Financial Accounting
Module 8
June 2009

Suggested Solutions

Question 1

This is Question 1 from Module 8 (Financial Accounting) for May 2009

The question is a Partnership Accounts Question. Much of the work that is done on a set of Partnership Accounts is very similar to the work done on the accounts of a sole trader. The main difference is the existence of partners Capital Accounts and partners Current Accounts. In this question the main adjustments are the changes to the partnership arrangements during the year (i.e. the entry of Enda into the firm). The question also requires the creation of the appropriation account which shows how the Capital and Current accounts for each person are changed.

So the original arrangement was:

	Bert	**Mary**
Profit sharing ratios	55%	45%
Salaries for the year	€18,000	€25,000
Interest on Capital	5%	5%
Interest on drawings were	€500	€700

This was changed when Enda entered the firm on 1 January 2009:

Arrangements after entry of new partner	**Bert**	**Mary**	**Enda**
Profit sharing of partners from 01/01/09	50%	25%	25%
Revised annual salaries	€15,000	€18,000	€12,000
Interest on capital	5%	5%	5%

(a)

Prepare the Appropriation Account showing each of the partners **entitlements**

The profit retained in the Trial Balance was €100,000. The profit generated was generated before the entry of Enda into the partnership, so the appropriations are done on that basis.

• Interest on Drawings is - (€500 + €700) = €1,200 – Note: The Interest on Drawings figures are given in the question
• The Interest on Capital arrangement under the new Partnership is 5% - Bert (€350,000 x 5%) , Mary (€200,000 x 5%) = Bert - €17,500, Mary - €10,000
• Salaries = Bert - €18,000, Mary - €25,000

So the profit before the appropriation of the Partnership is:

€100,000 + €1,200 - €17,500 - €10,000 - €18,000 - €25,000 = €30,700

Profit Appropriation = Bert €30,700 x 55% = €16,855
= Mary €30,700 x 45% = €13,815

Appropriation Account as at 31st December 2009

Balance B/D (from Question)			€100,000
Interest on Drawings			€1,200
Salaries	Bert	€18,000	
	Mary	€25,000	
Interest on Capital	Bert	€17,500	
	Mary	€10,000	
Residual Profit	Bert	€16,885	
	Mary	€13,815	
		€101,200	€101,200

(b)

Prepare the Capital Accounts for each Partner 1/1/09

Workings

The Goodwill value agreed at the time of the admission of the new Partner was €30,000, this was allocated:

- Bert - €30,000 x 55% = €16,500
- Mary = €30,000 x 45% = €13,500

This Goodwill is added to the value of each of the original owners share.
The question states that the Goodwill will not be retained in the books, so it has to be written-off straight away. This is done in line with the new profit and loss sharing agreement:

- Bert - €30,000 x 50% = €15,000
- Mary - €30,000 x 25% = €7,500
- Enda - €30,000 x 25% = €7,500

The revaluation of the assets should also be applied to the Partners Capital Accounts. As the revaluation was done before the admission of the new partner, the gain in value is only allocated to the original partners.

- Bert - €50,000 x 55% = €27,500
- Mary - €50,000 55% = €22,500

Capital Accounts	**Bert**	**Mary**	**Enda**	**Total**
Balance B/D before New Partner Admitted	€350,000	€200,000	€550,000	
Capital Introduced by Enda			€200,000	€200,000
Goodwill as valued 1/1/09 allocated at original profit share %	€16,500	€13,500		€30,000
Goodwill written-off at new profit share %	-€15,000	-€7,500	-€7,500	-€30,000
Subtotal	€351,500	€206,000	€192,500	€750,000
Fixed Asset Revaluation (€410k+€290k-€350k-€300k) = €50	€27,500	€22,500		€50,000
	€379,000	€228,500		€800,000

(c)

Prepare Current Account for each Partner

There are no additional calculations to create the Current Account so you just add the relevant data into the pro-forma layout.

Current Accounts	Bert	Mary	Enda	Total
Balance b/d before new partner admitted	3,500	(1,000)		2,500
Drawings	(7,000)	(8,000)		(15,000)
Interest on Drawings	(500)	(700)		(1,200)
Interest on Capital	17,500	10,000		27,500
Salaries	18,000	25,000		43,000
Residual Profit Allocation	16,855	13,815		30,700
	48,355	39,115		87,500

(d)

Balance Sheet as at 1st January 2009

Fixed Assets	Land	Machines	Buildings	
Cost per trial balance	350,000	200,000	300,000	850,000
Revaluation surplus	60,000		(10,000)	50,000
	410,000	200,000	290,000	900,000
Current Assets				
Inventory	35,000			
Receivables	25,000			
Cash at Bank	0			
				60,000
				960,000
	Bert	Mary	Enda	
Capital Accounts	379,000	228,500	192,500	
Current Accounts	48,385	39,115	0	
				887,500
Non Current Liabilities				0
Payables				
Creditors			40,000	
Bank			32,500	
				72,500
				960,000

Again there are no extra calculations in creating this Balance Sheet, you just need to slot the figures into a Pro-Forma layout for a Balance Sheet.

Question 2

Notes on this Question

The question requires the production of an Income Statement and also seeks a disclosure note on Non Current Assets in accordance with IAS 16, a Statement of a Change in Equity. In addition the question seeks a brief explanation on the purpose of the Statement of Changes in Equity. The approach to the question is to make the adjustment calculations and use these adjustments to create the Income Statement and the other requested Statements. The layout will be based on the division of expenses under the Headings, Production, Distribution, Administration.

Income Statement Workings

Wages

€85,000 - €10,000 = €75,000 (Trial Balance figure minus the €10,000 charged incorrectly to Wages)

Purchases

€460,000 - €18,000 = €422,000 (Trial Balance figure minus the €18,000 figure charged incorrectly to Materials)

Buildings Depreciation

Buildings at cost - €700,000
Accumulated Depreciation - €56,000

The Buildings at Cost figure is short two amounts that were accidentally included in the Wages and Materials figures respectively.

Buildings at Cost - €700,000 + €10,000 + €18,000 = €728,0000

Depreciation Calculation - €728,000 x 4% = €29,120

Machine Depreciation

Machinery at Cost - €400,000
Accumulated Depreciation - €200,000

Depreciation Calculation - €400,000 x 25% = €100,000

Motor Vehicle Depreciation

Motor Vehicles at Cost - €90,000
Accumulated Depreciation - €32,400

Depreciation Calculation - (€90,000 - €32,400) x 20% = €11,520

Bad and Doubtful Debts

A Bad Debt has been identified and the company has been told that it will only be paid €0.20 to the €1.00. So the amount of recoverable debt is €7,200 x .2 = €1,440 so the irrecoverable debt is €5,760. This is added to the existing Bad Debt of €5,000 so the total Bad Debts is €10,760.

Receivables = €36,000 - €5,760 = €30,240
Provision for Doubtful Debts = €30,240 x .07 = €2,117 => The charge to the Income Statement is €1,195. (€2,117 - €922).

VAT/Motor Expenses

Trial Balance €12,500. The VAT amount of €1,200 is not reclaimable and is therefore an expense of the business, so the full charge is: €12,500 + €1,200 = €13,700

Rent and Rates

The year-end for this company was 31st December 2008 but a payment of €7,200 for rent was for the year up to 31st March 2009. So the amount relevant to the year is (€7,200 x 9)/12 = €5,400. The charge therefore is €18,000 - €7,200 + €5,400 = €16,200

Revenue

Sales from Trial Balance less Returns

Allocation of Expenses :

	Production	Distribution	Administration
Building Depreciation	29,120		
Machine Depreciation	100,000		
Motor Vehicles		11,520	
Inventory	42,000		
Purchases	442,000		
Purchases Returns	(3,500)		
Settlement Discount Allowed			1,200
Settlement Discount Received			4,000
Bad Debts			10,760
Doubtful Debts			1,195
Rent and Rates	9,720	4,860	1,620
Sundry Expenses			8,000
Wages and Salaries	52,500		22,500
Motor Expenses		13,700	
Inventory Closing Balance	(46,200)		
	625,640	30,080	49,275

Income Statement for year Ending 31st December 2008

Revenue		897,200
Cost of Sales		(625,640)
Gross Profit		271,560
Other operating income-discounts		4,000
Distribution	(30,080)	
Administration	(49,275)	
		(79,355)
Operating Profit		196,205
Investment revenues		
Finance Cost		
Debenture Interest	(2,000)	
Redeemable Pref dividend	(8,000)	
		(10,000)
Profit before Tax		186,205
Income tax expense		(25,000)
		161,205

(b)

Non Current Assets

	Buildings	Plant Equip	Vehicles	Total
Cost	700,000	400,000	90,000	1,190,000
Capitalisation	28,000			28,000
Disposal				
Closing Balance	728,000	400,000	90,000	1,218,000
Depreciation				
Opening Bal	56,000	200,000	32,400	288,400
Disposal charged to I/S	29,120	100,000	11,520	140,640
Closing Balance	85,120	300,000	43,920	429,040
Opening NBV	644,000	200,000	57,600	901,600
Closing NBV	642,880	100,000	46,080	788,960

Notice the inclusion of the €28,000 which is made up of the €10,000 and €18,000 which were charged mistakenly to wages and materials respectively.

(c)

	Capital	Premium	Earnings	
Opening Balance	300,000	65,000	135,000	500,000
Profit			161,205	161,205
Dividends				0
Ordinary paid			(4,000)	(4,000)
	300,000	65,000	292,205	657,205

Ordinary proposed 5,000 on the 15/01/2009

(d)

A statement of changes in equity shows all changes in owner's equity for a period of time. According to IAS

1, this statement of financial reporting is one the five components of complete financial statements (balance sheet, income statement, statement of changes in equity, statement of cash flow and notes to financial statements.

IAS 1 requires an entity to present a statement of changes in equity as a separate component of the financial statements. The statement must show: [IAS 1.96]

• profit or loss for the period;
• each item of income and expense for the period that is recognised directly in equity, and the total of those items;

• total income and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to equity holders of the parent and to minority interest; and

• for each component of equity, the effects of changes in accounting policies and corrections of errors recognised in accordance with IAS 8.

The following amounts may also be presented on the face of the statement of changes in equity, or they may be presented in the notes: [IAS 1.97]

• capital transactions with owners;

• the balance of accumulated profits at the beginning and at the end of the period, and the movements for the period; and

• a reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and at the end of the period, disclosing each movement.

Question 3

		Balancing Difference		Correcting Correction	Journal Correction
		Debit	Credit	Debit	Credit
Item 1	Balancing difference	36,000			
	Suspense difference				
Cr	Suspence a/c				36,000
Dr	Receivables			36,000	
Item 2	Balancing difference		42,000		
	Suspense difference			42,000	
	Sales returns				21,000
	Purchase returns				21,000
Item 3	Balancing difference	34,000			
	Suspense difference				34,000
	Bad Debts			17,000	
	Bad Debts			17,000	
Item 4	No suspense difference				
	Repairs			9,000	
	Machine				9,000
	Depreciation reduction				900
	Accumualted depreciation			900	
Item 5	suspense difference		45,000		
	Suspense a/c			45,000	
	Creditors				45,000
Item 6	No suspense Difference				
	Sales			120,000	
	Share Capital				80,000
	Share Premium				40,000
Item 7	No suspense Difference				
	Accrual				13,000
	Advertising expense			13,000	
Item 8	No balancing difference				
	Sales			42,000	
	Vat				42,000
		70,000	87,000	341,900	941,900

Question 4

(i) = (a) Occurred within a the accounting period

Note there is no need to consider IAS 10 Post balance sheet

(ii) = (d) Present obligation arising from past events IAS 37

(iii) = (d) Post B/S adjusting element is €45,000

The IAS 10 Adjusting event refers to conditions existing at the Balance Sheet date

(iv) = (c) Restate comparatives and opening retained profits
IAS 8 Fundamental error in treatment of non production expenses

(v) = (d) Revaluation date 46 years left ie. 300K/46
equals deprec charged 6,522 Surplus €97,600 NBV €293,478

Building at cost-->	220,000
7 years x 2%	-17,600
Net Book value at revaluation	202,400
Surplus on revaluation	97,600
Revalued amount on 01/01/08	300,000
Depreciation charge is over 46 years left-->	(6,522)
	293,478

(vi) = (a) Impairment Lower of carrying value and recoverable amount
Recoverable amount higher of Value in use and NRV

	Carrying Value	**Recoverable Amount**	**Select**
Premises	162,000	170,000	162,000
Machine	70,000	62,000	62,000

(vii) = (a) Non development costs (1) and (2)

(viii) = (b)

Earnings	€300,000	€220,000
Shares	250,000	250,000 <-restated
Earing per share	€1.20	€0.88

(ix) = (a)

Profit after interest before tax is	€250,000
Add back depreciation	€48,000
Interest on loans	€10,000
Increase in Working capita	(5,000)
	€303,000

(x) = (iii) No present obligation constructive or otherwise