COMPAK

**ACCOUNTING UNITS 3 AND 4**

# Accounting Units 3 and 4 practice exam 2020 and suggested solutions

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The following VCE Accounting Units 3 and 4 practice exam consists of nine questions worth 100 marks. Students are required to answer all questions in the spaces provided in the answer book.

The command/task words in each question, the corresponding number of marks allocated and the number of lines provided after each question, where appropriate, give a guide to the appropriate length of responses. Suggested answers to this practice exam follow the answer book.

Please note that the following questions and solutions have no official status. Teachers are advised to preview and evaluate all practice exam material before distributing it to students. **Note:** The questions are based on the *VCE Accounting Adjusted Study Design for 2020 only.*

# ACCOUNTING UNITS 3 AND 4

## Practice written examination 2020

**Reading time: 15 minutes**
**Writing time: 2 hours**

## QUESTION BOOK

**Structure of book**

| *Number of questions* | *Number of questions to be answered* | *Number of marks* |
|---|---|---|
| 9 | 9 | 100 |

- Students are permitted to bring into the examination room: pens, pencils, highlighters, erasers, sharpeners, rulers and one scientific calculator.
- Students are NOT permitted to bring into the examination room: blank sheets of paper and/or white-out liquid/tape.

**Materials supplied**

- Question book
- Answer book

**Instructions**

- Write your name and your teacher's name in the spaces provided on the front page of the answer book.
- Answer **all** questions in the answer book.
- All written responses must be in English.

**Students are NOT permitted to bring mobile phones and/or any other unauthorised electronic devices into the examination room.**

## QUESTION 1: MISHA COSMETICS (14 MARKS)

Lucy Nicholls owns and operates Misha Cosmetics, a small business selling cosmetics. She operates a small store in a suburban shopping centre; however, most sales come from other small businesses, such as hairdressers and nail salons, via her online store. Cosmetics are imported from overseas locations and Lucy rebrands all items with the Misha Cosmetics name.

The following Inventory Card was available on 12 April 2020:

**STOCK ITEM: Misha Midnight Mascara** **SUPPLIER: Tuscan Imports**

**CODE: MM09** **COST ASSIGNMENT METHOD: Identified Cost**

| Date 2020 | Document | IN | | | OUT | | | BALANCE | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Qty | Cost | Total | Qty | Cost | Total | Qty | Cost | Total |
| Apr 1 | Balance | | | | | | | 15<br>100 | 12<br>14 | 1 580 |
| 4 | EFT 3521 | | | | 12 | 12 | 144 | 3<br>100 | 12<br>14 | 1 436 |
| 6 | Inv. MCD08 | | | | 1<br>49 | 12<br>14 | 698 | 2<br>51 | 12<br>14 | 738 |
| 9 | CN L211 | 5 | 14 | 70 | | | | 2<br>56 | 12<br>14 | 808 |
| 12 | Inv. S585 | 50 | 15 | 750 | | | | 2<br>56<br>50 | 12<br>14<br>15 | 1 558 |
| | | | | | | | | | | |

On 13 April 2020, the owner determined that 10 of the units purchased through Inv. S585 were damaged. These units and the five units returned through Credit Note (CN) L211 were returned to Tuscan Imports on 14 April 2020 for a full credit (CN P08). This line of inventory is sold at $40 per unit plus GST.

**a.** Record the information in CN P08 into the Inventory Card and the General Journal.

**Note:** A narration is **not** required.

1 + 3 = 4 marks

**b.** Record Inv. MCD08 into the General Journal.

**Note:** A narration **is** required.

3 marks

**c.** Explain how the use of a narration supports the qualitative characteristic of verifiability.

2 marks

Lucy has the opportunity to purchase 3 000 units of this stock item at a special price of $10 per unit plus GST. The purchase must be made for cash. Lucy believes with a small loan, a capital contribution, and her current bank balance, she will be able to afford this purchase. However, she is concerned about the effect of such a large purchase on business performance.

**d.** Discuss whether Lucy should proceed with this purchase and make a recommendation.

5 marks

## QUESTION 2: HUBBARD'S HOSES (17 MARKS)

Adam Hubbard owns Hubbard's Hoses, a small business that sells a range of domestic and commercial hoses. A growth in sales to larger commercial customers has prompted Adam to purchase a Van to deliver hoses to customers.

Details of the purchase of the Van on 1 February were as follows:

- Invoice price $55 000
- Van modifications $2 000
- Annual Insurance of Van $1 800
- GST on purchase $5 880
- Deposit paid $13 000
- Balance payable through a loan from Pitt Finance repayable at $12 920 per annum for four years. Interest payments of $6 000 per annum will also be required.

**a.** Record the information above in the General Journal on 1 February 2020.

**Note:** Narrations are **not** required.

5 marks

**b.** With reference to the General Journal entry in **part a.**, explain your treatment of the modifications to the Van.

2 marks

**c.** Adam depreciates the Van using the straight-line method at 12% per annum on cost.

At 30 June 2020, record the General Journal entries required for:

- Depreciation expense
- Insurance incurred.

**Note:** Narrations are **not** required.

2 + 2 = 4 marks

**d.** Explain the effect on profit for the period ending 30 June 2020 if Adam was to depreciate the Van using the reducing balance method at a rate of 24% per annum.

3 marks

**e.** Explain, with reference to an accounting assumption, why it is necessary to adjust revenue and expense accounts at the end of the period.

3 marks

## QUESTION 3: DILARA'S DENIM (16 MARKS)

Dilara Shepard owns Dilara's Denim, a small business specialising in selling jeans. All inventory is sourced locally—she buys small quantities of inventory from boutique manufacturers to appeal to customers who are looking for unique and limited items.

The following information relates to the Flower Power denim line of inventory.

- On 1 August 2020, the business purchased 40 units of this inventory. Details of the purchase were as follows:

| KD MELBOURNE | | | |
|---|---|---|---|
| Date: 01/08/20 | | | Invoice: XZ021 |
| **Charge to:** Dilara's Denim | | | |
| **Item** | **Qty** | **Unit Cost** | **$** |
| Flower Power | 40 | 100 | 4 000 |
| Low Rider | 10 | 130 | 1 300 |
| Hitop Jeans | 20 | 40 | 800 |
| Packaging | 70 | 10 | 700 |
| Cartage Inwards | | | 220 |
| | | | 7 020 |
| *Plus* GST (10%) | | | 702 |
| | | Total | **7 722** |
| **Terms**: 1/14,n45 | | | |

Upon receipt of goods, all items have a label added to them, identifying them as a Dilara Denim item. These labels cost $2 per item (plus GST). These labels were paid for with Chq. 743 on 2 August 2020.

The following information relates to the 80s Fashion denim line of inventory:

- On 1 August 2020, the following information was available from the Inventory Card:

| **STOCK ITEM: 80s Fashion denim** | | | | | | **SUPPLIER: Retro Clothing Co.** | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **CODE: DEN83** | | | | | | **COST ASSIGNMENT METHOD: FIFO** | | | | |
| **Date 2020** | **Document** | **IN** | | | **OUT** | | | **BALANCE** | | |
| | | **Qty** | **Cost** | **Total** | **Qty** | **Cost** | **Total** | **Qty** | **Cost** | **Total** |
| Aug 1 | Balance | | | | | | | 2<br>10 | 80<br>85 | 1 010 |
| | | | | | | | | | | |

The 80s Fashion denim line is to be discontinued and Dilara is keen to sell this inventory and buy newer, more fashionable inventory.

She has decided to offer these jeans for sale at a price of $70 per unit with $5 from every sale to be donated to a bushfire relief fund (Memo 25).

**a.** Calculate the cost of **one** unit of Flower Power denim and explain how you determined the value.

2 + 2 = 4 marks

**b.** Record the transactions in Invoice XZ021, Chq. 743 and Memo 25 in the General Journal.

**Note:** Narrations are **not** required.

3 + 2 + 2 = 7 marks

Despite heavy discounting, at the end of August the owner notices that she is carrying a lot of excess inventory of the 80s Fashion denim line and does not know what to do with these items. She is considering shredding the unsold inventory to avoid having to discount it further and tarnish her brand.

**c.** Discuss the ethical and financial considerations in this scenario.

5 marks

## QUESTION 4: SAYERS SAVINGS STORE (5 MARKS)

Matt Sayers prepares his business's financial reports annually on 30 June each year. On 30 June 2020, he made the following General Journal entries:

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
| June 30 | Wages | 1 300 | |
| | Accrued Wages | | 1 300 |
| | *4 days wages owing—Memo 45* | | |
| | Bad Debts | 230 | |
| | Allowance for Doubtful Debts | | 230 |
| | *Allowance for Doubtful Debts raised at 1% of net credit sales—Memo 46* | | |

Describe the impact of these two journal entries on the accounting reports of the business.

## QUESTION 5: WELSH'S WALLPAPER (8 MARKS)

Mia Welsh provided the following general ledger account for the month ended 31 March 2020:

**Cash at Bank**

| | | | | | |
|---|---|---|---|---|---|
| Mar 3 | Accounts Receivable | 5 400 | Mar 1 | Balance | 450 |
| 15 | Sales/GST Clearing | 7 700 | 4 | Accounts Payable | 3 600 |
| 18 | Capital | 12 000 | 6 | Loan—Able Finance Co. | 1 000 |
| 22 | Disposal of Equipment | 400 | 9 | Interest | 200 |
| | | | 10 | Advertising/GST Clearing | 440 |
| | | | 15 | Prepaid Rent/GST Clearing | 6 600 |
| | | | 17 | Wages | 1 800 |
| | | | 17 | Drawings | 900 |
| | | | 22 | Equipment/GST Clearing | 5 500 |
| | | | 22 | Cartage In/GST Clearing | 550 |
| | | | 25 | GST Clearing | 2 100 |
| | | | 28 | Insurance/GST Clearing | 1 320 |
| | | | 29 | Inventory/GST Clearing | 4 400 |
| | | | | | |
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**a.** Define the term 'Net cash flow from operating activities'.

2 marks

**b.** Prepare the extract of the classified Cash Flow Statement for the month ended 31 March 2020 to show Net Cash Flow from Investing Activities and Net Cash Flow from Financing Activities.

4 marks

**c.** Balance the ledger account shown.

2 marks

## QUESTION 6: AMY'S ANTIQUES (7 MARKS)

Amy Dawson owns and operates Amy's Antiques. The business has been operating for 15 years and in the last two years Amy has become concerned about the business's profit—there has been a decline.

She has provided you with the following information:

| | Year ended 31 Dec. 2016 | Year ended 31 Dec. 2017 | Year ended 31 Dec. 2018 | Year ended 31 Dec. 2019 |
|---|---|---|---|---|
| **Net Profit** | $132 000 | $138 000 | $101 000 | $88 000 |

**a.** Analyse the information provided by Amy, indicating the difference between profit and profitability.

5 marks

**b.** Identify **one** other financial indicator and **one** non-financial indicator Amy could use to gain a better understanding of the performance of her business.

1 + 1 = 2 marks

## QUESTION 7: HATS BY LOGAN (16 MARKS)

Logan Day owns and operates a small business selling hats and accessories. For years Logan has kept the financial records for the business and prepared its financial reports herself.

The business has grown in recent years and Logan believes her reports might not be accurate. Logan has provided her newly appointed accountant with the following unclassified Income Statement:

**HATS BY LOGAN**
**Income Statement for the month ended 30 June 2020**

| | $ | $ |
|---|---|---|
| **Revenue** | | |
| Cash Sales | 68 000 | |
| Credit Sales | 76 000 | |
| Discount Revenue | 2 300 | |
| Interest Revenue | 50 | 146 350 |
| ***Less* Expenses** | | |
| Advertising | 4 000 | |
| Prepaid Rent (Paid on 1 January 2020 for 12 months) | 18 000 | |
| Sales Returns | 2 400 | |
| Freight Inwards | 4 200 | |
| Bad Debts | 800 | |
| Inventory Loss | 1 000 | |
| Inventory Write-down | 500 | |
| Cost of Sales | 71 800 | |
| Wages Paid | 24 000 | |
| Discount Expense | 2 600 | |
| Interest Expense | 3 000 | |
| Cartage Out | 4 300 | |
| Office Expenses | 12 400 | |
| Accrued Wages (1 June 2020) | 1 900 | |
| Accrued Wages (30 June 2020) | 1 700 | |
| Drawings | 12 800 | 165 400 |
| **Profit / (Loss)** | | **(19 050)** |

**a.** Prepare the necessary General Journal entries that Logan should have prepared during the period in relation to Wages. **Note:** Wages are paid once a month on the 15th of each month.

**Note:** Narrations are **not** required.

5 marks

**b.** Redraft the Income Statement provided to show a classified Income Statement up to and including Other Revenue.

5 marks

**c.** Referring to an accounting assumption, explain why Logan's reporting of Drawings was incorrect.

3 marks

**d.** Referencing a qualitative characteristic, explain why it is important to classify an Income Statement.

3 marks

## QUESTION 8: CARR'S CARPETS (12 MARKS)

Theo Carr owns and operates Carr's Carpets, a small business selling carpets and rugs. He is concerned about the financial performance of the business and in 2019 he prepared budgets for the year ended 31 December 2020.

Some figures from the Variance Report are provided below:

**CARR'S CARPETS**
**Income Statement Variance Report for the year ended 31 December 2020**

| | Budgeted $ | Actual $ | Variance $ | F / U |
|---|---|---|---|---|
| **Revenue** | | | | |
| Cash Sales | 308 000 | 295 000 | 13 000 | U |
| Credit Sales | 120 000 | 107 000 | 13 000 | U |
| Sales Returns | (3 000) | (7 200) | 4 200 | U |
| ***Less* Other Expenses** | | | | |
| Discount Expense | 6 000 | 1 200 | 4 800 | F |
| Bad Debts | 3 000 | 6 400 | 3 400 | U |

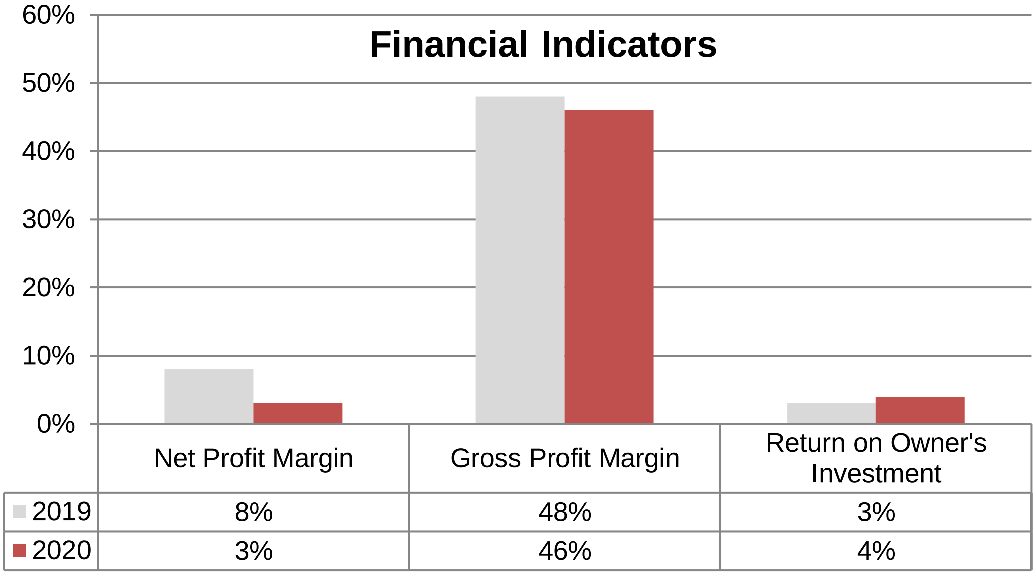
**a.** Explain **one** possible cause of the variances shown in the Income Statement Variance Report and explain the likely impact of these variances on the liquidity of the business.

2 + 2 = 4 marks

**b.** Outline **one** strategy the business could implement to improve its budgeting process.

2 marks

Theo also provided the following information:




**c.** Analyse the performance of the business in terms of profitability, suggesting **two** reasons for the performance.

6 marks

## QUESTION 9: CERRA'S CHAIRS (5 MARKS)

Julian Cerra owns and operates a small business selling an assortment of indoor and outdoor chairs.

On 1 March 2019, the business invested $20 000 in a term deposit earning 6% interest per annum with interest payable every six months on 1 September and 1 March.

The business reports annually on 30 June each year.

**a.** Record the General Journal entry necessary on 30 June 2019.

**Note:** A narration is **not** required.

2 marks

**b.** The owner redeemed the term deposit on 1 September 2020. Record the General Journal entry necessary on this date.

**Note:** A narration is **not** required.

3 marks

**END OF QUESTION BOOK**

Name: ______________________________ Teacher: ______________________________

# ACCOUNTING UNITS 3 AND 4

## Practice written examination 2020

**Reading time: 15 minutes**
**Writing time: 2 hours**

## ANSWER BOOK

**Instructions**

- A question book is provided with this answer book.
- Answer all questions in the spaces provided in this book.
- Write your name and your teacher's name in the spaces provided above on this page.
- Refer to the **Instructions** on the front cover of the question book.

**Students are NOT permitted to bring mobile phones and/or any other unauthorised electronic devices into the examination room.**

## QUESTION 1: MISHA COSMETICS (14 MARKS)

**a.** 1 + 3 = 4 marks

**STOCK ITEM: Misha Midnight Mascara** **SUPPLIER: Tuscan Imports**

**CODE: MM09** **COST ASSIGNMENT METHOD: Identified Cost**

| Date 2020 | Document | IN | | | OUT | | | BALANCE | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Qty | Cost | Total | Qty | Cost | Total | Qty | Cost | Total |
| Apr 1 | Balance | | | | | | | 15<br>100 | 12<br>14 | 1 580 |
| 4 | EFT 3521 | | | | 12 | 12 | 144 | 3<br>100 | 12<br>14 | 1 436 |
| 6 | Inv. MCD08 | | | | 1<br>49 | 12<br>14 | 698 | 2<br>51 | 12<br>14 | 738 |
| 9 | CN L211 | 5 | 14 | 70 | | | | 2<br>56 | 12<br>14 | 808 |
| 12 | Inv. S585 | 50 | 15 | 750 | | | | 2<br>56<br>50 | 12<br>14<br>15 | 1 558 |
| | | | | | | | | | | |

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
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**b.** 3 marks

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
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**c.** 2 marks

| **Explanation** |
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**d.** 5 marks

| **Discussion** |
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## QUESTION 2: HUBBARD'S HOSES (17 MARKS)

**a.** 5 marks

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
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**b.** 2 marks

| Explanation |
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**c.** 2 + 2 = 4 marks

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
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**d.** 3 marks

| Explanation |
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**e.** 3 marks

| Explanation |
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## QUESTION 3: DILARA'S DENIM (16 MARKS)

**a.** 2 + 2 = 4 marks

| **Calculation** | |
|---|---|
| **Cost of one unit of Flower Power denim** | **$** |
| **Explanation** | |
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**b.** 3 + 2 + 2 = 7 marks

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
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**c.** 5 marks

| **Discussion** |
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## QUESTION 4: SAYERS SAVINGS STORE (5 MARKS)

**a.** 5 marks

| **Description** |
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## QUESTION 5: WELSH'S WALLPAPER (8 MARKS)

**a.** 2 marks

| **Definition** |
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**b.** 4 marks

**WELSH'S WALLPAPER**
**Cash Flow Statement (Extract) for the month ended 31 March 2020**

| **Cash Flow from Investing Activities** | | |
|---|---|---|
| | | |
| | | |
| | | |
| **Net Cash Flows from Investing Activities** | | |
| **Cash Flow from Financing Activities** | | |
| | | |
| | | |
| | | |
| **Net Cash Flow from Financing Activities** | | |

**c.** 2 marks

**Cash at Bank**

| Date 2020 | Cross-reference | Amount | Date 2020 | Cross-reference | Amount |
|---|---|---|---|---|---|
| Mar 3 | Accounts Receivable | 5 400 | Mar 1 | Balance | 450 |
| 15 | Sales/GST Clearing | 7 700 | 4 | Accounts Payable | 3 600 |
| 18 | Capital | 12 000 | 6 | Loan—Able Finance Co. | 1 000 |
| 22 | Disposal of Equipment | 400 | 9 | Interest | 200 |
| | | | 10 | Advertising/GST Clearing | 440 |
| | | | 15 | Prepaid Rent/GST Clearing | 6 600 |
| | | | 17 | Wages | 1 800 |
| | | | 17 | Drawings | 900 |
| | | | 22 | Equipment/GST Clearing | 5 500 |
| | | | 22 | Cartage In/GST Clearing | 550 |
| | | | 25 | GST Clearing | 2 100 |
| | | | 28 | Insurance/GST Clearing | 1 320 |
| | | | 29 | Inventory/GST Clearing | 4 400 |
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## QUESTION 6: AMY'S ANTIQUES (7 MARKS)

**a.** 5 marks

| **Analysis** |
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**b.** 2 marks

| **Financial indicator** |
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| |
| **Non-financial indicator** |
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## QUESTION 7: HATS BY LOGAN (16 MARKS)

**a.** 5 marks

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
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**b.** 5 marks

**HATS BY LOGAN**
**Income Statement for the month ended 30 June 2020**

| | $ | $ |
|---|---|---|
| **Revenue** | | |
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**c.** 3 marks

| **Explanation** |
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**d.** 3 marks

| **Explanation** |
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## QUESTION 8: CARR'S CARPETS (12 MARKS)

**a.** 4 marks

| **Explanation** |
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**b.** 2 marks

| **Outline** |
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**c.** 6 marks

| **Analysis** |
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## QUESTION 9: CERRA'S CHAIRS (5 MARKS)

**a.** 2 marks

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
| | | | |
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| | | | |

**b.** 3 marks

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
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**END OF ANSWER BOOK**

# Suggested solutions

## QUESTION 1: MISHA COSMETICS (14 MARKS)

**a.** 1 + 3 = 4 marks

**STOCK ITEM: Misha Midnight Mascara** **SUPPLIER: Tuscan Imports**

**CODE: MM09** **COST ASSIGNMENT METHOD: Identified Cost**

| Date 2020 | Document | IN | | | OUT | | | BALANCE | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Qty | Cost | Total | Qty | Cost | Total | Qty | Cost | Total |
| Apr 1 | Balance | | | | | | | 15<br>100 | 12<br>14 | 1 580 |
| 4 | EFT 3521 | | | | 12 | 12 | 144 | 3<br>100 | 12<br>14 | 1 436 |
| 6 | Inv. MCD08 | | | | 1<br>49 | 12<br>14 | 698 | 2<br>51 | 12<br>14 | 738 |
| 9 | CN L211 | 5 | 14 | 70 | | | | 2<br>56 | 12<br>14 | 808 |
| 12 | Inv. S585 | 50 | 15 | 750 | | | | 2<br>56<br>50 | 12<br>14<br>15 | 1 558 |
| 13 | CN P08 | | | | 5<br>10 | 14<br>15 | 220 | 2<br>51<br>40 | 12<br>14<br>15 | 1 338 |

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
| Apr 14 | Accounts Payable—Tuscan Imports | 242 | |
| | Inventory | | 220 |
| | GST Clearing | | 22 |

***1 mark*** *for each line in General Journal*

***1 mark*** *for full line in Inventory Card—amount in OUT column is consequential to General Journal figure*

**b.** 3 marks

**General Journal**

| Date | Details | Debit | Credit |
|---|---|---|---|
| Apr 6 | Accounts Receivable | 2 200 | |
| | Sales | | 2 000 |
| | GST Clearing | | 200 |
| | Cost of Sales | 698 | |
| | Inventory | | 698 |
| | *Credit sale of 50 units of Misha Cosmetics Midnight Mascara—Inv. MCD08* | | |

***1 mark** for Accounts Receivable/Sales/GST Clearing entry*

***1 mark** for Cost of Sales/Inventory entry*

***1 mark** for narration—must include document number and line of inventory*

**c.** 2 marks

| |
|---|
| **Explanation** Narrations provide a link between the entry in the journal and the |
| transaction as the document number is provided in the narration. **[1]** |
| Documents provide evidence that the transaction has occurred and can be checked |
| to verify the transaction occurred and the recording is accurate. **[1]** |

**OR**

| |
|---|
| **Explanation** As the narration provides a reference to a source document, the transaction |
| is supported by evidence that the users can check. **[1]** |
| This allows independent and knowledgeable observers to agree that a transaction has been |
| faithfully represented. **[1]** |

**d.** 5 marks

| |
|---|
| **Discussion** There are a number of things for Lucy to consider before making this purchase. |
| The business must consider its ability to store this quantity of inventory and if it can be |
| managed appropriately so it does not get lost, stolen or confused with other lines of |
| inventory. Lucy must consider how long she might have to store this inventory by looking |
| at her monthly sales figure. She needs to consider the possibility that the inventory |
| might become obsolete over time. There is also the immediate impact on cash |
| flow as the business must use most of its current holdings of cash (plus a loan and a capital |
| contribution) to fund the purchase. This can negatively impact on future cash flows if the |
| item does not sell well. The business might need to arrange an overdraft to meet |
| expenses and other short-term debts. |
| On a positive note, the business has the opportunity to increase profit in the long-term, |
| as the reduced price will generate a higher profit on each item sold, assuming the |
| selling price does not change. Mark-up is higher and so Gross Profit Margin would improve |
| on this item. There is also the potential for improved cash flow if the line of inventory |
| is popular. Greater sales would lead to increased cash inflows from sales and |
| greater sales would lead to increased cash inflows from sales and accounts receivable. |
| The value of assets will also increase as the increase in inventory is reported. However, |
| as mentioned in the information, Cash at Bank will decrease and Liabilities |
| and Owner's Equity will also increase. Depending upon the size of the loan and the |
| capital contribution, the debt ratio and Return on Owner's Investment might deteriorate. |
| While the owner might be able to fund this purchase, it is recommended that she not |
| purchase the inventory in such large quantities, as there is no guarantee the inventory |
| will sell. Her Inventory Card also reveals that she only sold 62 units in April, which |
| indicates it is not a fast-moving line. |

*Mark globally. Responses should consider the performance of the business—this can be related to specific areas, such as profitability and liquidity, or general considerations such as profit, cash flow, etc.*

## QUESTION 2: HUBBARD'S HOSES (17 MARKS)

**a.** 5 marks

**General Journal**

| Date | Details | Debit | Credit | Mark |
|---|---|---|---|---|
| Feb 1 | Bank | 51 680 | | 1 |
| | Loan—Pitt Finance | | 51 680 | |
| | | | | |
| Feb 1 | Van | 57 000 | | 1 |
| | Prepaid Insurance Expense | 1 800 | | 1 |
| | GST Clearing | 5 880 | | 1 |
| | Bank | | 64 680 | 1 |
| | | | | |

**b.** 2 marks

**Explanation** The modifications are considered to be part of the cost of the Van as they are a one-off cost that adds a value to the Van **[1]** and allows the Van to be placed into a position and condition from which it can begin to generate revenue. **[1]**

**c.** 4 marks

**General Journal**

| Date | Details | Debit | Credit | Mark |
|---|---|---|---|---|
| Jun 30 | Depreciation—Van | 2 850 | | 1 |
| | Accumulated Depreciation—Van | | 2 850 | 1 |
| | | | | |
| | Insurance Expense | 750 | | 1 |
| | Prepaid Insurance Expense | | 750 | 1 |
| | | | | |

**d.** 3 marks

| |
|---|
| **Explanation** The reducing balance method of depreciation would see depreciation |
| of $5 700 charged. **[1]** This would mean that expenses were higher by $2 850 **[1]** |
| and profit would be lower by $2 850. **[1]** |

**e.** 3 marks

| |
|---|
| **Explanation** Revenue and expense accounts need to be adjusted to comply with |
| the period assumption, **[1]** which requires revenue to be recognised in the period in |
| which it is earned and matched against expenses incurred in earning that revenue. **[1]** |
| This means adjustments are made so only revenues and expenses for that period are |
| reported and the profit for that period is reported. **[1]** |

## QUESTION 3: DILARA'S DENIM (16 MARKS)

**a.** 2 + 2 = 4 marks

| | |
|---|---|
| **Calculation**<br>Invoice cost $100 + Packaging $10 **[1]** + Label $2 **[1]** | |
| **Cost of one unit of Flower Power denim** | **$**112 |

| |
|---|
| **Explanation** The cost of one unit is all costs associated with getting the inventory |
| into a condition and position for sale that can be logically allocated to a unit of |
| Inventory. **[1]** The inventory must be purchased, packaged and labelled before it can be |
| sold and so these costs are added together to determine the cost price. **[1]** |
| The cartage inwards is excluded from the cost of the Flower Power denim jeans |
| and is treated as a period cost. **[1]** |

**b.** 3 + 2 + 2 = 7 marks

**General Journal**

| Date | Details | Debit | Credit | Mark |
|---|---|---|---|---|
| Aug 1 | Inventory | 6 800 | | 1 |
| | Cartage Inwards | 220 | | |
| | GST Clearing | 702 | | 1 |
| | Accounts Payable—KD Melbourne | | 7 722 | 1 |
| | | | | |
| Aug 2 | Inventory | 140 | | 1 |
| | GST Clearing | 14 | | |
| | Bank | | 154 | 1 |
| | | | | |
| Aug 1 | Inventory Write-down | 230 | | 1 |
| | Inventory | | 230 | 1 |
| | | | | |

**c.** 5 marks

| |
|---|
| **Discussion** It is important for a business to protect its brand as this is what helps |
| businesses develop a loyal customer base. **[1]** Shredding the obsolete/unfashionable |
| inventory would seem like a good strategy as the business will not develop a reputation |
| for selling unfashionable items. **[1]** |
| However, shredding the inventory could be considered unethical as it is a waste of good |
| Inventory, which could be used in a different way. **[1]** |
| The business could donate the inventory to a local charity, which would assist less fortunate |
| people but also help the business gain a reputation for being ethical and demonstrating |
| corporate social responsibility. **[1]** |
| Financially, shredding the inventory is a cost that will increase expenses and lower profit |
| (something that will occur if the business donates the inventory) but it would be seen as |
| advertising rather than an inventory loss. **[1]** |
| |

**OR**

**Discussion** The issue in this case from the owner's perspective is whether it is ethical to destroy and dispose of perfectly good items made to a high standard in the sake of profit. **[1]** If the owner decides to shred the jeans, her actions can be justified on the basis that it is the business's inventory and it is free to dispose of it however it wishes as part of a rational business decision. **[1]**

As the owner is concerned about maintaining the brand's image, by shredding the jeans this will help to protect the brand's value and image.

Some customers will support the owner's decision to shred the jeans as it will maintain the exclusivity of the brand and this might lead to more sales and higher profits in the future. **[1]**

Another financial benefit would include the business will not need to spend as much on storage costs. Finally, if the owner does not further discount the jeans, there is more profit on each item sold.

However, by shredding the jeans there are financial costs and ethical implications. This will create an inventory loss and will reduce profit. This will also reduce the value of assets (inventory) in the Balance Sheet. **[1]** The business might also develop a negative reputation due to wasting resources and destroying good clothing that could be used. There is also a negative environmental impact due to overusing resources.

From an ethical and financial perspective, the business should carry less inventory and purchase the amount required and use the materials sustainably rather than purchasing too much and wasting resources. **[1]**

*Mark globally. Mark allocations shown above is a guide only.*

## QUESTION 4: SAYERS SAVINGS STORE (5 MARKS)

**a.** 5 marks

| |
|---|
| **Description** Both journal entries involve the recording of an expense. **[1]** |
| The first entry increases expenses and creates a current liability in the Balance Sheet. |
| Hence, expenses in the Income Statement are increased and profit decreases. Owner's |
| Equity is also decreased as profit is lower and offsets the increase in Liabilities. **[1]** The |
| second entry creates an expense that reduces profit in the Income Statement. **[1]** A |
| negative asset is created and so assets decrease, and Owner's Equity also decreases in the |
| Balance Sheet as profit is lower. **[1]** |
| Neither entry involves cash so there is no effect on the Cash Flow Statement. **[1]** |

*Mark globally. Mark allocations shown above is a guide only.*

## QUESTION 5: WELSH'S WALLPAPER (8 MARKS)

**a.** 2 marks

| |
|---|
| **Definition** Net Cash Flow from Operating Activities is the cash inflows less cash outflows |
| associated with the day-to-day trading activities of the business, **[1]** which includes |
| cash flows from buying and selling inventory, GST and paying expenses. **[1]** |

**b.** 4 marks

**WELSH'S WALLPAPER**
**Cash Flow Statement (Extract) for the month ended 31 March 2020**

| **Cash Flow from Investing Activities** | | | **Mark** |
|---|---|---|---|
| Proceeds from the Sale of Equipment | 400 | | **1** |
| Purchase of Equipment | (5 000) | | **1** |
| **Net Cash Flows from Investing Activities** | | (4 600) | |
| **Cash Flow from Financing Activities** | | | |
| Capital Contribution | 12 000 | | **1** |
| Drawings | (900) | | **1** |
| Loan Repayment | (1 000) | | |
| **Net Cash Flow from Financing Activities** | | 10 100 | |

**c.** 2 marks

**Cash at Bank**

| Date 2020 | Cross-reference | Amount | Date 2020 | Cross-reference | Amount |
|---|---|---|---|---|---|
| Mar 3 | Accounts Receivable | 5 400 | Mar 1 | Balance | 450 |
| 15 | Sales/GST Clearing | 7 700 | 4 | Accounts Payable | 3 600 |
| 18 | Capital | 12 000 | 6 | Loan—Able Finance Co. | 1 000 |
| 22 | Disposal of Equipment | 400 | 9 | Interest | 200 |
| 31 | Balance | 3 360 | 10 | Advertising/GST Clearing | 440 |
| | | | 15 | Prepaid Rent/GST Clearing | 6 600 |
| | | | 17 | Wages | 1 800 |
| | | | 17 | Drawings | 900 |
| | | | 22 | Equipment/GST Clearing | 5 500 |
| | | | 22 | Cartage In/GST Clearing | 550 |
| | | | 25 | GST Clearing | 2 100 |
| | | | 28 | Insurance/GST Clearing | 1 320 |
| | | | 29 | Inventory/GST Clearing | 4 400 |
| | | 28 860 | | | 28 860 |
| | | | Apr 1 | Balance | 3 360 |
| | | | | | |

***1 mark*** *for both balances as shown*

***1 mark*** *for totalling both sides of the account*

## QUESTION 6: AMY'S ANTIQUES (7 MARKS)

**a.** 5 marks

**Analysis** Amy is correct in her assessment of the performance of the business in terms of profit. The profit of the business has deteriorated in the last two years after improving between 2016 and 2017.

However, the figure for profit is just a raw number and is only a measure of the difference between revenue and expenses. If Amy wanted a better understanding of her business performance she should consider preparing a range of financial indicators that provide information regarding the profitability of the business. Profitability is a measure of the profit of a business against a base such as assets, sales and owner's investment.

While the profit figure might have declined, if sales also declined then the performance of the business might not be as disappointing as first thought—the issue might be with sales rather than profit itself. There might have been a rise in the cost price of inventory which Amy hasn't passed on to her customers or wages may have increased.

Alternatively, Amy could compare her results against other businesses in her industry as her business might not be the only one suffering a decline in profits—the industry as a whole may be going through a downturn. It is also possible for the business to compare itself against its budgeted reports—the result may have been planned or an unexpected event may have occurred.

*Mark globally. Students should refer to profitability and distinguish it from profit. An analysis of profit performance should be provided*

**b.** 2 marks

| **Financial indicator** |
|---|
| return on owner's investment; return on assets; net profit margin, asset turnover |
| **Non-financial indicator** |
| number of website hits; results of a customer satisfaction survey; number of sales returns |

***1 mark*** *for any logical financial indicator*

***1 mark*** *for any logical non-financial indicator*

## QUESTION 7: HATS BY LOGAN (16 MARKS)

**a.** 5 marks

**General Journal**

| Date | Details | Debit | Credit | Mark |
|---|---|---|---|---|
| Jun 1 | Accrued Wages | 1 900 | | **1** |
| | Bank | | 1 900 | **1** |
| Jun 15 | Wages Expense | 22 100 | | **1** |
| | Bank | | 22 100 | **1** |
| Jun 30 | Wages | 1 700 | | **1** |
| | Accrued Wages | | 1 700 | |
| | | | | |

**b.** 5 marks

**HATS BY LOGAN**

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

| | $ | $ | Mark |
|---|---|---|---|
| **Revenue** | | | |
| Cash Sales | 68 000 | | |
| Credit Sales | 76 000 | | 1 |
| *Less* Sales Returns | 2 400 | 141 600 | |
| ***Less* Cost of Goods Sold** | | | |
| Cost of Sales | 71 800 | | |
| Freight Inwards | 4 200 | 76 000 | 1 |
| **Gross Profit** | | 65 600 | |
| *Less* Inventory Loss | 1 000 | | |
| *Less* Inventory Write-down | 500 | 1 500 | 1 |
| **Adjusted Gross Profit** | | 64 100 | |
| ***Add* Other Revenue** | | | |
| Discount Revenue | 2 300 | | 1 |
| Interest Revenue | 50 | 2 350 | |
| | | 66 450 | 1 |

**c.** 3 marks

**Explanation** Drawings are not an expense of the business. They are a record of the owner withdrawing cash or assets from the business for their own personal use. **[1]**

As such it is not an expense of the business and so is not reported in the Income Statement. **[1]**

The accounting entity assumption requires transactions between the business and the owner be reported separately and so this entry should be reported in the Owner's Equity section of the Balance Sheet. **[1]**

**d.** 3 marks

| **Explanation** |
|---|
| Financial reports provide information to the owner of a business, and other interested parties |
| such as banks, employees, accounts payable and potential owners or investors. **[1]** |
| Not all of these parties might have a solid knowledge of accounting and so by classifying the |
| Income Statement these parties should be able to understand the report and draw |
| conclusions from them and make decisions. **[1]** |
| This upholds the qualitative characteristic of understandability. **[1]** |

## QUESTION 8: CARR'S CARPETS (12 MARKS)

**a.** 4 marks

| |
|---|
| **Explanation** Liquidity will deteriorate if Cash Sales were less than expected as there is |
| less cash on hand to meet short-term debts as they fall due. In addition, an unfavourable |
| variance for Credit Sales will also have a negative impact on liquidity as there will be less |
| cash received from Accounts Receivable. **[1]** |
| An unexpected increase in Bad Debts means more accounts receivable were written off. This |
| will worsen liquidity as these accounts will no longer be received. **[1]** |
| A favourable variance for Discount Expense might have been due to fewer Accounts |
| Receivable having taken advantage of the discount as they might be taking longer to settle |
| their accounts This will also result in poorer liquidity. **[1]** |
| A higher Sales Returns figure than expected will also have a negative impact on liquidity as |
| cash will no longer be received and may impact on future cash inflows if customer |
| satisfaction have decreased. **[1]** |

**b.** 2 marks

| |
|---|
| **Outline** Budgets are often better indicators of performance if they are prepared more |
| frequently. **[1]** If the business was to prepare budgets on a quarterly basis it would |
| be able to identify issues, such as rising bad debts, and take some action to minimise or |
| resolve the issue. **[1]** |

**c.** 6 marks

| |
|---|
| **Analysis** Profitability is the ability of a business to generate a profit as measured against |
| a base such as sales, assets or owner's investment. The profitability of the business has |
| shown mixed results over the period shown. **[1]** Both net profit margin and gross profit |
| margin have deteriorated. **[1]** As evidenced by the information in the Variance Report, |
| revenue has decreased over the period with both Cash Sales and Credit Sales being less |
| than expected. **[1]** |
| This is likely to have a negative impact on profit. As gross profit margin has fallen it would |
| suggest that the Cost of Sales has increased or expenses such as Freight In and Inventory |
| Loss have also increased. In addition to that, given the decline in the net profit margin that |
| overall expenses have increased while revenue has decreased. **[1]** |
| However, the business is still generating a profit as the return on owner's investment has |
| improved. One reason for this trend could be that, while the business generated a profit over |
| the period, the owner withdrew assets from the business in an amount that exceeded the |
| profit. **[1]** Hence, the balance of Owner's Equity has decreased and the amount of profit |
| compared to Owner's Equity has actually increased. If Owner's Equity was too high, then the |
| owner should be pleased with that result as their investment in the business is supporting a |
| profit and allowing for Drawings to occur. **[1]** |

*Mark globally. Mark allocations shown above is a guide only.*

## QUESTION 9: CERRA'S CHAIRS (5 MARKS)

**a.** 2 marks

**General Journal**

| Date | Details | Debit | Credit | Mark |
|---|---|---|---|---|
| Jun 30 | Accrued Interest Revenue | 400 | | 1 |
| | Interest Revenue | | 400 | 1 |
| | | | | |

**b.** 3 marks

**General Journal**

<table>
<tr><th>Date</th><th>Details</th><th>Debit</th><th>Credit</th><th>Mark</th></tr>
<tr><td>Sep 1</td><td>Bank</td><td>20 600</td><td></td><td>1</td></tr>
<tr><td></td><td>Term Deposit</td><td></td><td>20 000</td><td>1</td></tr>
<tr><td></td><td>Accrued Interest Revenue</td><td></td><td>400</td><td rowspan="2">1</td></tr>
<tr><td></td><td>Interest Revenue</td><td></td><td>200</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td></tr>
</table>