ACCOUNTING
Units 3&4 – Written examination

TSSM™
Creating VCE Success

2019 Trial Examination

SOLUTIONS

Question 1 **21 marks**

a. General Journal

Date 2019	**Details**	**Debit**	**Credit**
31/12	Depreciation – Equipment	1 800	
	Accumulation Depreciation – Equipment		1 800
31/12	Stationery	600	
	GST Clearing	60	
	Wages		660
31/12	Wages	800	
	Accrued Wages		800
31/12	Advertising	400	

	Inventory		400
31/12	Inventory	1 400	
	Inventory Gain		1 400
31/12	Insurance	2 000	
	Prepaid Insurance Expense		2 000
31/12	Allowance for Doubtful Debts	1 000	
	GST Clearing	100	
	Account Receivable – E Sendon		1 100

2 + 2 + 1 + 1 + 2 + 1 + 3 = 12 marks

b. Prepare the closing entries required for revenue accounts.

General Journal

Date 2019	**Details**	**Debit**	**Credit**
31/12	Inventory Gain	1 400	
	Credit Sales	380 000	
	Cash Sales	80 000	
	Sales Returns		9 250
	Profit and Loss Summary		452 150
	Closing of revenue accounts for the year ended 31 December 2019 (Memo 92)		

3 marks

c. The accrual basis assumption requires a business to record its expenses when they are incurred. Prepaid expenses provide economic benefit in the future when they are paid and become an expense as they are consumed by the business. Users of financial reports require them to be useful for decision making. Relevance demands that they include all information that is useful for decision making. In this scenario users of Industry Sneakers reports would want to recognise the expense when it is consumed.

4 marks

d.

Discount expense would be classified as another expense as it represents a decrease in assets (accounts receivable) that reduces owner's equity (net profit) and is not a distribution to the owner.

2 marks

Question 2 **14 marks**

Creative Cufflinks sell cufflinks using their online website. They have benchmarked their business against published industry averages. They have provided the following data for 2019.

	Creative Cufflinks	Industry Average
Return on Owner's Investment	7%	11%
Return on Assets	13.8%	11.6%
Inventory Turnover	11 days	34 days
Accounts Receivable Turnover	34 Days	20 Days
Accounts Payable Turnover	15 Days	30 Days
Working Capital Ratio	3:1	1.4:1
Quick Asset Ratio	2.8:1	1.2:1
Debt Ratio	21%	51%

a.

Creative Cufflinks have a faster inventory turnover than the industry average which indicates that they retain inventory for a shorter period than the industry. This is an indication of inventory management and will result in them being able to retain cash on hand longer than the industry. The accounts receivable turnover is slower than the industry average which would indicate that despite inventory not remaining on hand, the business is slower to collect cash and at the same time is paying its accounts receivable faster than the industry. Working capitals ratio indicates that the business has the current assets to comfortably meet its short term debts and they appear to be tied up in cash when considering the quick asset ratio. This would seem reasonable considering the fast inventory turnover. Overall the business has positive liquidity, however, there are areas of concern such as the control of accounts receivable and payable.

4 marks

b. Explain why Creative Cufflinks would use benchmarks to determine its performance.

Benchmarks allow Creative Cufflinks to identify areas of concern in their business and to look for ways to improve them. Industry averages are useful to consider what similar businesses are doing to look at potential opportunities such as reviewing accounts receivable terms. Past periods and budgeted figures are also benchmarks that indicate improvement or areas of concern based on the business itself.

4 marks

c. Creative Cufflinks maintains a faster inventory turnover than the industry average. This could be due to greater sales which allow the business to move inventory at a greater rate. It could also be due to Creative Cufflinks using just in time inventory management which would be practical to use as they are an online retailer which has a lag time before needing to deliver the inventory to customers.

3 marks

d. Return on Owner's Investment indicates the profit generated by a business from the capital contributed by the owner. If the business is able to maintain its profit but at the same time reduce the capital contributed by the owner it will result in an increase in the return on owner's investment. As Creative Cufflinks has a lower debt ratio than the industry average it is likely to have higher capital funding by the owner and therefore a lower return on investment from a similar net profit. The return on assets could be lower due to the business holding more assets than similar businesses in its industry. While the business may have borrowed funds to finance its assets rather than use the owners capital this has resulted in assets increasing at a greater rate than capital.

3 marks

Question 3 **9 marks**

Tower Blocks invested $20 000 into a two year term deposit with Lego Bank on 31 October 2018. Interest will be paid quarterly at a rate of 6% p.a. The business prepares financial reports on 30 June each year.

Required
a.

= 20 000 * 6% = $1 200 per year
= $100 per month
= 2 months * $100 = $200

2 marks

b.

General Journal

Date **2020**	**Details**	**Debit**	**Credit**
31/10	Bank	20 300	
	Term Deposit		20 000
	Interest Revenue		300

2 marks

c. According to the Period Assumption Tower Blocks are required to prepare accounting reports which include all information relevant to the reporting period. The Accrual Basis Assumption refers to the need to include revenues when they are earned. In this case the business is required to record and entry for the accrued interest that has been earned but not yet received by the business.

3 marks

d. Assets would be understated by $300 as bank would be understated by $20 300 and term deposit would be overstated by $20 000. Owner's equity would be understated by $300 as interest revenue would be understated by $300 and there would be no effect on liabilities

3 marks

Question 4 **10 marks**

a.

Quick as a Flash Cameras (extract)
Cash Flow Statement Variance report for the Year ended 31 December 2019

	Budget	Actual	Variance	F/U
Cash Flow from Operating Activities				
Cash Sales	90 000	**80 000**	10 000	U
Receipts from Accounts Receivable	150 000	140 000	10 000	U
GST Collected	9 000	8 000	6 000	F
Payments to Accounts Payable	(150 000)	**(146 000)**	4 000	F
Telephone	(2 000)	(2 200)	200	U
Advertising	(5 000)	(5 000)	10 000	F
Rent	(2 000)	(2 000)	-	-
Interest	(500)	(450)	**50**	F
Website Expense	(2 000)	(2 000)	-	-
GST paid	(1 100)	(2 120)	1 020	U
Net Cash Flow from Operations	[redacted]			
Cash Flows from Investing Activities				
Purchase of Display Cabinets	(30 000)	(32 000)	2 000	U
Purchase of Delivery Van	(25 000)	(15 000)	15 000	F
Net Cash Flow from Investing Activities	[redacted]			

4 marks

b. If a cash variance report is prepared on a monthly basis the owners are able to identify issues when they occur and take corrective action. If they prepare an annual cash variance report they will not be able to take corrective action when required but rather will have to wait until the end of the year until they identify variances.

2 marks

c. The business had budgeted to purchase a $25 000 delivery van which they have managed to purchase for $15 000. As they have reduced the amount paid for the new vehicle they would have been able to borrow less and therefore would have paid less interest than they had originally budgeted.

2 marks

d. Increase advertising to combat the unfavourable sales.
Review phone plans to reduce telephone expense

2 marks

Question 5 **18 marks**

a. General Journal

Date **2019**	**Details**	**Debit**	**Credit**
30/9	Disposal of Delivery Van	38 500	
	Delivery Van		38 500
	Accumulated Depreciation – Delivery Van	18 000	
	Disposal of Delivery Van		18 000
	Bank	10 500	
	Disposal of Delivery Van		10 500
	Loss on Disposal of Delivery Van	10 000	
	Disposal of Delivery Van		10 000
1/10	Bank	49 500	
	Loan – Super Bank		49 500
1/10	Delivery Van	44 200	
	Prepaid Registration expense	800	
	GST Clearing	4 500	
	Bank		49 500

2 + 2 + 2 + 2 + 3 = 13 marks

b. Peter is considering the cash paid for the delivery van less the cash received when it was sold. He has not taken into account the use of the vehicle over its life and its contribution to earning revenue. While he is not correct when he states the accountant "makes all this up" he has brought up the issues of assumptions used to determine the depreciation of the delivery van and the methods chosen to allocate depreciation. If the other accountant has used the straight line method of depreciation or has used a different useful life or residual value, it is possible that they would have ended up with a different profit on disposal of the delivery van

5 marks

Question 6 **16 marks**

a.

Screen Me Up

Balance Sheet as at 30 September 2019

Assets			**Equities**		
Current Assets			**Current Liabilities**		
Bank	42 000		Accounts Payable	39 600	
Inventory	24 000		Loan – State Bank	9 000	
GST Clearing	3 200				
Prepaid Rent Expense	5 000				
Accounts Receivable	26 400	100 600			48 600
Non-Current Assets			**Non-Current Liabilities**		
Vehicle	32 000		Loan – State Bank	15 000	
Display Cabinet	14 000	46 000			15 000
			Owner's Equity		
			Capital	72 000	
			Net Profit	11 000	83 000
		146 600			146 600

8 marks

b. If the sale of the screens was not recorded it would result in assets being understated by $14 400 as accounts receivable would be understated by $26 400 and inventory would be overstated by $12 000. Owner's equity would be understated by $12 000 which would be net profit and liabilities would be understated by $2 400 of GST liability.

3 marks

c. If the vehicle is valued at its original cost this would potentially create a number of issues.
The owner would have a greater claim on the assets of the business as its capital would be overstated by $16 000. The assets of the business would also be overstated which could result in the business appearing to have greater stability, although the business already appears to be able to meet its long term debts.
Changing the value of a non-current asset to appear at a greater value than its valuation also creates a situation in which the accounting reports do not faithfully represent the financial position of the business as they are not verifiable. When decisions are made by users of the reports on the basis that they believe they have accounting reports that fairly represent the businesses financial position this could impact on the viability of those decision.

5 marks

Question 7 **7 marks**

a.

General Journal

Date **2019** **June**	**Details**	**Debit**	**Credit**
30	**Sales Return**	**5 000**	
	GST Clearing	500	
	Account Receivable – Gorgeous Gifts		5 500
	Inventory	2 500	
	Cost of Sales		2 500

4 marks

b. Understandability requires that sales returns are classified separately in order to provide users of the reports who have a reasonable understanding of business and economics with understandable reports to make informed decisions.

Sales returns are classified separately to let the users of the reports to gain an understanding of whether the business has issues with customer satisfaction that could indicate poor quality of inventory, or perhaps over promising of what the goods can be useful for.

Sales returns could also indicate that the business has provided customers with a service for situations in which they have purchased incorrect sizes and could indicate customer satisfaction. Reviewing customer satisfaction surveys could be used in conjunction with sales returns.

3 marks

Question 8 **5 marks**

a.
Depreciation to 30/9/2019
= $30 000 * 25%12/4 = $1 875

Depreciation to 31/12/2019
= $28 125 * 25%/4 = $1758

3 marks

b. Depreciation is the allocation of the cost of a non-current asset over its useful life. The residual value represents the cost of the delivery van which will not be consumed by the business, but rather will be consumed by the next business. If the business depreciated the residual value it would be incurring an expense that would not relate to revenue earned by the business and therefore would breach the accrual accounting assumption.

2 marks