Foreword

This resource material was developed to provide teachers with examples of graded assignments for reference and is by no means exhaustive. Teachers are advised to adapt the materials according to the diverse learning needs of students if deemed necessary.

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Elementary Level – Question Paper

The trial balance of Alan Company as at 31 December 2019 was prepared as follows:

	Dr	Cr
	$	$
Capital		1,310,000
Purchases	1,600,000	
Sales		2,900,000
Electricity expenses	49,000	
Insurance expenses	36,000	
Rent and rates	150,000	
Inventory, 1 January 2019	167,000	
Returns inwards	38,000	
Returns outwards		25,000
Trade receivables	864,000	
Trade payables		420,000
Discounts	55,000	28,000
Allowance for doubtful accounts		20,000
Office equipment	1,900,000	
Accumulated depreciation – office equipment		670,000
6% Bank loan		200,000
Cash at bank	714,000	
	5,573,000	5,573,000

Additional information:

(i) Inventory as at 31 December 2019 was valued at $180,000.

(ii) In November 2019, goods invoiced at $120,000 were sent to a customer on a sale-or-return basis at cost plus 50% mark-up. These had been recorded as credit sales for the year. As at 31 December 2019, 80% of the goods were accepted by the customer.

(iii) Annual insurance premium of $6,000 for the year ended 31 March 2020 was paid on 1 May 2019.

(iv) An electricity bill amounting to $3,000 was received but not yet recorded in the books.

(v) Debts amounting to $8,000 were found to be uncollectible and to be written off as bad. Allowance for doubtful accounts is to be made at 5% of the trade receivables.

(vi) The bank loan was acquired on 1 September 2019 and is to be repaid on 30 August 2020.

(vii) Office equipment is to be depreciated at a rate of 20% per annum using the reducing balance method.

REQUIRED:

(a) Prepare the journal entries for items (ii) to (vi). Narrations are not required. (7 marks)

(b) Prepare an income statement for the year ended 31 December 2019. (7 marks)

(c) Prepare a statement of financial position as at 31 December 2019. (6 marks)

(Total: 20 marks)

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Elementary Level – Student Worksheet

Hint: Steps to prepare a journal entry:
(1) Identify the accounts (at least 2) involved.
(2) Determine the nature and the double entry rules of the accounts involved.
(3) Identify whether an increase or a decrease to be recorded in the accounts.
(4) Determine which account(s) to be debited and which account(s) to be credited according to the double entry rules of the accounts involved. (refer to reference page)
(5) State by how much the accounts increased or decreased.

(a) General Journal

		Dr $	Cr $
(ii)	______ (W1)	______	
	Trade receivables (e.g.)		______
	______ (W2)	______	
	Profit and loss (e.g.)		______

Hint 1: Sales overstated by 20%
Hint 2: Closing Inventory understated by 20%
= Cost of inventory × % of goods not yet accepted by the customer
= Invoice price ÷ (1 + mark-up) × % of goods not yet accepted by the customer

When goods are sent on a 'sale-or-return' basis, these goods are not treated as sales unless they are accepted by the customer. As at 31 December 2019, 20% of these goods were not yet accepted. In this case, they should be included in Alan's inventory valuation (at cost) but not in the figure of sales (selling price).

(W1) Sales overstated by

= $ ______________ × _____ %

= $______________

(W2) Closing inventory understated by

= $______________ ÷ (1 + _____ %) × _____ %

= $______________

General Journal

		Dr $	Cr $
(iii)	________ (Working)	________	
	Insurance expenses (e.g.)		________

Hint: Insurance expenses overstated by the amount not yet incurred in current financial year = Insurance premium × number of months not yet incurred ÷ 12

Prepaid expenses are payments made for expenses which have not yet been incurred (i.e. period related to year 2020). The amount not yet incurred shall be transferred to prepaid insurance expenses (assets).

(Working) Prepaid insurance expenses

= $ ______________ × _____ months ÷ 12

= $______________

		Dr $	Cr $
(iv)	________ (Working)	________	
	Accrued electricity expenses (e.g.)		________

Hint: Electricity expenses understated by the amount that are already incurred but have not yet been paid.

Accrued expenses are expenses that are already incurred but have not yet been paid. Accrued expenses are liabilities.

		Dr $	Cr $
(v)	________	________	
	________		________

Hint 1: Write off bad debts from the trade receivables account (assets) when the debt is determined to be uncollectible.

		Dr $	Cr $
	________ *(Hint 2)*	________	
	Allowance for doubtful accounts (e.g.)		________

Hint 2: Prepare the allowance for doubtful accounts account

-		Allowance for doubtful accounts			+
2019		$	2019		
Dec 31	Trade receivables (Bad debts written off)		Jan 1	Bal b/d (Stated on trial balance)	
Dec 31	Bal c/d (Calculation step*)		Dec 31	Bad debts (Balancing figure)	

**1st step: Calculate the adjusted trade receivables balance*

= *Original trade receivables balance (stated on trial balance) – credit sales overstated (item ii) – bad debts written off*

= $_____________ – $_____________ – $_____________

= $_____________

**2nd step: Calculate the allowance for doubtful accounts as at 31 December 2019*

= *Adjusted trade receivables balance × % (stated in (v))*

= $_________________ × ______ %

= $_________________

General Journal

		Dr $	Cr $
(vi)			

Hint: Loan interest expenses understated by the amount that are already incurred (i.e. period between 1 Sep and closing date of the year) but have not yet been paid = Bank loan amount × interest rate × number of months incurred ÷ 12

Working: $____________ × _____ % × _____ ÷ 12 = $____________

(b) Alan Company

	$'000	$'000	$'000
Sales *($____________ - $____________ (ii))*			
Less: Returns inwards			
Less: Cost of goods sold			
Opening inventory			
Add: Purchases			
Less: Returns outwards			
Less: Closing inventory			
($____________ + $____________ (ii))			
Gross profit			
Add: Discounts received			
Less: Expenses			
Electricity expenses			
($____________ +$____________ (iv))			
Insurance expenses			
($____________ - $____________ (iii))			
Bad debts *(v)*			
Rent and rates			
Discounts allowed			
Interest expenses *(vi)*			

Depreciation expenses *(vii)*

($______________-$______________) × ______*%* *

Net profit

*Depreciation expenses under reducing balance method

= (Cost – Accumulated Depreciation) x %

(c) Alan Company

	$'000	$'000	$'000
Non-current assets			
Office equipment at cost			
Less Accumulated depreciation			
: *($________________+$________________(vii))*			
Current assets			
Inventory *($________________+ $________________(ii))*			
Trade receivables			
($______________- $______________(ii) -$______________(v))			
Less: Allowance for doubtful accounts *(v)*			
Prepaid insurance expenses *(iii)*			
Cash at bank			
Capital			
Balance as at 1 January 2019			
Add: Net profit for the year			
Current liabilities			
Trade payables			
6% Bank loan			
Interest payable *(vi)*			
Accrued electricity expenses *(iv)*			

Reference:

Principles of Double Entry System

Dr	Asset	Cr
Increase		*Decrease*

Dr	Liability	Cr
Decrease		*Increase*

Dr	Capital	Cr
Decrease		*Increase*

Dr	Revenue	Cr
Decrease		*Increase*

Dr	Expense	Cr
Increase		*Decrease*

Dr	Prepaid expense	Cr
Increase		*Decrease*

Dr	Accrued expense	Cr
Decrease		*Increase*

Dr	Allowance for doubtful accounts	Cr
Decrease		*Increase*

Dr	Accumulated depreciation	Cr
Decrease		*Increase*

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Elementary Level – Suggested Solution and Explanatory Notes

(a) General Journal

		Dr	Cr
		$	$
(ii)	Sales	24,000	
	Trade receivables		24,000
	($120,000 × 20%)		
	Inventory	16,000	
	Profit and loss		16,000
	[$120,000 ÷ (1+50%) × 20%]		
(iii)	Prepaid insurance expenses	1,500	
	Insurance expenses		1,500
	($6,000 × 3 ÷ 12)		
(iv)	Electricity expenses	3,000	
	Accrued electricity expenses		3,000
(v)	Allowance for doubtful accounts	8,000	
	Trade receivables		8,000
	Bad debts	29,600	
	Allowance for doubtful accounts		29,600

Hint: Prepare the allowance for doubtful accounts account

- Allowance for doubtful accounts +

2019		$	2019		$
Dec 31	Trade receivables (Bad debts written off)	8,000	Jan 1	Bal b/d (Stated on trial balance)	20,000
Dec 31	Bal c/d (Calculation step*)	41,600	Dec 31	Bad debts (Balancing figure)	29,600
		49,600			49,600

1st step: Calculate the adjusted trade receivables balance
= *$864,000 - $24,000 - $8,000 = $832,000*

**2nd step: Calculate the allowance for doubtful accounts as at 31 December 2019*
= $832,000 × 5% = $41,600

General Journal

		Dr ($)	Cr ($)
(vi)	Interest expenses	4,000	
	Interest payable		4,000
	($200,000 × 6% × 4 ÷ 12)		

(b)

Alan Company
Income statement for the year ended 31 December 2019

	$'000	$'000	$'000
Sales *($2,900,000 – $24,000 (ii))*			2,876
Less: Returns inwards			38
			2,838
Less: Cost of goods sold			
Opening inventory		167	
Add: Purchases	1,600		
Less: Returns outwards	25	1,575	
		1,742	
Less: Closing inventory			
($180,000 + $16,000 (ii))		196	1,546
Gross profit			1,292
Add: Discounts received			28
			1,320
Less: Expenses			
Electricity expenses *($49,000 + $3,000 (iv))*		52	
Insurance expenses *($36,000 – $1,500 (iii))*		34.5	
Bad debts *(v)*		29.6	
Rent and rates		150	
Discounts allowed		55	
Interest expenses *(vi)*		4	
Depreciation expenses *(vii)*		246	571.1
($1,900,000 – $670,000) ×20%			
Net profit			748.9

(c)

Alan Company
Statement of financial position as at 31 December 2019

	$'000	$'000	$'000
Non-current assets			
Office equipment, at cost			1,900
Less: Accumulated depreciation *($670,000 + $246,000 (vii))*			916
			984
Current assets			
Inventory *($180,000 + $16,000 (ii))*		196	
Trade receivables	832		
($864,000 – $24,000 (ii) – $8,000 (v))			

Less: Allowance for doubtful accounts *(v)*	41.6	790.4	
Prepaid insurance expenses *(iii)*		1.5	
Cash at bank		714	1,701.9
			2,685.9
Capital			
Balance as at 1 January 2019			1,310
Add: Net profit for the year			748.9
			2,058.9
Current liabilities			
Trade payables		420	
6% Bank loan		200	
Interest payable *(vi)*		4	
Accrued electricity expenses *(iv)*		3	627
			2,685.9

Alternative Format

(c)

Alan Company
Statement of financial position as at 31 December 2019

	$'000	$'000	$'000
Non-current assets			
Office equipment, at cost			1,900
Less: Accumulated depreciation *($670,000 + $246,000 (vii))*			916
			984
Current assets			
Inventory *($180,000 + $16,000 (ii))*		196	
Trade receivables *($864,000 – $24,000 (ii) – $8,000 (v))*	832		
Less: Allowance for doubtful accounts *(v)*	41.6	790.4	
Prepaid insurance expenses *(iii)*		1.5	
Cash at bank		714	
		1,701.9	
Less: **Current liabilities**			
Trade payables	420		
6% Bank loan	200		
Interest payable *(vi)*	4		
Accrued electricity expenses *(iv)*	3	627	
Working capital			1,074.9
			2,058.9
Financed by			
Capital			
Balance as at 1 January 2019			1,310
Add: Net profit for the year			748.9
			2,058.9

Points to be noted:

1. Important formula for preparation of an income statement
   (1) Cost of Goods Sold
   = Opening inventory + (Purchases – Returns outwards) - Closing inventory
   (2) Gross Profit
   = Sales – Cost of goods sold
   (3) Net profit or Net loss
   = Gross profit + Other revenues – Expenses
   (4) Cost × (1 + mark-up) = Invoice price (Sales)

2. Discounts allowed – It occurs when the business grants a discount to the customer for earlier settlement of debt. It is an **expense** account with a **debit balance**.

3. Discounts received – It occurs when the business is granted a discount by the supplier for earlier settlement of debt. It is a **revenue** account with a **credit balance**.

4. As the bank loan will be repaid within one year (e.g. 30 Aug 2020), it is classified as **current liabilities** on the statement of financial position.

Common mistakes:

1. Unable to determine the accounts to be debited and credited correctly even though they can work out the correct figures.
2. Unable to handle the bad debts and the allowance for doubtful accounts.
3. Mixed up the discounts allowed and discounts received.
4. Wrong classification of prepaid expenses and accrued expenses on the statement of financial position.
5. Wrong classification of bank loan as non-current liabilities on the statement of financial position.
6. Inaccurate headings for the financial statements. For example, income statement as at 31 December 2019 or balance sheet as at 31 December 2019.

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Standard Level – Question Paper

The trial balance of Alan Company as at 31 December 2019 was prepared as follows:

	Dr	Cr
	$	$
Capital		1,310,000
Purchases	1,600,000	
Sales		2,900,000
Electricity expenses	49,000	
Insurance expenses	36,000	
Rent and rates	150,000	
Inventory, 1 January 2019	167,000	
Returns inwards	38,000	
Returns outwards		25,000
Trade receivables	864,000	
Trade payables		420,000
Discounts	55,000	28,000
Allowance for doubtful accounts		20,000
Office equipment	1,900,000	
Accumulated depreciation – office equipment		670,000
6% Bank loan		200,000
Cash at bank	714,000	
	5,573,000	5,573,000

Additional information:

(i) Inventory as at 31 December 2019 was valued at $180,000.

(ii) In November 2019, goods invoiced at $120,000 were sent to a customer on a sale-or-return basis at cost plus 50% mark-up. These had been recorded as credit sales for the year. As at 31 December 2019, 80% of the goods were accepted by the customer.

(iii) Annual insurance premium of $6,000 for the year ended 31 March 2020 was paid on 1 May 2019.

(iv) An electricity bill amounting to $3,000 was received but not yet recorded in the books.

(v) Debts amounting to $8,000 were found to be uncollectible and to be written off as bad. Allowance for doubtful accounts is to be made at 5% of the trade receivables.

(vi) The bank loan was acquired on 1 September 2019 and is to be repaid on 30 August 2020.

(vii) Office equipment is to be depreciated at a rate of 20% per annum using the reducing balance method.

REQUIRED:

(a) Prepare the journal entries for items (ii) to (vi). Narrations are not required. (7 marks)

(b) Prepare an income statement for the year ended 31 December 2019. (7 marks)

(c) Prepare a statement of financial position as at 31 December 2019. (6 marks)
(Total: 20 marks)

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Standard Level – Student Worksheet

(a) **Please circle the correct answers* and do the calculation in the working box provided for each item.**

General Journal

	Dr $	Cr $
(ii)		

Working 1: Credit sales (overstated / understated)* by the amount not yet confirmed by the customers: $_______________ × _______% = $______________

Working 2: Closing inventory (overstated / understated)* by the amount not yet confirmed by the customer at cost:

$_________________÷ (1 + _______%) × _________% = $______________

(iii)

Insurance expenses (overstated / understated)* and (accrued / prepaid)* expenses understated by the number of months not yet incurred in the current financial year: $__________________ × ________ ÷ 12 = $______________

General Journal

	Dr $	Cr $
(iv)		

Electricity expenses (overstated / understated)* and accrued expenses (overstated / understated)*

(v)

Working 1: When writing off bad debts, trade receivables will (increase / decrease)* while allowance for doubtful accounts will (increase / decrease)*.

Working 2: Prepare the allowance for doubtful accounts account

- Allowance for doubtful accounts +

2019		$	2019		$
Dec 31			Jan 1		
Dec 31	Bal c/d (Calculation step#)		Dec 31	Bad debts (Balancing figure)	

 # Trade receivables after adjustment (ii) and bad debts written off x %

= $(__________ - __________ - __________) x ____%

= $____________

General Journal

	Dr	Cr
	$	$
(vi)		

Loan interest and interest payable are (overstated / understated)* by the amount of interest incurred but not yet paid:

= Bank loan amount × interest rate × number of months incurred ÷ 12

= $______________ × ________% × _________ ÷ 12

= $______________

(b)

	$'000	$'000	$'000
Sales *($____________ - $_____________(ii))*			
Less:			
Less: <u>Cost of goods sold</u>			
Less: Closing inventory			
($____________ + $_____________(ii))			
Gross profit			
Add:			
Less: <u>Expenses</u>			
Electricity expenses			
($___________ + $___________(iv))			
Insurance expenses			
($___________ - $__________(iii))			
Bad debts *(v)*			
Net profit			

(c)

	$'000	$'000	$'000
Non-current assets			
Less: Accumulated depreciation			
($____________ + $_____________(vii))			
Current assets			
Inventory *($____________ + $_____________(ii))*			
Trade receivables			
($____________ - $___________(ii) - $____________(v))			
Less: Allowance for doubtful accounts *(v)*			
($____________ × _____%)			
Prepaid insurance expenses *(iii)*			
Capital			
Current liabilities			
Interest payable *(vi)*			
Accrued electricity expenses *(iv)*			

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Standard Level – Suggested Solution and Explanatory Notes

(a) General Journal

		Dr $	Cr $
(ii)	Sales	24,000	
	Trade receivables		24,000
	Inventory	16,000	
	Profit and loss		16,000

Working 1: Credit sales (overstated / understated)* by the amount not yet confirmed by the customers: $120,000 x 20% = $24,000

Working 2: Closing inventory (overstated / understated)* by the amount not yet confirmed by the customer at cost:

$120,000 ÷ (1 + 50%) × 20% = $16,000

		Dr $	Cr $
(iii)	Prepaid insurance expenses	1,500	
	Insurance expenses		1,500

Insurance expenses (overstated / understated)* and (accrued / prepaid)* expenses understated by the number of months not yet incurred in the current financial year:

$6,000 x 3 ÷ 12 = $1,500

Point to note: Insurance expenses incurred in the current financial year is determined by the starting date of covering period (i.e. Apr – Dec 2019) of the insurance policy instead of the payment date (i.e. 1 May).

		Dr $	Cr $
(iv)	Electricity expenses	3,000	
	Accrued electricity expenses		3,000

Electricity expenses (overstated / understated)* and accrued expenses (overstated / understated)*

(v)	Allowance for doubtful accounts	8,000	
	Trade receivables		8,000
	Bad debts	29,600	
	Allowance for doubtful accounts		29,600

Working 1: **When writing off bad debts, trade receivables will (increase / decrease)* while allowance for doubtful accounts will (increase / decrease)*.**

Working 2: **Prepare the allowance for doubtful accounts account**

\- Allowance for doubtful accounts +

2019		$	2019		$
Dec 31	Trade receivables (Bad debts written off)	8,000	Jan 1	Bal b/d (Stated on trial balance)	20,000
Dec 31	Bal c/d (Calculation step#)	41,600	Dec 31	Bad debts (Balancing figure)	29,600
		49,000			49,600

 # Trade receivables after adjustment (ii) and bad debts written off x %

= $(864,000 – 24,000 – 8,000) x 5% = $41,600

(vi)	Interest expenses	4,000	
	Interest payable		4,000

Loan interest and interest payable are (overstated / understated)* by the amount of interest incurred but not yet paid:

= Bank loan amount x interest rate x number of months incurred ÷ 12

= $200,000 x 6% x 4 ÷ 12

= $4,000

Point to note: Pay attention to the loan amount with interest rate stated in the trial balance. You are required to calculate the interest expenses and interest payable based on the loan amount and interest rate even though there is no additional information about the loan interest.

(b)

Alan Company
Income statement for the year ended 31 December 2019

	$'000	$'000	$'000
Sales *($2,900,000 - $24,000 (ii))*			2,876
Less: Returns inwards			38
			2,838
Less: <u>Cost of goods sold</u>			
Opening inventory		167	
Add: Purchases	1,600		
Less: Returns outwards	25	1,575	
		1,742	
Less: Closing inventory *($180,000 + $16,000 (ii))*		196	1,546
Gross profit			1,292
Add: Discounts received			28
			1,320
Less: <u>Expenses</u>			
Electricity expenses *($49,000 + $3,000 (iv))*		52	
Insurance expenses *($36,000 - $1,500 (iii))*		34.5	
Bad debts *(v)*		29.6	
Rent and rates		150	
Discounts allowed		55	
Interest expenses *(vi)*		4	
Depreciation expenses *(vii)* *($1,900,000 - $670,000) × 20%*		246	571.1
Net profit			748.9

(c)

Alan Company
Statement of financial position as at 31 December 2019

	$'000	$'000	$'000
Non-current assets			
Office equipment, at cost			1,900
Less: Accumulated depreciation *$(670,000 + 246,000 (vii))*			916
			984
Current assets			
Inventory *($180,000 + 16,000 (ii))*		196	
Trade receivables *($864,000 - $24,000 (ii) - $8,000 (v))*	832		
Less: Allowance for doubtful accounts *(v)* *($832,000 × 5%)*	41.6	790.4	
Prepaid insurance expenses *(iii)*		1.5	
Cash at bank		714	1,701.9
			2,685.9
Capital			
Balance as at 1 January 2019			1,310
Add: Net profit for the year			748.9
			2,058.9
Current liabilities			
Trade payables		420	
6% Bank loan		200	
Interest payable *(vi)*		4	
Accrued electricity expenses *(iv)*		3	627
			2,685.9

Alternative Format

(c)

Alan Company
Statement of financial position as at 31 December 2019

	$'000	$'000	$'000
Non-current assets			
Office equipment, at cost			1,900
Less: Accumulated depreciation *($670,000 +$246,000 (vii))*			916
			984
Current assets			
Inventory *($180,000 + $16,000 (ii))*		196	
Trade receivables *($864,000 – $24,000 (ii) – $8,000 (v))*	832		
Less: Allowance for doubtful accounts *(v)* *($832,000 × 5%)*	41.6	790.4	
Prepaid insurance expenses *(iii)*		1.5	
Cash at bank		714	
		1,701.9	
Less: **Current liabilities**			
Trade payables	420		
6% Bank loan	200		
Interest payable *(vi)*	4		
Accrued electricity expenses *(iv)*	3	627	
Working capital			1,074.9
			2,058.9
Financed by			
Capital			
Balance as at 1 January 2019			1,310
Add: Net profit for the year			748.9
			2,058.9

Points to be noted:

1. Principles of Double Entry System

Dr **Asset (e.g. prepaid expenses)**	Cr
Increase	*Decrease*

Dr **Liability (e.g. accrued expenses)**	Cr
Decrease	*Increase*

Dr **Capital**	Cr
Decrease	*Increase*

Dr **Revenue (e.g. discounts received)**	Cr
Decrease	*Increase*

Dr **Expense (e.g. discounts allowed)**	Cr
Increase	*Decrease*

Dr **Allowance for doubtful accounts**	Cr
Decrease	*Increase*

Dr **Accumulated depreciation**	Cr
Decrease	*Increase*

2. Important formula:

   (a) Cost × (1 + mark-up) = Selling Price

   (b) Closing balance of allowance for doubtful accounts

   =Trade receivables after adjustment and bad debt written off × %

   (c) Depreciation expense under reducing balance method

   = (Cost – Accumulated Depreciation) × %

3. When goods are sent on a 'sale-or-return' basis, these goods are not treated as sales unless they are accepted by the customer. In item (ii), 20% of these goods were still not accepted by the customer at the end of the financial year. In this case, they should be included in Alan's inventory valuation (at cost) but not in the figure of sales (selling price).

4. In item (vi), the acquisition date and repayment date of the bank loan were given. As the bank loan was borrowed in between the financial year, the interest expenses should be calculated based on the number of months incurred for the current year only. Since the bank loan would be repaid within one year, it should be classified as current liability instead of non-current liability.

<u>Common mistakes:</u>

1. Failed to convert the selling price to the cost of inventory based on the mark-up formula.

2. Mixed up the closing balance of and the change in allowance for doubtful accounts. For instance, reporting the closing balance of allowance for doubtful accounts account in the income statement.
3. Unable to identify the bank loan as current liability.
4. Missing headings for financial statements.
5. Inaccurate account name: Students are expected to adopt the account names given for answering the questions. For example: trade payables given in the question cannot be replaced by accounts payables.

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Advanced Level – Question Paper

The trial balance of Alan Company as at 31 December 2019 was prepared as follows:

	Dr	Cr
	$	$
Capital		1,310,000
Purchases	1,600,000	
Sales		2,900,000
Electricity expenses	49,000	
Insurance expenses	36,000	
Rent and rates	150,000	
Inventory, 1 January 2019	167,000	
Returns inwards	38,000	
Returns outwards		25,000
Trade receivables	864,000	
Trade payables		420,000
Discounts	55,000	28,000
Allowance for doubtful accounts		20,000
Office equipment	1,900,000	
Accumulated depreciation – office equipment		670,000
6% Bank loan		200,000
Cash at bank	714,000	
	5,573,000	5,573,000

Additional information:

(i) Inventory as at 31 December 2019 was valued at $180,000.

(ii) In November 2019, goods invoiced at $120,000 were sent to a customer on a sale-or-return basis at cost plus 50% mark-up. These had been recorded as credit sales for the year. As at 31 December 2019, 80% of the goods were accepted by the customer.

(iii) Annual insurance premium of $6,000 for the year ended 31 March 2020 was paid on 1 May 2019.

(iv) An electricity bill amounting to $3,000 was received but not yet recorded in the books.

(v) Debts amounting to $8,000 were found to be uncollectible and to be written off as bad. Allowance for doubtful accounts is to be made at 5% of the trade receivables.

(vi) The bank loan was acquired on 1 September 2019 and is to be repaid on 30 August 2020.

(vii) Office equipment is to be depreciated at a rate of 20% per annum using the reducing balance method.

REQUIRED:

(a) Prepare the journal entries for items (ii) to (vi). Narrations are not required. (7 marks)

(b) Prepare an income statement for the year ended 31 December 2019. (7 marks)

(c) Prepare a statement of financial position as at 31 December 2019. (6 marks)

(Total: 20 marks)

Challenging question

On 31 December 2019, it was discovered that part of the closing inventory costing $32,000 had been damaged and could only be sold at 30% of the normal selling price after having them repaired for $2,500. Alan Company normally sold goods at a gross profit margin of 20%. No adjustment had been made in the closing inventory mentioned in (i).

(d) Prepare the journal entry for adjusting the inventory. (3 marks)

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Advanced Level – Student Worksheet

(a)

(b)

(c)

Challenging question

(d)

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Advanced Level – Suggested Solution and Explanatory Notes

(a)

General Journal

		Dr	Cr
		$	$
(ii)	Sales ($120,000 × 20%)	24,000	
	Trade receivables		24,000
	Inventory ($120,000 ÷ 1.5 × 20%)	16,000	
	Profit and loss		16,000
(iii)	Prepaid insurance expenses ($6,000 ÷ 12 × 3)	1,500	
	Insurance expenses		1,500
(iv)	Electricity expenses	3,000	
	Accrued electricity expenses		3,000
(v)	Allowance for doubtful accounts	8,000	
	Trade receivables		8,000
	Bad debts (W1)	29,600	
	Allowance for doubtful accounts		29,600
(vi)	Interest expenses ($200,000 × 6% ÷ 12 × 4)	4,000	
	Interest payable		4,000

(W1)

- Allowance for doubtful accounts +

2019		$	2019		$
Dec 31	Trade receivables (Bad debts written off)	8,000	Jan 1	Bal b/d (stated on trial balance)	20,000
Dec 31	Bal c/d (Calculation)*	41,600	Dec 31	Bad debts (Balancing figure)	29,600
		49,600			49,600

*Allowance for doubtful accounts as at 31 December = $(864,000 – 24,000 – 8,000) × 5% = $41,600

(b)

Alan Company
Income statement for the year ended 31 December 2019

	$'000	$'000	$'000
Sales *($2,900,000 - $24,000 (ii))*			2,876
Less: Returns inwards			38
			2,838
Less: Cost of goods sold			
Opening inventory		167	
Add: Purchases	1,600		
Less: Returns outwards	25	1,575	
		1,742	
Less: Closing inventory *($180,000 + $16,000 (ii))*		196	1,546
Gross profit			1,292
Add: Discounts received			28
			1,320
Less: Expenses			
Electricity expenses *($49,000 + $3,000 (iv))*		52	
Insurance expenses *($36,000 - $1,500 (iii))*		34.5	
Bad debts *(v)*		29.6	
Rent and rates		150	
Discounts allowed		55	
Interest expenses *(vi) ($200,000 × 6% × 4/12)*		4	
Depreciation expenses *(vii) ($1,900,000 - $670,000) × 20%*		246	571.1
Net profit			748.9

(c)

Alan Company
Statement of financial position as at 31 December 2019

	$'000	$'000	$'000
Non-current assets			
Office equipment at cost			1,900
Less: Accumulated depreciation *($670,000 + $246,000 (vii))*			916
			984
Current assets			
Inventory *($180,000 + $16,000 (ii))*		196	
Trade receivables *($864,000 – $24,000 (ii) – $8,000 (v))*	832		
Less: Allowance for doubtful accounts *(v)*	41.6	790.4	
Prepaid insurance expenses *(iii)*		1.5	
Cash at bank		714	1,701.9
			2,685.9
Capital			
Balance as at 1 January 2019			1,310
Add: Net profit for the year			748.9
			2,058.9

Current liabilities			
Trade payables		420	
6% Bank loan		200	
Interest payable *(vi)*		4	
Accrued electricity expenses *(iv)*		3	627
			2,685.9

Alternative Format

(c)

Alan Company
Statement of financial position as at 31 December 2019

	$'000	$'000	$'000
Non-current assets			
Office equipment at cost			1,900
Less: Accumulated depreciation *($670,000 + $246,000 (vii))*			916
			984
Current assets			
Inventory *($180,000 + $16,000 (ii))*		196	
Trade receivables *($864,000 – $24,000 (ii) – $8,000(v))*	832		
Less: Allowance for doubtful accounts *(v)*	41.6	790.4	
Prepaid insurance expenses *(iii)*		1.5	
Cash at bank		714	
		1,701.9	
Less: **Current liabilities**			
Trade payables	420		
6% Bank loan	200		
Interest payable *(vi)*	4		
Accrued electricity expenses *(iv)*	3	627	
Working capital			1,074.9
			2,058.9
Financed by			
Capital			
Balance as at 1 January 2019			1,310
Add: Net profit for the year			748.9
			2,058.9

Challenging question

(d)

General Journal

	Dr	Cr
	$	$
Profit and loss	22,500	
Inventory		22,500

Narrations: Inventory value written down

Explanatory note

Under Prudence Concept, assets and profits should not be overstated while liabilities and expenses should not be understated. Hence, inventory should be valued at lower of cost and net realisable value (NRV) as follows:

If NRV > Cost, inventory is valued at cost;

If Cost > NRV, inventory is valued at NRV

Net realisable value (NRV)
= Estimated selling price – Estimated costs of completion and disposal
= $32,000 ÷ (1 – 20%)* × 30% - $2,500
= $9,500

As the NRV of $9,500 is lower than the cost of the inventory amounting to $32,000, the inventory value has to be written down by $22,500.

* Conversion from Cost (C) to Sales (S) based on gross profit margin (M)

$M = (S - C) \div S$

$S - C = S \times M$

$S - S \times M = C$

$S \times (1 - M) = C$

$S = C \div (1 - M)$

Sales = Cost ÷ (1 – Margin)

In the challenging question, the normal selling price = $32,000 ÷ (1 – 20%) = $40,000

Points to be noted:

1. Important formula:

a) Mark-up = Profit ÷ Cost

b) Gross profit margin = Profit ÷ Sales

c) Closing balance of allowance for doubtful accounts
=Trade receivables after adjustment (ii) and bad debt written off × %

d) Depreciation expense under reducing balance method
= (Cost – Accumulated Depreciation) × %

e) Net realisable value = Expected selling price - expected cost associate with the sales

2. According to the realisation concept, revenue should be recognised in the period when the goods are dispatched and accepted by customers or when the services are rendered. Revenues are recognised only when the whole earning process is completed. When goods are sent on a 'sale-or-return' basis, these goods are not treated as sales unless they are accepted by the customer. In item (ii), 20% of these goods were still not accepted by the customer at the end of the financial year. In this case, they should be included in Alan's inventory valuation (at cost) but not in the figure of sales (selling price).

3. Accrual concept states that income and expenses are recognised when they are earned or incurred, not when they are received or paid. For example, even though no payment was made on the interest expenses for the bank loan in item (vi), the interest expenses should be calculated based on the number of months incurred for the year (i.e. from Sep to Dec 2019) and recorded in the financial statements.

<u>Common mistakes:</u>
1. Fail to do conversion between cost and sales based on formulas of mark-up and margin.
2. Missing interest expenses in the income statement.
3. Mistakenly using the unadjusted balance of trade receivables to calculate allowance for doubtful accounts.
4. Missing narrations in part (d).

Graded Assignment 6:
Period-end Adjustments Relating to the Preparation of Financial Statements
Marking Scheme

(a) **General Journal**

		Dr $	Cr $	**Marks**
(ii)	Sales ($120,000 × 20%)	24,000		*0.5*
	Trade receivables		24,000	*0.5*
	Inventory ($120,000 ÷ 1.5 × 20%)	16,000		*0.5*
	Profit and loss		16,000	*0.5*
(iii)	Prepaid insurance expenses ($6,000 ÷ 12 × 3)	1,500		*0.5*
	Insurance expenses		1,500	*0.5*
(iv)	Electricity expenses	3,000		*0.5*
	Accrued electricity expenses		3,000	*0.5*
(v)	Allowance for doubtful accounts	8,000		*0.5*
	Trade receivables		8,000	*0.5*
	Bad debts (W1)	29,600		*0.5*
	Allowance for doubtful accounts		29,600	*0.5*
(vi)	Interest expenses ($200,000 × 0.06 ÷ 12 × 4)	4,000		*0.5*
	Interest payable		4,000	*0.5*

(Total: 7 marks)

(b) Alan Company
Income statement for the year ended 31 December 2019

	$'000	$'000	$'000	
Sales $(2,900,000 – 24,000)			2,876	*0.5*
Less: Returns inwards			38	*0.5*
			2,838	
Less: Cost of goods sold				
Opening inventory		167		
Add: Purchases	1,600			
Less: Returns outwards	25	1,575		
		1,742		*0.5*
Less: Closing inventory $(180,000 + 16,000)		196	1,546	*0.5*
Gross profit			1,292	
Add: Discounts received			28	*0.5*
			1,320	
Less: Expenses				
Electricity expenses $(49,000 + 3,000)		52		*0.5*
Insurance expenses $(36,000 – 1,500)		34.5		*0.5*

Bad debts (W1)	29.6		*1*
Rent and rates	150		*0.5*
Discounts allowed	55		*0.5*
Interest expenses	4		*0.5*
Depreciation expenses ($1,900,000 - $670,000) × 20%	246	571.1	*0.5*
Net profit		748.9	*0.5*

(Total: 7 marks)

(c)

Alan Company
Statement of financial position as at 31 December 2019

	$'000	$'000	$'000	
Non-current assets				
Office equipment at cost			1,900	
Less: Accumulated depreciation ($670,000 + $246,000)			916	
			984	*0.5*
Current assets				
Inventory $(180,000 + 16,000)		196		*0.5*
Trade receivables $(864,000 – 24,000 – 8,000)	832			*0.5*
Less: Allowance for doubtful accounts ($832,000 × 0.05)	41.6	790.4		*0.5*
Prepaid insurance expenses ($6,000 ÷ 12 × 3)		1.5		*0.5*
Cash at bank		714	1,701.9	*0.5*
			2,685.9	
Capital				
Balance as at 1 January 2019			1,310	*0.5*
Add: Net profit for the year			748.9	*0.5*
			2,058.9	
Current liabilities				
Trade payables		420		*0.5*
6% Bank loan		200		*0.5*
Interest payable		4		*0.5*
Accrued electricity expenses		3	627	*0.5*
			2,685.9	

(Total: 6 marks)

Alternative Format

Alan Company
Statement of financial position as at 31 December 2019

	$'000	$'000	$'000	
Non-current assets				
Office equipment at cost			1,900	
Less: Accumulated depreciation *($670,000 +$246,000)*			916	
			984	*0.5*
Current assets				
Inventory *($180,000 + $16,000)*		196		*0.5*

Trade receivables	832			*0.5*
($864,000 – $24,000 – $8,000)				
Less: Allowance for doubtful accounts ($832,000 × 0.05)	41.6	790.4		*0.5*
Prepaid insurance expenses		1.5		*0.5*
Cash at bank		714		*0.5*
		1,701.9		
Less: **Current liabilities**				
Trade payables	420			*0.5*
6% Bank loan	200			*0.5*
Interest payable	4			*0.5*
Accrued electricity expenses	3	627		*0.5*
Working capital			1,074.9	
			2,058.9	
Financed by				
Capital				
Balance as at 1 January 2019			1,310	*0.5*
Add: Net profit for the year			748.9	*0.5*
			2,058.9	

(Total: 6 marks)

(W1)

- Allowance for doubtful accounts +

2019		$	2019		$
Dec 31	Trade receivables (Bad debts written off)	8,000	Jan 1	Bal b/d (Stated on trial balance)	20,000
Dec 31	Bal c/d (Calculation step*)	41,600	Dec 31	Bad debts (Balancing figure)	29,600
		49,600			49,600

* Calculation steps

Step 1: Calculate the adjusted balance of trade receivables
= $(864,000 – 24,000 – 8,000) = $832,000

Step 2: Calculate the allowance for doubtful accounts as at 31 December 2019
= $832,000 × 5% = $41,600

Challenging question
(d)

General Journal

	Dr	Cr	
	$	$	
Profit and loss	22,500		(1)
Inventory		22,500	(1)

Narrations: Inventory value written down (1)

(3 marks)

Workings
Net realisable value (NRV)
= $32,000 ÷ (1 – 20%) × 30% - $2,500
= $9,500 (1 mark)

Amount written down in the inventory value
= $32,000 - $9,500
= $22,500 (1 mark)