Quality Assessment Tasks

NAME: ________________________

VCE® Accounting

Units 3 & 4 Practice Examination

Reading time: 15 minutes

Writing time: 2 hours

QUESTION BOOK

Number of questions	*Number of questions to be answered*	*Number of marks*
10	10	100

- Students are permitted to bring into the examination room: pens, pencils, highlighters, erasers, sharpeners and rulers.
- Students are NOT permitted to bring into the examination room: blank sheets of paper and/or white out liquid/tape.

Materials supplied
- Question book of 11 pages.
- Answer book of 17 pages.

Instructions
- Write your **student name** in the space provided above on this page and on the answer book.
- All written responses must be in English.

At the end of the examination
- Place the answer book inside the front cover of this book.

Students are NOT permitted to bring into the examination room mobile phones and/or any other unauthorised electronic devices.

 Ser11ACU34EA

Question 1 (12 marks)

Ralph Lauren owns Ralph's Rugs.

On 1 January 2019 Ralph contributed his own Van to his business.

Ralph originally purchased the Van in 2016 for $41 000 plus GST.

As at 1 January 2019 Ralph believes the fair value of the Van is $15 000.

a. Explain how Ralph should determine the appropriate method of depreciation for the Van.

Refer to alternative methods of depreciation in your answer. 4 marks

Ralph has chosen to report the Van in the Balance Sheet of Ralph's Rugs at 1 January 2019 as $41 000.

b. Explain how the Van should be classified in the Balance Sheet of Ralph's Rugs as at 1 January 2019. 3 marks

c. Prepare the necessary correcting entry required on 1 January 2019 in relation to Ralph's valuation of the Van.

A narration is **not** required. 2 marks

d. Referring to one qualitative characteristic, explain why it would be unethical of Ralph if he continued to report the Van on the Balance Sheet of Ralph's Rugs at its original cost.

3 marks

Question 2 (7 marks)

The following Inventory card relates to the ‘Hemsworth’ mirror for January 2019.

ITEM: ‘Hemsworth’ mirror								**Cost method:** Identified Cost		
		IN			**OUT**			**BALANCE**		
Date	Document	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
01/01	Balance							6	280	1 680
06/01	Inv.2091				2	280	560	4	280	1 120
12/01	Inv.864	10	310	3 100				4	280	1 120
								10	310	3 100
15/01	Inv.2106				2	280	560	2	280	560
								10	310	3 100
17/01	C/N.32	1	280	280				3	280	840
								10	310	3 100
19/01	Memo 87				1	280	280	2	280	560
								10	310	3 100
31/01	Inv.2119				1	310	310	2	280	560
								9	310	2 790
31/01	Memo 89				1	310	310	2	280	560
								8	310	2 480

Morgan’s Mirrors sells each ‘Hemsworth’ mirror for $770 including GST.
Memo 89 refers to the result of a physical inventory count.

a. Calculate the Adjusted Gross Profit made by Morgan’s Mirrors from selling the ‘Hemsworth’ mirror for the month ending 31 January 2019. 4 marks

b. Explain the effect on the value of the ‘Hemsworth’ mirror as at 31 January 2019 if Morgan’s Mirrors used the First In, First Out cost method instead of the Identified cost method. 3 marks

Question 3 (22 marks)

Cindy Chan owns and operates Cindy's Chairs, a small business which sells chairs and that applies a fixed mark-up of 150%.

The following source documents relate to the final week of March 2019.

IMAN PLASTICS

Date 24/03/19 **Invoice:** 879

Charge to Cindy's Chairs

Item	Qty	Unit Cost	$
'Don Jr' Chair	25	40	1 000
'Eric' Chair	15	60	900
		GST(10%)	190
		Total Owing	2 090

2/7, n/30

CINDY'S CHAIRS

Date 25/03/19 **Invoice:** 206

Charge to Leslie School

Item	Qty	Unit Cost	$
'Elaine' Chair	310	50	15 500
		GST(10%)	1 550
		Total Owing	17 050

2/7, n/30

CCA BANK
Bank Statement

Account Name: Cindy's Chairs

Date	Particulars	Debit	Credit	Balance
26/03	ATO Deposit		1 278	5 039 Cr

CINDY'S CHAIRS

Date 27/03/19 **Credit Note:** 17

Credit to Leslie School

Item	Qty	Unit Cost	$
'Elaine' Chair	10	50	500
		GST(10%)	50
		Total Owing	550

Date 28 March 2019
To Ray White
For April's Rent
Amount $3 300 inc. GST
Cheque Number 528
Cindy's Chairs

Question 3 - continued

Date	29 March 2019
To	N.Brown
For	Wages
Amount	$1 600
Cheque Number	529
Cindy's Chairs	

Cindy's Chairs
5/18 Joyce Road **Date:** 30 March 2019
Mulgrave VIC 3170

TO: Leslie School **RECEIPT:** 402

FOR: Outstanding Account

AMOUNT: $16 170

a. Explain, with reference to one reason, why Cindy's Chairs received a GST refund from the Australian Taxation Office on 26 March 2019. 3 marks

b. Record each source document in the General Journal.

Narrations are **not** required. 17 marks

c. Explain how a Bank Statement assists with Cindy's Chairs' internal control. 2 marks

Question 4 (4 marks)

The Debt Ratio of Bob's Books has increased from 45% in 2018 to 80% in 2019.

a. Explain how the trend in the Debt Ratio could positively impact Bob's Return on Owner's Investment. 2 marks

b. Explain how the trend in the Debt Ratio could negatively impact the stability of Bob's Books. 2 marks

Question 5 (13 marks)

The Bank account in the General Ledger of Louisa's Ladders for the month of May 2019 appears as follows.

Bank

Date	**Cross-reference**	**Amount**	**Date**	**Cross-reference**	**Amount**
01/05	Balance	6 080	03/05	Accounts Payable	7 546
02/05	Loan – CCA Bank	15 000	04/05	Accrued Advertising / GST Clearing	1 980
05/05	Cash Sales / GST Clearing	2 310	09/05	Inventory / GST Clearing	4 620
06/05	Accounts Receivable	5 390	14/05	Wages	980
15/05	Unearned Sales Revenue	4 000	17/05	Drawings	1 400
16/05	Disposal of Van	22 000	18/05	Van / GST Clearing	35 750
19/05	Capital	10 000	21/05	GST Clearing	3 166
25/05	Cash Sales / GST Clearing	924	24/05	Loan – CCA Bank	500
			24/05	Interest Expense	300
			26/05	Accounts Payable	1 650
			28/05	Equipment / GST Clearing	5 632
			29/05	Wages	1 030
			31/05	Balance	1 150
		65 704			65 704
01/06	Balance	1 150			

a. Prepare the Cash Flow Statement for the month ending 31 May 2019. 10 marks

b. Explain, with the use of one reason, why Louisa's Ladders reported a Net Profit in the Income Statement for the month endng 31 May 2019 yet the Cash Flow Statement reported a negative Net Cash from Operations for the same period. 3 marks

Question 6 (4 marks)

Harley Davidson owns Harley's Hats.

One of Harley's inventory items is the 'Norman' hat imported from Canada.

Harley has provided you with the following information as at 30 June 2019.

Model	Quantity as per Inventory Card	Quantity as per Inventory Count	Purchase Price per Hat	Import Duties per Hat
'Norman' Hat	6	5	$60 plus GST	$4

Additional information

- Each 'Norman' hat will have its selling price reduced from $132 including GST to $44 including GST (Memo 616).
- With each 'Norman' hat sold, Harley will provide a free scarf to the customer. Each scarf cost Harley's Hats $15 plus GST.

a. Calculate the Net Realisable Value of one 'Norman' hat. 1 mark

b. Prepare the necessary General Journal entry as a result of the valuation of the 'Norman' hats.

A narration **is** required. 3 marks

Question 7 (15 marks)

John Deere, the owner of John's Jackets, has provided the following Pre-Adjustment Trial Balance extract.

John's Jackets
Pre-adjustment Trial Balance (extract) as at 30 June 2019

Account	Debit	Credit
Accounts Receivable	5 500	
Allowance for Doubtful Debts		230
Cash Sales		3 000
Credit Sales		14 000
Interest Revenue		150
Sales Returns	500	
Term Deposit	30 000	

Additional information

- Reports are prepared on a quarterly basis.
- Term Deposit with CCA Bank earns 6% interest per annum received half-yearly on 30 April and 31 October.
- Malcolm Gibson's debt of $2 200 including GST needs to be written off.
- John has a policy of reporting 2% of Net Credit Sales as a doubtful debt each period.
- Advertising owing to AAA Advertising as at 30 June 2019 was $880 including GST.

a. Prepare the necessary balance day adjustments in the General Journal.

Narrations are **not** required. 8 marks

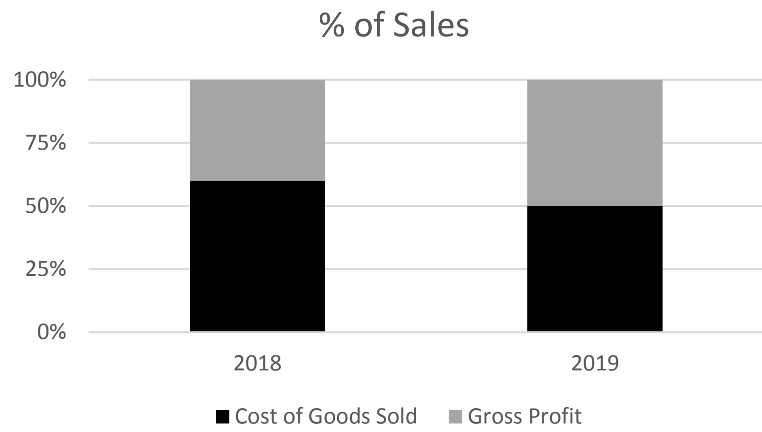
b. Referring to one accounting assumption, explain the purpose of preparing balance day adjustments. 3 marks

On 6 July 2019 AAA Advertising were paid $1 320 including GST with cheque 883.

c. Record cheque 883 in the General Journal. A narration is **not** required. 4 marks

Question 8 (8 marks)

Selina Spanos, the owner of Selina's Stationery, has been presented with the following.



a. Explain whether Selina's Stationery's mark-up percentage has increased or decreased from 2018 to 2019. 2 marks

b. Explain how an increase in the mark-up percentage could actually lead to a decrease in Gross Profit. 2 marks

c. Discuss the effect of using product costing instead of period costing on a business' Gross Profit Margin when not all the inventory purchased in the period has been sold. 4 marks

Question 9 (6 marks)

Tiffany Ko owns Harley's Hats, a small business that prepares reports on an annual basis.

On 1 January 2018 Harley's Hats purchased a Van for $55 000 including GST.

The Van has an effective life of 4 years and a residual value of $12 000.

On 30 June 2019 Harley's Hats sold the Van for $25 000.

a. Complete the Disposal of Van account in the General Ledger. 4 marks

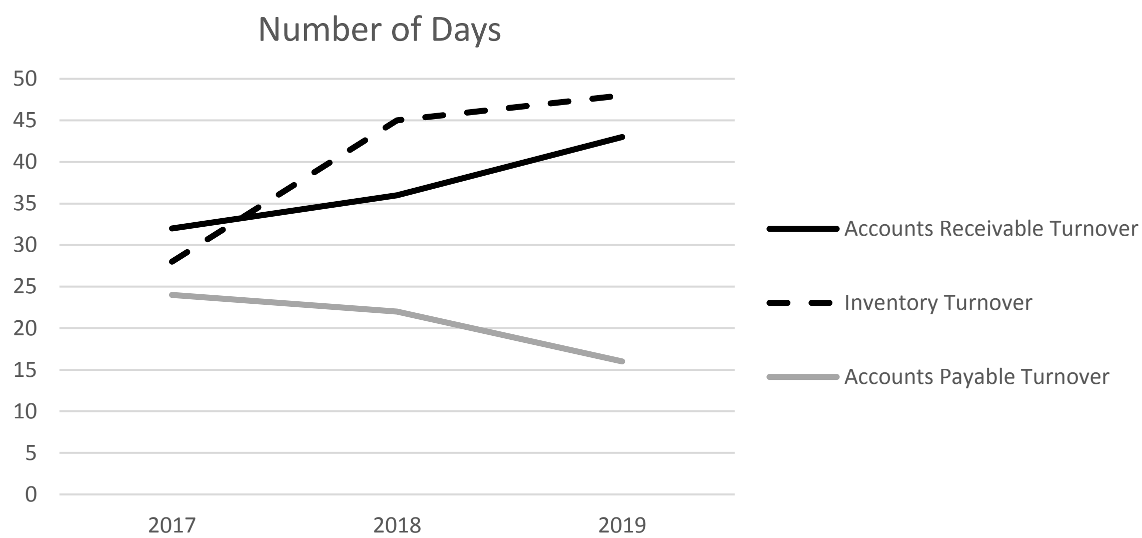
b. With reference to your answer in part a., explain why a Profit or a Loss on Disposal of the Van occurred. 2 marks

Question 10 (9 marks)

Di Natalie owns Di's Desks, a small business that offers their customers' credit terms of 2/7, n/30.

Di has negotiated credit terms of 2/7, n/45 with her supplier.

Di has been presented with the following.



a. Explain why the trends have led to a negative impact on the liquidity of Di's Desks. 3 marks

b. Discuss strategies Di could introduce to improve each of the trends. 6 marks

END OF QUESTION BOOK

Quality Assessment Tasks

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VCE® Accounting

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ANSWER BOOK

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Question 1 (12 marks)

a. 4 marks

Explanation

b. 3 marks

Explanation

c. 2 marks

General Journal

Date	**Details**	**Debit**	**Credit**

d. 3 marks

Explanation

Question 2 (7 marks)

a. 4 marks

Adjusted Gross Profit	

b. 3 marks

Explanation

Question 3 (22 marks)

a. 3 marks

Explanation

b. 17 marks

General Journal

Date	**Details**	**Debit**	**Credit**

Question 3 - continued

General Journal

Date	Details	Debit	Credit

c. 2 marks

Explanation

Question 4 (4 marks)

a. 2 marks

Explanation

b. 2 marks

Explanation

Question 5 (13 marks)

a. 10 marks

Louisa's Ladders
Cashflow Statement for the month ended 31 May 2019

	$	**$**
Cash Flow from Operating Activities		
Net Cash Flows from Operations		
Cash Flows from Investing Activities		
Net Cash Flows from Investing Activities		
Cash Flows from Financing Activities		
Net Cash Flows from Financing Activities		
Net Increase / (Decrease) in Cash Position		
Bank Balance at 1 May 2019		
Bank Balance at 31 May 2019		

b. 3 marks

Explanation

Question 6 (4 marks)

a. 1 mark

Net Realisable Value of one 'Norman' hat	

b. 3 marks

General Journal

Date	Details	Debit	Credit

Question 7 (15 marks)

a. 8 marks

General Journal

Date	Details	Debit	Credit

b. 3 marks

Explanation

c. 4 marks

General Journal

Date	Details	Debit	Credit

Question 8 (8 marks)

a. 2 marks

Explanation

b. 2 marks

Explanation

c. 4 marks

Discuss

Question 9 (6 marks)

a. 4 marks

Disposal of Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount

b. 2 marks

Explanation

Question 10 (9 marks)

a. 3 marks

Explanation

b. 6 marks

Discuss

END OF ANSWER BOOK

Solution Pathway

NOTE: This task is sold on condition that it is NOT placed on any school network or social media site (such as Facebook, Wikispaces etc.) at any time.

NOT FOR PRIVATE TUTOR USE.

Below are sample answers. Please consider the merit of alternative responses.

Question 1 (12 marks)

a. Explain how Ralph should determine the appropriate method of depreciation for the Van.

Refer to alternative methods of depreciation in your answer. 4 marks

Ralph would determine the appropriate method of depreciation for the Van based on the expected revenue-earning pattern of the van. **(1 mark)**

If the Van is expected to generate the same amount of revenue each period, the straight-line method should be adopted as it allocates the same amount of cost each period. **(1 mark)**

However, if the Van is expected to be more productive in its earlier years and therefore generate more revenue in those periods, the reducing balance method should be adopted. **(1 mark)**

The reducing balance method allocates more cost in the earlier years and less in the asset's later years, when it is less productive and therefore match the assets revenue earning pattern with the allocation of the expense. **(1 mark)**

b. Explain how the Van should be classified in the Balance Sheet of Ralph's Rugs as at 1 January 2019. 3 marks

The Van should be classified as a non-current asset as the Van is a present economic resource **(1 mark)** *controlled by the business as a result of past events* **(1 mark)** *which is expected to be used by the business for a number of years and is not held for resale.* **(1 mark)**

c. Prepare the necessary correcting entry required on 1 January 2019 in relation to Ralph's valuation of the Van.

A narration is **not** required. 2 marks

General Journal

Date	Details	Debit	Credit
01/07	*Capital*	*26 000*	
	Van		*26 000*

1 mark – per line entry

d. Referring to one qualitative characteristic, explain why it would be unethical of Ralph if he continued to report the Van on the Balance Sheet of Ralph's Rugs at its original cost. 3 marks

The qualitative characteristic of faithful representation supports the use of fair values as the amount recorded for the Van is to be representative of the real world economic event **(1 mark)** *being the value of the Van if it was sold at the time it was transferred to the business.* **(1 mark)**

If Ralph continued to report the Van on the Balance Sheet at its original cost instead of its fair value, he is knowingly presenting reports to users that are misleading as the value of assets and owner's equity would be overstated. **(1 mark)**

Question 2 (7 marks)

a. Calculate the Adjusted Gross Profit made by Morgan's Mirrors from selling the 'Hemsworth' mirror for the month ending 31 January 2019. 4 marks

Sales	*$3 500*
Less: Sales Returns	*$700*
Less: Cost of Sales	*$1 150*
Less: Inventory Loss	*$310*
Gross Profit	*$1 340*

1 mark – per item

b. Explain the effect on the value of the 'Hemsworth' mirror as at 31 January 2019 if Morgan's Mirrors used the First In, First Out cost method instead of the Identified cost method. 3 marks

If Morgan's Mirrors used the First In, First Out cost method instead of the Identified cost method, the value of the 'Hemsworth' mirror as at 31 January would be higher. **(1 mark)**

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 just the most recent, higher cost prices. **(1 mark)**

Question 3 (22 marks)

a. Explain, with reference to one reason, why Cindy's Chairs received a GST refund from the Australian Taxation Office on 26 March 2019. 3 marks

Cindy's Chairs received a GST refund from the Australian Taxation Office on 26 March 2019 as the GST collected on Cash Sales and the GST charged on Credit Sales **(1 mark)** *was less than the GST paid on payments and GST incurred on credit purchases of Inventory during February.* **(1 mark)**

This may have been due to a purchase of inventory that remained unsold or a purchase of a non-current asset. **(1 mark)**

b. Record each source document in the General Journal.

Narrations are **not** required. 17 marks

General Journal

Date	Details	Debit	Credit
24/03	*Inventory*	*1 900*	
	GST Clearing	*190*	
	Accounts Payable – Iman Plastics		*2 090*
25/03	*Sales*		*15 500*
	GST Clearing		*1 550*
	Accounts Receivable – Leslie School	*17 050*	
	Cost of Sales	*6 200*	
	Inventory		*6 200*
26/03	*Bank*	*1 278*	
	GST Clearing		*1 278*

..continued over page

General Journal

Date	Details	Debit	Credit
27/03	*Sales Returns*	*500*	
	GST Clearing	*50*	
	Accounts Receivable – Leslie School		*550*
	Inventory	*200*	
	Cost of Sales		*200*
28/03	*Prepaid Rent Expense*	*3 000*	
	GST Clearing	*300*	
	Bank		*3 300*
29/03	*Wages*	*1 600*	
	Bank		*1 600*
30/03	*Bank*	*16 170*	
	Discount Expense	*330*	
	Accounts Receivable – Leslie School		*16 500*

1 mark – Inventory and GST Clearing debit entries on 24/03
1 mark – Accounts Payable – Iman Plastics credit entry on 24/03
1 mark – Sales and GST Clearing credit entries on 25/03
1 mark – Accounts Receivable – Leslie School debit entry on 25/03
1 mark – Cost of Sales debit entry on 25/03
1 mark – Inventory credit entry on 25/03
1 mark – Entry on 26/03
1 mark – Sales Returns and GST Clearing debit entries on 26/03
1 mark – Accounts Receivable – Leslie School credit entry on 27/03
1 mark – Inventory debit entry on 27/03
1 mark – Cost of Sales credit entry on 27/03
1 mark – Prepaid Rent Expense and GST Clearing entries on 28/03
1 mark – Bank credit entry on 28/03
1 mark – Entry on 29/03
1 mark – Each line entry on 30/03 (3 marks).

c. Explain how a Bank Statement assists with Cindy's Chairs' internal control. 2 marks

Cindy's Chairs could use the Bank Statement as a cross checking mechanism against the transactions recorded in the General Ledger. **(1 mark)**

The Bank Statement will assist the internal control of Cindy's Chairs as the amounts recorded in the Bank account in the ledger must equal the amounts on the Statement to ensure that the transactions have been recorded correctly and any errors can be followed up with the Bank. **(1 mark)**

Question 4 (4 marks)

a. Explain how the trend in the Debt Ratio could positively impact Bob's Return on Owner's Investment. 2 marks

An increase in the Debt Ratio means the business has a greater reliance on borrowed funds and less reliance on the owner's capital. **(1 mark)**

As the business is using other external funds to buy additional Assets without having to rely on the owner's funds, any relative increase in profit will result in a higher Return on Owner's Investment. **(1 mark)**

b. Explain how the trend in the Debt Ratio could negatively impact the stability of Bob's Books.

2 marks

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

An increase in the Debt Ratio would generally have a negative effect on the business to continue its operations in the long term due to an increase in interest expense and loan repayments. **(1 mark)**

Question 5 (13 marks)

a. Prepare the Cash Flow Statement for the month ending 31 May 2019. 10 marks

Louisa's Ladders
Cashflow Statement for the month ended 31 May 2019

	$	**$**
Cash Flow from Operating Activities		
Cash Sales	*2 940*	
GST Collected	*294*	
Receipts from Accounts Receivable	*5 390*	
Unearned Sales Revenue	*4 000*	
Payments to Accounts Payable	*(9 196)*	
Advertising	*(1 800)*	
Purchases of Inventory	*(4 200)*	
Wages	*(2 010)*	
GST Settlement	*(3 166)*	
Interest Paid	*(300)*	
GST Paid	*(4 362)*	
Net Cash Flows from Operations		*(12 410)*
Cash Flows from Investing Activities		
Disposal of Van	*22 000*	
Purchase of Van	*(32 500)*	
Purchase of Equipment	*(5 120)*	
Net Cash Flows from Investing Activities		*(15 620)*
Cash Flows from Financing Activities		
Loan Borrowings – CCA Bank	*15 000*	
Capital	*10 000*	
Drawings	*(1 400)*	
Loan Repayments – CCA Bank	*(500)*	
Net Cash Flows from Financing Activities		*23 100*
Net Increase / (Decrease) in Cash Position		*(4 930)*
Bank Balance at 1 May 2019		*6 080*
Bank Balance at 31 May 2019		*1 150*

1 mark – Cash Sales and GST Collected
1 mark – Receipts from Accounts Receivable and Unearned Sales Revenue
1 mark – GST Paid
1 mark – per any three remaining Operating outflows
1 mark – per three remaining Operating outflows
1 mark – Disposal of Van
1 mark – Purchase of Van and Purchase of Equipment
1 mark – Loan Borrowings – CCA Bank and Capital
1 mark – Drawings and Loan Repayments – CCA Bank
1 mark – Final three lines.

b. Explain, with the use of one reason, why Louisa's Ladders reported a Net Profit in the Income Statement for the month endng 31 May 2019 yet the Cash Flow Statement reported a negative Net Cash from Operations for the same period. 3 marks

Louisa's Ladders reported a Net Profit in the Income Statement for the month ending 31 May 2019 as the revenues earned were greater than the expenses incurred. **(1 mark)**
Whereas, Louisa's Ladders reported a negative Net Cash from Operations as the cash outflows from day-to-day trading activities were greater than the cash inflows. **(1 mark)**
The reason for this could be any one of the Payments to Accounts Payable, Purchases of Inventory, GST Settlement or the GST Paid. These payments would contribute to the negative Net Cash from Operations but have no impact on the calculation of profit. **(1 mark)**
Other reasons include Credit Sales being significantly greater than the Cash Sales, GST Collected and Receipts from Accounts Receivable or that the business made a Profit from Disposal of the Van which would contribute to Louisa's Ladders reporting a Net Profit.

Question 6 (4 marks)

a. Calculate the Net Realisable Value of one 'Norman' hat. 1 mark

Reduced Selling Price	*$40*
Less: Scarf Cost	*$15*
Net Realisable Value	*$25*

b. Prepare the necessary General Journal entry as a result of the valuation of the 'Norman' hats.

A narration **is** required. 3 marks

General Journal

Date	Details	Debit	Credit
30/06	*Inventory Write Down*	*195*	
	Inventory		*195*
	5 'Norman' hats written down to NRV (Memo 616)		

1 mark – per line entry; **1 mark –** narration.

Question 7 (15 marks)

a. Prepare the necessary balance day adjustments in the General Journal.

Narrations are **not** required. 8 marks

General Journal

Date	Details	Debit	Credit
30/06	*Accrued Interest Revenue*	*300*	
	Interest Revenue		*300*
	Allowance for Doubtful Debts	*2 000*	
	GST Clearing	*200*	
	Accounts Receivable – Malcolm Gibson		*2 200*
	Doubtful Debts	*2 040*	
	Allowance for Doubtful Debts		*2 040*
	Advertising	*800*	
	Accrued Advertising		*800*

1 mark – per line entry (except Allowance for Doubtful Debts / GST Clearing a total of 1 mark).

b. Referring to one accounting assumption, explain the purpose of preparing balance day adjustments.
3 marks

The Accrual Basis assumption states that for an accrual basis profit to be determined, expenses incurred for a period are subtracted from revenue earned in that same period. **(1 mark)**

Therefore, the purpose of recording balance day adjustments is to ensure that the balances of revenue and expense accounts are adjusted to reflect the revenues earned and expenses incurred for the period, **(1 mark)** *not just the cash revenues and cash expenses during the period in order to report an accurate profit.* **(1 mark)**

c. Record cheque 883 in the General Journal.

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

General Journal

Date	Details	Debit	Credit
06/07	*Accrued Advertising*	*800*	
	Advertising	*400*	
	GST Clearing	*120*	
	Bank		*1 320*

1 mark – per line entry.

Question 8 (8 marks)

a. Explain whether Selina's Stationery's mark-up percentage has increased or decreased from 2018 to 2019.

2 marks

The mark-up percentage has increased from 2018 to 2019 **(1 mark)** *as a greater percentage of each sales dollar is made up of Gross Profit.* **(1 mark)**

b. Explain how an increase in the mark-up percentage could actually lead to a decrease in Gross Profit.

2 marks

An increase in the mark-up percentage would lead to more profit being made on each unit sold. **(1 mark)**

However, this increase in sales price could lead to a decrease in sales quantity and a decrease in Sales Revenue leading to a decrease in Gross Profit. **(1 mark)**

c. Discuss the effect of using product costing instead of period costing on a business' Gross Profit Margin when not all the inventory purchased in the period has been sold. 4 marks

Student responses are to be marked globally. High scoring responses demonstrate a knowledge of how an Income Statement, and therefore the Gross Profit Margin, would be different under product costing compared to period costing. Ideally, a student should conclude by identifying the possibility of the Gross Profit Margin not changing should the business apply a fixed mark-up percentage.

If a business uses product costing instead of period costing, any additional costs incurred in getting the inventory into a condition or location ready for sale that can be directly allocated to each unit of inventory on a logical basis is included in the cost price of the inventory and remains on the Balance Sheet until the unit of inventory is sold. Therefore, Cost of Goods Sold would be lower and the Gross Profit Margin higher.

Whereas, under period costing, any additional costs incurred in getting the inventory into a condition or location ready for sale that are unable to be allocated to each unit of inventory on a logical basis are reported in the Income Statement under the Cost of Goods Sold heading in the period they are incurred, regardless of the quantity of inventory sold. Therefore, Cost of Goods Sold would be higher and the Gross Profit Margin lower.

However, if the business uses product costing and includes these additional costs in the cost price of the unit of inventory, the Gross Profit Margin will remain unchanged if the business applies a fixed mark-up percentage. Even though the cost price of the unit of inventory would be higher, the increase in the selling price after applying a fixed mark-up percentage would result in the same Gross Profit Margin.

Question 9 (6 marks)

a. Complete the Disposal of Van account in the General Ledger. 4 marks

Disposal of Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	*Van*	*50 000*	*30/06*	*Accumulated Depreciation – Van*	*14 250*
				Bank	*25 000*
				Loss on Disposal – Van	*10 750*
		50 000			*50 000*

1 mark – per entry.

b. With reference to your answer in part a., explain why a Profit or a Loss on Disposal of the Van occurred. 2 marks

A loss on the disposal of the Van occurred as the proceeds from the disposal was less than it's carrying value. **(1 mark)**

This was due to under depreciating the Van due to over estimating the useful life or residual value. **(1 mark)**

Question 10 (9 marks)

a. Explain why the trends have led to a negative impact on the liquidity of Di's Desks. 3 marks

A slower Accounts Receivable Turnover indicates that Di's Desks is taking longer to collect outstanding debts from its credit customers. Having to wait longer to receive cash from their credit customers will worsen the ability of Di's Desks to meet its short-term debts as they fall due. **(1 mark)**

A slower Inventory Turnover indicates that Di's Desks is taking longer to sell its inventory. The longer it takes Di's Desks' to convert jts inventory into sales, the harder it is for the business to meet its short-term debts as they fall due. **(1 mark)**

As Di's Desks is paying its outstanding accounts payable balances faster than in previous periods and well within the credit terms offered, the liquidity of the business might worsen. This could create problems as the business might be in a worse position to repay other debts as, and when, they fall due. **(1 mark)**

b. Discuss strategies Di could introduce to improve each of the trends.

6 marks

Suggested Scheme

One mark for strategy to improve Accounts Receivable Turnover.

One mark for negative impact of the strategy to improve the Accounts Receivable Turnover.

One mark for strategy to improve Inventory Turnover.

One mark for negative impact of the strategy to improve the Inventory Turnover.

One mark for strategy to improve Accounts Payable Turnover.

One mark for negative impact of the strategy to improve the Accounts Payable Turnover.

Sample Answer

In order to improve the Accounts Receivable Turnover Di could increase the discount offered to encourage credit customers to pay earlier. However, this may result in an increase in discount expense which would decrease profit. Not only will the increase in the discount offered reduce profit, the actual amount of cash received by the business will decrease. Alternatively, Di could issue invoices more promptly, apply credit checks to new customers or make regular contact with outstanding credit customers. This may require additional staff which will increase wages expenses and decrease profit.

In order to improve the Inventory Turnover Di could decrease the selling price of the desks in order to attract additional sales. However, this would result in less profit being made from each desk sold. Alternatively, Di could increase advertising, but this would come at a cost to the business which would decrease profit in the short term.

In order to improve the Accounts Payable Di should delay payment to their credit customers by ensuring they are paid when they are actually due rather than unnecessarily paying them well within the credit terms. However, if Di decides to start paying outstanding accounts payable balances close to, or just after, the due date, she risks damaging the relationship she has with her suppliers and having her credit facilities removed.

END OF SUGGESTED SOLUTIONS