# MINI EXAM NO 1: UNIT 3 AREA OF STUDY 1 (50 MARKS)

**Question 1 (18 marks)**

1. **Prepare the General Journal entries required to record each transaction.**

**Narrations are not required. 13 marks**

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Details** | **Debit** | **Credit** |
| 16/02 | Advertising | 1 500 |  |
|  | GST Clearing | 150 |  |
|  | Bank |  | 1 650 |
| 18/02 | Inventory | 8 000 |  |
|  | GST Clearing | 800 |  |
|  | Accounts Payable |  | 8 800 |
| 20/02 | Bank | 7 500 |  |
|  | Accounts Receivable |  | 7 500 |
| 20/02 | GST Clearing | 1 278 |  |
|  | Bank |  | 1 278 |
| 21/02 | Accounts Payable | 2 200 |  |
|  | Inventory |  | 2 000 |
|  | GST Clearing |  | 200 |
| 23/02 | Drawings | 680 |  |
|  | Inventory |  | 680 |
| 24/02 | Accounts Payable | 6 600 |  |
|  | Discount Revenue |  | 132 |
|  | Bank |  | 6 468 |
| 29/02 | Wages | 1 800 |  |
|  | Bank |  | 1 800 |

**2 marks** – per General Journal entry except the two entries on 20/02 and the entry on 29/02 which are to be awarded 1 mark each as the amounts were provided in the question.

1. **Explain one ethical issue Oscar should consider when choosing to purchase**

**inventory from a new supplier. 2 marks**

Ethical considerations refer to the impact choices made by the business have on society and the environment. **(1 mark)**

Oscar should consider the supplier’s use of sustainable materials from renewable resources / the impact of the supplier’s packaging of the mattresses has on the environment / the supplier’s treatment of their employees. **(1 mark)**

1. **Explain how the GST Clearing balance owing to the Australian Taxation Office would have been classified on the Balance Sheet of Mayer’s Mattresses as at 31 January 2019. 3 marks**

The GST Clearing balance owing to the Australian Taxation Office would have been classified as a Current Liability **(1 mark)** on the Balance Sheet of Mayer’s Mattresses as at 31 January 2019 as this amount represents a present obligation **(1 mark)** that is reasonably expected to be settled within 12 months of the end of the reporting period. **(1 mark)**

**Question 2 (11 marks)**

1. **Explain why Brown’s Blankets would use the FIFO cost assignment method instead of the Identified Cost assignment method. 2 marks**

Brown’s Blankets would use the FIFO cost assignment method when it is impossible or impractical to label each unit of inventory with its original cost. **(1 mark)**

The Identified Cost assignment method requires each unit of inventory to be marked with its original cost which is a timely and expensive process. **(1 mark)**

1. **Record the transactions in the ‘Red Tartan’ blanket inventory card. 6 marks**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **ITEM:** ‘Red Tartan’ blanket **Cost method:** First In, First Out  **SUPPLIER:** McLennan’s | | | | | | | | | | |
|  | | **IN** | | | **OUT** | | | **BALANCE** | | |
| Date | Document | Qty | Cost | Total | Qty | Cost | Total | Qty | Cost | Total |
| 01/03 | Balance |  |  |  |  |  |  | 13 | 40 | 520 |
| 05/03 | Inv.829 | 20 | 45 | 900 |  |  |  | 13 | 40 | 520 |
|  |  |  |  |  |  |  |  | 20 | 45 | 900 |
| 08/03 | Rec.637 |  |  |  | 3 | 40 | 120 | 10 | 40 | 400 |
|  |  |  |  |  |  |  |  | 20 | 45 | 900 |
| 16/03 | Inv.395 |  |  |  | 10 | 40 | 400 |  |  |  |
|  |  |  |  |  | 2 | 45 | 90 | 18 | 45 | 810 |
| 18/03 | C/N.13 | 2 | 40 | 80 |  |  |  | 2 | 40 | 80 |
|  |  | 2 | 45 | 90 |  |  |  | 20 | 45 | 900 |
| 27/03 | C/N.34 |  |  |  | 4 | 45 | 180 | 2 | 40 | 80 |
|  |  |  |  |  |  |  |  | 16 | 45 | 720 |
| 31/03 | Memo 61 |  |  |  | 1 | 40 | 40 | 1 | 40 | 40 |
|  |  |  |  |  |  |  |  | 16 | 45 | 720 |

**1 mark** – per date entry

1. **Apart from the identification of an inventory loss or inventory gain, state one benefit of using inventory cards in the management of inventory. 1 mark**

* help with the re-ordering of inventory
* identifies fast and slow-moving lines of inventory
* provides an estimate of inventory balances at any point in time

1. **Explain why the value of the ‘Red Tartan’ blanket reported in the Balance Sheet may be higher using the FIFO cost assignment method compared to Identified cost assignment method. 2 marks**

As the supplier’s prices are rising, under the FIFO cost assignment method, the older, cheaper unit costs are allocated as an expense in the order they are purchased. **(1 mark)**

This results in the most recent, more expensive unit costs being reported on the Balance Sheet compared to the specific cost prices under the Identified Cost assignment method remaining on hand at the end of the period which could be a combination of the cheaper and most recent cost prices. **(1 mark)**

**Question 3 (5 marks)**

1. **Using product costing, calculate the unit cost at which the ‘Taylor’ air conditioner would be recorded in the inventory card. 1 mark**

Invoice Price (excluding GST) $1 400

Import Duties $168

**$1 568**

1. **Referring to your answer in part a. explain your treatment of the transportation costs paid to Donald’s Deliveries. 2 marks**

The transportation costs paid to Donald’s Deliveries were not included in the unit cost of the ‘Taylor’ air conditioner as they were treated as a period cost. Even though it was a cost incurred in getting the inventory into a condition or location ready for sale, **(1 mark)** because there were multiple lines of inventory delivered, the cost is unable to be directly allocated to each air conditioner. **(1 mark)**

1. **Explain the effect on the Income Statement for the month ended 30 April 2019 if Aleisha’s Air used period costing instead of product costing assuming not all the items are sold. 2 marks**

If Aleisha’s Air uses period costing instead of product costing, Cost of Goods Sold would be higher and Profit would be lower. **(1 mark)**

Under period costing, these additional delivery costs are reported in the Income Statement under the heading of Cost of Goods Sold in the period the expense was incurred, regardless of the quantity of item sold. **(1 mark)**

**Question 4 (9 marks)**

1. **Calculate the Net Realisable Value of one ‘Survivor’ tent. 2 marks**

$290 - $15 - $20 = $255

**1 mark** deducted per error / omission

1. **Record the General Journal entry required on 30 June 2019 in relation to the valuation of the ‘Survivor’ tent.**

**A narration is required. 3 marks**

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Details** | **Debit** | **Credit** |
| 30/06 | Inventory Write Down | 700 |  |
|  | Inventory |  | 700 |
|  | 11 ‘Survivor’ tents written down to NRV (Memo 63) |  |  |

1. **Referring to the faithful representation qualitative characteristic, explain why a valuation adjustment is required for Inventory on 30 June 2019. 2 marks**

According to the qualitative characteristic of faithful representation, an adjustment to the value of Inventory to be reported on the Balance Sheet as at 30 June 2019 is required to ensure that the financial statements represent real economic events and that the information reported is complete, free from error and without bias. **(1 mark)**

As Tai’s Tents realises that they will not be able to sell the 11 ‘Survivor’ tents for more than its cost price, the value of inventory reported on the Balance Sheet would be overstated and not complete. **(1 mark)**

**Question 5 (9 marks)**

1. **Discuss whether the liquidity of Kevin’s Kites has improved or worsened between 2017 and 2019. 4 marks**

**Suggested Approach**

**1 mark –** explanation of Accounts Receivable Turnover trend

**1 mark –** explanation of Inventory Turnover trend

**1 mark –** explanation of Accounts Payable Turnover trend

**1 mark –** conclusion

**Suggested Response**

The trend in the Accounts Receivable Turnover is favourable as it is faster (taking fewer days) for Kevin’s Kites to collect cash from their outstanding Accounts Receivable balances. This will have a positive impact on the liquidity of Kevin’s Kites as the business is going to have more cash available to meet its short-term debts as they fall due. However, the Accounts Receivable turnover is still above the credit terms offered to credit customers by Kevin’s Kites and this requires further improvement. **(1 mark)**

The trend in the Inventory Turnover is unfavourable as it is slower (taking more days) for Kevin’s Kites to sell their inventory. This means that Kevin’s Kites is delaying its ability to convert its inventory into sales and therefore convert its inventory into cash faster which is making it harder for them to meet its short-term debts as they fall due. **(1 mark)**

The trend in the Accounts Payable Turnover is favourable as Kevin’s Kites is paying their outstanding Accounts Payable balances faster. However, this may in fact have a negative impact on liquidity as the Accounts Payable balances are being paid well within the credit terms of 45 days without taking advantage of the discount terms which may make it difficult to repay other short-term debts as they fall due. **(1 mark)**

Therefore, even though there is an improvement in the Accounts Receivable Turnover, the number of days still fall outside the credit terms. A combination of waiting longer to convert inventory into cash and paying their Accounts Payable balances too soon, Kevin’s Kites’ liquidity has worsened. **(1 mark)**

1. **Explain one consequence for a business that is experiencing a decline in its liquidity. 2 marks**

When there is a decline in liquidity, a business will have difficulty meeting their short-term debts as they fall due. **(1 mark)**

Consequences include suppliers removing credit facilities, the owner being required to make continued capital contributions, the selling off of non-current assets or the advance of a loan or a bank overdraft. **(1 mark)**

1. **Suggest and justify one strategy Kevin could introduce to improve the Inventory Turnover. 2 marks**

Strategy **(1 mark)**

* employ strategies to increase sales, like advertising, changing selling prices, or changing the inventory mix
* decreasing the level of inventory on hand by ordering less, ordering smaller amounts more frequently, replacing slow moving inventory lines
* reducing the selling price of slow-moving items
* relocating inventory within the store to highlight particular goods

Justification **(1 mark)**

The strategy employed will act as an incentive for a potential customer to purchase the Inventory and the business to increase sales / the strategy will reduce the quantity and value of Inventory on hand which will mathematically improve the Inventory Turnover.

1. **State one other benchmark Kevin could use to assess the liquidity of his business. 1 mark**

* Industry Averages or other Similar Businesses
* Budget Estimates or Predicted Results

**END OF MINI EXAM NO. 1**