ACCOUNTING

Units 3&4 – Written Examination

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Creating VCE Success

(TSSM's 2012 trial exam updated for the current study design)

SOLUTIONS

Question 1 (12 marks)
a.

General Journal

Date 2019	**Details**	**General Ledger Debit**	**Credit**
25/2	Inventory	4 400	
	GST Clearing	400	
	Bank		4 800
26/2	Advertising	120	
	Inventory		120
27/2	Account Payable – Trounce Corp	6 600	
	Discount Revenue		132
	Bank		6 468
28/2	Delivery Van	18 000	
	Capital		18 000

8 marks

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b. **Discuss** the conflict between the Qualitative Characteristics of Verifiability and Relevance if assets are valued at agreed values.

4 marks

When an asset of the owner is contributed to a business an estimate (agreed value) of its value is made in an attempt to provide a relevant value for the balance sheet.

The qualitative characteristic of Verifiability states that for information to be reported to users it must be relied upon for accuracy.

Information is verifiable if it can be verified against a business document as this avoids the use of estimates.

The estimate of fair value will not satisfy the demands of verifiability as there are no source documents available to verify the actual value of the asset at the time it was contributed to the business.

In order to satisfy the demands of relevance, a reasonable estimate may be adopted as the agreed value of an asset so that meaningful information can be reported in the balance sheet of the business.

Question 2 (18 marks)

a.

Accounts Receivable

Date	**Cross-reference**	**Amount**	**Date**	**Cross-reference**	**Amount**
1/7/19	Balance	12 000	30/6/20	Bad Debts	2 750
30/6/20	Sales/GST Clearing	242 550		Discount Expense	1 200
				Bank	**220 600**
				Balance	30 000
		254 550			254 550

6 marks

Inventory

Date	**Cross-reference**	**Amount**	**Date**	**Cross-reference**	**Amount**
1/7/19	Balance	10 000	30/6/20	Drawings	12 000
30/6/20	Inventory	180 000		Inventory Loss	900
	Bank	50 000		Cost of Sales	47 250
				Cost of Sales	110 250
				Balance	**69 600**
		240 000			240 000

3 marks

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/6/20	Discount Revenue	1 200	1/7/19	Balance	15 000
	Bank	**166 800**	30/6/20	Inventory/GST Clearing	198 000
	Balance	45 000			
		213 000			213 000

3 marks

b. Budget preparation relies on estimating figures. While the owner may identify this as a breach of reliability they must take into account the concept of relevance. Budgets are prepared to plan for the future and to be used as a control mechanism. Planning can involve staff rostering and purchasing decisions while the figures can be checked regularly against actual reports to determine whether the business has met its goals. As budgets are prepared on a regular basis and the accuracy can be improved by identifying variances against actuals and amending future budgets.
Students are required to discuss the relationship between relevance and verifiability and faithful representation as well as the reasons for preparing budgets in order to maximise their marks.

6 marks

Question 3 (11 marks)

a. **Record** these two transactions into the Inventory Card provided.

2 marks

Product: 'Clean Skin Electric Razor'

Date	Details	In			Out			Balance		
2019		**Qty**	**Cost**	**Total**	**Qty**	**Cost**	**Total**	**Qty**	**Cost**	**Total**
01/07	Balance							4	28	112
02/07	Inv.4988	16	30	480				4	28	
								16	30	592
05/07	Inv.2395				4	28				
					2	30	172	14	30	420
08/07	C/N 42	1	28					1	28	
		2	30	88				16	30	508
10/07	C/N 588				3	30	90	1	28	
								13	30	418

b. **Record** the transaction on 8 July 2019 into the General Journal.

A narration is **not** required.

5 marks

General Journal

Date	**Details**	**General Ledger**	
		Debit	**Credit**
08/07	Sales Returns	180	
	GST Clearing	18	
	Accounts Receivable		198
	Inventory	88	
	Cost of Sales		88

3c. **Referring** to one Qualitative Characteristic, **explain** the benefit of reporting Sales Returns separately in the Income Statement each reporting period.

1 + 3 = 4 marks

Relevance **(1 mark)**
By reporting Sales Returns separately it provides additional information to the owner that will be useful for decision making **(1 mark).**

The Sales Returns account will provide the owner with an indicator of the suitability of inventory / levels of customer satisfaction **(1 mark).**

The higher the value of sales returns the lower the customer satisfaction levels / the lower the value of sales returns the higher the customer satisfaction levels **(1 mark).**
OR
The owner will then be able to take action to reduce Sales Returns in the future by changing supplier, change delivery company or improve packaging or efficiency of ordering process **(1 mark).**

Question 4 (15 marks)

a. Excluding posting to incorrect accounts, **state** two reasons why errors can still be present despite a Trial Balance balancing.

1 + 1 = 2 marks

- using the wrong amount for a transaction in both the debit and credit entries
- reversing the debit and credit entries of a particular transaction
- omitting a transaction
- recording the same transaction twice

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b.

Clare's Chairs
Income Statement for month ended 31 August 2019

	$	$
Revenue		
Cash Sales	4 260	
Credit Sales	5 640	9 900
***Less:* Cost of Goods Sold**		
Cost of Sales	4 950	
Cartage Inwards	970	5 920
Gross Profit		3 980
Plus: Inventory Gain		150
Adjusted Gross Profit		4 130
Plus: Other Revenue		
Discount Revenue	130	
Interest Revenue	120	250
		4 380
***Less:* Other Expenses**		
Advertising	750	
Bad Debts	130	
Cartage Outwards	400	
Discount Expense	320	
Interest Expense	300	
Office Supplies	420	
Rent Expenses	1 900	
Wages	3 200	7 420
Net Loss		3 040

6 marks

c. Referring to your Income Statement prepared in **4b**, **explain** how you have classified Cartage Inwards and Cartage Outwards in your Income Statement for the month ended 31 August 2019.

2 marks

Cartage Inwards is reported under the heading of Cost of Goods Sold as it is a cost incurred in getting the inventory into a location ready for sale.

Cartage Outwards is reported under the heading of Other Expenses as it is a cost incurred after the actual sale was made.

d.

Drawings

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/08	Bank	100	31/08	Capital	500
	Inventory	400			
		500			500

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/08	Drawings	500	01/08	Balance	8 885
	Profit and Loss Summary	3 040	31/08	Cash at Bank	12 000
	Balance	17 345			
		20 885			20 885
			1/9	Balance	17 345

2 + 3 = 5 marks

Drawings amount in Capital General Ledger consequential of Drawings General Ledger.

Profit and Loss Summary amount in Capital General Ledger consequential of Income Statement result.

Question 5 (4 marks)

a. **Explain** how an increase in Sales could actually lead to a decrease in the Gross Profit Margin.

2 marks

Selling prices may have been decreased, with no change in the cost prices from suppliers.

With a lower selling price the business may have been able to attract significantly more customers and therefore overall Total Sales may have increased.

OR

As cost prices may not have changed and selling prices were decreased, this would mean that the Gross Profit Margin would fall, as the average mark-up of the business would have fallen over the period.

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b. **State** two reasons that explain how the Net Profit Margin improved yet the Gross Profit Margin declined.

1 + 1 = 2 marks

- Improved expense control
- Profit on Disposal of Non-Current Asset
- Inventory Gain
- Discount Revenue

Question 6 (10 marks)

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

1 mark

The Working Capital Ratio is a static or historical measure of the level of liquidity of a business and does not take into account the speed at which the business is able to generate cash to meet their debts as and when they fall due.

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b. **State** a specific item and **explain** why that specific item is excluded from the calculation of the Quick Asset Ratio compared to the Working Capital Ratio.

1 + 1 = 2 marks

Inventory is excluded as it cannot be liquidated in order to meet the immediate debts of the business when they fall due**.**

Accept both Prepayments with appropriate explanation.

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

1 mark

Cash Flow Cover

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d. **Discuss** how high levels of debt can affect both the liquidity and profitability of a business.

4 marks

Liquidity

High levels of debt would worsen the liquidity of the business.

The more a business is required to repay, the less cash it will have to meet other short term debts as and when they fall due.

Profitability

High levels of debt would worsen the profitability of the business.

As the business has high levels of debt, the more the business will be charged in interest and therefore would reduce its profitability. Secondly, as the business would have poor liquidity, it would not be able to make prompt payments to accounts payable to take advantage of discounts.

Alternatively, if these borrowings are used to purchase revenue generating non-current assets, the profitability of the business could improve should the percentage increase in Profit be greater than the percentage increase in Sales.

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e. **State** two potential negative effects of improving the business's Inventory Turnover.

1 + 1 = 2 marks

By selling inventory in fewer numbers of days and/or reducing its average inventory holdings, the business runs the risk of running out of a particular inventory line**.**

If a particular inventory line runs out, a customer may seek an alternative supplier and this customer may be lost to the business**.**

The increased costs incurred in ordering more inventory (delivery charges) that could lead to a decrease in profit**.**

Question 7 (19 marks)

a. **Reconstruct** the Accounts Receivable Account to calculate budgeted Receipts from Accounts Receivable.

4 marks

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
1/7/19	Balance	40 640	30/6/20	Discount Expense	10 000
30/6/20	Sales **(1)**	535 000		**Bank**	**573 900**
	GST Clearing **(1)**	53 500		Balance	45 000
		629 140			629 140
1/7/20	Balance	45 000			

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b. **Reconstruct** the Inventory Account and Accounts Payable Account to calculate budgeted Payments to Accounts Payable.

7 marks

inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
1/7/19	Balance	32 690	30/6/20	Cost of Sales	267 500
30/6/20	Accounts Payable	278 810		Drawings	3 000
				Inventory	6 000
				Balance	35 000
		311 500			311 500
1/7/20	Balance	35 000			

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/6/20	**Bank**	**304 901**	1/7/19	Balance	28 210
	Balance	30 000	30/6/20	Inventory	278 810
				GST Clearing	27 881
		334 901			334 901
			1/7/20	Balance	30,000

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c. **Prepare** the Budgeted Cash Flows from Operations extract from the Budgeted Cash Flow Statement for the year ending 30 June 2020.

6 marks

Christine's Coats
Budgeted Cash Flow Statement (extract) for the year ended 31 December 2020

	$	$
Cash Flow from Operating Activities		
Receipts from Accounts Receivable	566 640	
Payments to Accounts Payable	(304 901)	
Advertising	(25 000)	
Interest Paid	(2 400)	
Prepaid Insurance	(3 300)	
Other Expenses	(80 000)	
Wages Paid	(63 100)	
GST Paid	(12 830)	
GST Clearing	(26 750)	
Net Cash flows from Operations		48 359

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d. **Explain** how the Budgeted Cash Flow Statement can be used to facilitate control during the budget period.

2 marks

Decision-making: Budgeted amounts can be compared to actual amounts during a budget period and can be used to identify areas of concern

Planning: By setting targets, control may be achieved over cash payments thus improving performance.

Question 8 (5 marks)
Prepare the necessary Journal entries on 15 October 2019 in relation to the purchase of the new Delivery Van.

A narration is **not** required.

General Journal

Date	**Details**	**General Ledger**	
		Debit	**Credit**
15/10	Delivery Van	42 050	
	Prepaid Insurance and Registration expense	750	
	GST Clearing	4 280	
	Bank		47 080

- **1 mark** for each line entry except Delivery Van worth 2 marks

Question 9 (6 marks)

a. **State** how the $4 800 received would be classified in the Cash Flow Statement of Ian's Industries.

1 mark

Investing Inflow

b. **Show** how the Disposal of Delivery Van ledger account would appear on 31 October 2019 after the Journal entries relating to the sale of the Delivery Van have been posted.

3 marks

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Disposal of Delivery Van

Date 2019	Cross-reference	Amount	Date 2019	Cross-reference	Amount
31/10	Delivery Van	34 890	31/10	Acc. Dep. – Delivery Van	27 690
				Bank	4 800
				Loss on Disposal – Delivery Van	2 400
		34 890			38 890

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c. **Explain** why a profit or a loss on the Disposal of the Delivery Van occurred.

2 marks

A Loss on Disposal occurred as the sale value of the delivery van was less than its carrying value.

This might be due to under depreciating the asset due to over estimating the asset's useful and/or residual value.

OR

The delivery van was in poorer condition than expected when it was sold.

100 marks