



INSIGHT

Trial Exam Paper

2011

ACCOUNTING

Written examination 2

Suggested solutions

This book presents:

- correct solutions
- mark allocations
- tips

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Question 1

Charlie's Model Trains

Charlie Michaels owns and operates a small business, Charlie's Model Trains, which specialises in the sale of rare miniature train sets. The business uses the double entry accounting system based on the accrual method of accounting. Other features of Charlie's Model Trains accounting system are as follows.

- The business uses control accounts and subsidiary records for Debtors, Creditors and Stock.
- The perpetual method of stock recording and the FIFO cost assignment method are used.
- The business reports quarterly in March, June, September and December.

1.1 The following Non-Current Asset appeared in the Balance Sheet of Charlie's Model Trains on 31 December 2010:

	\$	\$
Display Equipment	50 000	
Less Accumulated Depreciation of Display Equipment	<u>15 000</u>	<u>35 000</u>

The following information was extracted from the journals and other records:

Cash Receipts Journal

Date 2011	Details	Rec. No.	Bank	Disc. Exp.	Debtors	Cost of sales	Sales	GST	Sundries
Mar 31	Disposal of Display Equipment	67	1 000						1 000*

- * Proceeds of the sale of Display Equipment that cost \$8000 when purchased on 1 April 2008.

Fixtures R Us	
ABN 234 567 980	
Date 31/3/11	Invoice No. 907
Sold to CHARLIE'S MODEL TRAINS	
Display Equipment as per Order 42	17 500
Installation fee	500
Plus GST	<u>1 800</u>
TOTAL DUE	\$19 800

All display equipment is to be depreciated at 30% per annum.

Required

1.1.1 Calculate the depreciation expense on the Display Equipment for the quarter ending 31 March 2011.

Solution 1.1.1

Calculation $\$50,000 \times 30\% = 15,000$

$15,000 / 4 = \$3,750$

Depreciation expense

\$3 750

2 marks

Mark Allocation

- 1 mark for calculation
- 1 mark for correct answer in box

1.1.2 Show how the following accounts will appear in the General ledger after all entries have been posted.

- Display Equipment
- Accumulated Depreciation – Display Equipment
- Disposal of Display Equipment

(You are **not** required to balance the accounts.)

Solution 1.1.2**Display Equipment**

Date 2011	Cross-reference	Amount \$	Date 2011	Cross-reference	Amount \$
1 Jan	Balance	50 000	<i>31 Mar</i>	<i>Disposal of Display Equipment</i>	<i>8 000</i>
<i>31 Mar</i>	<i>Sundry Creditor – Fixtures R Us</i>	<i>18 000</i>			

2 + 2 + 2 = 6 marks

Mark allocation

- 1 mark each for each entry on debit/credit side

Accumulated Depreciation - Display Equipment

Date 2011	Cross-reference	Amount \$	Date 2011	Cross-reference	Amount \$
31 Mar	<i>Disposal of Display Equipment</i>	7 200	1 Jan	Balance	15 000
			31 Mar	<i>Depreciation Expense - Display Equipment</i>	3 750

Mark allocation

- 1 mark each for each entry on debit/credit side

Disposal of Display Equipment

Date 2011	Cross-reference	Amount \$	Date 2011	Cross-reference	Amount \$
31 Mar	<i>Display Equipment</i>	8 000	31 Mar	<i>Accumulated Depreciation – Display Equipment</i>	7 200
	<i>Profit on disposal of Display Equipment</i>	200		<i>Bank</i>	1 000

Mark allocation

- 1 mark for Bank entry on credit side
- 1 mark for Profit on disposal of Display Equipment entry on debit side

1.1.3 Suggest two reasons for the profit or loss on the disposal of the Display Equipment.

Solution 1.1.3

Reason 1: *Underestimation of Useful life/Residual value*

Reason 2: *Display Equipment was in good condition/had not been superseded*

2 marks

Mark allocation

- 1 mark for each reason

1.1.4 Show how the display equipment would appear in the Balance Sheet as at 31 March 2011.

Solution 1.1.4

Non-Current Assets		
<i>Display Equipment</i>	<i>\$60 000</i>	
<i>Less Accumulated Depreciation – Display Equipment</i>	<i>11 550</i>	<i>48 450</i>

2 marks

Mark allocation

- 1 mark each for the Display Equipment and Accumulated Depreciation entries
- 1 mark for showing carrying value
- -1 for incorrect titles

1.1.5 Explain the difference between Creditors Control and a Sundry Creditor.

Solution 1.1.5

Explanation: <i>Creditors control is used when a business purchases stock on credit from a trade</i>
<i>creditor whereas a sundry creditor is used when a business buys a non-current asset on credit.</i>

2 marks

Mark allocation

- 1 mark for definition of Creditors Control
- 1 mark for definition of a Sundry Creditor

- 1.2** The following table indicates the financial analysis of Charlie's Model Trains over the last 2 years ending 31 June:

	2010	2011
Gross Profit Ratio (Gross Profit/Sales)	51%	58%
Return on Assets (Net Profit/ Ave Total Assets)	40%	35%

Required

- 1.2.1 Explain** the trend in the Gross Profit Ratio from 2010 to 2011. **Explain** two factors that might account for this trend.

Solution 1.2.1

Explanation: <i>The trend is favourable. The business is retaining 58 cents as gross profit for every dollar of sales in 2011; this increased from 51 cents in the dollar in 2010.</i>
Factor 1: <i>Markup increased - Cost of sales decreased and selling price remained constant</i>
Factor 2: <i>Markup increases - Selling price increased and cost of sales remained constant</i>

4 marks

Mark allocation

- 1 mark for 'favourable'
- 1 mark for explanation of how ratio changed
- 1 mark each for the two factors; each factor should comment on both the cost and selling price

1.2.2 Explain the trend in the Return on Assets. Identify one **reason** for change.

Solution 1.2.2

Explanation: <i>The trend is unfavourable. The business earned 35 cents profit from every dollar of assets in 2011. This decreased from 2010, when it was 40 cents from every dollar.</i>
Reason: <i>Expense control worsened – expenses increased at a faster rate than average total assets.</i>

3 marks

Mark allocation

- 1 mark for ‘unfavourable’
- 1 mark for explanation of how ratio changed
- 1 mark for the reason

1.2.3 Explain one limitation of using ratios to analyse the performance of Charlie’s Model Trains.

Solution 1.2.3

Explanation: <i>Ratios are based on historical data and do not provide a reliable estimation of how the business will perform in the future. Ratios often use averages, and these can provide an inaccurate indicator of its performance over a period of time.</i>

2 marks

Mark allocation

- 1 mark for limitation
- 1 mark for explanation of limitation

- 1.3** At 1 July 2011 the balance of stock held of the Eurostar 100 Model Train Set was recorded as follows:

Date	Item	Units on Hand	Cost price
1 July 2011	Eurostar 100 (purchased 13/6/11)	25	70
	Eurostar 100 (purchased 22/5/11)	10	65

During July the following transactions occurred in relation to this stock item.

Document A

Charlie's Model Trains			
231 Low St Highett 3190 ABN: 98 908 987 654			
Inv No: 23		Date 8/7/11	
Sold to Preston Model Train Club			
<u>QTY</u>	<u>DESC.</u>	<u>COST</u>	<u>TOTAL</u>
15	Eurostar 100	140	\$2 100
		+ GST	210
TOTAL DUE			\$2 310
Terms: 2/14, n/30			

Document B

Charlie's Model Trains	
231 Low St Highett 3190 ABN: 98 908 987 654	
Credit Note C5	Date: 14/7/11
To:	Preston Model Train Club
For:	10 Eurostar 100 train sets - faulty
Amount:	\$1 400
GST:	<u>\$140</u>
	\$1 540

Document C

European Model Train Importers	
231 High St Port Melbourne 3207 ABN: 89 809 789 456	
Credit Note 128	Date: 18/7/11
To:	Charlie's Model Trains
For:	10 Eurostar 100 train sets - faulty
Amount:	\$675
GST:	<u>\$67.50</u>
	\$742.50

Document D

Charlie's Model Trains	
Memo - 33	
Date - 31/7/11	
Instruction:	Stocktake revealed 18 units of Eurostar 100 on hand
Signed:	<i>Charlie</i>

Required

1.3.1 Record documents A, B, C, and D in the Stock Card for the Eurostar 100 train set.

Solution 1.3.1

Stock Item: Eurostar 100					Location: Shelf 4C					
Date 2011	Details	IN			OUT			BALANCE		
		Qty	Cost \$	Total \$	Qty	Cost \$	Total \$	Qty	Cost \$	Total \$
1 July	Balance							10	65	
								25	70	2400
8 July	Inv 23				10	65	650			
					5	70	350	20	70	1400
14 July	C/N C5	5	70	350				5	65	325
		5	65	325				25	70	1750
18 July	C/N 128				5	70	350			
					5	65	325	20	70	1400
31 July	Memo 33				2	70	140	18	70	1260
	Memo 35 (1.3.3 solution)				18	40	720	18	30	540

5 marks

Mark allocation

- 1 mark per date (1 July, 8th July, 14th July, 18th July 31st July)
- Be careful of consequential errors

Question 1 – continued
TURN OVER

1.3.2 Record Document B in the General Journal of Charlie's Model Trains.
A narration is **not** required.

Solution 1.3.2

Date	Details	General Ledger		Subsidiary Ledger	
		Debit \$	Credit \$	Debit \$	Credit \$
31 July	Sales Returns	1400			
	GST Clearing	140			
	Debtors Control		1540		
	Preston Model Trains				1540
	Stock Control	675			
	Cost of Sales		675		

4 marks

Mark allocation

- 1 mark each for Sales Returns and GST Clearing entries
- 1 mark for Debtors Control and subsidiary debtor entry
- 1 mark for stock control/cost of sales entry

On the 31st July 2011 Charlie's Model Trains received notification that a new model of Eurostar model train, the Eurostar 200, would be arriving in Australia in mid-August 2011. This model would supersede the Eurostar 100. Charlie decided that the remaining Eurostar 100 model trains could be sold for \$50. The business would also need to advertise this in the local paper, which would cost \$360 (plus \$36 GST).

Required

1.3.3 Record any necessary stock write-down in the Stock Card provided for Question 1.3.1 (record as Memo 35).

Solution 1.3.3 – see solution 1.3.1

2 marks

Mark allocation

- 1 mark for 'OUT' column entry
- 1 mark for 'BALANCE' column entry

1.3.4 Prepare the General Journal entry to record any stock write-down at 31 July 2011.

A narration is required

Solution 1.3.4

Date	Details	General Ledger		Subsidiary Ledger	
		Debit \$	Credit \$	Debit \$	Credit \$
31 July	Stock Write Down	720			
	Stock Control		720		
	<i>Memo 35 – write down of 18 Eurostar 100 Model train sets - superseded</i>				

3 marks

Mark allocation

- 1 mark per line
- Narration must include memo number, stock item, number of units, reason for write down for mark to be allocated

1.3.5 Explain why the lower of cost or net realisable value rule is applied when valuing stock. **Identify** one accounting principle that supports your explanation.**Solution 1.3.5**

Explanation: <i>Businesses write down the value of their stock if they believe that circumstances have arisen to indicate they are no longer able to sell the stock at a profit. This may be due to damage, obsolescence or new stock becoming available. In these circumstances it is best to not overvalue assets (stock) or net profit.</i>
Principle: <i>Conservatism</i>

2 + 1 = 3 marks

Mark allocation

- 1 mark for the correct principle
- 2 marks for the explanation. The explanation must state that, for NRV to be used, the stock is being sold at a loss (below cost). A rote-learned definition of stock write down does not score any marks.

- 1.4** On 1 August 2011 Charlie's Model Trains purchased a new stock item, the Albuquerque Flyer. The Albuquerque Flyer will be purchased in 40 unit batches delivered monthly with other stock purchases. Details are as follows.

	\$	GST
Supplier's invoice price (per unit)	120	12
Packaging costs (per unit)	15	1.50
Insurance of stock in transit (per unit)	5	0.50
Monthly delivery costs – all stock purchases	350	35

Required

- 1.4.1 Calculate** the cost at which each unit of The Albuquerque Flyer will be recorded in the Stock Card.

Solution 1.4.1

$\$120 + 15 + 5 = 140$	
Budgeted cost price	\$ 140

1 mark

Mark allocation

- 1 mark for correct calculation

- 1.4.2 Explain**, using the information provided in **1.4** above, the difference between product and period costs.

Solution 1.4.2

Explanation: <i>Product costs are costs which can be allocated to individual units of stock on a logical basis (such as the costs of packaging and insurance in transit), whereas period costs are costs that are not allocated to individual units of stock because there is no logical basis to do so (as with the monthly delivery costs on all stock purchases).</i>

2 + 2 = 4 marks

Mark allocation

- 1 mark each for an accurate definition of product and period costs
- 1 mark each for examples of both product and period costs

Total 45 marks

End of Question 1

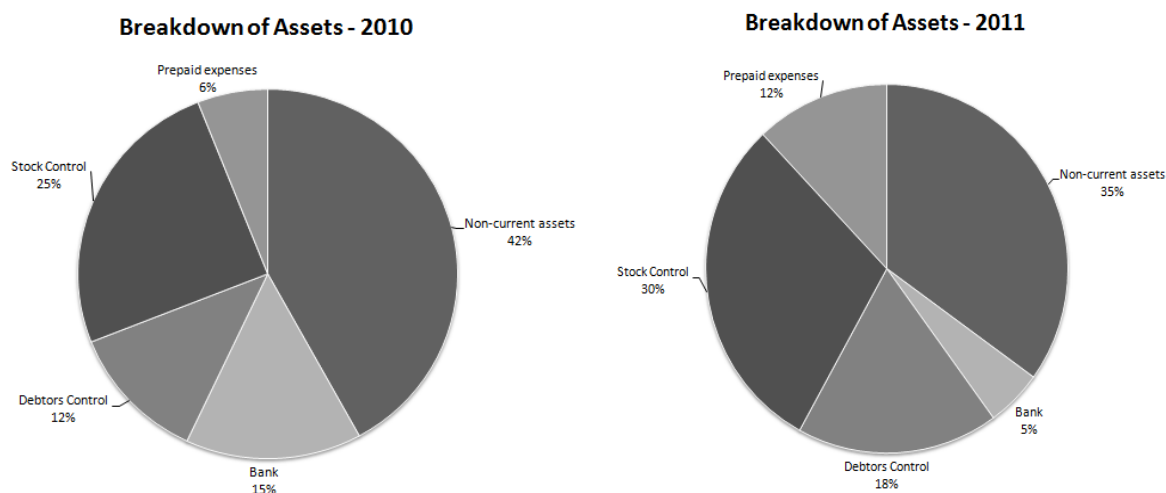
Question 2

Freya's Furniture

Freya Johnson owns and operates a small business, Freya's Furniture, selling a range of household furniture. Her accounting system is based on the double entry accrual system of recording and reporting. Other features of the accounting system are:

- The business uses control accounts and subsidiary records for Debtors, Creditors and Stock.
- Use of the perpetual method of stock recording and the FIFO method of cost assignment.
- The business completes accounting reports monthly.

2.1 The following pie chart provides a breakdown of the business' assets on 2010 and 2011.



Additional information:

	2010	2011
Debtors Turnover	22 days	27 days
Stock Turnover	21 days	33 days

Required

2.1.1 Explain what is meant by the term liquidity.

Solution 2.1.1

Explanation: <i>Liquidity is defined as the business' ability to meet short-term obligations as they fall due.</i>

1 mark

Mark allocation

- 1 mark for 'short term obligations as they fall due'

2.1.2 Explain why the Debtors Turnover and Stock Turnover ratios are an effective measure of a business' liquidity.

Solution 2.1.2

Explanation: <i>Debtors turnover measures the average length of time it takes to collect cash from</i>
<i>debtors. The ratio provides a good indication of how long it takes for the business to collect cash</i>
<i>so that it can then pay its short-term debts. Stock turnover measures the average length of time it takes</i>
<i>for the business to sell its stock. This ratio gives the business an indication of how long it will take to</i>
<i>receive cash from the sale of stock so that it can then pay its short-term debts.</i>

4 marks

Mark allocation

- 1 mark each for explanation of debtors and stock turnover
- 1 mark each for linking the ratios back to liquidity

2.1.3 State whether liquidity has improved, deteriorated or remained the same. Referring to at least **two assets** above, explain your answer.

Solution 2.1.3

State (please circle)	Improved	Deteriorated	Stayed the same
Explanation: The bank account has decreased from 15% of assets to 5% of assets. This means that the business has less cash at its disposal to pay short-term debts. Debtors has increased from 12% of assets to 18%. This may not be good for liquidity given that DTO has increased unfavourably from 22 days to 27 days. Similarly, Stock has increased from 25% of assets to 30%. This has negative implications for liquidity given that STO has increased unfavourably from 21 days to 33 days. The changes in these two assets indicate that it is taking longer for the business to collect cash, and this will adversely affect liquidity.			

1 + 4 = 5 marks

Mark allocation

- 1 mark for 'deteriorated'
- 2 marks for the explanation of **each** asset. Explanation must include the trend from each year, as well as a link to liquidity. If debtors and stock are listed, the explanation must link to the trend in debtors and stock turnover.

For the purposes of question 2.2 you are not required to consider GST.

- 2.2** Freya has provided you with the following information about the budgeted and actual cash receipts and payments for July 2011.

FREYA'S FURNITURE		
Profit and Loss Statement (extract) for the month ended 30 July 2011		
	Budgeted	Actual
Revenue		
Cash Sales	7 700	8 500
Credit Sales	2 500	2 800
Less Sales Returns	(125)	(140)
	10 075	11 160
Less Cost of Sales	6 120	6 780
GROSS PROFIT	3 955	4 380
Less stock loss	300	800
ADJUSTED GROSS PROFIT	3 655	3 580

Required

- 2.2.1** In your answer book, **complete** a Profit and Loss Variance Report (extract) for the month ending 30 July 2011, indicating size and direction of each of the variances.

Solution 2.2.1

FREYA'S FURNITURE				
Profit and Loss Variance Report (extract) for the month ended 30 July 2011				
	Budgeted	Actual	\$	U/F
Revenue				
Cash Sales	7 700	8 500	800	F
Credit Sales	2 500	2 800	300	F
Less Sales Returns	(125)	(140)	15	U
	10 075	11 160	1085	F
Less Cost of Sales	6 120	6 780	660	U
GROSS PROFIT	3 955	4 380	425	F
Less stock loss	300	800	500	U
ADJUSTED GROSS PROFIT	3 655	3 580	75	F

5 marks

Mark allocation

- 1 mark for the variance in cash and credit sales
- 1 mark for the variance in sales returns
- 1 mark for the variance in cost of sales
- 1 mark for the variance in stock loss
- 1 mark for variances in net sales, gross profit and adjusted gross profit

2.2.2 List one reason for the variance in sales returns during July 2011

Solution 2.2.2

Explanation: <i>As both cash and credit sales increased, the business should expect a higher level of sales returns.</i>

1 mark

Mark allocation

- 1 mark for the link between increased sales and increased sales returns.

2.2.3 Explain how a Profit and Loss Variance report can be used to assist the future planning of a business.

Solution 2.2.3

Explanation: <i>By comparing actual and budgeted figures, the business owner can make decisions to improve the firm's performance. The variance report allows problems to be identified and corrected. This improves planning by ensuring that future budgets are as accurate as possible.</i>

2 marks

Mark allocation

- 1 mark for explanation of a variance report
- 1 mark for improved accuracy of budgets

In addition to the Profit and Loss Statement extract for July 2011 (above) Freya provides the following information on the business' expected financial activities for August 2011.

From the Balance Sheet

	Actual 31 July 2011	Predicted 31 August 2011
	\$	\$
Balance of Stock Control	2 600	3 640
Balance of Debtors Control	2 400	2 800
Balance of Creditors Control	8 600	9 600
Balance of Bank account	3 210	3 900

From the Profit and Loss Statement

	Predicted August 2011
Cash Sales	will increase 10% on July figures
Credit sales	will increase 10% on July figures
Discount expense	\$120
Cost of Sales	60% of sales
Sales Returns	\$160
Stock loss	\$600
Discount revenue	\$150
Wages expense	\$1600
Bad debts	\$100
Cash operating expenses	\$200
Depreciation of vehicle	\$210

Additional information:

- All stock is purchased on credit.
- The business pays its rent (\$500 per month) 6 months in advance. It is scheduled to make its next payment on 1 August 2011.
- Freya has also confirmed that a line of stock did not sell. She will write his stock down by \$300 as a result.
- In August Freya expects to receive an order from Down Under Imports, who will pay \$3,000 in advance on the 12th August 2010. The business will supply the order on the 9th September 2011.
- Freya expects to take drawings of \$1,000 (cash), and \$250 (stock).

Required

2.2.4 Reconstruct the Debtors Control Account to **calculate** budgeted cash received from Debtors for August.

Solution 2.2.4

Calculation			
Debtors Control			
<i>Balance</i>	<i>2400</i>	<i>Discount expense</i>	<i>120</i>
<i>Credit sales</i>	<i>3080</i>	<i>Sales returns</i>	<i>160</i>
		<i>Bad debts</i>	<i>100</i>
		<i>Bank</i>	<i>2300</i>
		<i>Balance</i>	<i>2800</i>
Budgeted Receipts from Debtors			<i>\$ 2 300</i>

3 marks

Mark allocation

- 1 mark opening and closing balances
- 1 mark for credit sales and discount expense
- 1 mark for sales returns and bad debts

2.2.5 Reconstruct the Stock Control and Creditors Control accounts to calculate budgeted cash payments to Creditors for August.

Solution 2.2.5

Calculation			
Stock Control			
<i>Balance</i>	2600	<i>Cost of Sales</i>	7458
<i>Cost of Sales</i>	96	<i>Stock loss</i>	600
<u><i>Creditors Control</i></u>	<u>9552</u>	<i>Stock write down</i>	300
		<i>Drawings</i>	250
		<i>Balance</i>	3640
Creditors Control			
<i>Bank</i>	8402	<i>Balance</i>	8600
<i>Discount revenue</i>	150	<u><i>Stock control</i></u>	<u>9552</u>
<i>Balance</i>	9600		
Budgeted Payments to Creditors			\$ 8 402

5+3 = 8 marks

Mark allocation - Stock control

- 1 mark for opening/closing balances
- 1 mark for cost of sales entry on debit side (sales return)
- 1 mark for stock loss and stock write down
- 1 mark for drawings
- 1 mark for missing creditors control figure

Mark allocation - Creditors control

- 1 mark for opening/closing balances
- 1 mark for discount revenue
- 1 mark for correct posting of the credit purchases figure from the stock control reconstruction

2.2.6 Prepare a Budgeted Cash Flows from Operating Activities for the month ending 31 August 2011.

Solution 2.2.6

Freya's Furniture

Budgeted Cash Flow Statement for month ending 31 August 2011

	\$	\$
OPERATING ACTIVITIES		
Cash inflows		
<i>Cash Sales</i>	9350	
<i>Receipts from Debtors</i>	2300	
<i>Prepaid sales</i>	<u>3000</u>	14650
Less Cash outflows		
<i>Payments to creditors</i>	(8402)	
<i>Wages</i>	1600	
<i>Cash operating expenses</i>	200	
<i>Prepaid Rent</i>	<u>3000</u>	13202
Net Cash from Operating Activities		1448

8 marks

Mark allocation

- 1 mark each for each entry (3 inflows, 4 outflows)
- 1 mark total for sub-totals of cash inflows, cash outflows and net cash from operating activities

2.2.7 Identify one disadvantage of producing monthly budgets.

Solution 2.2.7

Explanation: *Monthly budgeting takes time, which is a scarce resource for a business owner. If the business pays an accountant to prepare its budgets, monthly budgets will increase costs.*

1 mark

Mark allocation

- 1 mark for link between frequent budgeting and increased time/money spent on budgeting

2.3 During September 2011 the business received \$2 000 plus \$200 GST from Blackburn Auto Sales. This amount was for the purchase of 4 office chairs, which Freya's Furniture agreed to supply in October. At the end of October 2011 Freya has supplied three of the four items. Freya applied a mark-up of 50% for this transaction.

Required

2.3.1 Show the General Journal entry required at 31 October 2010 to record the sales revenue earned.
(A narration is **not** required.)

Solution 2.3.1

General Journal

Date	Details	General Ledger		Subsidiary Ledger	
		Debit \$	Credit \$	Debit \$	Credit \$
31 Oct	Prepaid sales Revenue	1 500			
	Sales revenue		1 500		
	Cost of Sales	1 000			
	Stock Control		1 000		

4 marks

Mark allocation

- 1 mark per line

2.3.2 Referring to one qualitative characteristic, **explain** why a balance day adjustment is required for prepaid sales.

Solution 2.3.2

Explanation: <i>The reporting period principle states that revenue earned in an accounting period must be matched against expenses incurred in the same reporting period in order to calculate an accurate profit. This will ensure that reports contain information that is relevant for decision-making.</i>
Qualitative characteristic: <i>Relevance</i>

3 marks

Mark allocation

- 1 mark for the correct qualitative characteristic
- 2 marks for the explanation, mentioning ‘accurate profit’ and ‘decision-making’

Total 45 marks

END OF SOLUTIONS BOOK