Distribution costs	
	Advertising	4,750
3.	Administration expenses	
	Motor expenses	74,500
	Depreciation: Motor vehicles	6,500
	Fixtures & fittings	550
	Wages and salaries	63,000
	Audit fee	1,750
	Directors' remuneration	6,000
		152,300
4.	Retained profit	86,050
	Surplus for the year	(40,600)
	Brought forward from previous years	45,450

(b) MSADALIRA SUPERMARKET LTD

BALANCE SHEET AS AT 31 MARCH 2009

ASSETS	K
NON CURRENT ASSETS	
Property, plant and equipment (W1)	118,250
CURRENT ASSETS	
Inventory	103,000
Trade receivables (W2)	160,950
Bank	57,150
Cash	950
TOTAL ASSETS	440,300
EQUITY AND LIABILITIES	
Share capital: authorized and issued (W3)	200,000
8% Debenture	20,000
General reserve	45,000
Retained profit	53,300
	318,300
CURENT LIABILITIES	
Trade payables (91,000 + 6,000)	97,000
Corporation tax	18,000
Proposed dividend	7,000
	440,300

WORKINGS

1. NON CURRENT ASSETS

	Cost	Depn	Net
	K	K	K
Freehold land & building	85,000	-	85,000
Fixtures & fittings	32,300	11,700	20,600
Motor vehicles	19,600	6,950	12,650
	136,900	18,650	118,250

2. Trade Receivables

Balance	169,950
New provision	(9,000)
	160,950

3. Share capital

Preference shares K1 each	K100,000
Ordinary shares K1 each	100,000
	K200,000

6. (a) (i) Cash is an asset to a firm hence appears as a debit in the books of that firm.

Cash held by banks belonging to its customers appears on the credit side of the bank's record i.e. the bank statement, because it is a liability of the bank.

(ii) A bank reconciliation seeks to compare balances of cash held by a firm in its bank (as shown by the bank statements) against the balances appearing in its own accounting records. It is important to carry out bank reconciliation regularly in order to:

1. identify and correct errors.
2. find out what charges, payments and receipts the bank may have made but which have not been recorded in the firm's records.
3. identify differences which have occurred due to time differences, between, for instance, receipt of amounts from customers and the crediting of such items in the bank statements.

(b) CORRECTED CASH BOOK

	K		K
Advertising	1,800	Balance b/d	38,000
Balance c/d	40,800	Standing order	4,000
		Overstated	600
	42,600		42,600
		Balance b/d	40,800

Bank Reconciliation

Balance per cash book	(40,800) O/D
Add: Cheques paid but not presented	103,700
	62,900
Cheques paid but not cleared	(168,000)
Bank balance	(105,100)O/D

(ii) A company may increase its bank balance while not making profit because cash is not synonymous with profit.

(1) A firm can borrow through a loan or seek overdraft facilities.

(2) The company may dispose of some of its assets and obtain cash.

(3) It may issue new shares or receive from outstanding issued shares.

(4) Debtors may have paid into the bank's account.

(5) By withholding payment of dividends i.e. pay scripts or bonus shares.

(6) Delayed payment to suppliers or corporation tax.

7. (a) Accounting involves activities whose objective is to produce information of financial nature for decision making. Accounting practices are, therefore, influenced by changes in business practice. Some of the factors which have led to changes in accounting practice are:

(i) Technology: Technological developments have brought changes in methods of production, transport, selling and other business activities so that the collection of data concerning production processes, inventory valuation, transport and sales is done online (using computers).

(ii) Globalization: Most companies are operating worldwide so that the world is now considered as one market. Modern accountants are therefore more diversified in knowledge, often working across national borders in multinational companies.

(iii) Regulation: Regulation of accounting information is becoming more and more important as the number of users continue to increase.

(iv) Growth of capital markets: Business financing has changed greatly with free movement of capital worldwide. This means that accounting reports are having to address the information needs of many and varied stakeholders.

(b) (i) Underlying accounting concepts are guidelines arising from observation or convictions of preparers of accounting information on the nature of certain aspects of business activities and how they should be accounted for. These concepts are generally agreed upon and are observed through custom and practice.

Examples of underlying accounting concepts include:

- The historical cost concept
- The money measurement concept
- The business entity concept
- The dual aspect concept
- The time interval concept

(ii) Fundamental accounting concepts are those aspects of business whose nature is so important in the production of accounting information that they must be adhered to because they affect the nature of accounting information. Fundamental accounting concepts are therefore enforced through accounting standards and the Companies Act (the law).

Examples of Fundamental accounting concepts include:

- The going concern concept
- The consistency concept
- The Prudence concept
- The accruals concept
- Separate determination
- Materiality
- Substance over form

(c) The International Accounting Standards Board is a body comprising of people from Europe, USA, Asia/Pacific and other parts of the world who act as trustees of the accounting profession. Their basic function is to ensure objectivity, harmonization and reliability of accounting information.

The IASB was established in response to:

- Growth in international investment which has led to the need for uniformity in accounting practice.

- the need to harmonize various countries' accounting standards boards.

- the need to cover countries which do not have accounting standards boards.

E N D