Solution Manual & Marking Scheme
Mid Monsoon Semester Examination 2022-23
MSC504 – Financial Accounting &Reporting

Q1] **Income statement for the period ended August 31, 20XX**

Revenue:		
Service revenue		₹ 3,76,000
Less, Expenses:		
Salaries expense	72,000	
Rent expense	48,000	
Advertising expense	20,000	
Utility expense	16,000	(1,56,000)
EBITDA		2,20,000
Less, Interest on loan		(3,000)
EBT (Net income)		**₹2,17,000**

[Revenue – 1 mark + Expenses @ 0.5 – 2.5 Marks + Net Income- 0.5 = 4 marks]

Statement of Changes in Owner's Equity for the period ended August 31, 20XX

Raghu, Capital – August 1, 20XX	₹ 7,00,000
Add: Net income	2,17,000
Less: Drawings	(1,04,000)
Raghu, Capital, August 31, 20XX	8,13,000

[Each of the above items @ 0.5 marks = 2 Marks]

Balance sheet as on August 31, 20XX

Assets	**₹**	**Liabilities & OE**	**₹**
Cash Accounts receivableSupplies Equipment	6,44,000 1,12,000 1,28,000 5,60,000	Accounts payableInterest Payable Long- Term Debt Owner's equity: Raghu, Capital	1,28,000 3,000 5,00,000 8,13,000
Total	14,44,000	Total	14,44,000

[All assets – 1 mark + All Liab & Capital - 1 mark + B/s Total – 1 Mark = 4 marks]

Statement of Cash Flows for the period ended August 31, 20XX

Cash flows from operating activities	₹
Cash receipts from revenues	2,64,000
Cash payments for expenses	(1,56,000)
[*Salaries 72,000(+) Rent 48,000(+) Advertising 20,000(+) Utilities 16,000*]	
(1) Net cash inflows from operating activities	**1,08,000**
Cash flows from Investing activities	
Cash inflows	NIL
Cash outflows (Purchase of equipment)	(5,60,000)

(2) Net Cash outflows from investing activities	**(5,60,000)**
Cash flows from Financing activities	
Cash inflows (Investments by owner)	12,00,000
Cash outflows(Drawings by owner)	(1,04,000)
(3) Net Cash inflows from financing activities	**10,96,000**
Net increase in cash (1+2+3)	**6,44,000**
Cash at the beginning of the period	NIL
Cash at the end of the period	**6,44,000**

[Op Cash Inflows & outflows – 2 Marks (+) Inv Cash outflows – 0.5 marks (+) Fin cash inflows & outflows – 1.5 marks = 4 Marks]

Q2] Total inventory quantity available for sale for the period 1400 units of which 1,100 unitshave been sold out. So, the unsold inventory is 300 units.

<u>As per FIFO</u>

Opening Inventory…………………………(100*150)} = ₹15,000

Add, Purchases {(600* 160) + (300* 180) + (400* 190)}] = ₹226,000

Less, Ending Inventory = [300*190]............................ = (₹57,000)

COGS..= ₹184,000

<u>As per WAC</u>

Opening Inventory…………………………(100*150)} = ₹15,000

Add, Purchases {(600* 160) + (300* 180) + (400* 190)}] = ₹226,000

Less, Ending Inventory = [300*172.14]........................ = (₹51,642)

COGS..= ₹189,358

Particulars	FIFO	WAC
Sales revenue (1,100 * 250)	₹275,000	₹275,000
Less, COGS	(184,000)	(189,358)
Gross Margin	91,000	85,642
Less, Operating Expenses:Salary expenses Misc. Operating expenses	(16,000) (24,000)	(16,000) (24,000)
EBITDA	51,000	45,642
Less, Depreciation	(3,500)	(3,500)
EBIT	47,500	42,142
Less, Tax @ 30%	(14,250)	(12,643)
EAT – Net Income	33,250	29,499

While both FIFO and WAC are popular inventory valuation methods, firms can decide which method to use based on their discretion. The difference between the two depends on the way the inventory is issued; FIFO sells the goods purchased first and WAC calculates the average price for the total inventory. The acceptability of any inventory valuation method is internal to the firm, and the effect is identified through COGS in the income statement, leading to the variability of income.

[*Computation of COGS under two methods @ 2 marks – 4 marks + Income Statements under two methods @ 1.5 marks – 3 marks + comment on the results – 1 mark = 8 Marks]*

Q3] (a)Office supplies expenses = [opening Inv + Purchases – Closing Inv] = ₹ 4,28,500

Debit Office supplies expenses...............₹ 4,28,500
Credit Office Supplies ....₹ 4,28,500
(Office supplies consumed during the month)

(b) Debit Unearned Revenue…........................... ₹ 49,000
Credit Sales Revenue… ....₹ 49,000
(Actual sales executed against the advance revenue received)

(c) Debit Depreciation expense…....................... ₹ 6,000**
Credit Accumulated Depn, Equipment… ₹ 6,000
(Depreciation expense of the equipment for one month)

Depreciation Exp pa = [{(260,000+4,000) -12,000} *{6/(1+2+3+4+5+6)}]= ₹ 72,000; per month - ₹ 6,000

[Each journal entry @ 1 mark – 3 marks (+) Computation of Depreciation under SYD Method 1 Mark = 4 Marks]

Q4] Part (a)

1) Current Ratio = [CAs ÷ CLs] = For 20X3 – (5,00,000/ 3,47,000)= 1.47 & For 20X2 – (4,00,000/3,00,000)= 1.33
2) Acid - Test Ratio = [(CAs – Inventory) ÷ CLs] = For 20X3 – [(5,00,000-2,50,000)/ 3,47,000] =0.74 & For 20X2 –[(4,00,000 – 2,00,000)/3,00,000]= 0.67
3) Accounts receivable turnover Ratio = [Sales ÷ {(Opening AR+ Closing AR)/2}] = For20X3 [14,00,000 ÷ {(110,000+105,000)/2}] – 13.02 times & For 20X2 – [15,00,000 ÷ {(120,000+110,000)/2}] 13.04 times
4) Inventory turnover Ratio = [COGS ÷ {(Opening Inv+ Closing Inv)/2}] = For 20X3 –4.98 times & For 20X2 – 4.25 times
5) Inventory turnover in days = [360 /Inventory Turnover Ratio] = For 20X3 – 72.29days & For 20X2 – 84.71 days

[For computation of 5 ratios @ 1 Mark = 5 marks]

Part (b)

The short-term liquidity of the firm improved between 20X2 & 20X3. The working capital increased by ₹60,000, while the current ratio increased from 1.33 to 1.47. The Acid-test ratio also increased from 0.67 to 0.74. Using a rule of thumb of 2 for the Current Ratio and 1 for the Acid-test Ratio, the firm needs to increase its liquidity position.

Also, during the period of comparison, AR turnover remained the same, while the inventory turnover improved from 84.71 to 72.29 days. Thus, much of the improvement in the current position can be attributed to the improved control of inventory, which in lieu willhelp the firm in effectively reduce the duration of the operating cycle.

[For interpretation of Ratios as indicated above – 2 marks]