THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2010 EXAMINATIONS

CERTIFICATE IN FINANCIAL ACCOUNTING PROGRAMME

PAPER FA 4 : BUSINESS ACCOUNTING

(DECEMBER 2010)

TIME ALLOWED : 3 HOURS

SUGGESTED SOLUTIONS

D2010M

1. (a) Trial balance for Zonse Limited for the month of April 2010

	Dr K	Cr K
Capital		709,000
Drawings	45,000	
Motor vehicle – cost	350,000	
Motor vehicle – depreciation		120,000
Office equipment – cost	600,000	
Office equipment – depreciation		200,000
Inventories	180,000	
Receivables	320,000	
Provisions for doubtful debt		30,000
Payables		210,000
Cash	30,000	
Sales		1,200,000
Purchases	740,000	
Returns inwards	30,000	
Carriage inwards	50,000	
Salary and wages	40,000	
Discounts received		25,000
Discount allowed	15,000	
Electricity	14,000	
Rent and rates	10,000	
Insurance costs	15,000	
Carriage outwards	20,000	
Advertisement costs	25,000	
Bad debts	10,000	
	2,494,000	2,494,000

(b) Four errors which do not affect the trial balance

(i) Error of principal
Where a transaction has been recorded in a wrong class of account. Example motor vehicle purchase recorded in a motor vehicle expenses account.

(ii) Error of commission
Where a transaction has been recorded in a wrong class of personal account. Sales to Mrs Phiri was recorded in Mr Phiri's account.

(iii) Error of omission
Where a transaction has not been recorded in the books of accounts. Purchase of office furniture has not been recorded by the Accountant.

(iv) Compensating error
Where there are two completely unrelated error with a knock on effect to both credit and debit balance of the accounts. Sales value was understated by K12,000. Purchases worth K12,000 were omitted.

(v) Transposition error
Where the figures for a transaction have been recorded interchangeably but the double entry was completed. Payment for rent amounting to K870 was recorded as K780 in both rental and cash account.

(vi) Error of original entry
This is where transaction had wrong figures recorded in the first place but double entry was completed. Electricity paid of K10,000 was wrongly recorded in all accounts (cash and electricity) as K1,000.

2. (a) Accounting refers to the gathering and recording of financial information. Summarizing and analyzing it for the use by various stakeholders.

(b) Basic elements of financial statements

(i) Capital
The amount set aside by the owner to start business. Capital represents the difference between assets and liabilities.

(ii) Assets
Assets are resources owned by the business which are expected to bring future economic benefits to the enterprise. Assets are categorized as current and non-current.

(iii) Liabilities
Liabilities is the amount which the business owes. Liabilities represents obligation to transfer economic benefits to other entities as a result of past obligations.

(iv) Income
Gross inflow of economic benefits expected to flow to a business as a result of trading or investment.

(v) Expenses
Expenses are gross outflow of economic benefits from a business through trading activities as the entity is generating future income.

(c) Other accounting concepts

(i) Consistency concept
(ii) Accruals concept
(iii) Money measurement concept
(iv) Historical cost concept
(v) Materiality concept

(d) Information provided by accounting to the shareholders

(i) How profitable the business has been
(ii) The level of external borrowing from other investors
(iii) An estimate of the value of their holding in the business
(iv) The total resources controlled by the business
(v) The liquidity levels of the business
(vi) The size and growth of the business.

3. (a) Inventory valuation using last in first out method

Date	Purchases			Issues			Balance		
	Unit	Price	Amount	Unit	Price	Amount	Unit	Price	Amount
1 May							200	120.00	24,000.00
3 May	650	125	81,250 ½				850	123.82	105,250.00
4 May				100	250	25,000 ½	750	123.82	92,867.65
7 May				400	250	100,000 ½	350	123.82	43,338.24
10 May	400	130	52,000 ½				750	127.12	95,338.24
15 May	200	132	26,400 ½				950	128.15	121,738.24
20 May				700	250	175,000 ½	250	128.15	32,036.38
25 May				150	250	37,500 ½	100	128.15	12,814.55
30 May	300	135	40,500 ½				400	133.29	53,314.55
31 May				200	250	50,000 ½	200	133.29	26,657.28

(c) Trading account

	K	K
Sales revenue		387,000.00
Cost of goods sold		
Opening inventories	24,000.00	
Purchases	200,150.00	
Closing inventories	(26,657.28)	197,492.72
Gross profit		190,007.28

(c) Disadvantages of last in first out (LIFO) method:

(i) The method does not truly represent what really happens in practice.

(ii) The method is not favoured by IAS 2.

(iii) The method usually results in understatement of inventories during the times of inflation.

(d) Control measures required for inventories

(i) Inventories storage should have strong locks.

(ii) Inventories should be well stacked to avoid pilferage.

(iii) Inventories should be kept in a place in accordance with the manufactures instructions.

(iv) Proper records should be kept for inventories.

(v) Adequate insurance cover should be obtained for the inventories.

4. (a) Process account

Process Account

	Unit	Amount(K)		Units	Amount(K)
Raw materials	12,000	30,000	Output	11,500	76,134
Skilled labour		14,000	Normal loss	1,200	-
Unskilled labour		15,000			
Overheads		12,500			
Abnormal gain	700	4,634			
	12,700	76,134		12,700	76,134

Total costs 71,500 K6.62 **2**

Expected output 10,800

Normal loss : 10% of 12000 = 1,200

Abnormal gain : Output + Normal loss – input
11,500 + 1,200 – 12,000 = 700

Expected output = Input – normal loss
12,000 – 1,200
10,800

(b) Trading account

		K	K
Sales	(9,700 x 9)		87,300
Cost of goods sold			
Opening inventories	(2,100 x 5.5)	11,550	
Production costs	(11,500 x 6.62)	76,134	
Closing inventories	(1,800 x 6.62)	(11,916)	75,768
Gross profit			11,532

(c) By-product are inferior product to come out of a process and usually will sell at a less than the normal selling price of main products.

The sales for by-products are treated as:

(i) Other income in the income statement account.

(ii) Reduce the cost of production cost.

(iii) Added to sales together with other main products.

5. Short notes

(a) Provision for doubtful debts

The amount from the receivable totals which the business is expecting that it will not be able to recover from the customers.
The provision for doubtful debt is recognized basing on past experience of the business and usually a percentage estimate of the receivable balance is used.

The provision for doubtful debt is charged as expense in the income statement account in the first year while in subsequent years; only the increase is recognized as expense while a decrease is credited to income statement account.

In the balance sheet – provision for doubtful debt is shown as a subtraction from receivables.

(b) Property plant and equipment

Property plant and equipment (PPE) are non-current assets held in business to be used for production of goods or provision of services or for rental to others or for administration purpose.

PPE should be recognized when the business has obtained rights or title ownership to the asset. The assets should initially be measured at historical cost to the business and in subsequent years should be measured at depreciated historical cost.

The depreciation expense for PPE should be charged as expense in the income statement account while the net book value of the PPE should be included in balance sheet under non-current asset.

(c) Bank overdraft

Bank overdraft represents an amount withdrawn in excess of the current account balance currently maintained by an entity.

Bank overdraft is recognized when an account with the bank has changed from credit to debit balance. The amount of overdraft attracts interest so the carrying amount will be increased by either more withdrawals being made from the account or the interest charged on the balance.

Only bank overdraft interest is included in the income statement as expense while the carrying value is included in balance sheet under current liabilities.

(d) Mortgage

A mortgage is a loan obtained by a business for the acquisition or construction of a property and is usually secured on the same property it has financed.

Mortgage is recognized as a liability in balance sheet when the business has entered into a contractual agreement with the lender for the advance. The amount of mortgage is increased by finance costs (interest) while any repayments made reduce the carrying value.

In income statement mortgage interest is included under finance costs while in balance sheet the amount is included under non-current liabilities.

6. Non-current asset schedule for the year to 31 May 2010

	Building	Motor vehicle	Equipments	Total
Cost	K	K	K	K
Balance brought forward	900,000	700,000	450,000	2,050,000
Additions		200,000	140,000	340,000
Disposals		(150,000)	(110,000)	(260,000)
	900,000	750,000	480,000	2,130,000
Depreciation				
Balance brought forward	40,000	120,000	100,000	260,000
Depreciation charge	18,000	150,000	44,000	212,000
Disposals		(70,000)	(60,000)	(130,000)
	58,000	200,000	84,000	342,000
Net book value b/f	860,000	580,000	350,000	1,790,000
Net book value c/f	842,000	550,000	396,000	1,788,000

Depreciation calculations

Buildings	900,000 x 2%	18,000
Motor vehicles	750,000 x 20%	150,000
Equipments	(480,000 – 40,000) x 10%	44,000

7. (a) Provision for doubtful debts

(i) T account for provision for doubtful debt

Provision for doubtful debts

	K		K
		2007	
Balance c/d	16,400	Income statement account	16,400
		2008	
		Balance b/f	16,400
Balance c/d	40,600	Income statement	24,200
	40,600		40,600
		2009	
Income statement	10,600	Balance b/f	40,600
Balance c/d	30,000		
	40,600		40,600

(ii) Income statement extract

	K
2007	
Expenses	
Provision for doubtful debts	16,400
2008	
Expenses	
Provision for doubtful debt	24,200
2009	
Other income	
Provision for doubtful debt	10,600 2

Balance sheet extract

	K	K
2007		
Current assets		
Receivables	410,000	
Less: Provision for doubtful receivables	(16,400)	393,600
2008		
Current assets		
Receivables	580,000	
Less: Provision for doubtful receivables	(40,600)	539,400
2009		
Current assets		
Receivables	600,000	
Less: Provision for doubtful receivables	(30,000)	570,000 1

(b) General and specific provision for bad debts

Provision for doubtful debts relates to amount anticipated not recoverable from the credit customers. With general provision the amount is computed as a percentage of the total debtors while specific provision is where the company is able to identify the customers who are expected to fail in honoring their obligation.

(c) Journal entries

		K	K
Bad debts recovered			
Dr	Bank	12,600	
Cr	Income statement (Bad debts written off recovered a/c)		12,600
Discount allowed		K	K
Dr	Bank	42,750	
Dr	Discount allowed	2,250	
Cr	Receivables		45,000

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