COMMERCE PRESENTATIONS AND PUBLICATIONS

VCE ACCOUNTING UNIT 3

2019

Examination

SUGGESTED SOLUTIONS

Question 1 – Leo's Lighting (13 marks)

a. Prepare the Current Asset and Current Liability extracts from the classified Balance Sheet for Leo's Lighting as at 1 January 2019.

5 marks

Leo's Lighting
Balance Sheet
as at 1 January 2019

	$	**$**		**$**	**$**
Current Assets			**Current Liabilities**		
Bank	46 420		Accounts Payable	9 900	
Inventory	9 000		Loan – MNC Bank	5 500	15 400
GST Clearing	1 680	57 100			

1 mark – per entry

1 mark deducted – no totals

b. Referring to two qualitative characteristics, explain why fair values should be used when non-cash assets are contributed to the business by an owner.

4 marks

The qualitative characteristic of relevance supports the use of fair values. Relevance outlines that information is relevant when it is capable of making a difference to the decisions made by users. **(1 mark)**

Fair values are more relevant than an asset's original cost as it provides an estimate of the future economic benefit the asset is expected to provide the business from the date it is contributed by the owner. **(1 mark)**

The qualitative characteristic of faithful representation also supports the use of fair values. Faithful representation outlines that the amount recorded representative of the real world economic event, is complete, free from material error and neutral without bias. **(1 mark)**

As the fair value is the price that would be received if the asset was sold at the time it was transferred to the business, in the absence of a professional valuation, a market value estimate would be appropriate as the amount would be deemed to be free of material error. **(1 mark)**

c. Referring to the definition of a liability, explain how the loan balance owing to MNC Bank would be treated differently to the bank overdraft limit on the Balance Sheet of Leo's Lighting as at 1 January 2019.

4 marks

The loan owing to MNC Bank would be treated as a liability on the Balance Sheet of Leo's Lighting as at 1 January 2019 as it represents a present obligation as a result of past events. **(1 mark)**

Under the heading of Current Liabilities, $5 500 would be reported as this amount represents the amount reasonably expected to be repaid within the next 12 months. **(1 mark)**

The remaining amount owing on the loan of $34 500 would be reported under the heading of Non-Current Liabilities as it represents the amount reasonably expected to be repaid in a period greater than the next 12 months. **(1 mark)**

However, the bank overdraft limit would not be included in the Balance Sheet as at 1 January 2019 as it is not an outstanding balance owing to the bank. It does not satisfy the definition of a liability as it is not a present obligation and is only an agreement with the bank to provide an overdraft if required. **(1 mark)**

Question 2 – Fiona's Frames (17 marks)

Prepare the General Journal entries required to record each transaction.

Narrations are not required.

General Journal

Date	Details	Debit	Credit
09/02	Inventory	3 200	
	GST Clearing	320	
	Accounts Payable – McGowans		3 520
16/02	Accounts Receivable – Murphy Motel	5 500	
	Credit Sales		5 000
	GST Clearing		500
	Cost of Sales	2 000	
	Inventory		2 000
17/02	Bank	440	
	Cash Sales		400
	GST Clearing		40
	Cost of Sales	175	
	Inventory		175
19/02	Sales Return	1 000	
	GST Clearing	100	
	Accounts Receivable – Murphy Motel		1 100
	Inventory	400	
	Cost of Sales		400
20/02	Accounts Payable - McGowan	704	
	Inventory		640
	GST Clearing		64
21/02	Bank	4 312	
	Discount Expense	88	
	Accounts Receivable – Murphy Motel		4 400

1 mark – Inventory and GST Clearing entries on 09/02

1 mark – Accounts Payable entry on 09/02

1 mark – Accounts Receivable entry on 16/02

1 mark – Credit Sales and GST Clearing entries on 16/02

1 mark – Cost of Sales and Inventory entries on 16/02

1 mark – Bank entry on 17/02

1 mark – Cash Sales and GST Clearing entries on 17/02

1 mark – Cost of Sales entry on 17/02

1 mark – Inventory entry on 17/02

1 mark – Sales Returns and GST Clearing entries on 19/02

1 mark – Accounts Receivable entry on 19/02

1 mark – Inventory and Cost of Sales entries on 19/02

1 mark – Accounts Payable entry on 20/02

1 mark – Inventory and GST Clearing entries on 20/02

1 mark – Bank entry on 21/02

1 mark – Discount Expense entry on 21/02

1 mark – Accounts Receivable entry on 21/02

Question 3 – Bert's Books (8 marks)

a. Show how Williams Publishing's account would appear in the General Ledger of Bert's Books as at 31 March 2019.

You are required to balance the account. **6 marks**

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
03/03	Bank / Discount Revenue	7 150	01/03	Balance	7 150
14/03	Inventory / GST Clearing	418	11/03	Inventory / GST Clearing	10 670
29/03	Bank	3 000			
31/03	Balance	7 252			
		17 820			17 820
			01/04	Balance	7 252

1 mark – per entry in ledger account

1 mark – balancing ledger account

b. Explain how the Statement of Account could assist internal control for Bert's Books.

2 marks

Bert's Books could use the Statement of Account as a cross checking mechanism against the balance of Accounts Payable. **(1 mark)**

The Statement of Account will assist the internal control of Bert's Books Williamson's as the balance in the ledger must equal the final balance on the Statement to ensure that the transactions have been recorded correctly and any errors can be followed up with the supplier. **(1 mark)**

Question 4 – Katie's Kitchens (13 marks)

a. Prepare the Cash Flow Statement for the month ending 30 April 2019.

10 marks

Katie's Kitchens
Cash Flow Statement for the month ending 30 April 2019

	$	$
Cash Flows from Operating Activities		
Cash Sales	11 650	
GST Collected	1 165	
GST Refund	1 003	
Receipts from Accounts Receivable	9 900	
Payments to Accounts Payable	(8 624)	
Rent	(1 500)	
Purchases of Inventory	(3 100)	
Wages	(3 740)	
Cartage Inwards	(1 400)	
Advertising	(800)	
Interest	(300)	
GST Paid	(3 380)	
Net Cash Flows from Operations		874
Cash Flows from Investing Activities		
Purchase of Van	(27 000)	
Net Cash Flows from Investing Activities		(27 000)
Cash Flows from Financing Activities		
Capital contribution	15 000	
Loan Borrowings – MNC Bank	20 000	
Drawings	(2 500)	
Loan Repayments – MNC Bank	(1 200)	
Net Cash Flows from Financing Activities		31 300
Net Increase / (Decrease) in Cash Position		5 174
Bank Balance at 1 April 2019		(4 110)
Bank Balance at 30 April 2019		1 064

1 mark – Cash Sales and GST Collected

1 mark – GST Refund and Receipts from Accounts Receivable

1 mark – Payments to Accounts Payable, Rent and Purchases of Inventory

1 mark – Wages

1 mark – Cartage Inwards, Advertising and Interest

1 mark – GST Paid

1 mark – Investing outflows

1 mark – Financing inflows

1 mark – Financing outflows

1 mark – final three lines

b. Explain to Katie, with the use of an example, how the Cash Flow Statement reported a Net Increase in Cash but the Income Statement can report a Net Loss for April 2019. 3 marks

Katie's Kitchens reported a Net Increase in Cash for April 2019 as the cash inflows were greater than the cash outflows. **(1 mark)**

Whereas, Katie's Kitchens reported a Net Loss for April 2019 as the expenses incurred were greater than the revenues earned. **(1 mark)**

This could have been due to the capital contribution and loan borrowings from MNC Bank which increased the cash yet had no direct impact on the calculation of the net loss. **(1 mark)**

Question 5 – Gerry's Garden Supplies (21 marks)

a. Explain why it is necessary for businesses to use a cost assignment method.

2 marks

A business would use a cost assignment method when it is not possible to identify the actual cost price of each item of inventory sold. **(1 mark)**

A cost assignment method is used in order allocate a cost price to each item of inventory sold so as to report a Cost of Sales value and calculate an accurate profit for a reporting period. **(1 mark)**

b. Identify the transaction that occurred on each of the following dates:

- **5 May 2019**
- **20 May 2019**
- **29 May 2018 Cheque 762**

3 marks

Date	**Transaction**
5 May 2019	Capital Contribution
20 May 2019	Purchase Return
29 May 2019 (Cheque 343)	Product Cost

1 mark – per entry

c. Calculate the net sales revenue for the 'Vista' pots for May 2019.

2 marks

Sales

03/05 2 units
13/05 6 units
24/06 1 unit

9 units @ $200 = $1 800 **(1 mark)**

Less: Sales Returns

17/05 3 units

3 units @ $200 = $600 **(1 mark)**

Net Sales = $1 200

d. Prepare the General Journal entry required on 31 May 2019 to record the result of the physical inventory count.

A narration is required.

3 marks

General Journal

Date	Details	Debit	Credit
31/05	Inventory Loss	210	
	Inventory		210
	Inventory loss of 3 'Vista' pots as per physical inventory count (Memo 55).		

1 mark – per line entry in General Journal

1 mark – narration including quantity, type of item, description of entry and memo

e. Explain what is meant by the term 'net realisable value'.

2 marks

Estimated selling price (excluding GST) **(1 mark)** less any costs incurred in the marketing, selling and distribution of the item. **(1 mark)**

f. State the effect on the accounting equation as a result of the inventory valuation.

3 marks

Element	Increase / Decrease / No Effect	Amount
Assets	Decrease	$200
Liabilities	No Effect	Nil
Owner's Equity	Decrease	$200

1 mark – per element

g. Discuss the effect of applying the lower of cost and net realisable value rule on the liquidity of Gerry's Garden Supplies. 4 marks

- **2 marks** – accurate description of the potential positive effects on liquidity
- **2 marks** – accurate description of the potential negative effects on liquidity

Note: It is important for responses to explain the potential positive and negative effects on the liquidity of the business as a result of applying the lower of cost and net realisable value rule and its impact on financial indicators.

Suggested Answer: When the lower of cost and net realisable value rule is applied, Gerry assumes that, by reducing the estimated selling price, the 5 pots will be likely to be sold more quickly. This will lead to an improvement in the inventory turnover as the inventory is being converted into sales and therefore cash faster, making it easier for the business to meet its short term debts as they fall due. However, the inventory write down of the 5 pots will result in a lower value of inventory being reported on the Balance Sheet. This will result in a lower Working Capital Ratio calculation which will be interpreted as having a negative impact on the liquidity of the business.

h. Explain why the value of the 'Vista' pot reported in the Balance Sheet may be higher using the FIFO cost assignment method compared to the Identified cost assignment method. 2 marks

As the supplier's prices are rising, under the FIFO cost assignment method, the older, cheaper unit costs are allocated as an expense in the order they are purchased. **(1 mark)**

This results in the most recent, more expensive unit costs being reported on the Balance Sheet compared to the specific cost prices under the Identified Cost assignment method remaining on hand at the end of the period which could be a combination of the cheaper and most recent cost prices. **(1 mark)**

Question 6 – Jack's Jackets (22 marks)

a. State one error that will not be detected by the preparation of a Trial Balance.

1 mark

- entering an incorrect amount for both the debit and credit
- entering a debit or credit in the wrong account
- the debit and credit entries are reversed
- omitting a transaction completely

b. Prepare the General Journal entry to close the revenue accounts on 30 June 2019. A narration is not required.

3 marks

General Journal

Date	Details	Debit	Credit
30/06	Cash Sales	4 080	
	Credit Sales	6 270	
	Discount Revenue	121	
	Sales Returns		870
	Profit and Loss Summary		9 601

1 mark – Cash Sales and Credit Sales

1 mark – Discount Revenue and Sales Returns

1 mark – Profit and Loss Summary

c. State one reason why revenue and expense accounts are required to be closed.

1 mark

- calculation of profit for the current reporting period
- return the revenue and expense accounts to zero in readiness for the commencement of the next period

d. Prepare the Income Statement for the month ended 30 June 2019.

9 marks

Jack's Jackets
Income Statement for the month ended 30 June 2019

	$	$
Revenues		
Cash Sales	4 080	
Credit Sales	6 270	
Less: Sales Returns	870	9 480
Less: Cost of Goods Sold		
Cost of Sales	6 320	
Freight Inwards	750	7 070
Gross Profit		2 410
Less: Inventory Loss	630	
Less: Inventory Write Down	1 080	1 710
Adjusted Gross Profit		700
Add: Other Revenues		
Discount Revenue		121
		821
Less: Other Expenses		
Advertising	900	
Discount Expense	143	
Freight Outwards	210	
Interest Expense	190	
Rent Expense	3 000	
Wages	4 020	8 463
Net Profit / (Loss)		(7 642)

1 mark – Cash Sales and Credit Sales

1 mark – Sales Returns

1 mark – Cost of Sales

1 mark – Freight Inwards

1 mark – Inventory Loss and Inventory Write Down

1 mark – Discount Revenue

1 mark – per any three Other Expense items

1 mark – remaining three Other Expense items

1 mark deducted – incorrect formatting such as missing headings and/or no Net Profit / (Loss)

e. Justify one strategy the business could introduce to reduce Sales Returns occurring in the future.

2 marks

Jack could improve packaging **(1 mark)** to reduce inventory being damaged in the delivery process. **(1 mark)**

OR

Jack could change supplier **(1 mark)** to reduce inventory being returned due to its poor quality. **(1 mark)**

f. Show how the Profit and Loss Summary and Capital accounts would appear in the General Ledger after all closing and transfer entries have been made on 30 June 2019.

You are not required to balance the Capital account.

6 marks

Profit and Loss Summary

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Expense Accounts	17 243	30/06	Revenue Accounts	9 601
				Capital	7 642
		17 243			17 243

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Profit and Loss Summary	7 642	01/06	Balance	18 546
	Drawings	2 000	8/06	Bank	15 000

1 mark – Revenue accounts entry

1 mark – Expense accounts entry

1 mark – Capital credit entry in Profit and Loss Summary ledger and Profit and Loss Summary debit entry in Capital ledger

1 mark – Opening Balance entry

1 mark – Bank entry

1 mark – Drawings

Question 7 – Susan's Stationery (6 marks)

a. Explain the importance of credit terms when assessing the Accounts Receivable Turnover of Susan's Stationery.

2 marks

In order to make a more accurate assessment of the trend in the Accounts Receivable Turnover, the current result needs to be compared with the credit terms offered. **(1 mark)**

Even though the trend in the Accounts Receivable Turnover is favourable due to the number of days declining from 35 days to 30 days, the outcome remains unfavourable as the number of days still exceeds the 21 days credit terms offered. **(1 mark)**

b. State one other benchmark Susan could use to assess her Accounts Receivable Turnover.

1 mark

- Industry Averages or other Similar Businesses
- Budget Estimates or Predicted Results

c. Explain the relationship between the trend in the Inventory Turnover and Gross Profit Margin.

2 marks

An increase in the Gross Profit Margin indicates and increase in the mark-up percentage most likely due to Susan's Stationery increasing their selling price. **(1 mark)**.

The increase in the selling price has resulted in Susan's Stationery selling fewer units of inventory which was reflected in the increase in the Inventory Turnover. **(1 mark)**.

d. State one strategy Susan could introduce to improve the Inventory Turnover without effecting the Gross Profit Margin.

1 mark

- employ strategies to increase sales, like advertising or changing the stock mix
- decreasing the level of stock on hand by ordering less, ordering smaller amounts more frequently, replacing slow moving stock lines
- relocating stock within the store to highlight particular goods

Total Exam 100 marks

END OF SUGGESTED SOLUTIONS