LECTURE EXAMPLES
WEEK 3

Question 1: (Adopt from Leo. et. al. *Company Accounting* 8th edition)

During 2007, ABC Ltd discovered that inventory to the value of $6,500 that had been recognised as sold during 2006 was incorrectly included in the inventory as at 31 December 2006.

The income tax rate was 30% for 2007 and 2006.

Assume the following financial information was provided before the error was adjusted accordance with the requirements of AASB 108.

ABC LTD
Statement of comprehensive Income
For the year ended 31 December 2007

	2007	**2006**
Revenue	$104 000	$73 500
Cost of sale	(80 000)	(53 500)
Overstated cost of sale due to inventory error	(6 500)	-
Profit before income tax	17 500	20 000
Income tax expense	(5 250)	(6 000)
Profit for the period	$12 250	$14 000
Retained earnings (beginning)	$34 000	$20 000
Retained earning (end)	$46 250	$34 000

Required:

Adjust the errors in the statement of comprehensive income accordance with requirements of AASB 108.

Solution:

The correction of $6,500 inventory error should be disclosed in statement of comprehensive income as follows:

	2007	**2006**
Revenue		
Cost of sale		
Profit before income tax		
Income tax expense		
Profit for the period		
Retained earnings (beginning)		
Retained earning (end)		

Note X. Error in inventory

Inventory worth $6,500 had been recognised as sold in 2006, but was incorrectly included in inventory at 31 December 2006. This error was corrected during 2007. Restated financial information for 2006 is presented above as if the error had not been made. The effect of the restatement on the financial statements for 2006 is as follows:

	Effect on 2006
Increase in cost of sales	
Decrease in income tax expense	
Decrease in profit for the period	
Decease in inventory	
Decease in income tax payable	
Decease in equity	

Restatement of 2006 financial information in the balance sheet and the statement of changes in equity would also be required, but is not illustrated here.

Question 2:

The following unadjusted trial balance is available for Si's Knitting Service Ltd.:

Si's Knitting Service Ltd
Unadjusted Trial Balance
30th June, 2007

Cash	54,680	
Accounts Receivable	193,000	
Prepaid Insurance	36,000	
Buildings	80,000	
Accumulated Depreciation – Buildings		43,200
Machinery	480,000	
Accumulated Depreciation – Machinery		225,000
Land	400,000	
Accounts Payable		65,760
Notes Payable		100,000
Interest Payable		9,000
Customer deposits		12,000
Bank Loan		110,000
Ordinary Shares		460,000
Retained Earnings		80,940
Revenue		576,340
Cost of goods sold	245,000	
Utilities expense	14,660	
Maintenance expense	48,300	
Interest Expense	4,500	
Salaries expense	86,100	
Interim Dividends	40,000	
	1,682,240	1,682,240

Additional Information:

(i) Prepaid insurance represents the cost of a 24 month policy purchased on 1st July, 2006.

(ii) The buildings have an estimated useful life of 20 years and an estimated salvage value of $10,000.

(iii) The machinery has an estimated useful life of 6 years and an estimated salvage value of $30,000.

(iv) The notes payable were signed on 1st January, 2007. The principal and interest are due for repayment on 31st December, 2007. Interest is charged at 9% pa.

(v) The Customer deposits represent amounts paid in advance by new customers. A total of $6,000 of the balance in the account was earned during June, 2007.

(vi) Salaries earned by employees as at the end of June but not yet paid total $16,000.

(vii) The bank loan is due for repayment on 31st December, 2009. Interest is charged at 7½% pa and is payable on 30th June of each year.

(viii) The company income tax rate is 30%.

(ix) The company's directors decide to pay a final cash dividend of 11,500.

(x) The directors transfer $30,000 to a general reserve.

(xi) The company has decided to revalue it land upwards by 200,000

Required:

(a) Prepare necessary adjustment journal entries.

(b) Prepare a set of financial reports for the external users according to AASB 101 and other relevant accounting standards

LTD Statement of Comprehensive Income for the year ended			
	Note		
Revenue			
Cost of sales			
Gross profit			
Other income			
Operating expenses			
Finance costs			
Profit before income tax			
Income tax expense			
Profit for the year			
Other comprehensive income			
Revaluation Surplus			
Income tax relating to components of other comprehensive income			
Other comprehensive income for the year, net of tax			
Total comprehensive income for the year			

LTD Statement of Financial Position as at			
	Note		
ASSETS			
Current assets			
Cash and cash equivalents			
Trade and other receivables			
Inventories			
Other current assets			
Total current assets			
Non-current assets			
Property, plant and equipment			
Other intangible assets			
Total non-current assets			
Total assets			
LIABILITIES			
Current liabilities			
Trade and other payables			
Current tax payable			
Total current liabilities			
Non-current liabilities			
Long-term borrowings			
Deferred tax liabilities			
Total non-current liabilities			
Total liabilities			
Net assets			
EQUITY			
Share capital			
Reserves			
Retained earnings			
Total equity			

LTD Statement of Changes in Equity As at					
	Share capital	**General Reserve**	**Revaluation Surplus**	**Retained earnings**	**Total equity**
Balance at					
Total comprehensive income for the year					
Dividend declared – ordinary					
Dividend declared – preference					
Transfer to general reserve					
Balance at					

Note: Comparative figures should also be disclosed

Notes