



Units 3 and 4 Accounting

Practice Exam Solutions

Stop!

Don't look at these solutions until you have attempted the exam.

Any questions?

Check the Engage website for updated solutions, then email practiceexams@ee.org.au.

Marks allocated are indicated by a number in square brackets, for example, [1] indicates that the line is worth one mark.

Question 1

The perpetual system is a continuous system for recording stock movements. The perpetual system of stock recording involves recording stock transactions in stock cards then conducting a physical stocktake at the end of the Reporting Period to verify the balances of those stock cards. [1]

- Reordering of stock is assisted by maintaining a continuous record of the number of units on hand. Without a continuous record of stock available, the business will only know when reordering of stock is required when there are empty shelves. This could lead to a loss in sales and potential future customers. As levels of stock are known, stock can be reordered when levels fall to a certain point. [2]
- Stock losses and gains can be determined by comparing the balance in the stock control and stock card with the physical stocktake. Any discrepancies with stock cards and stocktake will identify a stock or loss or gain. [2]
- Slow-moving and fast-moving lines of stock can be identified (via stock cards). By examining the frequency of the OUT column, management can then identify which line of stock is selling well and which ones aren't selling at all. Stock lines can be moved, and stock mix can be adjusted to higher selling stock. [2]
- Greater control over stock is possible as up-to-date information is available throughout the reporting period (information is constantly updated, enabling better decisions to be made). [2]

Question 2a

VuVu's Budgeted Cash Flow Statement (extract) for quarter ended 30 June 2013

	\$	\$
Operating Activity Inflows		
Cash sales	161,000	
Receipts from debtors	63,900	
GST received	<u>16,100</u>	241,000
Operating Activity Outflows		
Payments to Creditors	(142,000)	
Purchases of Stock	(30,000)	
Customers Duty	(1,000)	
Interest on Loan	(4,000)	
Interest on Overdraft	(2,000)	
Wages Expense	(29,300)	
Office Expenses	(4,000)	
GST paid	(3,000)	<u>(203,300)</u>
Net Cash Flow from Operations		37,700

[1] for Sales and GST received.

[1] for Receipts from Debtors and Payments to Creditors.

[1] for GST Paid.

[1] for every 3 outflows not already identified. [2] in total.

Question 2b

There are numerous restraints on a budgeted cash flow statement, related to the issue of using estimations as a basis for their calculations. We can only estimate some figures according to seasonal and recent trends. Furthermore, the overall economic conditions might influence cash flow and hence, distort figures. Finally, simple changes such as creditors demanding a more timely repayment of bills can change entire estimates of a budgeted cash flow statement.

However, if a business owner recognises that budgeted reports are based on estimates then they can recognise that the report only gives an indication of performance and/or position and therefore the reports are only useful as a guide or even a target.

Secondly, by shortening the budget period – from 6 months to 2 months – will improve the accuracy of the budgeted report and allow for better and quicker reaction to an unplanned event.

Each restraint identified must be explained and then have the positive approach to that restraint addressed.

[2] for each restraint addressed and then [1] for the 'positive' of each restraint explained.

Question 2c

Management may find this to be unfavourable due to two reasons. Firstly, there has been less volume sold, hence leading to a lower cost of goods sold. Secondly, cost of goods sold has not changed by the same amount as sales. Cost of Goods Sold has decreased less than sales so cost per unit has actually increased. This is shown by the decrease in mark up from 185% to 172%.

[2] for identifying and explaining one benefit in detail OR Identifying and explaining two benefits.

Question 3a

Accounting Principle: Conservatism. [1]

Explanation: The conservatism principle states that revenues should only be recorded when certain and expenses should be recognised when probable, such that assets and owner's equity are not overstated or liabilities are not understated. [1] If Eason refuses to recognise net realisable value for the old earphones, he is omitting the high possibility of incurring a loss when stock can no longer be sold above its historical cost price. This is a breach to the conservatism principle, as potential loss is not being recognised where appropriate. As a result, assets (stock control) and owner's equity (net profit) are overstated. [1]

Question 3b**General Journal**

Date 2013	Details	General Ledger		Subsidiary Ledger	
		Debit \$	Credit \$	Debit \$	Credit \$
May 5	Stock Write Down	522			
	Stock Control		522		
	<i>Stock write down for 29 pairs of superseded EE-500 earphones (Memo 55)</i>				

[1] for each entry.

[1] for amount.

[1] for narration – must include document number, number of units, and model.

Question 3c

If the business fails to recognise NRV, the value of stock would be overstated by \$522, such that assets would consequentially be overstated by this amount. There would be no effect on liabilities. Since stock write down expense would not be recognised, net profit would be overstated by \$522, consequently leading to an overstated amount of owner's equity on the balance sheet.

[1] for the effect on each element in the balance sheet.

Question 4

Cash and profit are different resources. The cash surplus of \$10 000 dollars is calculated by cash inflows received less cash outflows paid in the reporting period while profit is determined by revenues earned less expenses incurred in the reporting period.

Jimmy could have made a cash surplus and net loss due to a variety of reasons. He could have received a considerably larger amount of Receipts from Debtors than earned Credit Sales for the period or received greater Prepaid Sales Revenue rather than Cash Sales earned for the period. These aspects would all increase the Cash Inflows more greatly than the Revenues in the Income Statement potentially leading to a Cash Surplus without creating a Net Profit. (A multitude of explanations could be accepted here including Expenses which decrease Income Statement without affecting Bank Balance etc).

[2] for explanation of difference between cash and profit.

[1] for an example.

Question 5a**General Journal**

Date 2013	Details	General Ledger		Subsidiary Ledger	
		Debit \$	Credit \$	Debit \$	Credit \$
June 30	Prepaid Rent Revenue	4640			
	Rent Revenue		4640		
	Rent Revenue	4640			
	Profit & Loss Summary Account		4640		

[1] for each line in journal.

Question 5b

Assets: no change. [1]

Liabilities: overstated. [1]

Owner's equity: understated. [1]

Question 6a

Stock Card: Mahogany Tables

Date 2013	Details	In			Out			Balance		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Jan 1	Balance							2 9	1 500 1 400	15 600
8	Rec 21				2 8	1500 1400	14200	1	1400	1400
14	Chq 71	15	1320	1980 0				1 15	1400 1320	21200
Feb 1	Inv F82				1 9	1400 1320	13280	6	1320	7920
6	Memo 21				1	1320	1320	5	1320	6600
14	Inv F94				3	1320	3960	2	1320	2640
19	Inv T45	20	1430	2860 0				2 20	1320 1430	31240
Mar 6	Memo 22				2 1	1320 1430	4070	19	28600	27170
18	CN X52	2 1	1320 1430	4070				2 20	1320 1430	31240
19	CN A45				3	1430	4290	2 17	1320 1430	26950
29	Inv G11				2 7	1320 1430	12650	10	1430	14300
31	Memo 23	1	1430	1430				11	1430	15730

[1] for each line as shown.

Question 6b
General Journal

Date 2013	Details	General Ledger		Subsidiary Ledger	
		Debit \$	Credit \$	Debit \$	Credit \$
Feb 6	Drawings	1320			
	Stock Control		1320		
Mar 18	Sales Returns	9900			
	GST Clearing	990			
	Debtors Control		10890		
	Debtors – J. Smith				10890
	Stock Control	4070			
	Cost of Sales		4070		
Mar 31	Stock Control	1430			
	Stock Gain		1430		

[1] for each line of journal except:

- Debtors Control/Dr - J Smith. [1]

Question 6c

FIFO is the assumption used for costing purposes [1] that the first stock purchased is the first stock to be sold. [1] This is so cost of sales can be easily determined without having to physical mark or determine which stock has been sold which can be both difficult and time consuming (e.g. FIFO saves time). It is an easier method of cost allocation. [2]

Question 7a
GST Clearing

Date 2013	Cross-reference	Amount	Date 2013	Cross-reference	Amount
30 Jun	Bank	1000	1 Jun	Balance	1000
	Creditors Control	500	30 Jun	Bank	4800
	Bank	6000		Debtors Control	5000
	Balance	<u>3300</u>			
		<u>10800</u>			<u>10800</u>
			1 Jul	Balance	3300

[1] for Opening Balance and Bank 1000.

[1] for Closing Balance and balance carried forward.

[1] for both of the other 2 Bank entries.

[1] for Debtors Control.

[1] for Creditors Control.

Question 7b

Accounting principle: Going Concern. [1]

Explanation: It is balanced and brought forward to the commencement of the new reporting period due to the Going Concern principle. [1] The life of the business is considered to go on for an indefinite period of time, and so the balance of the GST clearing account will continue on for future reporting periods, not just one. [1]

Question 7c

Identification: Debtors Control/Debtors Subsidiary ledger, or Creditors Control/Creditors Subsidiary ledger, or Stock Control/Stock Card [1]

Explanation:

Benefit: [1] for each, [2] in total

- *Detection of error – Having two sets of records on the same information gives us a built-in checking (control) mechanism. The balance of the control account should match the sum of the balances of the subsidiary ledger accounts (which would be detailed in the Debtors / Creditors Schedule or conducting a stocktake). If not, an error has been detected and can be corrected.*
- *Allocation of responsibility – As two sets of records are kept, responsibility for maintaining the subsidiary ledger and the general ledger can be allocated to different employees (division of labour). Like a particular employee may look after subsidiary ledgers and deal with collections and invoicing while the senior bookkeeper can manage the General Ledger.*
- *Ease of reporting – By preparing a Schedule, only one figure needs to be reported in the Balance Sheet, with insignificant details omitted. These details such as the names and balances of individual debtors or creditors, would not affect decision making, so in reporting the total relevance is upheld.*

Cost: [1] for each, [2] in total

- *Time consuming to prepare both a control accounts and subsidiary ledgers.*
- *Money may be wasted in getting an accounting or hiring a staff to look after control accounts and subsidiary ledgers.*

Question 8a

Qualitative characteristic: Relevance. [1]

Explanation: The relevance characteristic states that all crucial information for decision-making should be included in financial reports to assist users with relevant details. [1] Storage cost is treated as a period cost, as it is a cost incurred to bring stock into the condition and location ready for sale. However, there is no logical mean to divide it in order to determine its unit cost, since storage cost applies to all stock lines. [1] The quantity of tealeaves have been imported during the year hence does not provide a reason to treat the storage cost as a product cost. This treatment allows users to access the information about the sum of costs incurred specifically for Authentic Chia Tealeaves, which may be useful for determining the selling price.

Question 8b

State: incorrect. [1]

Explanation: In this example, there are $(100 \times 4/80) + 5 = \10 per kg of product costs not directly included in the suppliers invoice price compromising of packaging as well as freight and customs. [1] If these were written off as period costs, at the end of the period, stock would be understated by \$100, with net profit being understated by the same amount. [1]

Question 9

Explanation: Through looking at the ratios, Teresa is likely to struggle with her debt. Firstly, she is taking longer to sell inventory to raise cash. [1] Secondly, there has been a worsening of debtors' turnover, meaning that the business is taking longer to receive cash [1]. Thirdly, the low QR indicates a shortage of cash and decreased likelihood of being able to pay immediate debts with immediate funds. [1]

One 'bright' point for the business is that WCR has remained unchanged which means the business does have enough current assets to meet short term debts. However, this may only be due to the rise in stock and debtors turnover meaning more assets are on hand. [1]

Question 10a
General Journal

Date 2013	Details	General Ledger		Subsidiary Ledger	
		Debit \$	Credit \$	Debit \$	Credit \$
Nov 1	Disposal of Computer System	15000			
	Computer System		15000		
	Accumulated Depreciation – Computer System	9000			
	Disposal of Computer System		9000		
	Sundry Creditor – Dom’s Discounts	9000			
	Disposal of Computer System		9000		
	Disposal of Computer System	3000			
	Gain on Disposal of Computer System		3000		
	Computer System	21000			
	GST Clearing	2100			
	Sundry Creditor – Dom’s Discounts		23100		

[1] for each line of journal except Computer System/GST Clearing treated as one line.

Question 10b

Using the straight-line method of depreciation, the amount of annual depreciation remains constant over the useful life of the system. Benefits involved with using the straight line method include its ease of use and application, and as a result is a fairly cost effective method of calculating depreciation, and is often appropriate for office equipment, fittings etc. However, issues arise as it is often too simplistic of a measure to apply to all non-current assets, as such an allocation of cost may not be indicative of how it is being used. In order to match depreciation with the revenue earned through the asset other methods, such as reducing balance are used, where the depreciation expense decreases every year in reflection of the fact that the asset helps generate more revenue at the start of its useful life. This is often more relevant for assets with moving parts such as vehicles, as wear and tear decreases its efficiency over time. In essence when selecting a method of depreciation used for a particular asset, efforts must be made to match the expense (depreciation) with the amount of revenue it helps generate throughout its useful life.

[1] for identifying 1 benefit of straight line.

[1] for identifying 1 drawback of straight line.

[1] for identifying and explaining reducing balance depreciation.

[2] for logical discussion about matching revenues with expenses and when each method may be useful.

Question 11

Craig should not be concerned with his business performance for the year ending June 30th 2015, but rather pleased with the growth of his business. The increase of the ROI by 10% indicates that the business has used the owner's capital effectively in order to earn Net Profit for the last reporting period. This may allow Craig to withdraw more assets from the business for personal use without affecting the businesses ability to make a Net Profit. Similarly the 5% Net Profit Margin increase indicates that Craig has been able to effectively manage expenses incurred by the business, or gain greater revenue for the period in order to override costs incurred by the business. The business should measure its performance upon benchmarks such as performance in previous periods and so too budgeted figures. Other similar business could be inaccurate benchmarks as they may have larger asset bases, clientele or other aspects which could allow them to gain a greater profit. Also profit figures are not simply an overall measure of business performance and profitability for the period. This is indicative of World of RVs making a greater Net Profit than Craig's Caravans during the period. Therefore, Craig should not necessarily be concerned with comparing Profit figures in assessing business performance but rather using profitability markers in order to gauge his business's performance over a respective reporting period.

[1] for explanation of the favourable increase in ROI.

[1] for explanation of the favourable increase in NPM.

[2] for evaluation of pleasing increase in business performance and how profit figures are not a totally accurate figure for business performance (exploration of another benchmark).