COMMERCE PRESENTATIONS AND PUBLICATIONS

VCE ACCOUNTING 3/4

CPAP Practice Examination No 4 2019

SUGGESTED SOLUTIONS & ADVICE

This exam is an updated version of the 2018 CPAP Exam 2 in accordance with the VCE Accounting Study Design for the accreditation period 2019 to 2023.

Question 1 – Heather's Hats (11 marks)

a. Prepare a classified Balance Sheet for Heather's Hats as at 1 January 2019.

7 marks

Advice: This type of question has appeared on the 2010 and 2014 VCAA exams with statistics showing students encountered major difficulties on both occasions. More recently, the 2018 VCAA June exam provided students with a list of transactions and required the preparation of a Balance Sheet. It is recommended that students draw up 'T' accounts, record each transaction separately and 'foot' each account in order to determine the balances to be recorded in the Balance Sheet.

Heather's Hats
Balance Sheet
as at 1 January 2019

	$	$		$	$
Current Assets			**Current Liabilities**		
Bank	11 580		Accounts Payable	22 000	
Inventory	20 000		Loan – MNC Bank	3 000	25 000
GST Clearing	3 220				
Prepaid Rent Expense	4 200	39 000			
Non-Current Assets			**Non-Current Liabilities**		
Office Equipment	1 500		Loan – MNC Bank		12 000
Shelving	8 000	9 500	**Owner's Equity**		
			Capital		11 500
Total Assets		48 500	**Total Equities**		48 500

1 mark – Bank

1 mark – Inventory and Accounts Payable

1 mark – GST Clearing

1 mark – Prepaid Rent Expense

1 mark – Office Equipment and Shelving

1 mark – Loan – MNC Bank split between Current and Non-Current Liabilities

1 mark – Capital

1 mark deducted – not having Total Assets and Total Equities label and totals

b. With reference to the qualitative characteristics of relevance and verifiability, discuss whether fair values should be used when non-cash assets are contributed to a business by their owner.

4 marks

Advice: The concept of fair values was not assessed by VCAA since moving towards a single exam in 2013. The 2012 Unit 3 exam required students to explain, with reference to one accounting assumption and two qualitative characteristics, the issues involved in determining the value at which a non-cash asset is recorded when contributed to a business by an owner. A common error for this type of question is for students to focus on two qualitative characteristics or two accounting assumptions. This is an interpretation error that could be overcome by students highlighting the key terms in the question once writing time commences. The use of the task word 'discuss' requires students to explain whether relevance or verifiability supports the use of fair values and which of these does not support the use of fair values.

Sample Answer: The qualitative characteristic of verifiability does not support the use of fair values. Verifiability outlines that for accounting data to be recorded it needs to be accurate so that all users will come to the same conclusion. (1 mark)

As fair value is the price that would be received if the asset was sold at the time it was transferred to the business, this amount may not be able to be verified by a source document through the auditing process and should therefore not be used. (1 mark)

However, 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)

Question 2 – Walter's Warehouse (6 marks)

a. Prepare the General Journal entries required to record all transactions from both sources documents.

Narrations are not required. 4 marks

Advice: A key knowledge dot point in Unit 4 Outcome 1 is the purchase of non-current depreciable assets for cash and financed by a loan. This question requires students to record both of these transactions. The initial borrowing of the funds as identified by the Bank Statement and the invoice provided by the supplier of the Equipment. The recording of a purchase of a non-current depreciable asset generally requires one additional amount to be included in the cost of the asset, such as the installation cost, whilst another additional amount, such as the 12-month service agreement, is required to be reported as a Current Asset and labelled 'Prepaid'.

General Journal

Date	Details	Debit	Credit
01/02	Bank	15 000	
	Loan – MNC Bank		15 000
01/02	Equipment	13 700	
	Prepaid Service Agreement	900	
	GST Clearing	1 460	
	Bank		16 060

1 mark – Bank and Loan – MNC Bank $15 000 entries

1 mark – Equipment and GST Clearing entries

1 mark – Prepaid Service Agreement

1 mark – Bank $16 060 entry

b. Explain how the above purchase demonstrates Walter's Warehouse's commitment to operating as an ethical trading business.

2 marks

Advice: The Study Design introduces the concept of ethical considerations and outlines that business decisions made by the owner will not only be influenced by financial considerations but also includes those which are social and environmental in nature. In addition, dot points throughout Units 3 and 4 make reference to ethical considerations when making business decisions in relation to operating a trading business, recording and reporting accounting information and strategies used to improve business performance. It is recommended that any response to a question involving an ethical consideration begins with an attempt to demonstrate an understanding of ethical considerations (perhaps via a definition) before specifically addressing the question in relation to the possible potential impact on society and the environment.

Sample Answer: Ethical considerations refer to the impact choices made by the business have on society and the environment. (1 mark)

By installing a solar panel energy system, Walter's Warehouse are choosing to source their energy needs from the sun rather than coal which will have a positive impact on the environment. (1 mark)

Question 3 – Tom's Tents (20 marks)

a. Using product costing, prepare the General Journal entries required to record the above transactions.

Narrations are not required.

14 marks

Advice: This is designed to be both an approachable yet challenging question. Many students should be able to record most of the transactions. However, the treatment of the *payment to Don's Deliveries*, the calculation of the *Cost of Sales for the Sales Return* and the treatment of the *damaged inventory* are expected to pose difficulty for students given the absence of an inventory card.

General Journal

Date	Details	Debit	Credit
09/03	Inventory	900	
	GST Clearing	90	
	Accounts Payable		990
09/03	Inventory	60	
	GST Clearing	6	
	Bank		66
14/03	Sales		1 650
	GST Clearing		165
	Accounts Receivable	1 815	
	Cost of Sales	492	
	Inventory		492
18/03	Sales Returns	330	
	GST Clearing	33	
	Accounts Receivable		363
	Inventory	96	
	Cost of Sales		96
18/03	Inventory Write Down	76	
	Inventory		76

1 mark – first Inventory and GST Clearing entries on 09/03

1 mark – Accounts Payable entry on 09/03

1 mark – second Inventory and GST Clearing entries on 09/03

1 mark – Bank entry on 09/03

1 mark – Sales and GST Clearing entries on 14/03

1 mark – Accounts Receivable entry on 14/03

1 mark – Cost of Sales entry on 14/03

1 mark – Inventory entry on 14/03

1 mark – Sales Returns and GST Clearing entries on 18/03

1 mark – Accounts Receivable entry on 18/03

1 mark – first Inventory entry on 18/03

1 mark – Cost of Sales entry on 18/03

1 mark – Inventory Write Down entry on 18/03

1 mark – second Inventory entry on 18/03

b. Discuss whether the use of both product costing and period costing satisfy the demands of the accrual basis assumption.

6 marks

Advice: It is likely that students who simply define the concepts of product costing, period costing and accrual basis assumption would be awarded only 3 marks. To be awarded full marks, students need to discuss whether product costing and period costing reflect the concept of allocating an expense incurred with the revenues earned in order to determine an accurate profit.

Sample Answer: A product cost is a cost incurred in getting the inventory into a condition or location ready for sale that can be directly traceable and allocated to each unit of inventory on a logical basis. This additional product cost is added to the original cost price of the unit of inventory sourced from the supplier in the inventory card and is included in the balance of Inventory on the Balance Sheet. This new cost price in the inventory card is only reported in the Income Statement under the heading of Cost of Goods Sold as Cost of Sales when the item is sold under the FIFO cost assignment method.

Whereas, a period cost is also a cost incurred in getting the inventory into a condition or location ready for sale, it can't be directly traceable or allocated to each unit of inventory as there is no logical basis to do so. These period costs are reported separately under the heading of Cost of Goods Sold in the Income Statement in the reporting period in which the expense is incurred, rather than when the individual unit of inventory is sold.

The adoption of product costing best satisfies the demands of the accrual basis assumption as it allocates the cost price under the FIFO cost assignment method as an expense incurred when the revenue is earned, namely, only when the item is actual sold. Whereas, period costing does not accurately satisfy the demands of the accrual basis assumption as, even though the cost is reported in the Income Statement in the reporting period it is incurred, this expense may not be matched against the revenue earned as the item may be sold in a future reporting period. When period costing is used a less accurate profit is reported as the expenses incurred are overstated and profit understated when compared to the adoption of product costing.

Question 4 – Pier's Pianos (6 marks)

a. State the nature of transaction (1) and transaction (2) in the GST Clearing account.

2 marks

Advice: A key knowledge dot point listed in Unit 3 Outcome 1 is the GST Clearing account. As transactions are posted to the General Ledger on the date they occur, the number of transactions that can appear in the GST Clearing account are limited. However, students need to be familiar with the format of the GST Clearing account and be able to explain what each of the transactions are. This approach was outlined in the 2019 VCAA Sample exam.

Transaction (1) – GST refund

Transaction (2) – GST incurred in credit purchase of Inventory

1 mark – per transaction

b. Prepare the General Journal entry required on 30 April 2019 to increase the Allowance for Doubtful Debts account for the current period. 2 marks

A narration is not required.

Advice 1: This is designed to be a discriminating question for students. It is important to note that the recording of Bad Debts as a debit and Allowance for Doubtful Debts as a credit (using the same amount, irrespective of whether it is $340 or not) should be sufficient to be awarded one mark. Of course, the inclusion of the correct amount of $340 will earn students the second mark.

Advice 2: The introduction of the creation of an allowance for doubtful debts using the Income Statement approach and the writing off of bad debts using the allowance method in the subsequent period has provided both teachers and students alike with confusion. A recommendation to adopt when completing any question involving the Allowance for Doubtful Debts is to reconstruct the account in the General Ledger.

General Journal

Date	Details	Debit	Credit
30/06	Bad Debts	340	
	Allowance for Doubtful Debts		340

1 mark – per line entry

Allowance for Doubtful Debts

Date	Cross-reference	Amount	Date	Cross-reference	Amount
12/04	Accounts Receivable	300	01/04	Balance	680
30/04	Balance	720	**30/04**	**Bad debts**	**?**
		1 020			1 020

($4 400 + $9 600) x 3 = Credit Sales of $42 000

Credit Sales of $42 000 less Sales Returns of $6 000 = Net Credit Sales of $36 000

Net Credit Sales of $36 000 x 2% = closing balance of Allowance for Doubtful Debts of $720

c. Referring to the Faithful Representation assumption, explain why it is important to report the Allowance for Doubtful Debts.

2 marks

Sample Answer: The Faithful Representation assumption requires that information reported represents the real-world event, is complete, free from material error and neutral (without bias). (1 mark)

The reporting of an Allowance for Doubtful Debts on the Balance Sheet ensures that users base their decisions on a historically based estimated amount of cash to be collected from outstanding Accounts Receivable balances rather than a belief that all of the outstanding balances will be collected within the next 12 months. (1 mark)

Question 5 – Mary's Magnets (22 marks)

a. Explain the benefit of preparing a Pre-adjustment Trial Balance.

2 marks

Advice: This question appeared in the 2017 VCAA exam with 71% of responses awarded zero marks and only 13% awarded full marks. It remains the case that, not only do students need to record accounting information and prepare reports, they also need to be able to explain all functions of an accounting system such as the uses of a Pre-adjustment Trial Balance compared with a Post-adjustment Trial Balance.

Sample Answer: The purpose of preparing a Pre-adjustment Trial Balance is to ensure the total of the debit balances from the General Ledger equal the total of the credit balances. (1 mark)

The benefit is to assist in ensuring that the double entry process has been done accurately, identifying any recording errors and taking corrective action prior to reports being prepared. (1 mark)

b. Calculate the carrying value for Equipment as at 30 June 2019.

4 marks

Existing Equipment

($14 900 - $4 400) x 20% = $2 100 per annum

$\frac{\$2\ 100}{12}$ = $175 per month

$175 x 6 months = $1 050 (January to June)

New Equipment

$9 000 x 20% = $1 800 per annum

$\frac{\$1\ 800}{12}$ = $150 per month

$150 x 3 months = $450 (April, May and June)

Depreciation expense for the six months ended 30 June 2019: $1 050 + $450 = $1 500

Equipment Cost $23 900 less Accumulated Depreciation ($4 400 + $1 500) = **$18 000**

1 mark – both annual amounts

1 mark – both monthly amounts

1 mark – correct allocation of months for both existing and new Equipment

1 mark – deduction of Accumulated Depreciation from Historical Cost

c. Prepare the General Journal entry required to close the Revenue accounts on 30 June 2019.

A narration is not required. **4 marks**

Advice: A common question that relates entirely to Unit 3. Students need to realise that Sales is not the only sources of revenue for a business. Students should scan the Trial Balance for other revenue items such as Inventory Gains, Interest Revenue and Profit on Disposal of a non-current asset that are required to be closed to the Profit and Loss Summary account at the end of each reporting period. Students are also guided by page 11 of the Study Guide which now outlines that only one General Journal entry is required to close all revenues (including Sales Returns) to the Profit and Loss Summary account, resulting in one entry in the General Ledger account.

General Journal

Date	Details	Debit	Credit
30/06	Sales	80 450	
	Sales Returns		1 740
	Discount Revenue	506	
	Interest Revenue	900	
	Profit and Loss Summary		80 116

1 mark – Sales

1 mark – Sales Returns and Discount Revenue entries

1 mark – Interest Revenue

1 mark – Profit and Loss Summary

d. Referring to the period assumption, explain the purpose of recording closing entries.
2 marks

Sample Answer: *The period assumption outlines that profit is determined by recognising the revenue for a period and deducting the expenses incurred for that same period. **(1 mark)***

*The purpose of closing entries is to ensure that only the revenues earned and the expenses incurred for the period are included in the calculation of profit by resetting the account balances of revenues and expenses to zero in readiness for the start of the next period. **(1 mark)***

e. Show how the Prepaid Rent Expense and Capital accounts would appear in the General Ledger at 30 June 2019 after all adjusting, closing and transfer entries have been posted.

You are not required to balance either account.

7 marks

Advice: This is a good example of students being required to complete General Ledger accounts. A recommendation is for students to practice completing common ledger account cross-references as this can make it easier to complete the exam within time constraints. Students' knowledge of a Pre-Adjustment Trial Balance is crucial for this question. Even though there is no General Journal provided, students are required to take into account the impact of any capital contributions made during the reporting period. The balance of Capital in the Pre-Adjustment Trial Balance reflects the opening balance of Capital plus any capital contributions made during the reporting period. The Drawings ledger account is an example of how the adjustments made in the General Journal effect the final balances of the accounts in the General Ledger at the end of each month.

Prepaid Rent Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	5 000	30/06	Rent Expense	16 200
01/02	Bank	33 600			

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Drawings	9 690	01/01	Balance	43 290
			14/06	Bank	15 000
			30/06	Profit and Loss Summary	24 006

1 mark – per entry

f. Explain the effect on the Accounting equation of recording cheque 197 in the Cash Payments Journal.

3 marks

Sample Answer: The recording cheque 197 will decrease Assets (Cash at Bank) by $1 800. (1 mark)

Liabilities (Accrued Wages) would decrease by $1 500. (1 mark)

Owner's Equity would decrease by $300 as this amount represents Wages expense for July which will decrease profit. (1 mark)

Question 6 – Westy's Wallets (9 marks)

a. Reconstruct the Accounts Receivable ledger in order to calculate budgeted Receipts from Accounts Receivable for the year ended 30 June 2020.

4 marks

Advice: Templates! Templates! Templates! These are common exam questions that require the careful reading of questions during reading time where difficult concepts need to be identified and applied to the scenario presented.

ACCOUNTS RECEIVABLE

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	0		Bank	299 500
	Credit Sales	300 000		Discount Expense	3 000
	GST Clearing	30 000		Sales Returns	5 000
				GST Clearing	500
				Balance	22 000
		330 000			330 000

1 mark – Credit Sales and GST Clearing

1 mark – Discount Expense

1 mark – Sales Returns and GST Clearing

1 mark – Closing Balance

b. Prepare the Net Cash from Operations extract from the Budgeted Cash Flow Statement for the year ended 30 June 2020.

5 marks

Advice: The rules of accrual accounting still apply when budgeted reports are prepared. The completion of a budgeted report or extract requires the same skill set for that of student asked to complete a report at the end of a reporting period.

Westy's Wallets
Budgeted Cash Flow Statement (extract)
for the year ended 30 June 2020

	$	**$**
Cash Flow From Operating Activities		
Receipts from Accounts Receivable	299 500	
Payments to Accounts Payable	(203 500)	
Advertising	(9 000)	
General Expenses	(7 500)	
GST Paid	(4 950)	
GST Settlements	(3 050)	
Interest Paid	(3 000)	
Prepaid Rent Expense	(18 000)	
Wages	(35 000)	
Net Cash from Operations		15 500

1 mark – Receipts from Accounts Receivable

1 mark – Payments to Accounts Payable

1 mark – GST Paid

1 mark – per any three remaining Operating outflows

1 mark – remaining three Operating outflows

1 mark deducted – not having Net Cash from Operations and total providing mark has not already been deducted in Question 1A

Question 7 – Brian's Bargains (6 marks)

a. Explain the implication of the change in the Debt Ratio on the Cash Flow Cover.

2 marks

Sample Answer: A higher Debt Ratio means the business has a greater reliance on borrowed funds. The increase in the Debt Ratio has seen a decline in the Cash Flow Cover. Due to the increase in borrowings, a larger proportion of the Net Cash Flows from Operations is being used to repay current liabilities, as reflected in the Cash Flow Cover from 2018 to 2019. (1 mark)

This can be due to a combination of an increase in interest paid on the borrowings reducing the Net Cash Flows from Operations and the increase in loan repayments increasing the Current Liabilities. (1 mark)

b. Explain one consequence for a business that is experiencing a decline in its liquidity.

2 marks

Sample Answer: If there is a decline in liquidity this could result in the business not being able to meet their immediate or short-term debts as they fall due. (1 mark)

Consequences include suppliers removing credit facilities, the owner being required to make continued capital contributions, the selling of non-current assets or the advance of a loan or a bank overdraft. (1 mark)

c. Justify one strategy Brian could consider to improve the liquidity of his business.

2 marks

Sample Answer: Assuming Brian sells inventory on credit, he could offer discounts to accounts receivable customers (1 mark) to encourage prompt payments and improve cash flowing into the business. (1 mark)

OR

Assuming Brian purchases inventory on credit, he could delay payment until the final due date (1 mark) to help keep cash in the business longer to assist the business in meeting their short-term debts as they fall due. (1 mark)

Question 8 – Jordan's Jackets (15 marks)

a. Prepare the necessary General Journal entries required on 30 June 2018 in relation to both Vans.

Closing entries are not required.

13 marks

Advice: When recording the disposal of a non-current asset, the asset needs to be depreciated up until the date of disposal. An additional suggestion when students are required to record the General Journal entries relating to the purchase and disposal of a non-current asset would be to sketch the necessary General Ledger accounts, namely the Disposal of Van account. This may allow students to feel more comfortable in determining which entries require a debit entry and which entries require a credit entry.

General Journal

Date	Details	Debit	Credit
30/06	Depreciation Expense – Van	4 200	
	Accumulated Depreciation - Van		4 200
	Disposal of Van	36 000	
	Van		36 000
	Accumulated Depreciation - Van	10 500	
	Disposal of Van		10 500
	Van	20 000	
	Disposal of Van		20 000
	Loss on Disposal – Van	5 500	
	Disposal of Van		5 500
	Van	12 000	
	GST Clearing	3 200	
	Bank		15 200

1 mark – per line entry

b. With reference to your answer in part a., explain why a Profit or Loss on disposal of the Van occurred.

2 marks

Sample Answer: A Loss on Disposal occurred as the agreed trade-in allowance of the Van was less than its carrying value. (1 mark)

This might be due to under depreciating the Van due to over estimating the Vans useful life and/or residual value or the Van was in poorer condition than expected when it was traded-in. (1 mark)

Question 9 – Cheadle's Candles (5 marks)

a. Explain the difference between the concepts of 'profit' and 'profitability'.

2 marks

Advice: This is an excellent example of how students can approach an exam with a series of memorised responses to common theory questions. A common SAC and Trial Exam question, this question appeared in the VCAA 2010 Unit 4 exam with 32% of responses being awarded zero marks, yet 33% being awarded full marks.

Sample Answer: Profit is calculated by deducting expenses incurred from revenues earned in the current reporting period and is expressed as a dollar amount. (1 mark)

Whereas, profitability compares the profit the business earns to a base figure such as sales, capital or assets and is generally expressed as a percentage. (1 mark)

b. Explain how it is possible for the Return on Assets to improve even though the Net Profit Margin declined.

2 marks

Advice: Again, just like part a., this is a common SAC and Trial Exam question where students are encouraged to prepare memorised responses. There are a series of questions which involve two of the three following profitability indicators - Return on Assets, Net Profit and Asset Turnover. Whenever two of the three profitability indicators are included in the question, students are required to address the third or 'missing' indicator. Students should practice all combinations and all movements in the indicators.

Sample Answer: When the Net Profit Margin decreases and the Return on Assets increases it means that the Asset Turnover has increased, meaning that sales have increased by a greater percentage than the percentage increase in assets. (1 mark)

Even though the Asset Turnover has increased, it is the worsening of expense control that has caused the Net Profit Margin to decrease. However, the increase in the Asset Turnover has had a proportionally larger impact than the decrease in the Net Profit Margin, resulting in an increase in the Return on Assets. (1 mark)

c. State one other benchmark Don could use to assess the profitability of his business.

1 mark

Advice: The purpose of this question is to test student's knowledge of the difference between an indicator and a benchmark. Some students may provide the Gross Profit Margin or the Return on Owner's Investment as their response. However, these would be marked incorrect as these are indicators of profitability and not a benchmark. The other key word in this question is 'other'. Students are required to provide another benchmark not specified in the question. As the question provides results for 2018 and 2019, a student who provides 'previous reporting periods' would also be penalised.

Sample Answer:

- *budget*
- *industry average*

100 marks

END OF SOLUTIONS