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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN MALAWI

DECEMBER 2014 EXAMINATIONS

KNOWLEDGE LEVEL

PAPER P1: ACCOUNTING FRAMEWORK

EXAMINER'S REPORT

COMMENTS ON INDIVIDUAL QUESTIONS

QUESTION 1

The question aimed at examining the candidates' understanding of the basic accounting procedure up to the final accounts.

(a) (i) What is a trial balance? Candidates correctly responded that it was a summary of closing debit balances compared with closing credit balances in the accounts of all the ledgers of a business.

Emphasis should be on the fact that a trial balance is a test of the correctness of the double entry procedure of accounting.

(ii) Two reasons why it is necessary to adjust certain items in the trial balance.

Most candidates missed this part of the question. A variety of answers were presented but most importantly not showing the nature of a trial balance.

- Accounting relates to a specific time period while business transactions are continuous. As a result, some transactions undertaken during an accounting period relate to a previous period while others relate to a future period. Such items must be included in, or excluded from, the books in order to give a true picture of the specified present accounting period i.e. timing differences.

- Incomplete information

  Some information for preparing final reports may depend on what has transpired during the accounting period. It is not known until the end of the period when it can be determined.

(iii) Those who got (ii) correctly mostly also got question (a)(iii) correct.

Items which do not appear in the trial balance are given as additional information because their accounts will not have been opened at the time the trial balance is taken, for instance.

(1) Closing inventory is not known until physical stock-take and valuation are done.

(2) Depreciation is based on usage of a non-current asset during a period. It may not be determined until the end of the year.

(3) Prepayments and accruals are only ascertained after the expense for the period is known and provisions are based on outstanding receivable balances.

(b) (i) Journal entries for adjustments to the trial balance.

The candidates showed lack of knowledge in making journal entries. The most common problem was their inability to identify the name of the account to be debited and credited. For instance in note:

(1) Account to be credited was
Accounts payable because the amount had not been invoiced. Purchases would increase by the same amount. Therefore, debit purchases and credit accounts payable with the same amount.

(2) Most candidates debited and credited the same account.
Rent account instead of debiting prepaid rent crediting the rent account.

(3) Similarly, the accrued electricity account should be created and credited with the amount while debiting the electricity account.

(4) Depreciation charge for the year was to be debited while the accumulated depreciation was to be increased i.e. credited.

(ii) Adjusted trial balance
Some candidates were able to get the corrected trial balance by adjusting items on the face of the trial balance rather than through journal entries. Journal entries are useful in identifying the appropriate accounts.

(c) Final Reports

Common errors were:
Terminology i.e.
Statement of financial statements instead of statement of comprehensive income and financial position. These were well done and well presented in spite of the wrong terminology.

(d) Prepayments and accruals with related accounting concepts.

(i) K48,000 was income received in advance for a period of 12 months on the first day of the last month of the current year i.e. on 1 December 2014. 1 month received as revenue for the year and K44,000 revenue for the next 11 months.

Concept: The large sum of K44,000 received in advance assumes that the business would be in operation for the foreseeable future i.e. going concern concept or the accruals concept.

(ii) The goods cost K25,000 will be delivered at a selling price of K34,000 next year.

No revenue for the current year. The realization concept provides that revenue from the sale of goods should be realized at the time title passes to the buyer.

(iii) Season tickets for four football matches at K40,000 a ticket with only one match played during the year.

The club should recognize only K10,000 as revenue for the current year K30,000 for the future period.

The accruals concept provides that income should be recognized in the period in which it is earned.

(iv) Depreciation is the allocation of the cost on a non-current asset over a given period.

The allocation should be made regardless of the amount of net income. This is in line with the concept of consistency.

QUESTION 2

Accounts of not-for-profit organizations: Clubs

The question sought to establish the financial position of a club at the end of an operating period.

Students should first bear in mind that clubs do not intend to make profit, nonetheless, they carry out activities that intend to provide income for the organization in the form of income generating activities, and sales of various items. Their main source of income is subscription from members.

Leading to the preparation of the statement of financial position as at 31 December 2013 were the following stages.

(a) Bar Trading Account
The club made some income from sales of drinks.

(b) Income and expenditure account
The gross profit from (a) subscriptions which may sometimes need to be adjusted for prepayment and accruals, plus other incomes less expenses of all sorts give the club a surplus or deficit.

(c) Accumulated fund as at 1 January 2013
This is an equivalent of an opening balance sheet in profit making organizations. It shows the non-current assets, liabilities and the current assets of the club.

(d) Statement of financial position as at 31 December 2013

- Non-current assets are given: depreciated at 10%
- Current assets consisting of inventory and bank balance obtainable in the bank summary (adjusted by information provided).
- Financed by the accumulated fund in (c) and surplus in (b).

Follow the step by step procedure of:

- Drawing the opening of the accumulated fund
- Bar trading account and adjusted subscriptions account
- Income and expenditure account
- Statement of financial position.

QUESTION 3

The greater part of question 3 was narrative. It sought to establish the candidates' understanding of the meaning of consolidated accounts.

(a) (i) 1 mark was awarded for including in the definition of a parent company, the following points:

A parent company has control over a subsidiary either because:

- it holds more than 50% of the voting share capital, or has the
- power to govern the financial and financial policies of the subsidiary and
- has power to appoint or remove a majority of directors in a subsidiary

Most students defined the term with the first point only.

(ii) Definition of consolidated financial statements should include the fact that:

- they bring together financial statements of the parent company and those of its subsidiaries.

Almost all candidates named the consolidated statements correctly that the business would be in operation for the foreseeable future i.e. going concern concept or the accruals concept.

(iii) The basic rules of consolidation

Rule 1 Like things cancel out each other e.g. An account receivable in one company's balance sheet cancels out a similar account that appears as account payable.

Shares bought in one subsidiary by the parent company are shown as investment in the subsidiary and appear as issued share capital in the subsidiary.

Sales and purchases by one company appearing in each other's company accounts should cancel each other.

(iv) Where the parent buys less than 100% in the subsidiary so that part is owned by outsiders other than the parent there is minority interest.

(b) (i) Peters and Suzan's consolidated financial position
Like things cancelled out; investment of 70,000 K1 shares by Peters Ltd in Suzan's Fashions Ltd cancelled out Suzan's 50,000 K1 shares (70,000 – 50,000) = 20,000 leaving 20,000 in the consolidated statement. All other items are added together.

Peters paid 100% 70,000 as cost for 50,000 shares i.e. paid more than the value of the investment leaving a goodwill of 20,000.

30% of the assets in Suzan's Fashions are owned by outsiders i.e. 30% of 50,000 = 15,000 minority interest.

(ii) Consolidation
Goodwill (70,000 – 35,000)
All other items of the parent company and subsidiary added together represented by share capital of 250,000
Plus non-controlling interest 15,000

Many students are not conversant with this topic. The few who tried knew it very well.

QUESTION 4

Partnership Account

The purpose of partnership accounts is to determine how partners contribute and share the resources of the firm. They contribute capital, share profits, goodwill and revaluations.

(a) (i) Revaluation

Note 3 shows that non-current assets have increased from 150,000 to 200,000 i.e. by 50,000. Goodwill is at 90,000 working capital has reduced 150,000 – 130,000 = 20,000

$\therefore$ Revaluation $= 50{,}000 + 90{,}000 - 20{,}000 = 120{,}000$
Alice and Beatrice share $1:2$
$A = \frac{1}{3} \times 120{,}000 = 40{,}000$
$B = \frac{2}{3} \times 120{,}000 = 80{,}000$

Share of revaluation after admitting Cathy sharing profits and losses equally:

A $\frac{1}{3}$	40,000
B $\frac{1}{3}$	40,000
C $\frac{1}{3}$	40,000

With this information you can draw the partners' capital accounts after revaluation crediting each partner with her capital contribution revaluation to Alice and Beatrice before revaluation and crediting ABC with revaluation after admission.

(b) Appropriation Account

Most candidates lost marks on

- Calculating interest of partners capital
- Interest on drawings
- Hence share of residual profits

QUESTION 5

(a) Financial statements of Limited Companies

This was a straight forward statement of comprehensive income. Common errors included:

(i) Adjusting for cost of sales:
Purchases: The figure of 875,000 shown on the trial balance was to be adjusted by K50,000 caused by error of transposition reported in note no. 2

Goods bought got K821,000 recorded as K871,000
Therefore purchases = (875,000 – (871,000 – 821,000)

(ii) Depreciation
Was mostly affected by depreciation on furniture and fittings which was to be 20% on reducing balance. Most students missed this point.

Statement of financial position

- Non-current assets – accumulated depreciation was mostly wrong.
- Accounts receivable and
- Accounts payable should have been adjusted by note No. 1 where the two cancelled out each other i.e. less 180,000 in each case.
- Share capital composed of b/f

Plus rights issue	60,000
Plus bonus issue	180,000

(b) Share premium composed of

Proceeds from rights issues	80,000
Rights issues	60,000
Share premium	20,000

Retained earnings composed of

b/f Profit for the year

Less: interim dividend
Final dividend
Bonus shares = retained earnings

(c) Definitions of: Rights issues
Share premium
Bonus issued

These were correctly answered. Candidates lost marks through adjustments.