ACCOUNTING

Units 3&4 – Written examination

Reading time: 15 minutes
Writing time: 2 hours

SOLUTIONS

Question 1 (28 marks)
a. 12 marks

General Journal

Date 2020	Details	Debit	Credit
30/6	Wages Expense	1 200	
	Accrued Wages Expense		1 200
	Advertising Expense	4 000	
	Prepaid Advertising Expense		4 000
	Depreciation of Equipment	5 400	
	Accumulated Depreciation of Equipment		5 400
	Depreciation of Delivery Van	250	
	Accumulated Depreciation of Delivery Van		250
	Sales Return	6 000	
	GST Clearing	600	
	Accounts Receivable – AJ Accountants		6 600

	Inventory	3 000	
	Cost of Sales		3 000
	Inventory Loss	4 000	
	Inventory		4 000

b. When the delivery van was contributed by the owner to the business it would result in a change of ownership. The accounting entity assumption requires the business to record the transaction separately in the accounts of the owner and the business. As the value of the asset at date of contribution is different to the original purchase price the owner would use the fair value, being the market value of the delivery van on the day it was contributed to the business.

3 marks

c. When choosing a depreciation method the owner needs to consider the revenue earning pattern of the delivery van to ensure that the expense incurred is matched to the revenue earned using the accrual basis assumption. Straight line depreciation is used when the assets contributes evenly to revenue over the life of the non-current asset whereas reducing balance is used for assets that contribute more to revenue earlier in their life.
The delivery van is likely to experience wear and tear and will contribute less to earning revenue over its life.

4 marks

d.

Elite Stationery
Income Statement for the Year ended 30 June 2020

	$	**$**
Revenue		
Sales	190 500	
Less Sales Returns	8 500	182 000
Less Cost of Goods Sold		
Cost of Sales	91 000	
Freight in	2 300	93 300
Gross Profit		88 700
Less Inventory Loss	4 000	
Adjusted Gross Profit		84 700
Less Other Expenses		
Advertising Expenses	4 000	
Depreciation of Equipment	5 400	
Depreciation of Delivery Van	250	
Wages Expense	29 200	38 850
Net Profit		35 000

3 marks

e.

Elite Stationery

Balance Sheet (extract) as at 30 June 2020

Assets		
Current Assets		
Accounts Receivable	22 650	
Cash at Bank	29 000	
GST Clearing	15 100	
Inventory	26 000	
Prepaid Advertising	10 000	105 750
Non-Current Assets		
Equipment	60 000	
Less accumulated depreciation	11 400	48 600
Delivery Van	30 000	
Less accumulated depreciation	250	29 750

5 marks

Question 2 (9 marks)

a.

Rudolph Lights	24 * $54 = $1 296
Santa Lights	30 * $74 = $2 220
Christmas Star Lights	20 * $15 = $ 300
	$3 816

3 marks

b.

Inventory

Date 2020	Cross-reference	Amount	Date 2020	Cross-reference	Amount
1/12	Balance	15 000	31/12	Inventory Loss	54
				Inventory Write down	580

Inventory Loss

Date 2020	Cross-reference	Amount	Date 2020	Cross-reference	Amount
31/12	Inventory	54			

Inventory Write down

Date 2020	Cross-reference	Amount	Date 2020	Cross-reference	Amount
31/12	Inventory	580			

4 marks

c. The freight costs are included as part of the cost of the inventory as they are a product cost that is incurred to get the inventory into condition and location ready for sale.

2 marks

Question 3 (13 marks)

a.

General Journal

Date 2020	Details	Debit	Credit
30/6	Bad Debts Expense	3 000	
	Allowance for Doubtful Debts		3 000

2 marks

b.

General Journal

Date 2020	Details	Debit	Credit
19/7	Allowance for Doubtful Debts	2 000	
	GST Clearing	200	
	Accounts Receivable – Northern Stars		2 200

3 marks

c.

General Journal

Date 2020	Details	Debit	Credit
30/6	Bad Debts Expense	4 250	
	Allowance for Doubtful Debts		4 250
	Record allowance for doubtful debts based on 3% of net credit sales (Memo 125)		

2 marks

d. Joe needs to ensure that the financial reports that are prepared for Klopp's Sports faithfully represent the financial position and performance of the business. If Joe decides to prepare reports that intentionally understate expenses and overstate assets it may influence the decision made by the bank to loan cash to the business. This will impact relevance as the predictions made by the users of the counts could be incorrect. If he is able to receive the loan from the bank it could allow him to grow his business although if the loan is received based on a second set of reports it would be unethical as Joe has overstated his net profit and his assets to the bank.

It could also be argued that the impact of the bad debts is minimal and may have no impact on the decision made by the bank. Students should consider the advantages and disadvantages for the business of recording an allowance for doubtful debts. They could also consider that it is based on an estimate and therefore may have minimal impact on decision making as Joe could adjust the percentage of net sales revenue that he is using to determine the allowance.

Mark this question globally

6 marks

Question 4 (6 marks)

Pete needs to consider the impact of all three options.

If he chooses to use Option One, he needs to consider that while it may improve his accounts receivable by focusing on debt collection and reducing flexibility for sales staff it could result in a significant decline in sales. The additional bonus could combat this, however, the lack of being able to negotiate prices could result in loss of sales.

If he chooses Option Two there is less incentive to sell to customers who won't pay as there is no longer a bonus system in place for the number of sales. Implementing a bonus for new customers could work well if the business is enforcing improved credit checks for customers. Increased salaries could result in sales staff wanting to work for the business, although they may receive bonuses elsewhere,

If he chooses Option Three which is to continue trading as usual the business will continue to experience debt collection and profitability issues.

Mark globally

Question 5 (10 marks)

a. The working capital ratio is determined by dividing the current assets of a business by the current liabilities. The quick asset ratio divides the current assets less inventory and prepaid assets by current liabilities. The business is holding increased inventory and prepayments over the years which results in an increasing working capital ratio but does not increase the quick asset ratio. The inventory turnover is also slowing over the years which indicates the business is holding more inventory.

3 marks

b. The net profit margin is declining while the gross profit margin is improving due to poor expense control. While the business is increasing its mark-up which results in an improved gross profit margin, increased expenses have led to a reduction in net profit margin.

2 marks

c. The business is experiencing an improved working capital ratio which indicates that it is able to cover its current liabilities with its current assets, although, when inventory and prepayments are removed the business has a quick asset ratio of less than 1:1 which indicates that it is not able to meet its immediate debts as they fall due. The slowing inventory turnover would also indicate that the business is experiencing difficulty turning its inventory into sales. Harry's Hardware is experiencing difficulty collecting cash from its accounts receivable, although they are projecting to reduce the payment days from 31 days to 29 days which is still well beyond the credit terms.

The business is paying its accounts payable in 14 days which is very early considering there is no discount offered for early payment.

Global marking

6 marks

Question 6 (6 marks)

Refrigerator

Date 2020	Cross-reference	Amount	Date 2020	Cross-reference	Amount
1/7	Balance	25 000	30/4	Disposal of Refrigerator	25 000
30/4	Disposal of Refrigerator	10 000			
30/4	Bank	20 000			

Accumulated Depreciation - Refrigerator

Date 2020	Cross-reference	Amount	Date 2020	Cross-reference	Amount
30/4	Disposal of Refrigerator	10 000	***1/7***	***Balance***	***8 000***
			30/4	Depreciation - Refrigerator	2 000

Disposal of Refrigerator

Date 2020	Cross-reference	Amount	Date 2020	Cross-reference	Amount
30/4	Refrigerator	25 000	30/4	Accumulated Depreciation - Refrigerator	10 000
			30/4	Refrigerator	10 000
			30/4	Loss on Disposal of Refrigerator	5 000

Loss on Disposal of Refrigerator

Date 2020	Cross-reference	Amount	Date 2020	Cross-reference	
30/4	Disposal of Refrigerator	5 000			

Bank

Date 2020	Cross-reference	Amount	Date 2020	Cross-reference	
	Loan – Dollar Bank	23 000	30/4	Refrigerator/GST Clearing	23 000

Question 7 (10 marks)

a.

General Journal

Date 2020	Details	Debit	Credit
31/12	Accrued interest revenue	60	
	Interest revenue		60

2 marks

b. The term deposit would be reported as a current asset of $24 000 as it represents a bank deposit that is reasonably expected to be turned into cash within 12 months after the end of the reporting period.

2 marks

c.

General Journal

Date 2020	Details	Debit	Credit
31/5	Bank	24 360	
	Accrued Interest Revenue		60
	Interest Revenue		300
	Term Deposit		24 000

3 marks

d. The transaction on 31 May 2020 results in interest revenue of $300 which increases net profit in the Income Statement. Assets will increase in the Balance Sheet by $300 as bank will increase by $300 overall. Term Deposit will decrease by $24 000 but Bank will increase by $24 000, negating each other. Accrued Interest revenue will decrease by $60 but Bank will increase by $60, again negating each other. The receipts of the $300 interest will increase Bank.
There will be no effect on Liabilities.

3 marks

Question 8 (10 marks)

a. The deposit of $750 paid by Southern High will be reported as unearned revenue of $750 in the current liabilities of Southern High's Balance Sheet. The unearned revenue represents a present obligation of XY Music to transfer an economic resource (guitars) to Southern High within 12 months of the reporting period.

3 marks

b.

General Journal

Date 2020	**Details**	**Debit**	**Credit**
19/9	Bank	750	
	Unearned Revenue		750
5/10	Unearned Revenue	750	
	Accounts Receivable – Southern High	900	
	Sales		1 500
	GST Clearing		150
	Cost of Sales	1 000	
	Inventory		1 000

4 marks

c. Assets will decrease by $100 as accounts receivable increase by $900 and inventory will decrease by $1 000. Liabilities will decrease by $600 as unearned revenue will decrease by $750 and GST clearing will increase by $150. Owner's Equity will increase by $500.

3 marks

Question 9 (8 marks)

a. Luggage Planet could have negative cash flows from operating activities while the business is profitable for a number of reasons.
Net cash flows from operating is determined by subtracting cash flows paid from operating activities from cash flows received from operating activities while net profit is calculated by subtracting expenses incurred from revenues earned.
Examples could include the business collecting more cash from accounts receivable than credit sales earned during the year or an inventory gain which increases net profit but does not impact on cash flow.

Global marking

4 marks

b. Luggage Planet has provided a chart that indicates that cash flow has improved from operating activities and is projected to continue to improve in the 2020 year. The business has also been profitable in both years of operations and is projected to improve its net profit in 2020.
The owner is concerned by overall cash flow which is mainly due to the cash used to fund the growth which has resulted in the business purchasing significant non-current assets. While the owner borrowed and contributed funds to start the operations, the business has used a bank overdraft and cash flows from day to day trading activities to fund its business in 2019 and is projecting to do the same in 2020.
The owner needs to provide more detailed financial reports in order to complete a more detailed analysis.

Global marking

4 marks