2022 ACCOUNTING

UNIT ¾ TRIAL EXAMINATION 1

SOLUTION

Question 1 (23 marks)

a. 3 marks

Explanation: The business is using the Identified Cost method of cost assignment. [1]

This method of cost assignment involves the physical labelling or coding of each item of inventory at the time of purchase and keeping a record of the exact cost price. [1]

The business may choose to adopt the Identified Cost method as the Vacuum Cleaners are high value, low volume inventory items that can be easily labelled using a code or sticker with the cost price and it provides a more accurate net profit figure. [1]

b. 3 marks

Explanation: Cheque 71 is treated as a product cost [1] as it is a payment associated with getting the Roomba Robotic Vacuum into a condition and location ready for sale and can be easily allocated on a logical basis [1]

This allows for a more accurate calculation for the cost price of the inventory as all additional cost are assigned to the inventory prior to the mark up being applied. [1]

c. 3 marks

Great Guys
General Journal

Date	**Details**	**Debit**	**Credit**
Aug 31	Inventory Write Down	1 700 [1]	
	Inventory		1 700 [1]
	Inventory Write Down of 10 Roomba Robotic Vacuums to NRV Memo 18 [1]		

d. 3 marks

Justification: Inventory should be valued at the lower of cost and net realisable value (NRV) to uphold Faithful Representation. [1]

When the value of inventory falls below its cost price it indicates that the inventory is not expected to be sold at a profit because something has impacted the inventory or demand for the product has decreased.[1]

This means that the cost no longer provides an accurate representation of the value of the inventory and that the NRV should be used to ensure that the information in the financial reports is complete and free from bias and reflects the current economic climate as the value of the inventory has decreased and can no longer be sold at a profit. [1]

e. 4 marks

Great Guys
Income Statement (extract) for month ended 31 August 2022

Revenue	**$**	**$**
Sales	23 000	
Less Sales Returns	2 250	20 750
Less Cost of Sales		8 300
Gross Profit		12 450
Less Inventory Write Down		1 700
Adjusted Gross Profit		**$10 750**

f. 3 marks

Explanation: Relevance dictates that all information useful for decision making should be included in the financial reports. [1]

Reporting the Adjusted Gross Profit allows for the business to assess the effectiveness of their inventory management from one period to the next as it highlights the possible Inventory Losses or Gains and any Inventory Write Downs. [1]

In doing so the business is then able to make the necessary decisions to improve the management of inventory to avoid inventory write-downs from occurring. [1]

g. 4 marks

Discussion: An increase in the selling price of the inventory would improve the Gross Profit Margin (GPM) as it would mean that a greater percentage of the net sales revenue is retained as Gross Profit. [1]

However, if the increase in the selling price causes the volume of sales to decrease this could lead to a decrease in the Net Profit Margin if the expenses remain constant (NPM). [1]

This may occur if customers are not willing to pay the higher selling prices causing the number of sales to decrease which would decrease the Net Profit generated by the business. [1]

However, if the inventory is in high demand and customers are not deterred by the higher selling price then the business could possibly achieve both a higher GPM due to the increase in the average mark up applied and NPM if sales were to remain constant. [1]

Question 2 (15 marks)

a. 4 marks

General Journal

Date	**Details**	**Debit**	**Credit**
Aug 31	Prepaid Rent Expense	8 400	
	Insurance		8 400
	Cleaning Expenses	2 000	
	GST Clearing	200	
	Drawings		2 200

b. 4 marks

General Journal

Date	**Details**	**Debit**	**Credit**
Aug 31	Profit and Loss Summary	14 550	
	Capital		14 550
	Capital	3 250	
	Drawings		3 250

Expenses (18 650 + 2000) – no change to rent as the impact is the same

Drawings (5 000 + 450 – 2200)

c. 3 marks

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
Aug 31	Drawings	3 250	**Aug 1**	**Balance**	**17 000**
	Balance	29 800	Aug 31	Computer/Laptop	1 500
				Profit/Loss Summary	14 550
		33 050			**33 050**
			Sept 1	Balance	29 800

d. 4 marks

Explanation: Revenue and expense accounts are closed and reset to zero each period as the Period Assumption requires profit to be determined on a periodic basis (within 12 months). [1]

Revenue and expense accounts are temporary Owner's Equity accounts and are closed to determine net profit or loss which is then transferred to the capital account.[1]

Asset, Liability and Owner's Equity are balanced at the end of the period as the Going Concern Assumption assumes the business will continue into the future. [1]

As a result, these accounts are balanced and their amounts are carried forward to the next reporting period. [1]

Question 3 (9 marks)

a. 3 marks

Explanation: Stability refers to the ability of the business to meet its debts and continue to operate in the long term. If the owner was to move to a larger premises, they would increase their reliance on borrowed funds to achieve this objective.

Increasing reliance on the use of borrowed funds has implications for the business in the long term and short term as both interest and principal repayments must be met. Pressure is placed on existing cash flows to meet these payments whilst the interest payments increase expenses and decrease net profit.

The owner would need to be confident that the benefit of increasing their reliance on borrowed funds outweighs the risk associated with higher debt obligations.

b. 6 marks

Discussion: If the owner were to move overall expenses should decrease as they will be operating from one set of premises not two.

The move to larger premises will also allow the business to produce more motor homes for sale which would positively impact net profit.

Given the increase in demand for motor homes post COVID the owner should take advantage of this opportunity to increase profits as much as possible.

However, if the demand for the motor homes diminishes the business may not be able to meet the interest and principal repayments associated with their increased borrowings which would put the business in financial risk as the loan must be repaid over as period of 10 years.

The Working Capital Ratio (WCR) would decrease as the business would have a higher reliance on borrowed funds leading to higher current liabilities.

The Return on Owner’s Investment would see an improvement as the business seeks to rely more on borrowed funds and less on the owner’s contributions with a potential increase in Net Profit due to the increase demand.

The Net Profit Margin would improve as the business could seek to decrease expenses by not operating on two separate sites whilst increasing revenue from higher sales.

However, the increase in the Debt Ratio to finance the move to larger premises could be risky if the business is unable to meet the demand for motorhomes or the demand decreases over time. Interest and loan repayments must be made regardless of profits generated or the business could face financial collapse.

Non financial information the owner should consider are the expected market trends after COVID for the demand in motor homes – will it increase, decrease or remain the same. Another example could be the ability of the business to access the materials required to produce the motor homes given the issues with the supply chains during COVID both locally and from overseas.

Question 4 (14 marks)

a. 4 marks

General Journal

Date	Details	Debit	Credit
Dec 31	Allowance for Doubtful Debts	1 710	
	GST Clearing	171	
	Accounts Receivable – R. Biggs		1 881
	Bad Debts	1 940	
	Allowance for Doubtful Debts		1 940

b. 3 marks

Allowance for Doubtful Debts

Date	Cross-reference	Amount	Date	Cross-reference	Amount
2022 Dec 31	Accounts Receivable	1 710	2022 Dec 31	Balance	2 070
	Balance	2 300		Bad Debts	1 940

		4 010			**4 010**
			2023 Jan 1	Balance	2 300

c. 5 marks

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
2022 Dec 31	Balance	69 000	2022 Dec 31	Allowance Doubtful Debts/GST Clearing	1 881
	Credit Sales/GST Clearing	132 000		Sales Returns/GST Clearing	5 500
				Discount Expense	1 000
				Bank	130 619
				Balance	62 000
		201 000			**201 000**
2023 Jan 1	Balance	62 000			

d. 2 marks

Caitlin's Copy
Balance Sheet as at 31 December 2022

Current Assets	$	$
Accounts Receivable	62 000	
Less Allowance for Doubtful Debts	(2 300)	59 700

Question 5 (11 marks)

a. 7 marks

General Journal

Date	Details	Debit	Credit
Sept 30	Bank	13 500	
	Unearned Sales Revenue	11 250	
	Sales		22 500
	GST Clearing		2 250
	Cost of Sales	11 250	
	Inventory		11 250
	Rent Expense	1 400	
	Prepaid Rent Expense		1 400
	Interest Expense	60	
	Accrued Interest Expense		60

b. 4 marks

Explanation: Under the Accrual Assumption the entries to record the balance day adjustments are necessary to ensure that the revenues earned in a period regardless of whether they have been received are matched against the expenses incurred regardless of whether they have been paid to calculate an accurate net profit.
For example, the Unearned Revenue is a current liability, however since 15 of the drones have now been delivered the business can now recognise some of this revenue on this sale as it no longer represents a current obligation.

Question 6 (17 marks)

a. 4 marks

Balance at 1 January	54 560 (1)
+ Jan purchases and GST	55 990 (1)
+ February purchases + GST	59 400 (1)
Total	**$169 950**
Less 2% discount	**(3 399) (1)**
Estimated Payments to Accounts Payable for the quarter ended 31 March 2023:	**$166 551**

b. 4 marks

		January	February	March
November	99 000	29 700		
December	110 000	77 000	33 000	
January	106 700		74 690	32 010
February	93 500			65 450
March	90 200			
		106 700	107 690	97 460
Estimated Receipts from Accounts Receivable for the quarter ended 31 March 2023:				**$ 311 850**

1. **mark per line across**

c. 2 marks

GST on Advertising $1 120 + GST on Electricity $750 + Other Expenses $ 2 013 (1)
+ GST on Equipment $5 600

Estimated GST Paid for the quarter ended 31 March 2023: **$9 513**

d. 4 marks

Honey Bee
Budgeted Cash Flow Statement for the quarter ended 30 June 2023

Cash Flows from Operating Activities	**$**	**$**
Accounts Receivable		311 850
Accounts Payable	(166 561)	
Wages	(116 000)	
Advertising	(11 200)	
Other Expenses	(20 130)	
GST Paid	(9 513)	(323 404)
Net Cash Outflows from Operating Activities		**(11 554)**

e. 3 marks

Explanation: The information provided by the Budgeted Cash Flow Statement extract highlights that the business expects cash outflows to exceed the cash inflows from day to day trading activities.

This is not desirable as the business should be generating cash from its day to day trading activities to fund the investing and financing areas of the business.

The business may need to consider if they are applying a high enough mark up on their hampers or consider if they can source their materials from a cheaper supplier.

Alternatively, they may need to consider ways of increasing receipts from Accounts Receivable or increasing sales revenue through providing cash sales to private customers by expanding their market. The business could also consider seeking a loan or providing additional capital to provide the needed cash.

Question 7 (11 marks)

a. 2 marks

‘Old’ Equipment
11 000 – 5 520 = 5 480
5 480 x .2 = 1 096 x 3/12 = 274

‘New’ Equipment
3,000 x .2 = 600 x 2/12 = 100

Depreciation Expense: $ 374

1 mark for 274

1 mark for 100

b. 3 marks

Justification: No- current assets should be depreciated based on their revenue earning pattern.

In this case the owner must believe that the Equipment will be used more productively in earning revenue when it is new, and a higher depreciation expense is allocated against revenue and less productive as it ages where a lower depreciation expense is allocated.

If the Equipment were to contribute evenly to earning revenue over its life, then the owner should have used the straight line method of deprecation which allocates the same depreciation expense each period.

c. 4 marks

Disposal of Equipment

Date 2022	Cross-reference	Amount	Date 2022	Cross-reference	Amount
Dec 1	Equipment	11 000	Dec 1	Accumulated Depreciation - Equipment	5 968
				Equipment	3 000
				Loss on Disposal of Equipment	2 032
		11 000			11 000

1 mark for each entry in each account

Accept 5 967 for the Accumulated Depreciation and $2 033 for the Loss on Disposal if students have rounded down

d. 2 marks

Explanation: A loss on the disposal of a non-current asset occurs when the carrying value is less than the proceeds from its disposal. This may occur because the asset has been under depreciated over its life possibly caused by overestimating the residual value and or the useful life. This may also occur because the asset at the time of its disposal was in a poor condition or not in demand and thus the residual value was less than expected or the business chose to replace the asset before its useful life had expired.