2019 VCE Accounting examination report

General comments

The 2019 Accounting examination was the first examination for the 2019–2023 study design. The significant additions to the new study design were four accounting assumptions, six qualitative characteristics, a second inventory method and ethical considerations in relation to business decisions. All of these areas were examined in 2019.

The 2019 examination consisted of nine questions, each containing several parts. For the first time, students were asked to consider an ethical issue in relation to a business scenario. The issue was in relation to how inventory was stacked in the business, along with a decision by the owner to change the inventory valuation method being used. This question tested students' knowledge in relation to inventory valuation. The Identified Cost method of inventory valuation was also new. There were misconceptions held by some students about the First In, First Out (FIFO) inventory method; it appears that the Identified Cost method is also not well understood. This is the most accurate method of valuing inventory as it is based on the actual cost price of each individual item. Therefore, no matter which item is selected by a customer (whether it be on top of the stack, the front or the back), under Identified Cost the actual cost price would be recorded as the cost of the sale. Many students argued that faithful representation had been breached by the way the owner had stacked the inventory and valued cost of sales. As Identified Cost was being applied, cost prices would be 100% accurate and therefore faithful representation had been met. However, the change in inventory method was the key to this question as this would make comparisons of results difficult to interpret and therefore comparability would be breached.

Teachers and students are strongly advised to ensure that both methods of inventory valuation are fully understood. Ethical issues are now an integral part of the study.

An income statement was included in this examination, along with an extract from both a cash flow statement and a balance sheet. Depreciation under both methods was also examined. However, disposal of a non-current asset did not make an appearance this year. It is timely to remind students that not all areas of the course are examined each year. Sometimes a full cash flow statement will be required. Students should always revise all areas of the course, knowing that some topics may not be part of their examination.

Question 9 compared two possible outcomes for a business based on budgeted data. Students were asked to compare the two proposals, analyse the budgeted results and make a recommendation to the owner. Students should be prepared to consider 'what if' scenarios and provide an analysis of financial data. When doing so, responses should always be supported by evidence and students should not hesitate to provide pros and cons of a business decision. For example, Option A may show a higher profit but Option B may provide greater opportunities for future growth. A simplistic approach would be to simply compare two profit figures. Students are encouraged to explore all possibilities when considering such questions.

Specific information

This report provides sample answers or an indication of what answers may have included. Unless otherwise stated, these are not intended to be exemplary or complete responses.

The statistics in this report may be subject to rounding resulting in a total more or less than 100 per cent.

Question 1a.

Marks	0	1	2	3	Average
%	5	7	25	63	**2.5**

Inventory Card

Item: Racing Plus video game **Cost Assignment Method: Identified Cost**

Code: RP2018

Supplier: XA Imports

Date 2019	Document	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Mar. 1	**Balance**							**10** **5**	**45** **47**	**450** **235**
3	**CrN. 23**	**1**	**45**	**45**				**11** **5**	**45** **47**	**495** **235**
6	**Inv. 564**				**3** **2**	**45** **47**	**135** **94**	**8** **3**	**45** **47**	**360** **141**
12	**Memo 43**				**8** **3**	**20** **22**	**160** **66**	11	25	275
14	Chq. 355	3	20	60				11 3	25 20	225 60
22	Memo 46				2	25	50	9 3	25 20	225 60
30	Memo 47	1	25	25				10 3	25 20	250 60

This question required students to enter the details of three different transactions into the inventory card. One mark was awarded for each correct entry. The first two transactions were handled well by most students. However, the third entry, that of an inventory gain, often included the incorrect cost price, with some students entering this item in the 'Out' column.

Question 1b.

Marks	0	1	2	Average
%	27	35	38	**1.1**

3 March: A credit note was issued to a customer for a sales return of one copy of Racing Plus, which had a cost price of $45.

12 March: All 11 copies of Racing Plus were written down to $25 each, which is lower than their cost price, as per the lower of Cost and NRV rule.

The first point to note in this question is that students were instructed to describe, not just state. They were therefore required to describe the nature of each transaction in full. Although most students could identity the transaction on 3 March as a sales return, some thought it was a return to a supplier. Some responses for 12 March indicated that it was a drawings or advertising entry, which was incorrect. This was not possible as there were no inventory items with cost prices of $20 or $22.

Question 1c.

Marks	0	1	2	Average
%	30	17	53	**1.3**

Inventory

Date 2019	Cross-reference	Amount	Date 2019	Cross-reference	Amount
			Mar 12	Inventory Writedown	226

Inventory Writedown

Date 2019	Cross-reference	Amount	Date 2019	Cross-reference	Amount
Mar 12	Inventory	226			

This question was handled well by most students, with the double entry for an inventory writedown being fairly straightforward. However, some students were confused with the response required for Question 1b. and, as a consequence, did not complete the entries required in Question 1c. Students and teachers should note that consequential errors are not penalised and if, for example, a student thought the March 12 entry was drawings, they should have provided the double entry for drawings in part c.

Question 1d.

Marks	0	1	2	3	Average
%	52	17	15	16	**1**

Income Statement: An increase in expenses of $226 – inventory writedown, which will lower gross profit and net profit by $226.

Balance Sheet: Current Asset – Inventory would be decreased by $226 and owner's equity would decrease by $226 because of the decrease in net profit.

Cash Flow Statement: No effect as an inventory writedown is a non-cash item.

This question required students to describe the effect of an inventory writedown on each of the three financial reports. Students are advised to consider all three reports in this type of question and, when describing the changes in the balance sheet, should clearly describe both sides of the report. That is, the effect on assets and owner's equity in this case.

Question 1e.

Marks	0	1	2	3	Average
%	58	20	15	7	**0.7**

The Working Capital Ratio (WCR) and Quick Asset Ratio (QAR) are both measures of liquidity but are based on different financial data. The WCR includes all current assets but the QAR excludes inventory and prepaid expenses. For the WCR to decrease without impacting on the QAR, the owner may have decided to drastically reduce the level of inventory being carried. This change could also be affected by inventory writedowns and the consumption of prepaid expenses. These three factors all decrease the WCR, without affecting the QAR.

Some responses to this question referred to the slow inventory turnover rate, which would lead to an increase in current assets, resulting in an increase in the WCR. This type of response contradicted the data provided in the question, as the WCR decreased over time. Students are reminded to read questions carefully so their responses are in line with the data provided by indicators.

Question 2a.

Marks	0	1	2	3	4	5	6	7	Average
%	30	11	8	8	10	10	13	9	**2.9**

Students are expected to use their knowledge of double entry to find 'missing information' in the ledger accounts. Marks were allocated as follows:

- two marks for the accounts receivable account
- three marks for the inventory account
- two marks for the accounts payable account.

Students are reminded that correctly determining the cash outflow to accounts payable usually requires that the inventory account is completed first, followed by accounts payable.

Freja's Furniture

General Ledger

Accounts Receivable

Date 2019	Cross-reference	Amount	Date 2019	Cross-reference	Amount
1/10	Balance	28 000	31/12	Bank	98 000
31/12	Sales/GST Clearing	88 000	31/12	Balance	18 000
		116 000			116 000
1/1	Balance	18 000			

Accounts Payable

Date 2019	Cross-reference	Amount	Date 2019	Cross-reference	Amount
31/12	Inventory/GST Clearing	6600	1/10	Balance	60 000
	Bank	222 015	31/12	Inventory/GST Clearing	245 300
	Discount Revenue	11 685			
	Balance	65 000			
		305 300			305 300
			1/1	Balance	65 000

Inventory

Date 2019	Cross-reference	Amount	Date 2019	Cross-reference	Amount
1/10	Balance	22 000	31/12	Cost of Sales	210 000
31/12	Accounts Payable	223 000		Inventory Loss	4 000
				Accounts Payable	6 000
				Balance	25 000
		245 000			245 000
1/1	Balance	25 000			

Question 2b.

Marks	0	1	Average
%	88	12	**0.1**

Working space	
GST on advertising	$1 500
GST on Prepaid advertising	$ 450
Total GST paid	$1 950
GST paid on cash payments	$1 950

Many students did not accurately determine the GST paid on cash payments. The GST settlement is not included as part of this calculation. Students should note that there is no GST recorded on cost of sales or on the inventory loss.

Question 2c.

Marks	0	1	2	3	4	5	6	Average
%	39	10	11	11	13	10	8	**2.1**

Freja's Furniture

Cash Flow Statement (extract) for the three months ended 31 December 2019

Cash Flows from Operations	$	$
Cash Sales		320 000
GST received		32 000
Accounts Receivable		98 000
Accounts Payable		(222 015)
Advertising		(19 500)
Wages		(55 200)
GST Paid		(1 950)
GST Settlement		(31 350)
Net Cash Flow from Operations		$119 985

The six marks available on this question were allocated as follows:

- one mark for both cash sales and GST received
- one mark for both accounts receivable and accounts payable
- one mark for each of advertising, wages, GST paid and GST settlement.

Students should be reminded to include all information determined in Question 2a. in the Cash Flow Statement, as consequential errors are not penalised when information is transferred from one part of a question to the next. When preparing accounting reports, students should note that headings are expected as part of the format of these reports and marks may be lost if these formal headings are not included.

Question 2d.

Marks	0	1	2	3	4	Average
%	48	15	17	11	9	**1.2**

Net profit is based on accrual concepts and only revenue earned and expenses incurred are considered. The Cash Flow statement only includes cash in and cash out and does not consider the concept of profit under accrual accounting. An income statement also includes non-cash items such as inventory loss, which is not a cash flow and is therefore not included in the calculation of net cash from operating activities. This could result in cash from operating activities being greater than the net profit earned for the period. If there are significant accruals then expenses incurred may be more than the cash paid for expenses and cash from operations could then exceed net profit. Also, the receipts from accounts receivable could also be greater than the current period's credit sales as collections could include receipts from the previous period's sales. This too could cause net cash from operating activities to be greater than the net profit reported for the period.

Question 3a.

Marks	0	1	2	Average
%	24	37	39	**1.2**

The Cash Flow Cover shows the number of times the business's cash from operations can cover the current liabilities in a reporting period. Going 321 has seen a decline in this indicator from seven times to four times to 0.6 times over the three-month period. This represents deterioration in the liquidity of the business, as at the end of June it cannot cover its current liabilities. This means that the business will have great difficulty in meeting its short-term debts as they fall due.

Students are advised that in responding to this type of question they should focus on identifying the trend and then explaining fully what the trend indicates for the business under consideration. A full explanation is required, rather than simply stating that a number went from seven to four to 0.6.

Question 3b.

Marks	0	1	2	Average
%	22	28	50	**1.3**

Reason 1: The business took out a new loan, which would lead to an increase in the current liabilities of the business.

Reason 2: The business may have suffered from a significant decrease in cash sales, which would lead to a decline in the amount reported as cash flows from operating activities.

Question 3c.

Marks	0	1	2	3	Average
%	28	22	24	26	**1.5**

The business could put in place strategies to increase both cash sales and credit sales. However, the focus should be on increasing cash sales so that slow paying accounts receivable do not create a further issue. They should consider promotions designed to bring in more cash customers to the business, including ‘2 for 1’ offers or special bulk deals. Perhaps cheaper prices for customers paying cash could also be considered. Expenses should also be reviewed to ensure there is no unnecessary spending in the next quarterly period. These strategies should help ensure that net cash flows from operating activities increase and therefore help improve the Cash Flow Cover in the coming months.

Question 4a.

Marks	0	1	2	3	4	5	6	7	8	9	10	Average
%	15	10	10	8	7	7	7	7	10	11	8	4.7

Klapper Bikes

General Journal

Date 2019	Details	Debit $	Credit $
Jun 30	Advertising	2 500	
	Prepaid Advertising		2 500
Jun 30	Rent Expense	5 500	
	Accrued Rent		5 500
Jun 30	Wages	2 000	
	Accrued Wages		2 000
Jun 30	Accrued Interest Revenue	300	
	Interest Revenue		300
Jun 30	Depreciation of Vehicles	3 000	
	Acc. Depreciation of Vehicles		3 000

Five general journal entries were required for this question, with each double entry being allocated two marks. A variety of responses were assessed with a full range of marks being awarded. Common errors included:

- reversing some of the entries, especially the accrued expenses
- incorrectly calculating the interest revenue
- incorrectly calculating the depreciation for the period
- using incomplete or incorrect titles (e.g. depreciation expense).

Question 4b.

Marks	0	1	2	3	Average
%	26	18	25	31	**1.6**

Accounting assumption: Accrual Basis Assumption

Explanation: These entries are necessary to adjust the revenue and expense accounts to the amounts earned and incurred for the period. This ensures that both revenues and expenses are faithfully measured so that an accurate profit can be determined. This meets the demands of the accrual basis assumption, which defines profit as revenue earned less expenses incurred.

Question 4c.

Marks	0	1	2	3	4	5	Average
%	23	10	17	15	16	18	**2.5**

Klapper Bikes

Income Statement for the month ended 30 June 2019

	$	$
Sales		900 000
Cost of Sales		450 000
Gross Profit		450 000
Plus other revenue		
Interest Revenue		300
		450 300
Less Expenses		
Advertising	2 500	
Wages	192 000	
Rent Expense	5 500	
Depreciation of Vehicles	3 000	203 000
Net Profit		$247 300

The five marks for this question were allocated as follows:

- one mark for Sales Revenue
- one mark for Cost of Sales and Gross Profit
- one mark for Interest Revenue and the subsequent sub-total
- one mark for Wages
- one mark for the remaining three expenses.

The format of the income statement is specified in the study design. Teachers and students are encouraged to revisit these specifications to ensure that full marks can be achieved. Labels such as 'gross profit', 'other revenues' and 'net profit' should be used when required.

Question 5a.

Marks	0	1	2	Average
%	34	18	48	**1.2**

Outside Climber

General Journal

Date 2019	Details	Debit $	Credit $
30/6	Bad Debts	1 800	
	Allowance for Doubtful Debts		1 800

Two marks were available for this question and a calculation was required to determine the dollar value of the entry. However, the calculation must be based on net credit sales; many students forgot to deduct the sales returns as part of their workings.

Question 5b.

Marks	0	1	2	3	4	Average
%	26	18	19	21	16	**1.9**

Outside Climber

General Journal

Date 2019	Details	Debit $	Credit $
18/7	Allowance for Doubtful Debts	2 500	
	GST Clearing	250	
	Accounts Receivable		2 750
31/7	Bad Debts	4 000	
	Allowance for Doubtful Debts		4 000

This topic is new to the study design and it was evident that some students still need more work to be confident with these entries. A common error was to omit the adjustment to the GST Clearing account before writing off the bad debt against the allowance. Once the bad debts have been written off, the adjustment to the allowance can be determined. This question provoked a wide range of responses. Teachers are encouraged to revisit this area of the study.

Question 5c.

Marks	0	1	2	Average
%	33	35	32	1

Outside Climber

Balance Sheet (extract) as at 31 July 2019

Current Assets	$	$
Accounts Receivable	135 000	
Less Allowance for Doubtful Debts	(3 300)	131 700

This question required students to demonstrate how accounts receivable is presented in a balance sheet when an allowance for doubtful debts has been created. Some responses did not include the allowance as a separate item. This must always be done, with the net amount also being shown in the current assets section of the balance sheet.

Question 6a.

Marks	0	1	2	3	4	Average
%	14	7	13	34	33	2.7

YYY

General Journal

Date 2019	Details	Debit $	Credit $
1/4	Machinery	206 000	
	GST Clearing	20 600	
	Bank		226 600

Question 6a. was a test of how to treat the installation of machinery. As both the purchase of the machine and its installation was paid on the one date, it is acceptable to join the two payments into the total cost of the machinery. Some responses separated the two payments into two journal entries, which is also acceptable. What is not acceptable is the creation of an installation account. The cost of the installation becomes part of the machinery account, as it is a one-off cost to get the asset into a revenue earning capacity.

Question 6b.

Marks	0	1	2	3	4	Average
%	28	11	16	9	35	**2.1**

Straight-line method	**Reducing balance method**
206 000 – 11 600 = 194 400 194 400 / 10 years = 19 440 pa 3 months = 19 440 / 4 = 4 860	25% on cost = 206 000 * 0.25 = 51 500 51 500 / 4 = 12 875
$ 4 860	$ 12 875

This question provided an excellent example for students in relation to showing working. If the depreciation value was incorrect and no workings were shown, the response received zero marks. However, if workings were shown and some were correct, partial marks could be awarded. Two marks were allocated to the straight-line method, with another two for the reducing balance method.

Question 6c.

Marks	0	1	2	3	4	Average
%	21	20	23	23	13	**1.9**

The accountant is correct. Both methods will allocate the same total amount of depreciation over the life of the machinery. However, the amount of depreciation being allocated each period will be very different, depending on the method of depreciation selected. The reducing balance method allocates more depreciation in the early years of an asset's life, and less in the latter years. The straight-line method allocates the same amount of depreciation in every period until the asset reaches its residual value. The method chosen should be based on the revenue-earning pattern of the non-current asset. In the case of machinery, the reducing balance method should be selected as machinery usually generates more revenue in its early years and less as the asset gets older. Regardless of the method selected, after ten years the carrying value of the machine will be exactly the same.

Question 7a.

Marks	0	1	2	3	4	Average
%	36	10	16	10	27	**1.8**

The business is changing to the Identified Cost method of inventory valuation. The owner is also trying to ensure that items bought at the lowest cost are sold first. If this goal is achieved the result will be a lower cost of sales figure and therefore a higher profit result for the period. The inventory on hand, being the older inventory, will be valued at the higher cost prices, which will result in a higher inventory value at the end of the period. Of course, it does not matter which inventory method is used as the actual inventory flow may be very different to the owner's plan. However, if the owner achieves their objective, a higher profit will be determined, with a higher inventory value being reported in the balance sheet.

The owner's change in inventory method, along with their unusual approach to stacking inventory, provoked a variety of responses, with many students coming to the conclusion of lower cost of sales and higher inventory values. Some of the higher-scoring responses also included comments relating to the change of valuation methods not necessarily meaning that the actual flow of inventory will match the owner's plans. This is an important point to note: FIFO does not mean that the oldest inventory will be sold first and the owner's plans in this case do not necessarily mean that the latest purchases will be sold first.

Question 7b.

Marks	0	1	2	3	4	5	Average
%	29	21	21	16	9	4	**1.7**

If the owner is attempting to sell their business by inflating profits and inventory values, it clearly creates an ethical issue. A prospective buyer may be tricked into paying an inflated price for the business while under a misconception of its value. However, if the business is not sold in the near future, this plan may backfire. Once the cheaper inventory has been sold, the business may be stuck with the more expensive items of inventory. Given that it is selling health products, which usually have use-by-dates, the decision of the owner may be short-sighted. The items remaining have a higher cost price, will be closer to their use-by-date and the owner may be desperate to sell them, which could create a second ethical issue. Does the owner inform their customers that the goods on hand are older? Does he discount the selling price to try to get rid of these units? This may have a negative impact on profit but it may also cause damage to the reputation of the business.

With regard to qualitative characteristics of accounting, the owner is satisfying faithful representation by changing to the Identified Cost method. This is the most accurate method of inventory valuation as it is based on the actual cost prices of the inventory being sold. However, by changing inventory methods the owner may be in danger of breaching the QC of comparability. Changing methods will make the comparison of results from period to period very difficult. This adds to the ethical dilemma created by the owner's approach to inflating profits. This would make it even more difficult for a prospective owner to make an informed decision about buying the business. The owner has clearly created an ethical dilemma and perhaps should be more open and honest and not change inventory methods because of this.

A number of approaches were taken in response to this question. The discussion shown above is typical of many responses, however, other responses to this question were also acceptable.

Question 8a.

Marks	0	1	2	3	Average
%	10	9	23	58	**2.3**

General Journal

Date 2019	Details	Debit $	Credit $
30/6	Drawings	1 000	
	Wages		1 000
	Correcting entry – drawings incorrectly debited to wages (Memo X4)		

One mark was allocated for the debit entry, one for the credit entry and one for a detailed narration. Note that the Memo number should be quoted as part of the narration in such an entry. The majority of students handled this question very well.

Question 8b.

Marks	0	1	2	Average
%	37	33	31	**1**

Overall this will have no effect. Wages expense will decrease by $1000, leading to an increase in net profit and owner's equity of $1000. However, drawings will also increase by $1000, which will offset the increase in net profit by the same $1 000. Therefore, overall there is no effect on the total value of owner's equity.

Some students only noted the increase in drawings, while others only noted the decrease in wages and therefore an increase in profit. When dealing with a correcting entry, both the debit and credit entries should be considered in terms of their effect on the balance sheet.

Question 9a.

Marks	0	1	2	3	4	Average
%	13	2	13	10	62	**3.1**

	Current budget 100 000 units	**Option A 120 000 units**	**Option B 140 000 units**
Revenue			
Sales	$700 000	$840 000	$980 000
less Cost of Sales	$315 000	$361 200	$392 000
Gross Profit	385 000	$478 800	$588 000

Expenses	$		
Rent	$45 000	$45 000	$65 000
Wages	$140 000	$184 800	$245 000
Advertising	$70 000	$92 400	$127 400
Total expenses	$255 000	$322 200	$437 400
Budgeted Net Profit	**$130 000**	$156 600	$150 600

Question 9a. was allocated four marks and was typical of many budget-based questions with a ‘what if’ scenario being posed. Many students handled this part of the question well and made accurate calculations for the two options being considered.

Question 9b.

Marks	0	1	2	3	4	5	6	Average
%	16	10	20	24	17	9	4	2.6

There were many different approaches to this question and a variety of responses scored highly. Some of the higher-scoring responses included comments such as:

- Option A was recommended as it provides the higher budgeted profit.
- Option A is superior as it avoids the additional costs of moving to larger premises.
- Option B requires significantly higher expenses to generate 40 000 more sales (in units).
- Option B is expected to generate a higher gross profit.
- Option B provides an opportunity to grow the business in the future.
- Option B creates a chance of developing a greater share of the market.
- If expenses can be controlled more effectively in the future, with an increased sales volume Option B may be the better choice in the long run.

The key to achieving high marks on this type of question was to explore all possibilities, consider all alternatives and think beyond the obvious response. That is, students should not just select an option with higher profit without considering other factors, such as those outlined above.