Accounting

Course Code: ACC315116

Section A

Question 1

This question was answered well by a majority of candidates.

(a) Most candidates did not answer this question very well. Candidates who answered 1 (b) (i) need to focus on the many items on the Income Statement and Balance Sheet which are estimated or depend on Historical values. Candidates who answered 1 (b) (ii) need to focus on Debt or Equity financing and the advantages and disadvantages of each, and when discussing Debt financing talk about matching the type of borrowing with the life of the assets being purchased.

(b) Most candidates did not answer this question very well. It is a new part of the course, so in future, greater focus on comparison of related terms and the ability to discern and describe the differences is needed. Suggested answers are shown below.

Question 2

Most candidates did not answer this question very well. It is a new part of the course, so in future, greater focus on comparison of related terms and the ability to discern and describe the differences is needed.

(a) Many candidates were able to correctly identify the Assumptions and Characteristics. Greater focus on the effect of these on actual items on the Income Statement and Balance sheet is advised, and it is also helpful to suggest the correct way to record the transactions so that the Net Profit and Balance Sheet items are as accurate as possible.

Section B

Question 3 – General Journal Entries

Generally well done. The entry on 21 October - Fixtures and fittings or Warehouse asset accounts were accepted as this was viewed as capital expenditure (the cost of buying and installing or improving non-current assets).

- Candidates must rule off after each GJ entry.
- Dr entry must be written before Cr and the Cr entry must be indented
- Narrations should be descriptive (use brackets, put in chq # or credit note # and a description that explains the meaning of the transaction).
- GST – some candidates confused whether they should be finding 1/10 or 1/11 of an amount.

Question 4 – Calculating gain or loss on disposal

Generally well done. The entry on 21 October - Fixtures and fittings or Warehouse asset accounts were accepted as this was viewed as capital expenditure (the cost of buying and installing or improving non-current assets).

(a) Most candidates worked out WDV as $96 000 ($120 000 – 24 000) and forgot to depreciate to the point of sale which was an extra $6 000.

Question 5 – Bank Reconciliation

This question was problematic as the error related to an incorrect sales figure deposited in the bank a day later. Therefore some students did not pick up the error. The question did state 'Any errors or omissions are in the business records'. Based on this, if the error was identified three methods were accepted according to the textbooks for accounting to account for Business Errors.

Pg 227 – Accounting Concepts and Applications Text:

Any errors made by the business are usually corrected in either the cash receipts or cash payments journal. If the error is undetected until the reconciliation process, an entry correcting the situation can be made in either the appropriate cash journal or the general journal. Best practice suggests any error should be taken out of the books in full and the correct amount re-entered.

Candidates are reminded to:

- Double underline totals in journals
- Dates in the cash receipts and payments journals are at the end of the month
- Use correct setting out and wording for Bank Rec Statement. Include sub-totals, with the final total being double underlined.

Section C

Question 6

Generally well done. The entry on 21 October - Fixtures and fittings or Warehouse asset accounts were accepted as this was viewed as capital expendiuture (the cost of buying and installing or improving non-current assets).

- Many students incorrectly <u>added</u> the Inventory adjustment.
- Depreciation on the Delivery van was commonly miscalculated.
- Adjustment relating to Provision for doubtful debts was commonly miscalculated.
- Incorrect column usage was a common error.
- The Term deposit was commonly and erroneously placed under Non-Current Liabilities or in many cases, under Intangible Assets.
- Students need to be reminded to underline appropriately, especially under calculation of Net Profit, Net Assets and Proprietorship.
- They also need to be reminded of the correct order under 'Owner's Equity'. Many students again lost marks unnecessarily by placing 'Less Drawings' before 'Add Net Profit'.

Section D

Question 8

(a) Calculations were generally well done, although a number of students simply wrote 1.83 without indicating it was a ratio to 1 by showing the :1. Some students actually wrote it as a percentage by showing the percentage sign (%). A large number of students lost marks simply writing the 1.83 without indicating the :1. A small number of students wrote the ratio the wrong way – 1:1.83). Answers should be to x2 decimal places.

(b) Again, generally well done. Some students had the correct numbers but wrote the assets on the top line and the liabilities on the bottom line. Once again a large number of students simply wrote the number without the percentage sign. Answers should be to x2 decimal places.

(c) This part was done badly. Students needed to recognise that they needed to find the average OE. As they were only given the OE of $219 000 for the 30 June 2015 they needed to calculate the OE for June 30,

2016. This is done by taking the OE from 2015 and adding the Net Profit from 2016. (219 000 + 110 000). Answers should be to x2 decimal places.

Question 9

Students are reminded to check the mark allocation for each Question and parts thereof. Many students wrote more in their answers to Parts (b) & (c), worth only 5 marks each, than they did to Part (a) which had an allocation of 15 marks.

(a) Part (a) scored poorly as the vast majority of students failed to include in their comments relevant information provided in the Income Statement and Balance Sheet summaries. Students on the whole successfully analysed the profitability of Specialist Sports, commenting on the improvements to the GPR and NPR and compared these to industry averages. They also noted the decline in the Rate of Return on Total Assets. If they were successful in incorporating these in their answer then they scored enough marks to pass this part of the question.

Most students, however, failed to take their analysis a step further and incorporate information from the Income Statement and Balance Sheet summaries in their answer for 15 marks. For example, most failed to recognise why the RRoTA ratio had fallen to well below the IA despite the increasing NPR (ie the large investment in NCAs that had taken place over the 3 year period – and that, hopefully in the future, these assets would contribute to the profitability of the business). Better students took their analysis a step further, drawing on all the information provided in their responses.

(b) Responses to Part b were well done by the majority of students. Most recognised the worsening Current Ratio, were able to provide reasons for its decline and suggest one possible impact on the business should this trend continue. Some students erroneously referred to the ratio as measuring total assets to total liabilities. Only a small number of students stated that both CA and CL were increasing, but that CL had increased at a faster rate for full marks.

(c) Most students scored well on this question, clearly stating that the Inventory Turnover had worsened and offered one sound suggestion as to how this could be improved. Some students confused Inventory Turnover with Accounts Receivable Turnover in their comments.

Question 10

Students are reminded to check the mark allocation for each Question and parts thereof. Many students wrote more in their answers to Parts (b) & (c), worth only 5 marks each, than they did to Part (a) which had an allocation of 15 marks.

(i) Generally well done. The best answers mentioned the figures in the explanation of why Financing had a negative balance. Eg owner withdrew $120 000 and the bank loan was for $22 000, creating a negative cash flow of $98 000. Some students were confused by the bank overdraft of ($17 900), written at the end of the statement, going into great depths to explain this.

(ii) Students needed to talk about the overall increase in cash of $38 500. Indicating that the business had started with a negative balance in cash ($17 900) and finishing with a positive balance of $20 600. Generally well done, although some answers didn't recognise the negative figure and therefore didn't get the total of $38 500 increase.

(iii) Students needed to mention the figures eg sold shares for $170 000. A number of students thought the loan was an asset or simply could not identify a non-current asset.

(iv) Once again the best answers included the figures eg inflows from operating activities totalled $499 500, outflows were $495 000, resulting in a positive source from operation of $4 500. It was important that the student recognised that even though this was a positive number, it was very low considering the operating section of the CFS indicates what is happening in the core purpose of the business. Answers needed to discuss the impact of this figure on the overall positive change in the business cash flow.

(v) Answers needed to mention a course of action based on the figures in the report. They needed to back this up with an explanation of how this could occur and the positive impact on the overall cash flow. Popular answers included decreasing the owner's drawings (although a number of answers suggested more capital injections without mentioning the first step could have been to cut back on drawings), decreasing payments to suppliers (supported by explanations of how eg cheaper supplier with same quality goods, renegotiate with current supplier), increasing sales (eg advertising, decreasing prices etc), increasing receipts from debtors (eg discounts for paying on time), decreasing wages (although a number of answers simply wanted to sack employees without looking at how they could operate, some answers were better than others here, suggesting employing a younger and therefore cheaper work force etc). There were also suggestions that the purchase of the fork lift could be delayed.

ACC315116 Accounting Exam 2016
Suggested Solutions

Section A

Question 1

Part (a)

i. An item of value owned by a business which is in cash form (e.g. cash at bank, cash on hand, petty cash) or that will be or is intended to be liquidated in the relatively short term (accounting period or, say,12 months). E.g. Inventory, accounts receivable, short term deposit. Also includes balance day adjustment accounts (prepaid expenses and accrued revenues).
ii. Primary documentary evidence that a transaction has occurred. E.g. invoice, receipt, credit note, cheque butt
iii. A list of account balances taken at the end of an accounting period to test whether debit balances equal credit balances as they should do. E.g. Correct Dr and CR to wrong accounts, incorrect sides of accounts but correct amounts, offsetting errors, entries missed completely or entered more than once in error.
iv. The Bank Reconciliation Is a comparison between business records for receipts and payments and the bank statement. It results in the updating of the business records with items found on the bank statement such as bank fees, interest and direct deposits or withdrawals, and outstanding items (unpresented cheques and deposits not yet credited) then account for any difference between business records and the bank statement. It is therefore a process which reconciles (explains) the difference between the Cash at Bank account of the business with the bank account balance as presented by the bank's records. E.g. unpresented cheques, business deposits not credited, direct deposits, bank charges…
v. Assets which lack physical substance or existence but can have considerable value to a business as they are "sellable". E.g. patents, copyright, franchise rights, goodwill,….

Part (b)

i. Choose from inventory valuation, depreciation, doubtful debts, taxation , historic cost, intangibles. All of these practices involve some form of estimation that limit the reliability of figures shown on the Income Statement and Balance Sheet. This can have an effect on the Profit calculation or the net value of assets listed on the Balance Sheet. The true value of many items can only be determined when they are sold, however it is not possible to work this out until the business is sold, therefore estimation of items is required to arrive at the best possible calculation of profit.
ii. Choose from quantum of finance required, capacity to repay, cost (%interest), term of loan, matching loan term to usage, requirement for security, perhaps taxation aspects…

   A business should match the loan period to the useful life of the asset – e.g. you don't want to be paying off a car loan for 30 years as the car would have been long gone after perhaps only 5 or 10 years. When borrowing money, the lender will evaluate their ability to pay off the regular payments e.g. is the business making an adequate profit to afford this? They will also look at the assets that the business or the owners can offer as security (e.g. for a mortgage on real estate assets). If the business can offer assets as security, the interest rate charged should be lower due to lower risk to the lender.

Part (c)

i. Financial information is sourced directly or indirectly from the accounting reports (primarily the Income Statement and the Balance Sheet) whereas non-financial is from other sources such as staff turnover figures, economic data, benchmarking…
ii. Capital expenditure is expenditure on Non-current assets (assets that are intended to be held for longer than one accounting period, and will be recorded in the Balance Sheet. It includes the price of the asset and any delivery and installation costs plus the value of any upgrades that add to the value of the asset e.g. a new rear cab for a truck. Revenue expenditure is for purchase of goods and services which relate to the upkeep of Non-current assets. These are expenses intended to be consumed during the current

accounting period e.g. insurance, vehicle registration, consumables, maintenance costs etc. and will be offset against revenue to determine profit in the Income Statement.

iii. Straight line calculates the depreciation charge on an asset as a series of equal amounts by applying a flat rate of depreciation on the original cost in each period over which the asset is depreciated. Diminishing balance applies the rate of depreciation not as a series of equal charges but as series of diminishing charges as the rate is applied to the diminishing written down value of the asset rather than the original cost.

iv. A current liability is an amount owing by a business which is intended or required to be paid within the accounting period such as accounts payable GST payable, bank overdraft A non-current liability is one which the business is not intending to repay within the accounting period but will exist over future accounting periods such as a mortgage loan.

Question 2

Part (a)

i. Cash accounting records transactions only when the cash is actually transferred. For example when payment is received for a sale or when payment is made by the business. Accrual accounting records transactions when the economic impacts on the business occur (text) (perhaps better when legal obligation is created)- for example credit sale, and credit purchases, depreciation, bad and doubtful debts, inventory adjustment. Only accrual accounting can properly arrive at a profit figure.

ii. They have recorded the value of accounts receivable as the amount currently owed. Some of those amounts will not be collected and so an assessment is made of the quantum of such non-payments and used to reduce the value of the asset. As the amount is not actually known it is shown as a provision reducing the asset value. E.g. of procedures-ageing of debtors, credit checks, strict collection policies…

iii. Financial expenses are the costs of borrowing money/managing finances and the costs of offering credit to your customers. For example interest charges, bank fees and charges, collection fees, bad and doubtful debts. Administrative expenses are those dealing with general business management such as insurance, office wages, rent, telephone and communications…

iv. The entry for an accrued expense increases the expense account and recognises the liability (accrued expense) because it has accrued but not yet been recorded. E.g. wages earned but not yet paid or interest owing. Prepaid expenses are those that have not yet accrued but have been recorded. Hence the need to decrease the amount of the expense account and create the asset prepaid expense. E.g. rent paid in advance, insurance paid in advance.

Part (b)

i. Breaches the accounting entity convention. Separation needed of affairs of owner and the business entity. Implications of breach is over statement of business expenses which will reduce the profit of the business and potentially result in underpayment of taxes. The correct recording of this transaction would be as Drawings.

ii. Breaches requirements of accrual accounting and matching principle. Should match revenues to expenses in period incurred. Implications of breach that profit overstated in the current period and understated in the following period when the expenses are paid.

iii. Breaches historic cost assumption. Requirement for objectivity in asset valuation. Implications of breach is possible over statement of asset value. Any revaluation would need to be conducted by a qualified valuer. This would then provide documentary proof of the new valuation being arrived at in an objective manner.

iv. Likely to breach the materiality requirement for accounting data. Implications that relevant items not revealed. While rounding to the nearest $10,000 is OK for a big business, it is not OK for a smaller business, because these items would be important for the decision making of the smaller business.

Section B

Question 3

BUBBY'S BOUTIQUE
GENERAL JOURNAL

2016

4 October	Cash at bank	120 000	
	AZB Bank Loan		80 000
	Capital - C Mellors		40 000
	(Owner commenced business with sundry assets & liabilities as capital)		
21 October	Space Solutions	68 200	
	Cash at bank		68 200
	(Paid Space Solutions for Warehouse fitout)		
30 November	Inventories	1 350	
	GST Credits Received (Clearing)	135	
	Specialist Beds		1 485
	(Purchased inventory, GST inclusive, from Specialist Beds, tax invoice no. 6348)		
15 December	April Jones	1 320	
	Sales		1 200
	GST Collected (Clearing)		120
	(Sold inventory on credit (GST inclusive), tax invoice no. 400)		
	Cost of Goods Sold	680	
	Inventories		680
	(Cost price of goods sold, tax invoice no. 400)		
21 December	Specialist Beds	121	
	Inventories		110
	GST Credits Received (Clearing)		11
	(Returned inventories, GST inclusive)		
23 January	Computer	700	
	GST Credits Received (Clearing)	70	
	Cash at bank		770
	(Purchased computer, GST inclusive, cheque no. 119)		
12 February	Drawings	66	
	GST Credits Received (Clearing)		6
	Inventories		60
	(Owner withdrew GST inclusive inventory for personal use)		
16 March	Interest expense	210	
	Insurance expense		210
	(Correcting entry)		
8 April	Electricity	1 000	
	GST Credits Received (Clearing)	100	
	Cash at bank		1 100
	(Paid electricity, GST inclusive, cheque no. 142)		
30 June	Prepaid expense	200	
	Insurance		200
	(Insurance paid in advance on balance day)		

Question 4

(a) WDV at point of sale was $90 000. Sale price $80 000.
Loss on disposal of $10 000 for full 3 marks.

(b) Income Statement
General and Administrative expense – Loss on disposal of truck

Cost of truck	120 000
Accumulated depreciation	24 000
Written down value (WDV)	96 000
Depreciation to point of sale	6 000
WDV at point of sale	90 000

Sold for $80 000 therefore loss on disposal of $10 000.
b.
The loss would be reported as an expense in the Income Statement-

Administrative expense
Loss on disposal of truck 10 000

Question 5

Cash receipts journal (extract)

Date	Rec	Particulars	Bank
30 Nov	BS	Sales (correction of error)	(980)
	BS	Sales (correction of error)	890

OR

Cash receipts journal (extract)

Date	Rec	Particulars	Bank
30 Nov	BS	Sales (correction of error)	(90)

OR

Cash payments journal (extract)

Date	Particulars	Chq. No.	Bank
Nov 30	Sales (correction of error)	BS	90

Cash Receipts

		$
	Sales	820
	Sales	920
	Sales	1 086
	Sales	980
	Sales	1 100
	Sub total	4 906
	J.Singh	700
	B Wells	65
		5 671

Cash payments

	Chq. No.	$
	650	801
	651	79
	652	352
	653	61
	654	89
	655	221
	656	206
		65
Sub Total		1 809
Council rates		456
Loan interest		1 800
Bank fees		18
Credit charge		61
Correction of error		90
		4 234

Cash at Bank Account

1 Nov	Balance b/d	2 337	30 Nov	Payments	4 234
30 Nov	Receipts	5 671	1 Dec	Balance c/d	3 774
		8 008			8 008
1 Dec	Balance b/d	3 774			

Bank Reconciliation Statement as at 30 November

Credit balance as per bank statement	3 453
Add deposit not yet credited	1 100
	4 553
Less Unpresented cheques	
652 352	
655 221	
656 206	
	779
Debit balance as per cash at bank account	3 774

Section C

Question 6

Income Statement for Warmheart Home Heating for the year ending 30/6/16

Sales		520 000	
Less sales returns		4 800	515 200
Less Cost of sales			
Cost of goods sold		168 000	
Inventory adjustment		500	168 500
Gross profit			**346 700**
Add Other revenue			
Interest received		2 800	
Dividends received		1 500	4 300
		SUB TOTAL:	351 000
Less Other expenses			
Selling and distribution			
Sales wages	146 000		
Advertising	6 500		
Depreciation delivery vehicle	10 410	162 910	
General and administrative			
Administration wages	62 000		
Insurance	1 200		
Software fees	3 800	67 000	
Finance expenses			
Lease charges	13 600		
Mortgage interest	9 500		
Bad and doubtful debts	2 000		
Bank fees and charges	250	25 350	255 260
Net profit			**$ 95 740**

Balance Sheet for Warmheart Home Heating as at 30/6/16

Current assets				
Cash at bank		3 200		
Accounts receivable	9 100			
Less Provision for doubtful debts	600	8500		
Inventory		98 500	109 700	
Add Non-current assets				
Other financial assets				
Shares in Accord Ltd		30 000		
Term deposit		95 000	125 000	
Property, plant and equipment				
Office building		280 000		
Delivery van	43 000			
Less Accumulated depreciation	18 710	24 290	304 290	
Intangibles				
		0	0	
Total assets				538 990
Less Liabilities				
Current liabilities				
Accounts payable		15 300		
GST Clearing		5 000		
Accrued expanse		200	20 500	
Non-current liabilities				
Mortgage loan			300 000	
Total liabilities				320500
Net assets				$ 218 490
Owner's equity				
Capital- Herman Warmheart		172 750		
Add Net profit		95 740	268 490	
Less Drawings			50 000	$218 490

Question 7

(a)

		January	February	March
October	12 000	(4%) 480		
November	13 000	(20%) 2 600	(4%) 520	
December	16 000	(75%) 12 000	(20%) 3 200	(4%) 640
January	16 000		(75%) 12 000	(20%) 3 200
February	9 000			(75%) 6 750
March	10 000			
Totals		15 080	15 720	10 590

(b)

	January	February	March
Estimated cash receipts			
Receipts from accounts receivable	15 080	15 720	10 590
Cash sales	18 000	20 000	17 000
Total estimated receipts	33 080	35 720	27 590
Estimated cash payments			
Payments to accounts payable	20 160	17 280	16 320
Sundry	3 000	4 000	1 000
Wages	8 000	8 300	6 900
Land tax		2 000	
New site fit out		12 000	
Rent		2 000	2 000
Total estimated payments	31 160	45 580	26 220
Bank balance at start	5 800	7 720	(2 140)
Excess of receipts over payments	1 920		1370
Excess of payments over receipts		9 860	
Bank balance at end	7 720	(2 140)	(770)

Section D

Question 8

i. **Current Ratio** Current Assets/Current Liabilities 42 000/23 000 = **1.83:1**

1 mark

ii. **Debt Ratio** Total Liabilities/Total Assets × 100

($23 000 + $180 000/$42 000 + $490 000)

$203 000 / $532 000 = **38.16%**

1 mark

iii. **The rate of return on owner's equity**

Net Profit/Average Owner's Equity × 100

110,000/((219,000+219,000+110,000)/2) = **40.15%**

3 marks

(OE figure is from 12 months ago; add the profit to calculate the current OE and divide by 2 for average)
If answer is $110 000/$219 000 = **50.23%** (1 mark if this was the answer)

Question 9

(a) Comment required on net profit, gross profit and rate of return on total assets. Decline in return on assets evident.
The GPR has steadily increased from 58.44% to 61.29% and by 2016 is nearly level with the Industry Average of 62.9%.
The NPR has also improved from 31.33% to 35.48% and by 2016 is above average at 35.48%.

This indicates that in spite of a slightly lower GPR, by spending less per dollar of Sales on Other Operating Expenses, Specialist Sport are doing better than average and therefore turn more of each Sales dollar into profit. Specialist Sports are spending 61.29-35.48 = 25.81% on Other Operating Expenses compared to 62.9-34.75=28.15% for the Industry Average.

Overall Sales and Net Profit figures are also on the increase showing that Specialist Sports are increasing their profitability.

Their Rate of Return on Total Assets has fallen from 25.89% to 18.55% compared to 22.5% for the Industry Average.

This is because their Assets have increased at a faster rate than their Sales and Net Profit. Specialist Sports have invested more in the business, but their profits are not yet matching the increase in investment.

18.55% is still an excellent return on their assets when compared to alternative investments such as Term Deposits, or even Shares, so Specialist Sports should not be concerned.

It is suggested that they focus on increasing Sales further to capitalise on their investment in the business. They could do this by increasing advertising and looking at their marketing strategies. They could also examine their Cost of Sales expenses looking for a cheaper supplier (with equal quality goods), renegotiate with current supplier.

(b) Comment required on current ratio. Decline evident.

They have a worsening current ratio which has decreased from 1.73:1 to 1.32:1 and is now well below the Industry Average of 1.8:1, and the recommended benchmark of 2:1. This means that for every $1 of current liabilities they have $1.32 of current assets. They need to address this urgently as it can damage their reputation if they are not paying bills on time.

Current Assets are increasing but Current Liabilities have also increased, but at a faster rate.

They need a ready source of cash. I would suggest borrowing some money to inject cash into the business. This seems a good option as borrowings have barely increased even though the business has spent a lot of money on asset investment in the last 2 years. Short term funding for long-term assets.

i. Worsening inventory turnover evident. This could be the result of bad buying, an accumulation of obsolete stock, lower sales activity, carrying excessive stock etc.

   Inventory turnover is slightly slower than the industry average. This has worsened over the year and is now 7 days more than Industry Average. Increasing their Sales (as suggested for Profit) will improve this situation. Alternatively, they could reduce Inventory levels.

Question 10

i. Cash flows from financing. Negative because owner has withdrawn $120 000 cash from the business whilst financing inflow has been a bank loan of $22 000.

ii. Cash at the start of the period was an overdraft of $17 900 and at the end $20 600, an overall increase in cash of $38,500

iii. The business sold shares for $170 000 and purchased a forklift for $38 000

iv. Cash inflows from Operating Activities totalled $499 500 whilst outflows were $495 000, resulting in a relatively minor source of cash of $4 500 from operations. This small amount contributed in a minor capacity to the overall positive change in the cash flow position of the business. This very low figure from operations will also mean that the business has very limited cash available to use elsewhere eg to fund any future expansions or to repay debt.

v. Any sensible response