ACCOUNTING
Units 3&4 – Written Examination

*(*TSSM's *2011 trial exam updated for the current study design)*

SOLUTIONS

Question 1 (7 marks)
General Journal

Date	**Details**	**General Ledger**	
		Debit	**Credit**
01/01	Accounts Receivable	3 850	
	Inventory	32 890	
	Furniture and Fittings	17 800	
	Office Equipment	5 200	
	Cash at Bank		3 810
	Accounts Payable		15 400
	GST Clearing		5 300
	Loan – EZY Bank		15 000
	Capital		20 230

- **1 mark** – calculation of Accounts Receivable
- **3 marks** – Inventory/ Furniture and Fittings / Office Equipment
- **1 mark** – Cash at Bank / GST Clearing / Loan – EZY Bank
- **1 mark** – calculation of Accounts Payable
- **1 mark** – calculation of Capita

Question 2 (10 marks)

a.

Date	Details	In			Out			Balance		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Jan 1	Balance							4	70	280
04/01	Inv.410				2	70	140	2	70	140
09/01	Inv.3145	8	90	720				2	70	
								8	90	860
19/01	Memo 86				2	70	140			
					2	90	180	6	90	540
26/01	Memo 99				1	90	90	5	90	450
31/01	Memo 108				1	90	90	4	90	360

5 marks

- **1 mark** – line per entry

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b.

Element	Overstated / Understated / No Effect
Assets	Overstated
Liabilities	No Effect
Owner's Equity	Overstated

2 marks

- **1 mark** – Assets
- **1 mark** – Owner's Equity
- **Deduct 1 mark if 'No effect' not written for Liabilities**

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c.

Accounting Entity **(1 mark)**

The business is assumed to be separate from the owner. **(1 mark)**

Therefore, when the inventory was withdrawn by the owner, it is no longer recognised as an asset of the business, but rather owned by the owner. **(1 mark)**

Question 3 (11 marks)

a.

Date 2019	Details	IN Qty	IN Unit cost	IN Value $	OUT Qty	OUT Unit cost	OUT Value $	BALANCE Qty	BALANCE Unit cost	BALANCE Value $
18/06	Inv.390				2	70	140	10	70	700
19/06	C/N 76	1	70	70				11	70	770
22/06	C/N 67				1	70	70	10	70	700

2 marks

1 mark –per completed entry

b.

General Journal

Date 2019	Details	General Ledger Debit $	General Ledger Credit $	Subsidiary Ledger Debit $	Subsidiary Ledger Credit $
18/06	Sales Returns	150			
	GST Clearing	15			
	Accounts Receivable		165		
	Inventory	70			
	Cost of Sales		70		
22/06	Accounts Payable	77			
	Inventory		70		
	GST Clearing		7		

4 + 3 = 7 marks

1 mark –Sales Returns
1 mark –GST Clearing
1 mark –Accounts Receivable
1 mark –Inventory and Cost of Sales entry
1 mark –Accounts Payable
1 mark –Inventory
1 mark –GST Clearing

c. **State** two changes George can make to his management of inventory to reduce sales returns.

1 + 1 = 2 marks

Improve quality of products / improve packaging / improve delivery and ordering efficiency / change supplier

Question 4 (21 marks)

a. **State** two reasons to explain how the Net Profit Margin improved yet the Gross Profit Margin declined.

1 + 1 = 2 marks

- ↓ in Inventory Loss or Inventory Write-Down
- ↑ in Other Revenue
- improvement in expense control

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b. **Explain** to Harriett how it is possible for a business to have an increase in profitability even though there has been a decrease in profit.

2 marks

Profitability is the ability of a business to earn profit and is measured by comparing the profit relative to another measure allows for comparisons between different businesses and different periods.**(1 mark)**

Even though there is a decrease in the profit,

- if profit decreased by a lesser percentage than the decrease in sales
- if profit decreased by a lesser percentage than the decrease in average assets or owner's equity

profitability will increase. **(1 mark)**

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c. **Explain** why the Return on Owner's Investment is a more important indicator of business performance than Return on Assets.

2 marks

Return on Owner's Investment identifies the relationship between Net Profit and the actual investment made by the owner. Return on Assets identifies the relationship between net profit and value of assets. **(1 mark)**

The owner is more interested in the return from their investment (capital) as opposed to the return on their assets amount to evaluate whether the owner should continue their investment in the business as the asset value may be financed by external debt.
(1 mark)

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d. **Explain** the difference between the concepts of 'liquidity' and 'stability'.

2 marks

Liquidity is the ability of the business to meet its short-term debts as they fall due. **(1 mark)**

Whereas stability refers to the ability of the business to meet its debts and continue its operations in the long-term.**(1 mark)**

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e. **State** two negative consequences of the trend in working capital.

2 marks

Too much money tied up in Cash at Bank, Inventory or Accounts Receivable. **(1 mark)**

- Increase in storage costs
- Greater chance of damage, shoplifting and obsolescence
- Increase chance in bad debts, debt collection fees and legal costs **(1 mark for one of these or a valid point)**

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f. **State** one limitation of using the Working Capital Ratio as an indicator of business liquidity.

1 mark

The Working Capital Ratio is a static measure that does not take into consideration the speed in which accounts receivable and inventory are being turned into cash.

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g. **State** one other key indicator that could be used when assessing business liquidity.

1 mark

Quick Asset Ratio or Cash Flow Cover

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h. **State** one advantage and one disadvantage of being the owner of a business with a high Debt Ratio.

1 + 1 = 2 marks

Advantage

- businesses can use borrowed funds to invest in more Assets to generate a higher profit

Disadvantage

- more reliant on loans from banks so the business will have higher interest payments

- **1 mark –** per identification of advantage and then disadvantage

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i. **State** two strategies Harriet might introduce to improve the trend in the Accounts Receivable Turnover.

1 + 1 = 2 marks

- reduce credit terms
- better screening of accounts receivable
- follow up sales with reminder notices and phone calls
- prepare an accounts receivable Analysis
- endeavour to collect outstanding debts promptly

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j. **Discuss** how the trend in Account Receivable Turnover could have a negative effect on both the liquidity and profitability of the business.

4 marks

Liquidity
Accounts Receivable are being received at a slower rate,**(1 mark)** which means the business may have difficulty purchasing inventory and paying accounts payable and expenses **(1 mark)**

- the business may have to go into overdraft or taking out a short-term loan to pay for these items**(1 mark)**

Profitability

- negative effect on profitability because cash from accounts receivable is being received at a slower rate and outside the credit terms, which means there might be a greater likelihood of bad debts which would increase expense and decrease profit **(1 mark)**

- business may be generating high sales volumes, but it might be because the selling price is too low / business might be holding too little inventory / costs such as delivery may be higher (because deliveries are more frequent) **(1 mark)**

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k. **State** one limitation of ratio analysis.

1 mark

- Based on historical data
- Changes in accounting methods
- Frequency of reporting
- Limited understanding of users

Question 5 (21 marks)
a.
General Journal

Date	Details	General Ledger	
		Debit	**Credit**
28/02	Cash Sales	8 600	
	Credit Sales	13 200	
	Discount Revenue	120	
	Interest Revenue	20	
	Profit and Loss Summary		21 940

3 marks

- **1 mark** – Cash Sales and Credit Sales
- **1 mark** – Discount Revenue and Interest Revenue
- **1 mark** – Profit and Loss Summary

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b.

- returning account balances to zero for the beginning of the next reporting period**(1 mark)**

- only transactions for the current reporting period are included in the reporting process and calculation of profit**(1 mark)**

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c.

Abby's Appliances
Income Statement for month ended 28 February 2019

	$	$
Revenue		
Cash Sales	8 600	
Credit Sales	13 200	21 800
***Less:* Cost of Goods Sold**		
Cost of Sales	10 900	
Cartage Inwards	960	
Buying Expenses	280	12 140
Gross Profit		9 660
Less: Inventory Loss		210
Adjusted Gross Profit		9 450
Plus: Other Revenue		
Discount Revenue	120	
Interest Revenue	20	140
		9 590
***Less:* Other Expenses**		
Advertising	760	
Bad Debts	440	
Cartage Outwards	340	
Depreciation – Furniture and Fittings	75	
Depreciation – Office Equipment	65	
Discount Expense	190	
Insurance Expense	100	
Interest Expense	260	
Rent	2 500	
Wages	6 100	10 830
Net Loss		(1 240)

7 marks

1 mark – Revenues
1 mark – total Cost of Goods Sold items
1 mark – Inventory Loss
1 mark – Other Revenue items
2 marks – Other Expenses items per five items
1 mark – formatting of report

d.

Wages

Date	Cross-reference	Amount	Date	Cross-reference	Amount
28/02	Accrued Wages	1 800	28/02	Profit and Loss Summary	6 100
	Bank	4 300			
		6 100			6 100

Profit and Loss Summary

Date	Cross-reference	Amount	Date	Cross-reference	Amount
28/02	Expense Accounts	23 180	28/02	Revenue Accounts	21 940
				Capital	1 240
		23 180			23 180

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
28/02	Drawings	500	01/02	Balance	49 160
	Profit and Loss Summary	1 240			
	Balance	47 420			
		49 160			49 160
			1/03	Balance	47 420

3 + 3 + 3 = 9 marks

- **1 mark** – per line entry
- **1 mark deducted** – no total in Wages OR no total in Profit and Loss Summary or no total in Capital

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Question 6 (2 marks)

Item	Actual $	Budget $	Variance $	F/U
Sales	$820 000	$775 000	$45 000	F
Gross Profit	$425 000	$390 000	$35 000	F
Advertising	$26 000	$21 000	$5 000	U
Wages	$83 000	$96 000	$13 000	F

2 marks

1 mark – per two correct entries

Question 7
a.
General Journal

Date	**Details**	**General Ledger**	
		Debit	**Credit**
09/07	Cartage Inwards	130	
	Inventory	5 100	
	GST Clearing	523	
	Accounts Payable – KR America		5 753

Product: 'Fallon Flip'

Date	**Details**	**In**			**Out**			**Balance**		
2019		**Qty**	**Cost**	**Total**	**Qty**	**Cost**	**Total**	**Qty**	**Cost**	**Total**
08/07	Balance							5	100	500
0907	Inv.476	30	110	3 300				5	100	500
								30	110	3 300

6 marks

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b. **Explain** the effect on profit if period costing is used instead of product costing.

2 marks

Profit will be reduced or understated by using period costing instead of product costing.

Period costing will recognise the expense as incurred regardless of the number of items sold, thereby increasing/overstating Cost of Goods Sold and decreasing/understating Net Profit.

Product costing only recognises the expense as incurred when the actual item is sold.

1 mark –identifying that profit would be understated
1 mark –explanation of impact on Cost of Goods Sold

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c. **Discuss** whether the accountant should apply product costing to the cost of the display cards.

4 marks

Under product costing, all costs incurred in getting the tables into a condition and location ready for sale that can be directly traceable and allocated to each individual item are included in calculating the cost each table. **(1 mark)**
Even though the display card can be directly traceable and allocated to each individual unit of inventory on a logical basis, the display cards are only 16 cents each. **(1 mark)**

As they represent an insignificant amount, they are not useful for the decision making process of determining an accurate cost price **(1 mark)** and should be written off as a Period Cost and recognised entirely as an expense under the heading of Cost of Goods Sold. **(1 mark)**

Question 8 (9 marks)

a.

Delivery Van

Date 2019	Cross-reference	Amount $	Date 2019	Cross-reference	Amount $
01/10	Balance	24 000	31/10	Disposal of Delivery Van **(1)**	24 000
31/10	Bank**(1)**	27 400			

Accumulated Depreciation – Delivery Van

Date 2019	Cross-reference	Amount $	Date 2019	Cross-reference	Amount $
31/10	Disposal of Delivery Van **(1)**	22 000	01/10	Balance	21 600
			31/10	Depreciation – Delivery Van **(1)**	400

Disposal of Delivery Van

Date 2019	Cross-reference	Amount $	Date 2019	Cross-reference	Amount $
31/10	Delivery Van	24 000	31/10	Accumulated Depreciation – Delivery Van **(1 entire line)**	22 000
				Bank **(1)**	1 000
				Loss on Disposal – Delivery Van **(1)**	1 000
		24000			24 000

2 + 2 + 3 = 7 marks

1 mark deducted – no totals in Disposal of Delivery Van ledger

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b. **Explain** why a profit or a loss on the disposal of the Delivery Van occurred.

2 marks

Carrying value greater than disposal amount.
Under depreciated asset over its effective life **(1 mark)** due to over-estimating either the estimated residual value or estimate effective life. **(1 mark)**
OR
The delivery van may have been in poor condition **(1 mark)** or this model may have been in low demand or superseded by a new model. **(1 mark)**

Question 9 (7 marks)
a.

Calculation Cost - $22 NRV - $18 $4 x 34	
Inventory Write Down	$136

2 marks

1 mark –calculation of $4 inventory write down
1 mark –multiplication of inventory write down by 34 units

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b. With reference to an appropriate qualitative characteristic, **explain** why inventory is valued at the lower of cost and net realisable value.

1 + 2 = 3 marks

Relevance/Faithful Representation

Using a more conservative inventory valuation allows the users of the reports to make informed decisions. The reports are also prepared to more faithfully represent the real world economic event that they represent, and are more likely to be free from material error or bias.

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c. **State** two reasons for the net realisable value of a product being lower than its cost price.

1 + 1 = 2 marks

Damaged / obsolete / out of season or fashion/ deliberate marketing strategy

100 marks