**Accounting and Finance – ATAR Year 11 SOLUTION**

**Task 7 – Unit 2, 2020**

**Accruals and Balance Day Adjustments**

**SECTION ONE-MULTIPLE CHOICE (6 marks)**

Circle the most correct answer in each of the following questions.

The following is the trial balance (extract) for Bob’s Bikes as at 30 June 2020.

|  |  |  |
| --- | --- | --- |
| Prepaid Insurance | 3,000 |  |
| Wages | 50,000 |  |
| Unearned Sales Income |  | 22,000 |
| Interest Income |  | 3,500 |

**Additional information** at balance date is:

* Prepaid insurance amounted to $2,000
* Accrued wages amounted to $5,000
* Sales income earned for the period $23,000
* Unpaid Interest income to 30 June 2020 is $1,700, this will be paid in October 2020.

1. The adjusting entry for prepaid insurance is:
   1. Debit Prepaid Insurance $3,000, credit Insurance expense $3,000
   2. Debit Insurance expense $2,000, credit Prepaid Insurance $2,000
   3. Debit Insurance expense $1,000, credit Prepaid Insurance $1,000
   4. Debit Insurance expense $2,000, credit Prepaid Insurance $2,000
2. The adjusting entry for interest income is:
   1. Debit Accrued Income $1,800, credit Interest Income $1,800
   2. Debit Accrued Income $1,700, credit Interest Income $1,700
   3. Debit Interest Income $1,700, credit Accrued Income $1,700
   4. Debit Interest Income $3,500, credit Accrued Income $3,500
3. The wages expense for the period would be:
   1. $44,000
   2. $45,000
   3. $50,000
   4. $55,000
4. The sales income would equal:
   1. $23,000
   2. $22,000
   3. $55,000
   4. $1,000
5. The system where income that is recorded when the cash is received, rather than when the income is earned is called:
   1. An asset
   2. Cash accounting
   3. Income
   4. Accrual accounting
6. Accrued expenses at balance day are classified as:
   1. A non-current liability
   2. A current liability
   3. A current asset
   4. An expense

**SECTION TWO-SHORT ANSWER QUESTIONS (41 marks)**

1. The following is an extract of the Trial Balance of Billy’s Beekeepers which sells honey to retail outlets and restaurants.

**Trial Balance (Extract) at 30 June 2020**

|  |  |  |
| --- | --- | --- |
|  | **DEBIT** | **CREDIT** |
| Wages | 30,000 |  |
| Accounts receivable | 51,000 |  |
| Interest Income |  | 450 |
| Allowance for doubtful debts |  | 1,500 |
| Unearned Sales Income |  | 12,100 |
| Bad debts | 2,000 |  |
| Prepaid insurance | 3,600 |  |

**Additional information at 30 June 2020:**

* $800 wages were owing to employees.
* A fixed deposit of $30,000 earns 3% interest per year on a quarterly basis. The last time interest was received, was on 30 April 2020.
* The annual insurance premium was paid on the 1 March 2020.
* Unearned sales income at 30 June 2019 is $2,300.
* Additional bad debts of $1,000 needs to be written off.
* The allowance for doubtful debts was to be set at $2,000

**Required:**

1. Prepare the ledger accounts for the above balance day adjustment items at 30 June 2020. and balance as required. Closing entries are not required. (21 marks)

***Workings:***

Accrued Interest Income: $30,000 x 3% x 2/12 = $150 (1 mark)

Insurance expense: $3,600 x 4/12 = $1,200 (1 mark)

Allowance for Doubtful Debts: 12,100 – 2,300 = 9,800 (1 mark)

**Wages**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  June 30 | Balance b/f | 30,000 |  |  |  |
|  | Accrued expenses | 800 |  |  |  |

**Accrued Expenses**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
|  |  |  | 2020  June 30 | Wages | 800 |

**Interest income**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
|  |  |  | 2020  June 30 | Balance b/f | 450 |
|  |  |  |  | Accrued income | 150 |

**Accrued income**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  June 30 | Interest income | 150 |  |  |  |

**Insurance expense**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  June 30 | Prepaid insurance | 1,200 |  |  |  |

**Prepaid Insurance**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  June 30 | Balance | 3,600 | 2020  June 30 | Insurance expense | 1,200 |
|  |  |  |  | Balance c/d | 2,400 |
|  |  | **3,600** |  |  | **3,600** |
|  | Balance b/d | 2,400 |  |  |  |

**Unearned sales income**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  June 30 | Sales income | 9,800 | 2020  June 30 | Balance | 12,100 |
|  | Balance c/d | 2,300 |  |  |  |
|  |  | **12,100** |  |  | **12,100** |
|  |  |  | 2020  July 1 | Balance b/d | 2,300 |

**Sales income**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
|  |  |  | 2020  June 30 | Unearned sales income | 9,800 |

**Accounts Receivable**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  June 30 | Balance | 51,000 | 2020  June 30 | Bad Debts | 1,000 |
|  |  |  |  | Balance c/d | 50,000 |
|  |  | **51,000** |  |  | **51,000** |
|  | Balance b/d | 50,000 |  |  |  |

**Bad debts**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  June 30 | Balance | 2,000 | 2020  June 30 | Allowance for Doubtful debts | 3,000 |
|  | Accounts Receivable | 1,000 |  |  |  |

**Allowance for Doubtful Debts**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  June 30 | Bad debts | 3,000 | 2020  June 30 | Balance | 1,500 |
|  | Balance c/d | 2,000 | 2019  June 30 | Doubtful debts | 3,500 |
|  |  | **5,000** |  |  | **5,000** |
|  |  |  | 2019  July 1 | Balance b/d | 2,000 |

**Doubtful debts**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2019  June 30 | Allowance for doubtful debts | 3,500 |  |  |  |

**-1 mark for incorrect dates to a maximum of 2**

1. Prepare the general journal entries for the above transactions. (12 marks)

**GENERAL JOURNAL**

|  |  |  |  |
| --- | --- | --- | --- |
| **DATE** | **DETAILS** | **DEBIT** | **CREDIT** |
| 2019  June 30 | Wages | 800 |  |
|  | Accrued expenses |  | 800 |
|  | *Accrued wages on balance date.* |  |  |
|  |  |  |  |
|  | Accrued income | 150 |  |
|  | Interest income |  | 150 |
|  | *Interest income accrued.* |  |  |
|  |  |  |  |
|  | Insurance expense | 1,200 |  |
|  | Prepaid insurance |  | 1,200 |
|  | *Prepaid insurance expired.* |  |  |
|  |  |  |  |
|  | Unearned sales income | 9,800 |  |
|  | Sales income |  | 9,800 |
|  | *Fees income for the year.* |  |  |
|  |  |  |  |
|  | Bad Debts | 1,000 |  |
|  | Accounts Receivable |  | 1,000 |
|  | *Bad debts written off* |  |  |
|  |  |  |  |
|  | Allowance for doubtful debts | 3,000 |  |
|  | Bad debts |  | 3,000 |
|  | *Clear bad debts to allowance for doubtful debts.* |  |  |
|  |  |  |  |
|  | Doubtful debts | 3,500 |  |
|  | Allowance for doubtful debts |  | 3,500 |
|  | *Allowance for doubtful debts set at $2,000.* |  |  |

**-1 mark for incorrect dates to a maximum of 2**

**-1 for incorrect/no description to a maximum of 2**

1. Show the Current Assets and Current Liabilities sections of the Balance Sheet as at 30 June 2019. (6 marks)

|  |
| --- |
| **Current Assets** |
| **Accrued income 150** |
| **Prepaid insurance 2,400** |
| **Accounts receivable 50,000** |
| **Less Allowance for doubtful debts (2,000) 48,000** |
|  |
| **Current Liabilities** |
| **Accrued expenses 800** |
| **Unearned sales income 2,300** |
|  |

2. Define cash accounting and accrual accounting and explain with the help of an example the difference between these two methods of accounting.(3 marks)

Cash Accounting records Income when the cash is received and where as accrual accounting records income when it is earnt. 1 mark

Cash Accounting records records expenses are recorded when the cash is paid where as accrual accounting records expenses when they are incurred. 1 mark

Any relevant example: 1 mark

3.State the Accounting Framework definition of “Income” and discuss the recognition criteria for that element. (3 marks)

**Definition:** Increases in assets or decrease in liabilities that result in increase in equity, other than those relating to contributions from holders of equity claims.

**Recognition Criteria:** Income recognition criteria requires relevant information about the asset or liability and about any resulting income, expenses or changes in equity; and

a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity.

**½ mark for each underlined section mentioned.**

4. Define a “Asset” as per the Framework and give the recognition criteria for it. (3 marks)

**Definition:** An asset is a present economic resource controlled by the entity as a result of past events.

**Recognition Criteria:** Asset recognition criteria requires relevant information about the asset or liability and about any resulting income, expenses or changes in equity; and

a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity.

**½ mark for each underlined section mentioned.**