**PES**

**2020 ACCOUNTING**

## Unit 3&4 Exam 2

**SOLUTION**

**Question 1 (21 marks)**

1. 15 marks

**Phoebe’s Flowers**

**General Journal**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Date**  **2020** | **Details** | **Debit** | **Credit** |  |
| Feb 1 | Bank | 45 000 |  | **1** |
|  | Vehicle | 22 000 |  | **1** |
|  | Loan – McCallum Finance |  | 6 000 | **1** |
|  | Capital |  | 61 000 | **1** |
| 5 | Prepaid Rent Expense | 6 000 |  | **1** |
|  | GST Clearing | 600 |  |
|  | Bank |  | 6 600 | **1** |
| 8 | Shop Fittings | 20 000 |  | **1** |
|  | GST Clearing | 2 000 |  |
|  | Bank |  | 22 000 | **1** |
| 12 | Inventory | 16 000 |  | **1** |
|  | GST Clearing | 1 600 |  |
|  | Accounts Payable – Fresh Farms |  | 17 600 | **1** |
| 14 | Advertising | 800 |  | **1** |
|  | GST Clearing | 80 |  |
|  | Bank |  | 880 | **1** |
| 16 | Bank | 165 |  | **1** |
|  | Sales |  | 150 | **1** |
|  | GST Clearing |  | 15 |
|  | Cost of Sales | 100 |  | **1** |
|  | Inventory |  | 100 |

*Award marks as shown*

1. 3 marks

|  |
| --- |
| **Explanation** |
| The loan will be reported as a Current Liability **[1]**. The loan represents a present obligation of the business which will require the business to transfer resources to another entity (pay money to the lender) **[1]**. This transfer will occur within 12 months (by 30 November 2020) and so it is a Current Liability **[1]**. |

1. 3 marks

|  |
| --- |
| **Explanation** |
| The entity assumption required the transfer of the owner’s personal vehicle to the business **[1]**. The entity assumption requires the records of the business be kept separate from the records of the owner so there is clarity in recording and reporting **[1]**. The vehicle is now owned by the business and must be recorded and reported as such **[1]**. |

**Question 2 (8 marks)**

1. 5 marks

**Lawson’s Lighting**

**General Ledger**

**Accounts Receivable**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date**  **2020** | **Cross-reference** | **Amount** | **Date**  **2020** | **Cross-reference** | **Amount** |
| Apr 30 | Sales/GST Clearing | 7 920 | Apr 30 | Sales Returns/GST Clearing | 770 |
|  |  |  |  | Bank | 3 100 |
|  |  |  |  | Discount Expense | 120 |
|  |  |  |  | Balance | 3 930 |
|  |  | 7 920 |  |  | 7 920 |
| May 1 | Balance | 3 930 |  |  |  |

*Award 1 mark for each entry in account*

*Closing balance and balance brought forward are considered one entry*

1. 3 marks

|  |
| --- |
| **Explanation** |
| The creation of an Allowance for Doubtful Debts is a recognition that there is a likelihood that some accounts receivable will not pay their accounts **[1]**. The allowance is an estimate of the value of those non-paying accounts and is reported in the period the accounts are created. This recognises the accrual nature of the reporting – the expense is reported in the same period the revenue is earned **[1]**. This provides a faithful representation of the value of the accounts receivable **[1]**. |

**Question 3 (5 marks)**

|  |
| --- |
| **Analysis:** |
| The owner’s idea of using both cost assignment methods for her inventory is creating an ethical dilemma. The selection of a cost assignment method to provide a better picture of business performance could see the business change its cost assignment method each year so profit is continually shown as a higher amount. This would breach both the comparability and the faithful representation qualitative characteristics. It would be difficult to compare financial reports between periods if different cost assignment methods were used as the figures will be distorted and the reports may not actually reflect the true economic value of the revenues, expenses and assets of the business. This makes it difficult to analyse the performance of the business over time.  It will also provide unreliable information to interested parties – banks who may be considering lending to the business and future owners/partners if the owner considers expanding her business in the future.  Adopting this valuation scenario is unethical as the owner is making decisions to improve the perceived financial performance and position of the business rather than reflecting what may actually be occurring. |

*This question is marked globally*

*Students should ensure they refer to at least one qualitative characteristic and outline at least one ethical consideration*

**Question 4 (21 marks)**

**a**. 15 marks

**SWA**

**General Journal**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Date**  **2020** | **Details** | **Debit** | **Credit** |  |
| Dec 31 | Depreciation – Vehicle | 11 100 |  | **1** |
|  | Accumulated Depreciation - Vehicle |  | 11 100 |
|  | Accrued Interest Revenue | 180 |  | **1** |
|  | Interest Revenue |  | 180 | **1** |
|  | Allowance for Doubtful Debts | 250 |  | **1** |
|  | GST Clearing | 25 |  |
|  | Accounts Receivable |  | 275 | **1** |
|  | Bad Debts | 190 |  | **1** |
|  | Allowance for Doubtful Debts |  | 190 | **1** |
|  | Rent Expense | 3 600 |  | **1** |
|  | Prepaid Rent Expense |  | 3 600 |
|  | Advertising | 280 |  | **1** |
|  | GST Clearing | 28 |  |
|  | Wages |  | 308 | **1** |
|  | Drawings | 120 |  | **1** |
|  | Inventory |  | 120 | **1** |
| *.* | Inventory Write Down | 400 |  | **1** |
|  | Inventory |  | 400 |
|  | Inventory Loss | 420 |  | **1** |
|  | Inventory |  | 420 | **1** |

*Mark as shown*

1. 6 marks

|  |
| --- |
| **Discussion:** |
| The owner is correct in stating that using one depreciation method for all Non-Current Assets would be less confusing. However, the owner needs to consider a number of things. While making the change now may breach comparability, provided the owner doesn’t change methods again in the following year, there is no real issue with such a change. However, the change to a single depreciation method for all Non-Current Assets may not provide a faithful representation of the business performance or the financial reports.  Faithful representation is the concept that the information presented in reports must be an accurate and realistic representation of real world economic events. Using one depreciation method for all assets may breach this as some assets depreciate differently over time, representing their varying contribution to the revenue of the business.  On the other hand, some assets should be depreciated evenly over time as they contribute to revenue in a consistent manner. To record depreciation using methods that don’t reflect their contribution to revenue also breaches the accrual basis assumption which requires expenses to be matched against revenue in the period the revenue is earned and the expense is incurred. |

*This question is marked globally*

*Students should refer to at least one QC and one accounting assumption*

**Question 5 (18 marks)**

1. 7 marks

**Working space**

**Victory Equipment**

**Cash Flow Statement (extract) for the month ending 30 November 2020**

|  |  |  |  |
| --- | --- | --- | --- |
| **Operating Activities** | **$** | **$** |  |
| Sales | 45 000 |  | **1** |
| GST Received | 4 600 |  |
| Accounts Receivable | 39 500 |  | **1** |
| Accrued Commission Revenue | 1 000 | 90 100 |
| Payments to Accounts Payable | (36 320) |  | **1** |
| Wages/Accrued Wages | (19 500) |  |
| Prepaid Rent Expense | (6 000) |  | **1** |
| Office Expenses | (17 000) |  |
| Inventory | (7 600) |  | **1** |
| Interest Expense | (300) |  |
| Cartage In | (600) |  | **1** |
| GST Settlement | (800) |  |
| GST Paid | (3 120) | (91 240) | **1** |
| **Net Cash Flows From Operating Activities** |  | (1 140) |

**b.** 7 marks

**Victory Equipment**

**Income Statement for the month ending 30 November 2020**

|  |  |  |  |
| --- | --- | --- | --- |
| **Revenue** | **$** | **$** |  |
| Cash Sales | 45 000 |  | **1** |
| Credit Sales | 45 000 | 90 000 |
| Less Sales Returns |  | 2 000 | **1** |
| **Net Sales** |  | 88 000 |
| **Less Cost of Goods Sold** |  |  |  |
| Cost of Sales | 35 200 |  | **1** |
| Cartage In | 600 | 35 800 |
| **Gross Profit** |  | 52 200 |
| Less Inventory Loss |  | 500 | **1** |
| **Adjusted Gross Profit** |  | 51 700 |
| **Add Other Revenue** |  |  |  |
| Discount Revenue |  | 500 | **1** |
|  |  | 52 200 |
| **Less Other Expenses** |  |  |  |
| Depreciation – Equipment | 1 200 |  | **1** |
| Discount Expense | 800 |  |
| Wages Expense | 20 200 |  |
| Office Expenses | 17 000 |  | **1** |
| Interest Expense | 300 |  |
| Rent Expense | 2 000 | 41 500 |
| **Net Profit** |  | **10 700** |  |

**c.** 4 marks

|  |
| --- |
| **Explanation** |
| Budgeted Net Profit is based on estimated revenue earned and expenses incurred. The Budgeted Cash Flow Statement only includes estimated cash in and cash out and does not consider the concept of profit under accrual accounting **[1]**.  The budgeted income statement also includes non-cash items such as Discount Revenue, which is not a cash flow and are therefore not included in the calculation of cash **[1]**.  Furthermore, the credit sales are expected to be greater than the receipts from accounts receivable thus increasing net profit by a greater amount than the receipts from accounts receivable increases cash **[1]**.  In addition, it is expected that payments for the purchase of inventory (through cash purchases and payments to accounts payable) will be greater than cost of sales. The impact on cash is greater than the corresponding item decreases net profit.  It is expected that the significant budgeted prepaid expense for rent will exceed the rent expense resulting in the impact on cash flow being greater than the impact on profit **[1]**. |

**Question 6 (4 marks)**

|  |
| --- |
| **Evaluation** |
| The performance of the business deteriorated in terms of Asset Turnover between 2018 and 2019 **[1]** and is expected to improve in 2020.  The improvement in performance is linked to the purchase of new Non-Current Assets. The additional cost of these assets will increase the value of Average Total Assets. If there is no discernible increase in sales, then Asset Turnover will worsen as there are more assets relative to sales **[1]**.  However, the expected improvement in performance can be attributed to the new assets. The new packaging equipment will require fewer staff to be working in that area allowing them to spend more time in sales which should allow sales to increase in future periods **[1]**.  In addition, the depreciation charged against these new assets will reduce the value of total assets and so the Asset Turnover should increase over time – this is what the business expects to occur in 2020 **[1]**.  However, the owner is assuming the improved performance will stem from the new assets. It may benefit the owner to prepare these indicators more regularly to determine the actual source of the expected change and, if need be, take any corrective action in a more timely manner. |

**Question 7 (8 marks)**

**a.** 4 marks

|  |
| --- |
| **Discussion** |
| A Variance Report allows a business to compare its actual performance against its budgeted or expected performance for a period **[1]**. This allows the business to identify areas where the business performed better or worse than expected and build upon the positives or take corrective action to rectify any areas of concern **[1]**.  However, a Variance Report is only prepared after the budgeted period has passed and actual reports for that period have been prepared **[1]**. While some information is useful, most of the information can’t be used as the events have already occurred – it is not possible to rectify areas of concern or build on what may have been positive aspects of the business’s performance **[1]**. |

**b.** 2 + 2 = 4 marks

|  |
| --- |
| **Sales Staff Commission** |
| The business has seen a fall in sales compared to what was budgeted **[1]** which would lead to a decrease in the commission paid to staff as they earn their commission on the dollar value of sales **[1]**. |
| **Cost of Sales** |
| This has fallen as a result of the decrease in sales; however, it should have fallen further if the price of the inventory had remained the same **[1]**. It appears that the price of inventory has risen, while sales have fallen **[1]**. |

**Question 8 (5 marks)**

|  |
| --- |
| **Analysis** |
| The performance of the business has deteriorated over the period shown as both indicators show a worsening trend **[1]**. Net Profit has fallen which could be caused by a decrease in revenues (both cash and credit sales) or an increase in expenses. It could also be caused by a combination of these two factors **[1]**.  A decrease in profit could explain the deterioration in the Cash Flow Cover of the business. If revenue has decreased then this could mean that cash sales have fallen (and the GST received on those sales would also be lower). If credit sales also decreased then it is possible that receipts from accounts receivable will also fall although by possibly not as much, as there is a lag between a credit sale and the receipt of cash **[1]**.  In addition, an increase in expenses that reduces profit may also increase the cash payments of the business. Rises in wages, advertising, interest and other expenses will increase cash outflows leading to a reduction in Net Cash Flow from Operating Activities **[1]**.  Assuming there has been no substantial change to the amount of Current Liabilities, the worsening cash flow cover would suggest a decline in the liquidity of the business, although the business is still currently able to meet its current financial commitments **[1]**.  *Other statements students could refer to include:*   * *Cash Flow Cover is still positive and the business is able to meet its short-term financial commitments* * *Budgeted data could be prepared to determine if the deterioration is expected to be a short-term measure only or something that is a long-term trend* * *Other financial and non-financial data could be assessed to determine the cause of the issue and whether there are strategies that could be implemented* * *The existence of one off events that could explain the situation – purchase of a Non-current Asset on credit that required a loan and so expenses such as depreciation and interest have increased and interest payments have impacted cash flow* |

**Question 9 (10 marks)**

**West Wing Furniture**

**General Ledger**

**Disposal of Equipment**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date**  **2020** | **Cross-reference** | **Amount** | **Date**  **2020** | **Cross-reference** | **Amount** |
| Mar 1 | Equipment | 3 000 | Mar 1 | Accumulated Depreciation - Equipment | 2 200 |
|  | Profit on Disposal of Equipment | 400 |  | Bank | 1 200 |
|  |  | 3 400 |  |  | 3 400 |

**Profit & Loss Summary**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date**  **2020** | **Cross-reference** | **Amount** | **Date**  **2020** | **Cross-reference** | **Amount** |
| Mar 31 | Expenses | 76 950 | Mar 31 | Revenues | 86 500 |
|  | Capital | 9 550 |  |  |  |
|  |  | 86 500 |  |  | 86 500 |

**Drawings**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date**  **2020** | **Cross-reference** | **Amount** | **Date**  **2020** | **Cross-reference** | **Amount** |
| Mar 31 | Bank | 10 000 | Mar 31 | Capital | 12 000 |
|  | Inventory | 600 |  |  |  |
|  | Equipment | 1 400 |  |  |  |
|  |  | 12 000 |  |  | 12 000 |

**Capital**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date**  **2020** | **Cross-reference** | **Amount** | **Date**  **2020** | **Cross-reference** | **Amount** |
| Mar 31 | Drawings | 12 000 | Jan 1 | Balance | 67 600 |
|  | Balance | 73 150 | Mar 31 | Bank | 8 000 |
|  |  |  |  | Profit & Loss Summary | 9 550 |
|  |  | 85 150 |  |  | 85 150 |
|  |  |  | Apr 1 | Balance | 73 150 |

*Award 1 mark for both debit entries in Disposal of Equipment account*

*Award 1 mark for both credit entries in Disposal of Equipment account*

*Award 1 mark for Expenses entry and 1 mark for Revenue entry in Profit & Loss Summary account*

*Award 1 mark for Capital entry in Profit & Loss Summary account and Profit & Loss Summary entry in Capital account*

*Award 1 mark for Bank and Capital entries in Drawings account*

*Award 1 mark for Inventory and Equipment entries in Drawings account*

*Award 1 mark for Drawings entry and 1 mark for Bank entry in Capital accounts*

*Award 1 mark for all three balance entries in Capital account*

**END OF SOLUTIONS**