

- 1 Adam owns a retail business. He is aware that he must follow certain accounting concepts when preparing his business's financial statements.

REQUIRED

- (a) Explain how each of the following concepts is applied when preparing a business's financial statements.

- (i) Consistency

.....

.....

.....

.....

..... [2]

- (ii) Realisation

.....

.....

.....

.....

..... [2]

- (iii) Materiality

.....

.....

.....

.....

..... [2]

Additional information

Adam has completed the trading section of the income statement. However, some errors had been made.

Income statement for the year ended 31 December 2020

	\$	\$
Revenue		186 500
Less returns outwards		<u>(3 180)</u>
		183 320
Opening inventory	14 830	
Purchases	93 710	
Less returns inwards	<u>(2 940)</u>	
Add carriage inwards	730	
	106 330	
Less closing inventory	<u>(12 670)</u>	
Cost of sales		<u>93 660</u>
Gross profit		<u>89 660</u>

The following information is also available.

- 1 No record had been made of goods taken for own use by Adam, \$580.
- 2 Closing inventory included 14 damaged items which cost \$30 each. Six of these items cannot be sold and are to be regarded as waste. The remaining items could be sold for \$35 each but will incur total repairs cost of \$56.

REQUIRED

(b) Calculate a revised figure for gross profit for the year ended 31 December 2020.

[7]

Additional information

The following balances were extracted from the books of account of Adam's business on 31 December 2020.

	\$	
Discounts	1 580	credit
Furniture and equipment		
cost	18 220	
provision for depreciation (at 1 January 2020)	5 370	
Marketing expenses	4 850	
Motor vehicle		
cost	16 800	
provision for depreciation (at 1 January 2020)	13 900	
Office expenses	2 950	
Premises		
cost	160 000	
provision for depreciation (at 1 January 2020)	9 600	
Provision for doubtful debts (at 1 January 2020)	530	
Rent receivable	6 640	
Repairs and maintenance	1 970	
Trade receivables	9 800	
Wages and salaries	31 280	

The following information is also available.

- 1 Repairs and maintenance included a payment of \$380 for installation of new equipment on 1 January 2020.
- 2 The provision for doubtful debts should be maintained at 5% of trade receivables.
- 3 Rent receivable of \$1800 for the three months ended 28 February 2021 had not been received.
- 4 A payment of \$2000 for a five-month advertising campaign which began on 1 November 2020 was outstanding.
- 5 Depreciation should be provided on non-current assets as follows:
 - Furniture and equipment at 20% per annum using the reducing balance method
 - Premises at 2% per annum using the straight-line method
 - No depreciation is charged on non-current assets in the year of sale.
- 6 No record had been made of the sale of the only motor vehicle on 1 December 2020 for \$1350.

REQUIRED

- (c) Prepare the income statement for the year ended 31 December 2020. Start the statement with your gross profit figure in part (b).

Income statement for the year ended 31 December 2020

	\$	\$
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....
.....

Additional information

Adam would like to improve his business's profitability. He has been considering the following proposals.

Proposal 1: Reducing inventory levels

Proposal 2: Increasing mark-up by 5% on the current level

REQUIRED

- (d) Advise Adam which proposal he should choose. Justify your answer by considering **both** proposals.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....