**Student Name:**

**PES**

**2020 ACCOUNTING UNIT 3**

## Unit 3 Exam

## FINANCIAL ACCOUNTING FOR A TRADING BUSINESS

**SOLUTION**

**Question 1 (**8 marks)

1. 3 marks

|  |
| --- |
| **Explanation** |
| Documents provide evidence that a transaction has occurred. This evidence forms part of |
| the audit trail so the entries in the reports and records of a business can be traced back to |
| the original document **[1]**. This conforms to the qualitative characteristic of Verifiability |
| **[1]** as the reports and records can be verified by the information in documents and so the |
| recording and reporting is reliable **[1]** |
|  |
|  |
|  |

1. 2 marks

|  |
| --- |
| **Description:** |
| Document B will have no effect on the accounting equation **[1].** |
| The document is an order form and there is no financial exchange between the two entities |
| and so no transaction can be recorded at the time of the issue of the document **[1]**. |
|  |
|  |

c. 3 marks

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date**  **2020** | **Details** | **Debit** | **Credit** |
| May 30 | Sales Returns | 160 |  |
|  | GST Clearing | 16 |  |
|  | Accounts Receivable – O. Gillespie |  | 176 |
|  |  |  |  |
|  | Inventory | 80 |  |
|  | Cost of Sales |  | 80 |
|  |  |  |  |

*Award 1 mark for Sales Returns/GST Clearing*

*Award 1 mark for Accounts Receivable – O. Gillespie*

*Award 1 mark for Inventory/Cost of Sales*

**Question 2** (10 marks)

1. 5 marks

**Backboard**

**Balance Sheet as at 1 March 2020**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **$** | **$** |  | **$** | **$** |
| **Current Assets** |  |  | **Current Liabilities** |  |  |
| Bank | 61 300 |  | Loan – Lonestar Bank | 12 000 |  |
| Prepaid Rent | 12 000 |  | Accounts Payable | 63 800 | 75 800 |
| GST Clearing | 7 500 |  |  |  |  |
| Inventory | 58 000 | 138 800 | **Non-Current Liabilities** |  |  |
|  |  |  | Loan – Lonestar Bank |  | 48 000 |
| **Non-Current Assets** |  |  |  |  |  |
| Office Equipment |  | 14 000 | **Owner’s Equity** |  |  |
|  |  |  | Capital |  | 29 000 |
| **Total Assets** |  | **152 800** | **Total Equities** |  | **152 800** |

*Award 1 mark for each section of the report*

**b.**  2 marks

|  |
| --- |
| **Definition** |
| Owner’s equity is the residual interest in the assets of the entity **[1]** after deducting all its |
| Liabilities **[1]**. |
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|  |
|  |

1. 3 marks

|  |
| --- |
| **Explanation** |
| The loan is reported as both a current and a non-current liability **[1]**. |
| A liability is a present obligation of the entity to transfer an economic resource as a result |
| of past events which is the borrowing of the money which must be repaid **[1]**. |
| Current liabilities are obligations of the entity that are reasonably expected to be settled |
| within 12 months after the end of the reporting period whereas Non-current liabilities are |
| obligations of the entity that are settled over future reporting periods beyond 12 months **[1]** |
|  |
|  |

**Question 3** (10 marks)

**a.**  4 marks

|  |
| --- |
| **Explanation** |
| The Working Capital Ratio is a measure of the value of Current Assets compared to the |
| Current Liabilities of a business **[1]**. In 2017 the business had around $3.30 of Current |
| Assets for every $1 of Current Liabilities. Over the three year period this has fallen to $1.70 |
| and then $0.90 in 2019. This is a worsening trend as the business has fewer Current Assets |
| to use to meet current obligations **[1]**. |
| One reason for the worsening of this trend may be an increase in Current Liabilities. The |
| business may have taken out a loan to buy a Non-Current Asset of which some of the loan |
| is to be repaid within 12 months, meaning Current Assets are not affected but Current |
| Liabilities rise **[1]**. |
| A second reason may be poor cash flow which has led to a bank overdraft. This decreases |
| Current Assets and increases Current Liabilities **[1]**. |

**b.**  2 marks

|  |
| --- |
| **Explanation** |
| This trend is a worsening of the liquidity of the business as it suggests the business is |
| unable to meet its current financial commitments **[1]** as they fall due meaning the business |
| may need to go into overdraft or take out a short term loan to meet these obligations **[1]**. |
|  |
|  |

**c.**  2 marks

|  |
| --- |
| **Financial indicator 1:** |
| Quick Asset Ratio **[1]** |
| **Financial indicator 2:** |
| Cash Flow Cover **[1]** |

**d.**  2 marks

|  |
| --- |
| **Explanation** |
| One strategy to improve WCR is to increase Current Assets **[1]**. This could be through an |
| injection of cash by the owner. This would increase Current Assets but have no impact on |
| Current Liabilities (unless the business was operating an overdraft which would now be |
| removed **[1]**. |
|  |

**Question 4** (19 marks)

**a**. 2 marks

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date**  **2020** | **Details** | **Debit** | **Credit** |
| Jun 30 | Advertising | 600 |  |
|  | Drawings |  | 600 |
|  |  |  |  |

*1 mark for each line of journal as shown*

**b.**  2 marks

|  |
| --- |
| **Reason 1:** A transaction has been omitted completely |
| An incorrect amount was recorded in both accounts |
| **Reason 2:** A transaction has been recorded twice |
| The debit and credit entries of a transaction have been reversed |

*1 mark each for any valid reason provided*

*Students must consider the constraint in the question*

**c**. 3 marks

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date**  **2020** | **Details** | **Debit** | **Credit** |
| Jun 30 | Sales | 337 800 |  |
|  | Discount Revenue | 3 700 |  |
|  | Inventory Gain | 800 |  |
|  | Sales Returns |  | 4 500 |
|  | Profit & Loss Summary |  | 337 800 |
|  |  |  |  |

*Award 1 mark for debit entries*

*Award 1 mark for Sales return entry*

*Award 1 mark for Profit & Loss Summary entry*

**d.**  2 marks

|  |
| --- |
| **Explanation** |
| Revenue and expense accounts are closed at the end of each period to prepare the accounts |
| for the preparation of financial reports **[1]**. |
| In addition, as revenue and expenses are ‘for the period only’, closing these accounts resets |
| the accounts to zero in preparation for the recording of these items in the next period **[1]**. |
|  |

**e.**  7 marks

**Clickety Clack**

**Income Statement for the year ended 30 June 2020**

|  |  |  |
| --- | --- | --- |
| **Revenue** | **$** | **$** |
| Sales | 337 800 |  |
| **Less** Sales Returns | 4 500 | 333 300 |
| **Less Cost of Goods Sold** |  |  |
| Cost of Sales | 166 650 |  |
| Customs Duty | 3 000 | 169 650 |
| **Gross Profit** |  | 163 650 |
| **Add** Inventory Gain |  | 800 |
| **Adjusted Gross Profit** |  | 164 450 |
| **Add other Revenue** |  |  |
| Discount Revenue |  | 3 700 |
|  |  | 168 150 |
| **Less Other Expenses** |  |  |
| Wages | 80 000 |  |
| Freight Out | 11 500 |  |
| Insurance | 4 800 |  |
| Office Expenses | 7 100 |  |
| Discount Expense | 4 000 |  |
| Telephone | 720 |  |
| Advertising | 12 600 |  |
| Interest Expense | 6 500 |  |
| Rent Expense | 20 400 | 147 620 |
| **Net Profit** |  | **20 530** |
|  |  |  |

*1 mark for Sales/Sales Returns*

*1 mark for Cost of Sales/Customs Duty*

*1 mark for Inventory Gain/Discount Revenue*

*1 mark for Advertising*

*1 mark for every 4 other expenses (2 marks)*

*Deduct 1 mark (maximum) if headings are missing/incorrect*

**f.**  3 marks

**Capital**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date**  **2020** | **Cross-reference** | **Amount** | **Date**  **2020** | **Cross-reference** | **Amount** |
| Jun 30 | Drawings | 35 400 | Jun 30 | Balance | 73 620 |
|  | Balance | 58 750 |  | Profit & Loss Summary | 20 530 |
|  |  | 94 150 |  |  | 94 150 |
|  |  |  | Jul 1 | Balance | 58 750 |
|  |  |  |  |  |  |

*1 mark for Drawings*

*1 mark for Profit 7 Loss Summary*

*1 mark for the closing balance (must be carried forward)*

**Question 5** (8 marks)

**a.**  4 marks

|  |
| --- |
| **Explanation** |
| Not reporting the inventory loss this period will lead to a false value of profit for the |
| business, suggesting it is performing better than it actually is **[1]**. It will also artificially |
| inflate the value of Inventory (and hence assets) which is used to assist in gaining the loan |
| the owner is seeking **[1]**. |
| This is unethical as the bank should be able to make decisions based on accurate data and |
| incorrect values distort the data and falsely represent the value of the business **[1]**. The |
| misleading information may cover up issues with the way the business operates and hide |
| the true ability of the business to repay the loan **[1]**. |
|  |
|  |
|  |

**b.**  4 marks

|  |
| --- |
| **Description** |
| The first strategy would be to install a security system which involves a scanner at the |
| entrance to the store **[1]**, which will indicate if someone is leaving the store with unpaid |
| goods **[1]**. |
| A second measure may be to limit the number of students entering the store at any given |
| time **[1]**. This will make it easier to manage the people in the store and monitor their |
| Activity, discouraging theft **[1]**. |
| *Other valid options should also be accepted* |
|  |
|  |
|  |
|  |

**Question 6** (9 marks)

**a.**  2 marks

|  |
| --- |
| **Definition** |
| Profitability is a measure of the profit of a business measured against a base **[1]** such as |
| Assets, Sales or Owner’s Equity [1]. |
|  |
|  |
|  |

**b.**  4 marks

|  |
| --- |
| **Description** |
| The graph shows a mixed result in terms of profitability **[1]** – Net Profit Margin has |
| worsened as the business is retaining less $ of sales as Net Profit (down from 12% to 8%) |
| while Gross Profit Margin has improved - $55 of Sales are retained as Gross Profit , up |
| from $45 **[1]**. |
| The favourable increase in GPR may be a result of an increased mark-up, due to either |
| an increased sale price or reduced cost price of inventory or both **[1]**. |
| An increased sale price could lead to a reduction in revenue if some of the customers have |
| opted for cheaper alternatives. If expenses have remained relatively constant, then |
| this would explain a drop in the NPR **[1]**. |
| Separately, NPR may have deteriorated due to poor expense control. |
|  |

**c.** 1 mark

|  |
| --- |
| **Indicator:** Number of website hits/Number of customer complaints |

**d.**  2 marks

|  |
| --- |
| **Outline** |
| One possible strategy would be to increase sales revenue via a promotion **[1]**, providing |
| revenue increases proportionally more than expenses **[1]**. |
|  |
|  |
|  |

**Question 7** (10 marks)

**a.**  2 marks

**Bank**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date**  **2020** | **Cross-reference** | **Amount** | **Date**  **2020** | **Cross-reference** | **Amount** |
| Apr 2 | Sales/GST Clearing | 770 | Apr 1 | Balance | 3 500 |
| 4 | Accounts Receivable | 2 400 | 2 | Advertising/GST Clearing | 440 |
| 7 | Sales/GST Clearing | 880 | 5 | Drawings | 900 |
| 11 | Sales/GST Clearing | 1 320 | 6 | Inventory/GST Clearing | 3 300 |
| 12 | Accounts Receivable | 950 | 9 | Wages | 700 |
| 19 | Sales/GST Clearing | 550 | 15 | Rent/GST Clearing | 990 |
| 28 | Sales/GST Clearing | 1 100 | 16 | Loan – Ace Finance | 350 |
| 29 | Capital | 10 000 |  | Interest Expense | 150 |
|  | Balance | 2 430 | 20 | Accounts Payable | 2 800 |
|  |  |  | 23 | Wages | 1 400 |
|  |  |  | 29 | GST Clearing | 1 470 |
|  |  |  | 30 | Equipment/GST Clearing | 4 400 |
|  |  | 20 400 |  |  | 20 400 |
|  |  |  | May 1 | Balance | 2 430 |
|  |  |  |  |  |  |

*Award 1 mark for the totals of both sides of the account*

*Award 1 mark for the calculation and carrying forward of the closing balance*

1. 6 marks

**Door Jam**

**Cash Flow Statement (extract) for the month ended 30 April 2020**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **OPERATING ACTIVITIES** |  | | $ | $ |
| Cash Sales | | | 4 200 |  |
| GST Collected | | | 420 |  |
| Receipts from Accounts Receivable | | | 3 350 | 7 970 |
| Advertising | |  | (400) |  |
| Inventory | | | (3 000) |  |
| Wages | | | (2 100) |  |
| Rent | | | (900) |  |
| Interest Expense | | | (150) |  |
| Payments to Accounts Payable | | | (2 800) |  |
| GST Paid | | | (830) |  |
| GST Clearing | | | (1 470) | (11 650) |
|  | | |  |  |
| **Net Cash Flows from Operating Activities** | | |  | **(3 680)** |

*1 mark for Cash Sales/GST Collected*

*1 mark for Accounts Receivable/Accounts Payable*

*1 mark for GST Paid*

*1 mark for every 2 other outflows (3 marks)*

**c.**  2 marks

|  |
| --- |
| **Explanation** |
| Net Cash Flows from Investing Activities is the difference between cash inflows and cash |
| Outflows **[1]** related to the selling and purchasing of non-current assets for cash **[1]**. |
| In the ledger account provided the business purchased Equipment which is an outflow as it |
| is a Non-Current Asset **[1]**. |
|  |

**Question 8** (26 marks)

**a.**  9 marks

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Inventory Item: Nuline Pro Cost Assignment Method: FIFO** | | | | | | | | | | | | | | |
| **Date**  **2020** | **Details** | **IN** | | | | **OUT** | | | | **BALANCE** | | | |
| **Qty** | **Cost** | **Total** | **Qty** | | **Cost** | **Total** | **Qty** | | **Cost** | **Total** |
| June 1 | Balance |  |  |  |  | |  |  | 3 | | 50 | 150 |
| 3 | Inv. G801 | 15 | 55 | 825 |  | |  |  | 3  15 | | 50  55 | 975 |
| 7 | EFT 346 |  |  |  | 1 | | 50 | 50 | 2  15 | | 50  55 | 925 |
| 12 | Inv. Q012 |  |  |  | 2 | | 50 | 100 | 15 | | 55 | 825 |
| 18 | Inv. Q083 |  |  |  | 6 | | 55 | 330 | 9 | | 55 | 495 |
| 20 | CN 019 | 1 | 55 | 55 |  | |  |  | 10 | | 55 | 550 |
|  | CN X12 |  |  |  | 1 | | 55 | 55 | 9 | | 55 | 495 |
| 23 | Inv. G934 | 12 | 60 | 720 |  | |  |  | 9  12 | | 55  60 | 1 215 |
| 26 | EFT 411 |  |  |  | 1 | | 55 | 55 | 8  12 | | 55  60 | 1 160 |
| 28 | Memo 85 |  |  |  | 1 | | 55 | 55 | 7  12 | | 55  60 | 1 105 |
| 30 | Memo 86 |  |  |  | 2 | | 55 | 110 | 5  12 | | 55  60 | 995 |
|  | Memo 87 |  |  |  | 5  12 | | 15  20 | 315 | 17 | | 40 | 680 |
|  |  |  |  |  |  | |  |  |  | |  |  |

*Award 1 mark for each entry as shown*

*Deduct 1 mark maximum if document numbers are not used*

**b**. 6 marks

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date**  **2020** | **Details** | **Debit** | **Credit** |
| Jun 28 | Advertising | 55 |  |
|  | Inventory |  | 55 |
|  |  |  |  |
| 30 | Inventory Loss | 110 |  |
|  | Inventory |  | 110 |
|  |  |  |  |
|  | Inventory Write Down | 315 |  |
|  | Inventory |  | 315 |
|  |  |  |  |

*Award 1 mark for each line in General Journal*

**c.**  3 marks

|  |
| --- |
| **Explanation** |
| The inventory in Memo 87 is written down because it has been determined that it is no |
| longer possible to sell the inventory at its usual selling price nor able to be sold for a |
| profit **[1]**. The business is recording this to recognise the loss now as it is apparent it is going to |
| occur **[1]**. |
| This conforms to the qualitative characteristic of faithful representation as the value of the |
| Inventory now better represents its true value to the business and recognises real life |
| economic events **[1]**. |
|  |

*Students who refer to Relevance can be awarded full marks if response is valid.*

**d.** 2 marks

|  |  |
| --- | --- |
| **Calculation**  Invoice price + Customs Duty  $80 + $8 | |
| **Unit cost of 1 Nuline Expert** | **$88** |

**e.**  4 marks

|  |
| --- |
| **Explanation** |
| The freight cost is treated as a period cost **[1]**. It is a cost involved in getting inventory into |
| a position and condition ready for sale but it can’t be allocated logically to the individual |
| units of inventory **[1]**. |
| When reporting this expense it is reported as part of Cost of Goods |Sold **[1]** as it is part of the |
| incurred in getting the inventory into a condition and location ready for sale and is used to calculate |
| the Gross Profit of the business **[1]**. |
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|  |

**f.**  2 marks

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| --- |
| **Explanation** |
| Olivia is incorrect. Under product costing the cost of Customs Duty is added to the invoice |
| price of inventory. If the inventory is not sold the cost is not yet expensed **[1]**. |
| Under period costing however, the cost would be expensed regardless of the number of units sold |
| and the expenses would be higher and so profit is lower **[1]**. |
|  |

**END OF SOLUTIONS BOOK**