# MINI EXAM NO 2: UNIT 4 AREA OF STUDY 1 (50 MARKS)

**Question 1** (24 marks)

1. **Prepare the General Journal entry to close the revenue accounts on 31 March 2019.**

**A narration is not required.**

**3 marks**

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Details** | **Debit** | **Credit** |
| 31/05 | Cash Sales | 7 420 |  |
|  | Credit Sales | 14 040 |  |
|  | Discount Revenue | 143 |  |
|  | Sales Returns |  | 1 090 |
|  | Profit and Loss Summary |  | 20 513 |

**1 mark –** Cash Sales and Credit Sales entries

**1 mark –** Discount Revenue and Sales Returns entries

**1 mark –** Profit and Loss Summary entry

1. **Explain how recording closing entries satisfies the qualitative characteristic of relevance. 2 marks**

The qualitative characteristic of relevance outlines that information is relevant when it is capable of making a difference to the decisions made by users. **(1 mark)**

Closing entries ensure that only the revenues and expenses for a period are included in the calculation of profit. **(1 mark)**

1. **Prepare the Income Statement for the month ended 31 March 2019.**

**8 marks**

**Arthur’s Air Conditioners**

**Income Statement for the month ending 31 March 2019**

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
| **Revenues** |  |  |
| Cash Sales | 7 420 |  |
| Credit Sales | 14 040 |  |
| Less: Sales Returns | 1 090 | 20 370 |
| **Less: Cost of Goods Sold** |  |  |
| Cost of Sales | 6 790 |  |
| Customs Duties | 830 |  |
| Freight Inwards | 720 | 8 340 |
| **Gross Profit** |  | 12 030 |
| Less: Inventory Loss | 560 |  |
| Less: Inventory Write Down | 2 010 | 2 570 |
| **Adjusted Gross Profit** |  | 9 460 |
| **Add: Other Revenues** |  |  |
| Discount Revenue |  | 143 |
|  |  | 9 603 |
| **Less: Other Expenses** |  |  |
| Advertising | 1 500 |  |
| Discount Expense | 121 |  |
| Freight Outwards | 190 |  |
| Interest Expense | 125 |  |
| Rent Expense | 3 000 |  |
| Wages | 4 110 | 9 046 |
| **Net Profit / (Loss)** |  | 557 |

**1 mark –** Cash Sales and Credit Sales

**1 mark –** Sales Returns

**1 mark –** Cost of Sales plus either Customs Duties or Freight Inwards

**1 mark –** either Customs Duties or Freight Inwards not already awarded a mark

**1 mark –** Inventory Loss and Inventory Write Down

**1 mark –** Discount Revenue

**1 mark –** per any three Other Expense items

**1 mark –** remaining three Other Expense items

**1 mark deducted –** incorrect formatting such as missing headings and/or no Net Profit / (Loss)

1. **Explain the purpose of reporting the Adjusted Gross Profit in an Income Statement.**

**2 marks**

The benefit of reporting the Adjusted Gross Profit in an Income Statement is that it allows the management of inventory to be assessed from one period to the next. **(1 mark)**

The Income Statement will highlight the result of a physical inventory count and allow corrective action to be taken to reduce the likelihood of inventory losses and inventory write downs. **(1 mark)**

1. **Show how the Profit and Loss Summary and Capital accounts would appear in the General Ledger after all closing and transfer entries have been made on 31 March 2019.**

**You are required to balance the Capital account.**

**6 marks**

**Profit and Loss Summary**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross-reference** | **Amount** | **Date** | **Cross-reference** | **Amount** |
| 31/03 | Expense Accounts | 19 956 | 31/03 | Revenue Accounts | 20 513 |
|  | Capital | 557 |  |  |  |
|  |  | 20 513 |  |  | 20 513 |

**Capital**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross-reference** | **Amount** | **Date** | **Cross-reference** | **Amount** |
| 31/03 | Drawings | 4 500 | 01/03 | Balance | 60 197 |
|  | Balance | 71 254 | 16/03 | Bank | 15 000 |
|  |  |  | 31/03 | Profit and Loss Summary | 557 |
|  |  | 75 754 |  |  | 75 754 |
|  |  |  | 01/04 | Balance | 71 254 |

**1 mark –** Revenue and Expense accounts entries

**1 mark –** Capital debit entry in Profit and Loss Summary ledger and Profit and Loss Summary credit entry in Capital ledger

**1 mark –** Opening Balance entry

**1 mark –** Bank entry

**1 mark –** Drawings

**1 mark –** Balancing Capital account

1. **Prepare the Equities section of the Balance Sheet as at 31 March 2019.**

**3 marks**

**Arthur’s Air Conditioners**

**Balance Sheet (extract) as at 31 March 2019**

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
| **Current Liabilities** |  |  |
| Bank Overdraft | 10 670 |  |
| Accounts Payable | 7 040 |  |
| GST Clearing | 1 116 |  |
| Loan – MNC Bank | 4 800 | 23 626 |
| **Non-Current Liabilities** |  |  |
| Loan – MNC Bank |  | 13 200 |
| **Owner’s Equity** |  |  |
| Capital | 75 197 |  |
| Plus: Profit | 557 |  |
| Less: Drawings | 4 500 | 71 254 |
| **Total Equities** |  | 108 080 |

**1 mark –** Bank Overdraft, Accounts Payable and GST Clearing

**1 mark –** Loan – MNC Bank under both Current Liabilities and Non-Current Liabilities headings

**1 mark –** Owner’s Equity items

**1 mark deducted –** incorrect formatting such as missing headings and/or no Total Equities. If the mark has already been deducted in Question 1(c) for incorrect formatting, then no further marks should be deducted.

**Question 2 (4 marks)**

1. **Explain whether Makayla’s Merchandise’s mark-up percentage has increased or decreased from 2018 to 2019.**

**2 marks**

The mark-up percentage has increased from 2018 to 2019 **(1 mark)** as a greater percentage of each sales dollar is made up of Gross Profit. **(1 mark)**

1. **Explain how an increase in the mark-up could actually lead to a decrease in Gross Profit.**

**2 marks**

An increase in the mark-up percentage would lead to more profit being made on each unit sold.

**(1 mark)**

However, this increase in sales price could lead to a decrease in sales quantity and if the fall in quantity is a greater proportion than the increase in the mark up this can lead to a decrease in Gross Profit.

**(1 mark)**

**Question 3 (11 marks)**

1. **Prepare the Cash Flow Statement for the month ending 30 April 2019.**

**8 marks**

**Panahi’s Paint**

**Cash Flow Statement for the month ending 30 April 2019**

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
| **Cash Flows from Operating Activities** |  |  |
| Cash Sales | 11 780 |  |
| GST Collected | 1 178 |  |
| Receipts from Accounts Receivable | 3 300 |  |
| Payments to Accounts Payable | (6 600) |  |
| Purchase of Inventory | (8 400) |  |
| Advertising | (1 280) |  |
| Freight Inwards | (1 060) |  |
| Freight Outwards | (340) |  |
| Interest | (125) |  |
| Rent | (2 200) |  |
| Wages | (1 900) |  |
| GST Settlement | (774) |  |
| GST Paid | (4 507) |  |
| **Net Cash Flows from Operations** |  | (10 928) |
| **Cash Flows from Investing Activities** |  |  |
| Purchase of Shelving | (3 800) |  |
| Purchase of Van | (27 990) |  |
| **Net Cash Flows from Investing Activities** |  | (31 790) |
| **Cash Flows from Financing Activities** |  |  |
| Capital | 30 000 |  |
| Loan Borrowings – MNC Bank | 12 000 |  |
| Drawings | (2 900) |  |
| Loan Repayments – MNC Bank | (250) |  |
| **Net Cash Flows from Financing Activities** |  | 38 850 |
| **Net Increase / (Decrease) in Cash Position** |  | (3 868) |
| **Bank Balance at 1 April 2019** |  | (3 140) |
| **Bank Balance at 30 April 2019** |  | (7 008) |

**1 mark –** Cash Sales, GST Collected and Receipts from Accounts Receivable

**1 mark –** Payments to Accounts Payable and Purchases of Inventory

**1 mark –** per remaining 4 Operating items (2 marks)

**1 mark –** Investing outflows

**1 mark –** Financing inflows

**1 mark –** Financing outflows

**1 mark –** final three lines

1. **Explain to Rita, with the use of an example, how the Cash Flow Statement reported a Net Decrease in Cash but the Income Statement reported a Net Profit for the month ending 30 April 2019.**

**3 marks**

Panahi’s Paint reported a Net Profit for the month ending 30 April 2019 as the revenues earned were greater than the expenses incurred. **(1 mark)**

Whereas, a Net Decrease in Cash occurred for the same period as cash outflows were greater than the cash inflows. **(1 mark)**

**1 mark** – identification of example from question

A reason as to why this occurred would be the purchase of the Van. The purchase of the Van would decrease cash yet have no direct impact on the calculation of profit.

**Question 4 (3 marks)**

1. **Explain how it is possible for the Return on Assets to improve even though the Net Profit Margin declined.**

**2 marks**

When the Return on Assets improves and the Net Profit Margin decreases it means that the Asset Turnover has increased, meaning that Sales have increased by a greater percentage than the percentage increase in Assets. **(1 mark)**

Even though the Asset Turnover has increased, it is the worsening of expense control that has caused the Net Profit Margin to decrease; however, the increase in the Asset Turnover has had a proportionally larger impact than the decrease in the Net Profit Margin, resulting in an increase in the Return on Assets. **(1 mark)**

1. **State one non-financial indicator Bernard could use to assess the performance of his business.**

**1 mark**

* customer satisfaction surveys / number of repeat customers
* number of sales returns / quality of products
* number of hits on business website

**Question 5 (5 marks)**

1. **With the use of an example, explain how it is possible that the Working Capital Ratio trend is favourable while the Quick Asset Ratio trend is unfavourable.**

**2 marks**

Inventory is included in the Working Capital ratio but is excluded from the Quick Asset calculation **(1 mark).**

An increase in inventory levels may lead to a higher Working Capital ratio without affect the Quick Assets ratio **(1 mark).**

1. **Explain one possible negative effect on the profitability of Kevin’s Kettles as a result of the trend in the Working Capital Ratio.**

**2 marks**

Too much money tied up in Cash at Bank, Stock or Debtors.

Bank

* cash balance could be better used to reduce debt or purchase revenue generating non-current assets or taking advantage of discounts by paying creditors early to improve profitability

Stock

* increase in storage costs / greater chance of damage, shoplifting and obsolescence that could decrease profitability

Debtors

* increased chance in bad debts, debt collection fees and legal costs that could decrease profitability

**1 mark –** identification of issue

**1 mark –** explanation of impact on profitability

1. **State one limitation of using the Working Capital Ratio as an indicator of business liquidity.**

**1 mark**

* Does not assess the speed of a business’ liquidity.
* The composition of Current Assets is unknown.

**Question 6 (3 marks)**

**Explain the implication of the change in the Debt Ratio on the Cash Flow Cover.**

A higher Debt Ratio means the business has a greater reliance on borrowed funds. **(1 mark)**

The increase in the Debt Ratio has seen a decline in the Cash Flow Cover. Due to the increase in borrowings, a larger proportion of the Net Cash Flows from Operations is being used to repay current liabilities, as reflected in the Cash Flow Cover from 2018 to 2019. **(1 mark)**

This can be due to a combination of an increase in interest paid on the borrowings reducing the Net Cash Flows from Operations and the increase in loan repayments increasing the Current Liabilities. **(1 mark)**