ASSESSMENT REPORT 2020

ACC315116 – ACCOUNTING

Question 1

(a) Many students answered these questions vaguely; there were no marks allocated to answers that stated 'the accounting process is the process of accounting' or 'a current asset is an asset that is current' or 'a balance day adjustment is an adjustment made on balance day'. Candidates are reminded that they should not use the term as part of their definition/explanation.

For question 1(a)(iv). many students answered this question incorrectly and explained that BDAs were about fixing errors in the Trial Balance. Better answers identified the link with accrual accounting and the matching principle.

(b) (i) Candidates are reminded to read question carefully. This question was not about defining/explaining what debt finance and equity finance are. Rather, it was focused on why a manager might borrow rather than use equity funds for an expansion. Better answers focused on advantages of borrowing (debt finance) compared to the negatives of using capital (equity finance).

(ii) Candidates are reminded to read question carefully. This question was not simply about defining/explaining what a cash budget is. Rather, it was focused on how important a cash budget is to the sound management of a business. Better answers focused on ways a cash budget assists managers to run their business in terms of forecasting and preparing them for the upcoming 1-12 months.

Many candidates incorrectly discussed profitability in their answer, rather than projected cash position.

(c) (i) Many students said customers were external users. However, while customers are indeed outside of the business, customers generally would never look at a business's financial statements/accounting reports of a business before they purchase from them, so no marks were allocated to customers if used as an example.

(ii) Many students only defined what a Trial Balance was but did not provide examples of the errors disclosed and not disclosed. A number of candidates discussed what errors would be disclosed but didn't go on to explain them with an example and therefore didn't show complete understanding that would earn them full marks.

(iv) Many students defined a financial expense as 'an expense to do with the financials of a business' or a selling and distribution expense as 'an expense to do with selling and distributing'. No marks were awarded for this. It was essential that the explanation included an understanding of the type of expenses that are within each category. Selling and distribution expenses explanation must have included how they relate to the business trying to generate revenue through their product/service to get the full 1 and ½ mark allocation.

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Question 2

(a) (i) Question 2 (a) yielded very low marks generally. Those attempting question 2(a)(i)" matching principle" more often than not gained 2 marks out of a possible 6 by explaining what the matching principle is and stopping there, believing [possibly fairly] that they'd answered the question. For 6 marks, as per the suggested answer above, students needed to say much more than this and had to refer back to the question: what is the matching principle's effect on the preparation of accounting reports. Perhaps additional prompters or better wording of the question may have helped here, but students are reminded again to refer back to the question.

For the same question, a common error was students stating the "matching principle was the rule that debits must equal credits" which is more about the double-entry rule, rather than the matching principle.

(ii) Many students did not understand the qualitative characteristics of accounting information. Students are again reminded that the theory component of the course is the foundation of the practical application. Theory doesn't have to be difficult when it is connected to why it's needed.

(b) No specific comments for these questions other than the suggested answers.

Question 3

General Journal

A few general comments for students to note:

(1) No need to write $ signs in front of numbers.
(2) Stay consistent with account names e.g. don't use Cash for one entry and Bank for the next.
(3) If you are given a receipt or invoice numbers in the question, they need to be used in the narration.
(4) Rule off after the entire narration – not under every word of the narration if it takes more than one line e.g. many students ruled under each line of x2 or x3 lines of narration.
(5) Narrations should be in brackets.
(6) Write account names in full e.g. Cash at Bank not CAB.
(7) Control accounts are not used in this question. No need to write Account Receivable – F Murray. Simply write F Murray and save time.
(8) Make the indent before the credit entry obvious.
(9) No need to write the word "account" after the account name e.g. write Sales not Sales Account.
(10) Use account names not classifications e.g. Capital not Owner's Equity
(11) Narrations and Formatting (layout e.g. ruling off, Dr before Cr and indenting) are worth marks.
(12) GST still causes issues in regard to whether to calculate 1/10 or 1/11 of the price.

Specific comments:

- Students still forgot to account for the cost price of inventory when a sale was made (Aug 3).
- Jan 23: The most common error on this question was to forget the GST involved in returning damaged goods.
- Feb 9: There is no account called Inventory Returns. GST was often not accounted for.
- June 30: The balance day adjustment was badly done. Students frequently had the entry the wrong way around Crediting Sales and therefore increasing rather than decreasing Sales. The wrong temporary account was often used.

Question 4

(a) It is important that the student explains the entry itself. The explanation should start with the date that the entry occurred. The best answers also explained how the GST was reversed rather than just stating that the entry included GST. A number of students thought the owner of the business was J Smith rather than J Smith being an Account Receivable to the business.

(b) This part was done badly. Again, the date should be mentioned. Students attempted to relate this entry back to what had happened at A – probably as it was for the same amount. It isn't directly related to J Smith's account being written off. In fact, the Provision was decreased by $4000 to make the balance $3000.

(c) The best answers explained the Provision for Doubtful Debts was a) a negative Current Asset in the b) Balance Sheet and c) deducted from Accounts Receivable.

Question 5

Bank Reconciliation

This was a slightly more testing bank reconciliation question than in previous exam papers. The most common mistake students made was putting the refund in the Cash Receipts Journal when they had to include this in the bank reconciliation statement for the end of October. Some students may have been confused that the question didn't include who was at fault if there was an error.

The second most common mistake made by students was getting confused with a debit balance in the bank statement. This meant that students had to add the unpresented cheques and subtract the deposit not yet credited which resulted in a credit balance (overdraft) of the Cash at Bank Account.

Students need to take care that the opening balance brought down for their Cash at Bank Account is the 1st day of the current month (the 1st of October in this question) not the end of the previous month (30th September).

Question 6

The Income Statement and Balance Sheet

The Income Statement and Balance Sheet were reasonably well done by the majority of students.

The following observations need to be addressed by students (and teachers, in some instances):

(1) To gain a full mark for the report headings, the business name, report name and relevant date needed to be included (following the format used in both recommended texts). That is, the Income Statement is for a period ending on a certain date and the Balance Sheet is as at a certain date. Many students are still confusing these two.

(2) Students are reminded NOT to use abbreviations for account names in a formal accounting report, for example Provision for Doubtful Debts should NOT be written as PFDD; nor should Accumulated Depreciation on (a specific asset) be abbreviated to Acc Dep. Students are encouraged instead to use two lines, if required, to write the official account titles with relevant figures recorded on the second line.

(3) The balance day adjustments relating to the stocktake and depreciation allocations were, generally, accurately calculated and reported in the appropriate reports. The Rent and Sales Wages adjustments were more problematic.

Calculations as follows were accepted as being correct:

- Rent of $3 000 was paid on June 9 (for 4 weeks = $750 per week). Therefore 21 days (3 weeks = $2 250) has used in the current accounting period with 1 week's rent of $750 being prepaid for the next accounting period. A calculation based on 8 days of $800 was also accepted.
- Sales Wages of $6 200 were owing on balance day (for the preceding 2 weeks), therefore an Accrued Expense for this amount needed to be recorded as a Current Liability in the Balance Sheet. Alternate calculations for 9 or 13 days ($5 580 or $5757 – rounded to nearest $) were also accepted from a very small minority of students.

The following recommendations are highlighted in relation to the setting out / formatting of the accounting reports:

- The Net Sales and total Cost of Sales figures should be recorded in the final column to allow for a straightforward calculation of Gross Profit.
- The Gross Profit amount should be written on the same line as the Gross Profit heading on the proforma answer sheet. Many students wrote this on the line or two above, some writing in the words Gross Profit (not realising that these were already on the proforma) and others not recognising that the Net Sales minus the Cost of Sales figure is the GROSS PROFIT and therefore not writing this figure anywhere near the *Gross Profit* heading.
- Only the final totals on both reports should be double underlined. That is, the final Net Profit (Loss) figure in the Income Statement and the final totals of NET ASSETS and OWNERS' EQUITY in the Balance Sheet. Many students erroneously double underlined Total Assets and Total Liabilities in the Balance Sheet and/or failed to double underline the appropriate final totals at all.
- The calculation and/or placement of sub-totals, with correct / appropriate underlining also continues to be an issue for some students, demonstrating that they don't know the purpose of completing these calculations nor what they show.
- Some students failed to subtract the Provision for Doubtful Debts from the Accounts Receivable in the Current Asset section of the Balance Sheet; nor did some record the Accumulated Depreciation directly below and then subtract this amount from the asset to which it related to arrive at the written down value, and were penalised in both circumstances.
- The use of the term '*Owner's Capital*' was perplexing. This course only covers accounting for sole traders and therefore any Capital belongs to the owner. Including the term '*Owners*' in front of '*Capital*' in the Balance Sheet is superfluous. Neither recommended text includes this. Students were not penalised if they did this, but it is not a style that should continue to be used. Afterall, the heading 'OWNERS EQUITY' also implies that the Capital belongs to the owner.

Question 7

Generally answered well by most students. Students are reminded to show all workings in order to achieve part marks in the event that they don't get the correct answer.

Question 8

(a) Students generally did quite well on this question (profitability). They were able to describe the trend which showed an overall favourable profitability picture. Better students didn't use up too much space describing the trend in the ratios but were able to also refer to the financial reports and provide explanation about the trend appearing by referring to the figures contained in the Income Statement and Balance Sheet. The advice to students would be to be less laborious in describing the change in the ratios and spend more time on explaining what this means about the profitability of the business, and rather than saying "this might be because of…", to instead refer to the financial reports (if provided) to see what has actually happened, and comment on this.

(b) Answers tended to be descriptive of the ratios rather than explaining what the liquidity problem meant for this business – the likely inability to pay bills on time, and the probable consequences of this – poor reputation, reduced ability to trade with other businesses, action from creditors to enforce payment etc.

(c) Generally, this question (about Financial Stability) was answered quite well by most candidates. Better answers did pick up that the lower levels of overall debt did put the business in a good position to borrow money to alleviate its liquidity problem.

(d) Surprisingly, a significant number of students didn't understand the Inventory turnover ratio or the problems caused by holding slow moving inventory. Many answers used the term "stockpiling" e.g. "the business is stockpiling" but then didn't explain what this meant or offer reasons why this may or may not be a good idea.

Suggested Solutions: see following page

SUGGESTED SOLUTIONS

SECTION A

The following are suggestions only. The page references are from the following texts:
Stanley, T, et al, 2009, 3rd Ed, *Accounting: an introductory framework, Pearson Heineman*
Greig, P, et al, 2008, 4th Ed, *Accounting: Concepts & Applications*, VCTA Publishing

Question 1

(a) (i) Greig p 38 Stanley p 146

The accounting process, or 'cycle', involves the recording of transactions through the financial year and the production of the accounting reports at the end of the financial year. It is sometimes called a 'cycle' because it is repeated each financial year for the life of the business. Two stages of the process could be drawn from:

- Transaction – "a financial event that impacts upon the Accounting Equation" e.g. a cash sale, recording of depreciation etc
- Source document - "Evidence of a transaction – e.g. receipt, invoice, bank statement, memo etc"
- journal entry "The "book of first entry" – where double entry is first recorded showing the accounts affected by the transaction – total debit entries = total credit entries – e.g. the General Journal, Cash Payments or Cash Receipts journals.
- accounts (double entry into ledger accounts) – "A record of all transactions affecting a particular item". Columnar or T-account format. Increases go on the same side as the "nature of the account" (and decreases on the opposite side)
- trial balance – a list of all account balances at a particular date – shows the arithmetic accuracy of the ledger and also is the basis for preparing the Income Statement and Balance Sheet
- balance day adjustment – adjustments made to Revenue and Expense items to ensure the Matching principle is adhered to allowing for the most accurate calculation of profit as is possible – e.g. Accrued Revenues and Expenses, Prepaid Expenses and Unearned Revenues, Depreciation, Provision for Doubtful debts, Inventory Adjustment etc.
- adjusted trial balance
- final reports (Income Statement and Balance Sheet). These reports are used to evaluate business performance, including the profitability and financial stability of a business.

Marking Scheme: total of 3 marks

- 2 marks for accounting process: 1 mark for **recording of transactions through the financial year**, 1 mark for **production of the accounting reports at the end of the financial year**
- ½ mark for each identification of a stage in the process = 1 mark

(ii) Greig p 21, Stanley p 36

Note: two commonly used texts have varied definitions of expense ranging from quite technical to broad. I would expect that any definition used would explain that an expense is an outflow of resources from a business. It is a cost incurred in operating a business. Answers should make clear the distinction between purchasing an asset that still has value at balance day versus purchasing an item that is "consumed" within the accounting period.

- an expense is an expenditure ('outgoing')
- they are the costs of operating the business
- incurred in earning revenues
- there is no ongoing asset created by the expenditure

A range of examples are available; interest, insurance, wages, power, etc.

Marking Scheme: total of 3 marks

- 1 mark for COSTS OF OPERATING A BUSINESS
- 1 mark for identification of OUTGOING/ EXPENDITURE incurred in earning revenues
- ½ mark for each examples of an expense item = 1 mark

(iii) Greig p 22 & 338, Stanley p 19 & 434-444

Definition needs to include:

- an item of value owned or controlled by a business
- held by a business over time
- used to generate revenue
- current asset intended to be held for relatively short period of time- within an accounting period or 12 months often mentioned in texts.
- They are defined as current due to their "liquidity" – they are either in cash form already or will shortly be "turned" into cash – either being sold (inventories) or collected (debtors).

A range of examples are available – cash, accounts receivable, inventory, prepaid expenses, accrued revenues…

Marking Scheme: total of 3 marks

- 1 mark for item of value owned/controlled by a business and used to generate revenues
- 1 mark for identification of item held by a business that is liquid / will be converted to cash within the financial year
- ½ mark for each examples of a current asset item = 1 mark

(iv) Greig p 155, Stanley p 105 & 107

Definition of balance day adjustment needs to include:

- It is a general journal entry
- It changes (adjusts) account balances
- These adjustments are intended to ensure that:
  - revenues and expenditures are matched to calculate the most accurate profit figure possible
  - all assets and liabilities are recorded

A range of examples are available – prepaid expense, unearned revenue, accrued expense, accrued revenue, loss of inventory, bad and doubtful debts, depreciation…

Marking Scheme: total of 3 marks

- 1 mark for identifying it is a GJ entry that changes the account balances
- 1 mark for identification of how a BDA matches revenues earned in a period with the expenses incurred in earning that revenue to ensure an accurate profit figure (matching principle)
- 1 mark for one example of a balance day adjustment item

Note: Many students answered this question incorrectly and explained that BDAs were about fixing errors in the Trial Balance. Better answers identified the link with accrual accounting and the matching principle.
Additionally, many students answered this question vaguely; there were no marks allocated to answers that stated 'a balance day adjustment is an adjustment made on balance day'. Candidates are reminded that they should not use the term as part of a definition.

(b) (i) There are a variety of reasons why a manager may choose to borrow rather than seek additional capital including:

- low interest rates may make borrowing attractive
- repayments of loans can be matched to revenues derived
- existing funds held by the business may be preserved for future use (an attraction to borrow)
- avoids share/dilution of ownership (in an unincorporated structure) and future division of profit through dividends if new owners introduced (in a company structure)
- may be difficult to attract capital from outside of the current ownership
- current owners may have limited financial resources of their own to access and invest in the business

Marking Scheme: total of 3 marks

- 1 ½ marks for identifying ONE advantage of borrowing compared to relying on capital funds
- 3 marks given for a clear explanation of borrowing compared to relying on capital funds

Candidates are reminded to read question carefully. This question was not about defining/explaining what debt finance and equity finance are. Rather, it was focused on why a manager might borrow rather than use equity funds for an expansion. Better answers focused on advantages of borrowing (debt finance) compared to the negatives of using capital (equity finance).

(ii) Businesses must be able to meet their cash debt obligations as they fall due. In order that they can do this they must plan to have sufficient cash at the time cash obligations fall due. Also, if businesses can identify a time when there is a quantum of 'spare' cash in the future it can plan to invest and maximise its return.

The cash budget provides this forecast of cash balances in the future by comparing future cash inflows with future cash outflows and the consequent future cash balance. It allows the business to evaluate the availability of cash and to make plans to ensure that they can have sufficient cash or to use surplus cash. For example:

If there is a projected overdraft:

- spending plans can be adjusted (e.g. delaying purchases of assets)
- money can be sourced if required (e.g. further capital, increasing the overdraft limit, taking out a loan).

If there is a projected surplus:

- the cash might be used to purchase assets
- money could be invested in a term deposit to get a higher return
- the owner could take cash drawings.

Marking Scheme: total of 3 marks

- 1½ marks for identifying what a cash budget might be used for when managing a business
- 3 marks given for a clear explanation of the importance of using a cash budget when managing a business

Candidates are reminded to read question carefully. This question was not simply about defining/explaining what a cash budget is. Rather, it was focused on how important a cash budget is to the sound management of a business. Better answers focused on ways a cash budget assists managers to run their business in terms of forecasting and preparing them for the upcoming 1-12 months.

Many candidates incorrectly discussed profitability in their answer, rather than projected cash position.

(c) (i) Greig p 6, Stanley p 6

External users are those who are not connected with management of a business – they are outside the organisation. They have the external reports (Income Statement, Balance Sheet, Cash Flow Statement) available to them to inform them of the affairs of the business. Examples include lending institutions, government authorities, intending share purchasers…

Internal users are those within a business who have governance responsibilities. They have the external reports available to them, but in addition have internal documents such as budgets and sales reports available to them in order to support decision making. Examples may include sales managers, financial managers…

Marking Scheme: total of 4 marks:

- 1 mark for identifying external users are outside the business and not directly connected with management of a business
- ½ mark for identifying an appropriate external user
- ½ mark for identifying which financial reports an external user would be interested in – e.g.: Balance Sheet to see a business's financial position regarding debt obligations
- 1 mark for identifying internal users are inside the business and are directly connected with management of a business
- ½ mark for identifying an appropriate internal user
- ½ mark for identifying which financial reports an internal user would be interested in – e.g.: Cash Budget to see a business's expected receipts and payments in upcoming months in order to plan for future.

Many students said customers were external users. However, while customers are indeed outside of the business, customers generally would never look at a business's financial statements/accounting reports of a business before they purchase from them, so no marks were allocated to customers if used as an example.

(ii) Greig p 55 & 57-58, Stanley p 54 - 55

If double entry is properly applied, then the total of the debit balances must equal the total of the credit balances in the Trial Balance. If not, then a posting error has certainly occurred, but if they are equal it is not certain that an error **has not** occurred. For example, if an incorrect amount is posted to the correct sides of two accounts there is an error but the trial balance still balances. (Any other example where debits and credits are the same but another error has occurred in posting are acceptable.)

Marking Scheme: total of 4 marks

- 1 mark for identifying an example of an error that WOULD be disclosed and 1 mark for identifying an error that WOULD NOT be disclosed = 2 marks
- 1 mark for each explanation of the error x 2 = 2 marks

Many students only defined what a Trial Balance was, but did not provide examples of the errors disclosed and not disclosed. A number of candidates discussed which errors would be disclosed, but didn't go on to explain them with an example and therefore didn't show complete understanding in order to get full marks.

(iii) Greig p 155 - 159, Stanley p 107-111

While both of these items are balance day adjustments, and both appear in the Balance Sheet, they are different in nature.

An <u>accrued expense</u> is a current liability because it is an expense which has not been paid for in the current accounting period but for which the obligation to pay exists. For example, wages may have been earned by employees but payday falls in the next accounting period. The wages are owing in the current period, but the cash won't be paid until the following period.

A <u>prepaid expense</u> is a current asset because it is an item which has already been paid but won't be consumed/used up until the next accounting period. For example, insurance expense – premiums are paid in advance for a year to cover the upcoming insurance cover period – that is they are paid and recorded in the accounting period but will not be incurred until the next accounting period.

Marking Scheme: total of 4 marks:

- 1 mark for a definition/explanation of a prepaid expense and 1 mark for an accrued expense = 2 marks
- 1 mark for each example explained x 2 = 2 marks

(iv) Greig p 519, Stanley p 434-435

Financial expenses are those costs incurred which relate to funding business operations. Includes expenses associated with borrowing money or operating bank accounts such as interest charges, bank fees and costs of offering credit to outside parties such as bad debts…

Selling expenses are incurred in any activity relating to sale of business products or services. Advertising, sales staff wages and delivery costs are examples.

Marking Scheme: total of 4 marks:

- 1½ marks for a definition/explanation of a financial expense and 1½ marks for a selling and distribution expense = 3 marks
- 1 mark for each example x 2 = 1 mark

Many students defined a financial expense as 'an expense to do with the financials of a business' or a selling and distribution expense as' an expense to do with selling and distributing'. No marks were awarded for this. It was essential that the explanation included an understanding of the type of expenses that are within each category. Selling and distribution expenses explanation must have included how they relate to the business trying to generate revenue through their product/service to get the full 1½ mark allocation.

Question 2

(a) (i) Greig p 487, Stanley p 105-106

The matching principle is the accounting convention where the revenues earned in the accounting period must be matched to the expenses incurred in earning those revenues in that period in order to ascertain an accurate profit figure for that period. (2 marks).

This is achieved by balance day adjustments to recognize any prepayments and accruals. This will have the effect of altering (increasing or decreasing) the relevant revenue or expense item/s in the Income Statement (1½ marks) as well as creating a new account in the Balance Sheet, either a current asset or current liability (1½ marks). Any adjustment made to alter revenue or expense items with the aim of achieving a more accurate estimate of profit is an application of the Matching Principle.

For example, when a payday does not include all wages for a period, then an entry to include all wages owing as at balance day needs to be done, debiting the Wages account and crediting the Accrued Expenses (Current liability) account. (1 mark).

Other examples of entries include:

- Accrued Revenues, Prepaid expenses, Unearned Revenues, Depreciation and Bad and Doubtful Debts, inventory adjustments.
- Recording of Credit Sales and Purchases at the time of Sale/Purchase rather than when the related cash flow occurs.

Question 2 (a) yielded very low marks generally. Those attempting Q2(a)(i) "matching principle" more often than not gained 2 marks out of a possible 6 by explaining what the matching principle is and stopping there. For 6 marks, as per the suggested answer above, students needed to say much more than this and had to refer back to the question: what is the matching principle's effect on the preparation of accounting reports. Perhaps additional prompters or better wording of the question may have helped here, but students are reminded again to refer back to the question.

For the same question, a common error was students stating the "matching principle was the rule that debits must equal credits" which is more about the double-entry rule, rather than the matching principle.

(ii) Greig p 490-495, Stanley p 482-4983

<u>Relevance</u> means that when accounting reports are prepared their contents should be meaningful. That is, should relate to the matter at hand. The information must assist users in making and evaluating decisions. Relevance will also reflect accountability of those who prepare reports. Timeliness will also be a factor in determining relevance.

<u>Materiality</u> means that contents of accounting reports should be of significance in their value to decision making. That is the $ amount(s) must be of sufficient size to be a factor in decision making and understanding. One matter arising is whether the omission or non-disclosure of the information will affect decisions relating to it. If not, it may not be material. (Kirkwood-P.482 – "information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial report").

For example:

- using totals for categories or sub-categories rather than individual account balances in the Income Statement or Balance Sheet
- recording small value asset purchases as expenses.

Many students did not understand the qualitative characteristics of accounting information. Students are again reminded that the theory component of the course is the foundation of the practical application. Theory doesn't have to be difficult when it is connected to why it's needed.

(b)(i) Greig p 345, Stanley p 328

The matching principle requires that revenues of the period are matched to expenses of the period in order to calculate profit and therefore depreciation is an important part of determining profit, given assets are used to generate revenues, but lose value over the duration of them being used.

Depreciation allocates the cost of the asset over its useful life. By recording Depreciation each period, the cost of the asset is matched against the revenue earned in a particular period. Failing to record it would result in a profit figure that is too high - therefore not showing the true performance of the business (in the Income Statement) and overstating the financial position of assets and equity (in the Balance Sheet).

(ii) Stanley p 111

The effect on reported profit if unearned revenues are not accounted for is to overstate profits. This is because unearned revenues are revenues that have been received in advance, or prepaid. Unearned revenues should not be included in the reporting period as although the cash is received in the current period (recognised) the revenue is not earned (realised) until the following period. Therefore, a balance day adjustment is required to reduce the revenue in the current period by the amount that has yet to be earned. To account for it means that revenues will be correctly reduced by the adjustment.

(iii) Greig p 488 & 490-495, Stanley p 482-483

By using estimation of assets' value, the manager is breaching reliability, comparability and the Historical Cost assumption.

By changing asset values without an independent valuation, users of the accounting reports could not rely on them to accurately reflect the asset values of the business (a breach of the reliability characteristic), and between-year comparisons of asset values will also suffer due to the changes being made (comparability characteristic).

Changes to values (without an independent valuation being done) breaches the Historical Cost assumption that states that items should be shown at the purchase price which is objective in the sense that it is (at least) based on evidence.

Marking Scheme: total of 3 marks:

- 1 mark for identifying **reliability** or **comparability**
- 1 mark for explaining reliability or comparability
- 1 mark for identifying Historical Cost and explaining it

(iv) Greig p 486

The Accounting Entity Assumption is breached in this case. That is, the affairs of the owner must be kept separate from those of the business entity regardless of the legal structure of the business. The practice would increase business expenses leading to the business having a decreased reported profit when subtracted from revenue. This also means that tax paid on profit would be reduced which is illegal (tax fraud).

Marking Scheme: total of 3 marks:

- ½ mark for identifying Entity assumption and ½ mark for explaining it
- 1 mark for identifying that it would have the undesirable effect of overstating business expenses
- 1 mark for identifying that would have the undesirable effect of understating reported business profits and a decrease in OE.

SECTION B

Question 3 – General Journal

2020	Particulars	Debit	Credit	Marks
July 1	Cash at bank	100 000		1
	Motor Vehicle	42 000		1
	Capital		142 000	1
	(Owner commenced business with assets as Capital)			
Aug 3	F Murray	1 430		1
	Sales		1 300	1
	GST Clearing		130	1
	(Credit sale of GST inclusive inventory, Tax Invoice No C567)			
Aug 3	Cost of Goods Sold Sales	980		1
	Inventory		980	1
	(Cost price of goods sold, Tax Invoice No C567)			
Oct 24	Inventory	17 000		1
	GST Clearing	1 700		1
	Fourex Traders		18 700	1
	(Purchased GST inclusive inventory on credit, Tax Invoice No A745)			
Dec 6*	Insurance	1 500		1
	GST Clearing	150		1
	Cash at Bank		1 650	1
	(Paid insurance, GST inclusive by direct deposit)			
Jan 23	Fourex Traders	407		1
	Inventory		370	1
	GST Clearing		37	1
	(Returned GST inclusive inventory to supplier, Credit Note R26)			
Feb 9	Drawings	440		1
	Inventory		400	1
	GST Clearing		40	1
	(Owner withdrew GST inclusive inventory for personal use)			
March 26	Cash at Bank	45 000		1
	Capital		45 000	1
	(Owner introduced additional cash as Capital)			
May 17	GST Clearing	1 600		1
	Cash at Bank		1 600	1
	(GST owing paid to ATO)			
May 31	Cash at bank	450		
	Interest revenue		450	
	(Bank interest received)			
June 30	Sales	5 000		1
	Unearned revenue		5 000	1
	(Sales revenue received in advance on balance day)			

*If interpreted as a debit to the insurance company (Tassisafe) and a credit to cash, assuming that the purchase of insurance had been earlier recorded so as to create the insurance company as a creditor then 2 marks is to be allocated (1 mark per line).

Marking scheme:

- *Entries:* Marks for correct accounts totalled 28 (1 mark per line – the complete line to be correct to earn 1 mark).
- *Layout:* 2 marks for narrations and 2 marks for layout.

Total Marks: / 15 (score x 15 and divide by 32, rounded up or down to the nearest half mark).

Question 4

(a) (Transaction **A** records the writing off to bad and doubtful debts the amount owed by account receivable (debtor) J Smith as it has been deemed uncollectable. The GST collected as a result of this transaction is reversed as the tax liability is reduced.)

On 4th October 2019, $4 000 in J Smith's account was written off as a bad debt and the GST collected of $400 was reversed as the total amount of $4 400 will not be received by the business.

2 Marks

(b) (Transaction **B** is a balance day adjustment decreasing the Provision for Doubtful Debts from $7 000 to $3 000, or reducing the provision by $4 000)

On 30th June 2020, the Provision for Doubtful Debts is reduced to $3 000.

2 Marks

(c) The Provision for Doubtful Debts is recorded as an offset to Accounts Receivable in the Current Assets section of the Balance Sheet. That is, it is deducted from the Accounts Receivable balance.

1 Mark

SECTION C

Question 5

(a) Wren Cottage direct deposit ($196) to be added to cash receipts.
Total then becomes $2 624.

(b) Merchants fee ($35), Interest ($4) and Bank Fees ($18) to be added to cash payments.
Total then becomes $5 149.

A			MARKS
Cash Receipts			
Date	**Details**	**$**	
Oct 5	Cash sales	139	
	EFT Sales	320	
Oct 12	Cash sales	87	
	EFT Sales	247	
	Deposit- Kiddisafe Care	299	
Oct 19	Cash sales	121	
	EFT Sales	301	
Oct 26	Cash sales	96	
	EFT Sales	198	
	Deposit- Maud's Creche	200	
Oct 31	Deposit-mum's day event	420	
	Sub-total	*2 428*	
Oct 31	Wren Cottage	196	2
	Total	**$2 624**	**2**

4 marks

B				MARKS
Cash Payments				
Date	**Details**	**Cheque #**	**$**	
Oct 7	Wages--casual		175	
Oct 8	Transfer-Telecom		135	
	Transfer- Gym Gear		92	
Oct 13	A1 Insurance	528	1 120	
Oct 14	Wages-casual		175	
	Transfer-Swiftkleen		83	
Oct 19	Rent	529	1 680	
Oct 20	Transfer-Mod Office		67	
Oct 21	Wages-casual		175	
	Drawings-owner		260	
Oct 28	ATO	530	955	
	Wages-casual		175	
	Sub-total		**5 092**	
Oct 31	Merchants fee		35	1
	Interest		4	1
	Bank Fees		18	1
	Total		**5149**	1

4 marks

(c) Cash at Bank account

Cash at Bank A/c

Oct 1	Balance b/d	1 284	Oct 31	Cash Payments	5 149	**1+1**
Oct 31	Cash Receipts	2 624				**1**
	Balance c/d	1 241				
		$5 149			$5 149	
			Nov 1	Balance b/d	1 241	**1**

OR,

Cash at Bank A/c

Oct 1	Balance b/d	1 284	Oct 31	Cash Payments	5 149	**1+1**
Oct 31	Cash Receipts	2 624				**1**
				1241		**1**

OR,

Cash at Bank A/c

Date	Particulars	Debit	Credit	Balance	
Oct 1	Balance b/d	1 284		1 284 Dr	**1**
Oct 31	Cash Receipts	2 624		3 908 Dr	**1**
Oct 31	Cash Payments		5 149	1 241 Cr	**1 + 1**

4 marks

(d) Bank Reconciliation

Kinder Play Palace
Bank Reconciliation Statement as at 31 October 2020

			$	$	
Debit balance as per Bank Statement				613	1
Add Unpresented cheques:					
	Cheque No	526	38		1
		530	<u>955</u>	<u>933</u>	1
				1 606	0.5
Less Deposit not yet credited				<u>420</u>	1
				1 186	0.5
Add Bank error – direct deposit				55	1
Credit balance as per Cash at Bank Account				**$1 241**	1

8 marks

OR,

Kinder Play Palace
Bank Reconciliation Statement as at 31 October 2020

			$	$	
Debit balance as per Bank Statement				613	1
Add Unpresented cheques:					
	Cheque No	526	38		1
		530	955	933	1
				1 606	0.5
Add Bank error – *direct deposit*				55	1
				1 661	0.5
Less Deposit not yet credited				420	1
Credit balance as per Cash at Bank Account				**$1 241**	1

8 marks

SECTION C

Question 6

Adjustments to be made:

1 Inventory Adjustment

Inventory Adjustment	200	
Inventory		200

2 Prepaid Rent

Prepaid Expense	750	
Property Rent		750

3 Accrued Wages

Sales Wages	6 200	
Accrued Expenses		6 200

4 Provision

Bad and Doubtful Debts	400	
Provision for Doubtful Debts		400

5 Depreciation

Depreciation on Showroom Fittings	18 600	
Accumulated Depreciation on Showroom Fittings		18 600

6 Depreciation

Depreciation on office Computer Equipment	4 620	
Accumulated Depreciation on Office Computer Equipment		4 620

(a) Income Statement

Marks		$	$	$
0.5	***Glamour Bathrooms – Income Statement***			
0.5	***For the period ended 30 June 2020***			
	Net Sales	**$**	**$**	**$**
1	**Sales**		2 410 200	
1+1 (0 if SR not subtracted)	Sales Returns		22 000	2 388 200
	Less Cost of Sales			
1	Cost of Goods Sold		1 920 000	
2	Inventory adjustment		200	1 920 200
1	Gross Profit			468 000
	Add Other Revenue			
	Less Other Expenses			
	Selling and Distribution Expenses			
2	*Sales Wages	163 200		
1	Marketing	28 500		
2	Depreciation of showroom fittings	18 600	210 300	
	General and Administrative Expenses			
1	Administrative Wages	87 000		
2	*Property Rent	35 250		
1	Power	3 900		
1	Other Property Costs	8 200		
1	Insurance	5 000		
1	Telecommunications	5 300		
3	Depreciation of office computers	4 620	149 270	
	Finance Expenses			
1	Interest Expense	1 300		
1	Borrowing Charges	400		
1	Bank Charges	680		
2+1 (total Other Expenses)	Bad and Doubtful Debts	600	2 980	362 550
1	Net Profit			**$105 450**

* Alternate calculations were also accepted for the following balance day adjustments:

- Sales Wages: 9 days $5 580
  13 days $5 757 (rounded to nearest $)
- Rent: 8 days $800

Marking scheme (6a)

Guiding Principal: any entry can't have less than 0 marks

Entries:

- 1 mark for correct title (0.5 for identifying the report and 0.5 for the dates)
- 1 mark per correct entry
- 2 marks for simple correct BDA
- 3 marks for complex correct BDA's
- If the item is there but remains unadjusted, allocated a mark of 0.5
- For an adjustment attempted but incorrect, allocate 1 mark for a simple adjustment and 1.5 marks for a complex adjustment
- Minus 0.5 if correct statement, but wrong classification (e.g. if worth 3 marks, would be 2.5, 2 marks, 1.5, etc.)
- 0 marks if incorrect statement
- Minus 0.5 if transfer of incorrect amount from tail balance (e.g. if worth 1 mark, would be 0.5 (or 0 if also wrong classification)

Formatting:

- Correct use of columns for sub-totaling, sub-totals and ruling = /3 marks allocated overall
- Final score is out of 33 (30 + 3)
- **Calculation of final mark / 25** (score x 25 ÷ 33)

(b) Balance Sheet

			$	$	$	$
0.5		***Glamour Bathrooms – Balance Sheet***				
0.5		***as at 30 June 2020***				
		ASSETS				
		Current Assets				
1		Cash at bank		6 200		
1		Accounts Receivable	43 700			
2 +1	(if minus PFDD)	Less Provision for Doubtful Debts	400	43 300		
2		Inventory		52 600		
2		*Prepaid Expense		750	102 850	
		Add ***Non-Current Assets***				
		Other Financial Assets				
		Plant Property and equipment				
1		Computer Equipment	18 600			
3 +1	(minus Acc Dep, Dep, 0 if added)	*Less* Accumulated Depreciation on Computer Equipment	7 820	10 780		
1		Showroom Fittings	93 000			
2 + 1	(minus Acc Dep, 0 if added)	*Less* Accumulated Depreciation on Showroom Fittings	21 400	71 600	82 380	
		Total Assets				185 230
		Less **LIABILITIES**				
		Current Liabilities				
1		Accounts payable		46 200		
1		Bank Loan		5 000		
2		*Accrued Expense		6 200	57 400	
		Non-Current Liabilities				
1		Bank Loan (term 5 years)			40 000	97 400
		NET ASSETS				$87 830
		OWNER'S EQUITY				
1		Capital		94 000		
1		*Add* Net Profit		105 450	199 450	
1+1	(1 if balanced, otherwise 0)	*Less* Drawings			111 620	$87 830
+1	(0 if Drawings first)					

* Alternate calculations were also accepted for the following balance day adjustments:

Sales Wages:	9 days	$5 580
	13 days	$5 757 (rounded to nearest $)
Rent:	8 days	$800

Marking scheme (6b)

Guiding Principal: any entry can't have less than 0 marks

Entries:

- 1 mark for correct title (0.5 line)
- 1 mark per correct entry
- 2 marks for simple correct BDA
- 3 marks for complex correct BDA's – part marks for adjustment attempted but incorrect
- 1 mark for a simple BDA
- 1.5 marks for a 'complex' BDA
- **If adjustment is not attempted but the item is included, allocate 0.5 marks**
- Minus 0.5 if correct statement, but wrong classification (e.g. if worth 3 marks, would be 2.5, 2 marks 1.5 etc.)
- 0 marks if incorrect statement
- Minus 0.5 if transfer of incorrect amount from trial balance (e.g. if worth 1 mark, would be 0.5 (or 0 if also wrong classification))

Formatting:

- Correct use of columns for sub-totaling, sub-totals and ruling = /3 marks allocated overall
- Final score is out of 32 (29 + 3)
- **Calculation of final mark / 20** (score x 20 ÷ 32)

SECTION D

Question 7

(a) 22.22% = 90,000/((400,000+410,000)/2) (1 mark). 0.5 marks for calculation without averaging

(b) 4.13 times = 62,000/((14,000+16,000)/2) (2 marks) 1 mark for calculation without averaging

(c) 54.51 days = ((22,000+24,000)/2)/154,000*365 (2 marks) 1 mark for calculation without averaging

Question 8

(a) Must address three ratios and associated data.

Gross Profit Ratio

Relatively constant with small drop in 2020 from 64.47%to 63.10%. Margin on cost of goods sold has been generally maintained. Slightly better performance than industry average which means that the margin between the purchase and selling price of stock items is greater than comparable businesses, providing a potential competitive advantage.

Net Profit ratio

Significant improvement in this ratio from 38.88% to 44.36%. As the gross margin is fairly constant the business has been able to reduce its Other Operating expenses (both in $ terms (from~69k to ~$60k) and as a percentage of Sales dollars). At the same time they have also increased Net Sales from ~$275k to ~$322k). The main contributor to this improvement is a drop in Administrative expenses from $58 000 in 2018 to $47 000 in 2020. The business has better profit performance than industry average who spend 22% of each Sales dollar on Other Operating Expenses compared to this business who spent 18.72% of their Sales dollars on Other Operating Expenses in 2020 – a difference of 3.28 percentage points.

Rate of return on Owners' Equity

This increase in net profit is reflected in the return on Owners' Equity ratio improving from 31.15% to 39.42% over the period. Whilst Owners Equity has increased in 2020, the relative increase in net profit has been greater and thus the rate of return over the 3 years has improved to exceed industry average by 4.42 percentage points. Overall the business doesn't have any issues with profitability. Improvement could focus on increasing overall sales – possibly by applying marketing strategies to increase customer awareness e.g. an advertising campaign.

(b) Must address two ratios and associated data

Quick Asset Ratio

This ratio indicates the capacity of the business to meet its debts in the very short term. The ratio has fallen from 0.48:1 to 0.41:1. If the business was forced to meet its current liabilities in the short term then it would have insufficient assets with the required degree of liquidity. The company could meet less than half of its short term obligations. Industry average is significantly higher at 1.2:1.

Current ratio

This measure indicates the capacity of the business to meet its obligations over a longer period of, say, 12 months. The measure includes inventory, which is excluded from the Quick Assets ratio. A decline in 2020 from that of 2019 (1.54:1 to 1.39:1) reflects the liquidity issue. This current ratio is lower than the Industry average of 2:1. The business would be unlikely to pay its ongoing commitments on time, leaving it at risk of developing a bad reputation for paying on time and possible legal action from creditors.

Both ratios show that the business has a liquidity problem, and in fact at no point in the 3 year period has it had cash in the bank; running an overdraft that has increased from $42k in 2018 to $56k in 2020. Clearly they need to get rid of their overdraft and increase their cash at bank balance. Strategies to achieve this could include:

- Sale of un-needed assets
- Taking out a loan
- Equity funding – owner provides capital or bringing in an equity partner

(c) *Debt ratio.*

Total debt is decreasing and consequently equity is increasing, although changes are relatively small. Lower overall debt level than the industry average, which puts it in a good position to borrow money to assist with the liquidity problem. The low debt ratio suggests that in the longer term the business is financially stable.

(d) The inventory turnover has always been slow compared to average and has become even slower in 2020. The main cause of this is inventory levels increasing at a faster pace (from ~$70k to ~90k, which is an increase of ~28.5%) than the increase in Net Sales (from ~$275k to ~322k, which is an increase of ~17%). To improve this, the business either needs to reduce stock levels or increase Sales.

Holding too much inventory can cause the following problems:

- It ties up funds (e.g. could assist with reducing the overdraft and improving the Quick Asset Ratio).
- Increases storage costs
- Older stock can become obsolete, out of date, perish or out of season which can have negative effects on profits if stock has to be thrown out or sold cheaply or even sold at a loss.