Financial Accounting (BINBO1131E + BISHO1008E)

1. Multiple choice

1	B
2	C
3	B
4	C
5	C
6	E
7	C
8	C
9	E
10	C
11	A
12	B
13	B
14	C
15	D

2. Journal entries and financial statements

Question 1:

For this assignment I assume that the transactions must be recorded without including GST in any entries.

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Date		Journal entries:	$
June/2	Dr	Cash/Bank	20.000
	Cr	Capital stock	20.000
June/5	Dr	Computer system	15.000
	Cr	Cash/Bank	5.000
	Cr	Accounts payable	10.000
June/8	Dr	Cash/Bank	20.000
	Cr	Note payable	20.000
June/15	Dr	Accounts receivable	25.500
	Cr	Revenue	25.500
June/17	Dr	Advertising expense	1.500
	Cr	Cash/Bank	1.500
June/23	Dr	Cash/Bank	25.500
	Cr	Accounts receivable	25.500
June/28	Dr	Utilities expense	2.700
	Cr	Cash/Bank	2.700
June/29	Dr	Rent expense	12.200
	Cr	Rent payable	12.200
June/30	Dr	Salary and wage expense	26.500
	Cr	Cash/Bank	26.500
June/30	Dr	Accounts receivable	35.500
	Cr	Revenue	35.500
June/30	Dr	Dividends	12.000
	Cr	Cash/Bank	12.000

Question 2

Income statement:

Income statement		
For the month of June		
Revenue		61.000
Expenses		
Advertising expense	1.500	
Utilities expense	2.700	
Rent expense	12.200	
Salary and wage expense	26.500	
Total expenses		42.900
Net income		**18.100**

Statement of Retained Earnings

Statement of Retained Earnings		
For the month of June		
Beginning balance		0
+ Net income	18.100	
- Dividends	12.000	
Retained earnings		**6.100**

Balance sheet

Balance Sheet			
June 30			
Assets		Liabilities and Equity	
Current Assets		Current liabilities	
Cash	17.800	Accounts payable	10.000
Accounts Receivable	35.500	Rent payable	12.200
Total Current Assets	53.300	Total current liabilities	22.200
Non-current assets		Long-term liabilities	
Computer system	15.000	Note payable	20.000
		Stockholders' equity	
		Capital Stock	20.000
		Retained earnings	6.100
		Total stockholders' equity	26.100
Total assets	**68.300**	**Total liabilities and equity**	**68.300**

<u>Question 3</u>

Overall, I would consider joining the company as they first and foremost have a positive net income. This is a good sign, as it shows that their expenses do not exceed their revenues. They have a profit margin of 30%, which could be considered relatively good for a newly started company. Furthermore, the company is rather liquid. They have a working capital off $31,100 and their current ratio is 2.4 to 1. This means that they are able to pay their current liabilities as they come due.

3. Sales and purchase transactions

Journal entries:

03.05.2019	Dr	Accounting service expense	15.000
	Dr	GST (Input)	3.750
	Cr	Accounts payable	18.750
05.05.2019	Dr	Office equipment	500.000
	Dr	GST (Input)	125.000
	Cr	Note Payable	625.000
10.05.2019	Dr	Cost of goods sold	100.000
	Dr	Accounts receivable	183.750
	Cr	Revenue	147.000
	Cr	GST (Output)	36.750
	Cr	Inventory	100.000
11.05.2019	Dr	Accounts payable	18.750
	Cr	Cash/Bank	18.750
25.05.2019	Dr	Cash/Bank	187.500
	Cr	Accounts receivable	183.750
	Cr	Gain on discount	3.750

4. Bad debt and allowance methods

Question 1

Journal entry to record bad debt at the end of the current reporting period:

Dr	Bad debt expense	35.515
Cr	Allowance for doubtful debt	35.515

Here we have the estimated amount of uncollectable debt from the ageing schedule: 36,475. From this we subtract the money from the already existing Allowance for doubtful debt account: 960:

Then we get = 36475 - 960 = **35,515.**

Question 2

a) When making an Allowance for Doubtful debt account at the start of a period, the firm uses the Allowance method, and not the direct write-off method. The Allowance for Doubtful debt account is credited with an amount that the company has estimated to be the bad debt they will incur during the year. This estimation can be based upon an ageing schedule or a percent of the accounts receivable. The Allowance for Doubtful debt is a contra asset account, with a natural credit balance. Whenever a company incurs bad debt during the year, they debit the Allowance for Doubtful debt account to reduce the allowance. When we

end the period with a credit balance in the end of the reporting period, we know that the company must have had less bad debt that year than they accounted for.

b) We will have the following balances after we have entered the new estimate of bad debts for 3% of 310,000:

Dr	Bad debt expense	4.800
Cr	Allowance for doubtful debt	4.800

The expense and allowance is calculated as: $0.03 * 310{,}000$

But then we have to deduct the 4,500 from the Allowance for Doubtful debt credit balance

$$9{,}300 - 4{,}500 = 4800$$

After calculating this we get our new allowance account while we simultaneously record is as an expense.

c) First of all, I would become suspicious. As the text states, there have been no operational changes that would justify this change. Therefore, my superior must have other intentions. A possible reason for him wanting this change would be for tax purposes. If the expense for bad debts is higher the income before taxes will be lower. This will in turn result in a smaller taxation expense for the company. If this is done, the financial statement will be less consistent and comparable, because the company will not use the same methods as they have done previous years and the financial statements will maybe not be comparable both with past years financial statements and competitors financial statements.

Question 5

1. Cloud-based accounting software differs a lot from traditional desktop-based accounting software. First of all, cloud-based accounting software is in the cloud meaning that the software is to be found and used online (on the internet for instance). Traditional accounting software might be a program you would have to install on your computer, thus accessing it from one or more computers having the software installed.

   Cloud-based software has several advantages but also disadvantages. The advantages is that it is based on pay per use, so you pay for using it online. Furthermore, it is location independent, meaning that you can access it from anywhere, as long as you have an internet connection. Also, several people can be on the software at the same time. A disadvantage from cloud-based accounting software is that the software is most often not individualized, so it is a standard program that is created for many types of firms. Secondly, it could be subject to a cyber-attack, which would compromise all the financial information from the company.

2. Xero uses perpetual inventory system with a moving average costing method. Let us have a look at the following example showing how it works:

Purchase value	Amount
25.000	1.000
3.000	100
28.000	1.100
Moving average	25
Amount sold	300
Cost of goods sold	7.636

(These numbers are taken from the picture provided in the exam).

First of all, we see how the company has an opening balance in its inventory combined with a purchase of inventory. After these entries the company sells 300 books. The software accounts for the cost of this sale when it happens, and not at the end of a period (Perpetual). The costs that the software assigns to the goods sold, is the average from the latest inventory purchases.

3. A perpetual inventory system is a system where the cost of goods sold is updated at the moment a company sells goods, and the purchase of inventory is also updated on the balance sheet when they purchase new inventory.

   The periodic inventory system accounts for cost of goods sold at the end of a chosen period (every month, quarter etc.). Here they use the following equation to determine their cost of goods sold: COGS = Cost of goods available for sale - Ending inventory. When recording for purchasing inventory in the Periodic inventory system, the company uses a temporary purchase account which is an expense account.

4. Calculating COGS and ending inventory using FIFO:

Cost of Goods Sold - FIFO			
Date	**Purchase value**	**Amount**	**Price per unit**
1/March	25.000	1.000	25
10/March	1.500	50	30
16/March	-		33
18/March	-		35
Totals	26.500	1.050	

Ending inventory - FIFO			
Date	**Purchase value**	**Amount**	**Price per unit**
1/March	-		25
10/March	1.500	50	30
16/March	6.600	200	33
18/March	5.250	150	35
Totals	13.350	400	

Using the First-in, First-out method School Book Supplies has a COGS of 26,500 and an ending inventory of 13,350.

When using the FIFO method, you record the most recent costs to your ending inventory, while you use the elder costs to record the Cost of Goods sold.

5. When we have used FIFO, the ending inventory is larger in terms of value than what Xero states when they use the moving average method (Their ending inventory being 12,246.22). Therefore, the COGS is also lower in terms of value when using FIFO compared to moving average. This difference is due to increases in prices. If the prices did not change during March, the ending inventory and COGS would be the same for using FIFO and moving average. This is also why the ending inventory is lager in terms of value, because FIFO captures the price increases during the month.

Question 6

1.

Using the straight-line depreciation method:

Straight-line			
Year	Depreciation	Accumulated depreciation	Book Value
0			85.000
1	15.200	15.200	69.800
2	15.200	30.400	54.600
3	15.200	45.600	39.400
4	15.200	60.800	24.200
5	15.200	76.000	9.000

When we use the straight-line depreciation method, we depreciate the same amount each year. To do this we use the following formula: $\frac{Aquisition\ cost - Residual\ value}{Estimated\ life}$.

From this question we get an annual depreciation expense of 15,200. Therefore the depreciation expense for 2017 will be **15,200.**

Using the units of production method:

Units of production				
Year	Depreciation	Accumulated depreciation	Amount produced	Book Value
0				85.000
1	11.400	11.400	1.500	73.600
2	15.960	27.360	2.100	57.640

When using the units of production method we first find the depreciation per unit produced, which is found by this formula: $\frac{Aquisition\ cost - residual\ value}{Units\ produced\ in\ life\ time}$. The depreciation per unit is 7.6, and this we now multiply with the amount produced to find the annual depreciation.

The depreciation for 2017 is then **15,960.**

Using the double declining method:

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Double-declining balance

Year	Depreciation	Accumulated depreciation	Book Value
0			85.000
1	34.000	34.000	51.000
2	20.400	54.400	30.600
3	12.240	66.640	18.360
4	7.344	73.984	11.016
5	2.016	76.000	9.000

When using the double declining method we use the double percentage of the straight line depreciation method (20%*2=40%). Then we depreciate the book value with 40% each year until we reach the residual value. This results in a depreciation expense of **20,400** in 2017.

If the company wants to use the depreciation method which results in the highest depreciation expense for 2017, they should use the double-declining balance method.

2.

Depreciation of truck
Double-declining balance

Year	Depreciation	Accumulated depreciation	Book Value
0			80.000
2014	8.857	8.857	71.143
2015	8.857	17.714	62.286
2016	11.548	29.262	70.738
2017	11.548	40.810	59.190
2018	11.548	52.357	47.643
2019	11.548	63.905	36.095
2020	11.548	75.452	24.548
2021	11.548	87.000	13.000

The book value of the truck on December 31, 2017 is then **59,190.**

<u>Question</u>

1.

We now have an equation saying:

Amount * Factor = 70,000.

First we find the factor for future value of 1$.

Amount * 1.36857 (4%, 8 periods) = 70,000

Amount = 70,000/1.36857

Amount to be deposited = **51147.9**

2. .

a) As the market rate increased the issue price of the bonds decreased. Now the issue price will be below face value, because the market rate is above the face rate. If the market rate had not been increase, the bond would have been issued at a premium, because the market rate was below the face rate.

b) .

The journal entry for a market rate of 6%:

Dr	Cash/Bank	27.132
Cr	Premium on bonds payable	2.132
Cr	Bonds payablee	25.000

The journal entry for a market rate of 10%:

Dr	Cash/Bank	23.070
Dr	Discount on bonds payable	1.930
Cr	Bonds payablee	25.000