

ACCOUNTING
Unit 3&4 Examination 1

MARKING GUIDE

Question 1 [14 marks]

Tony commenced business on 1 July 2020 after registering the name ‘Corner’. His business specialises in soccer equipment.

He provided the following information regarding the business.

On 1 July 2020 Tony contributed:

- \$20 000 cash
- Soccer balls that he purchased for \$10 000 but believes he will sell for \$30 000
- A delivery van that he purchased for \$50 000 (plus GST) on 1 April 2018. Tony paid registration of \$1 200 on 31 August 2019. The vehicle was valued at \$35 000 on 1 July 2020.
- Tony purchased the delivery van with a loan from *ABC Bank*. The business has agreed to repay the loan which has an outstanding amount of \$30 000 on 1 July 2020.
- The delivery van was serviced on 1 June 2020 for \$100 (plus GST)

- a. Prepare the General Journal to record the information above on 1 July 2020.

(A narration is not required.)

Date	Details	Debit	Credit
1 July	Bank	20 000	
	Inventory	10 000	
	Delivery Van	35 000	
	Prepaid Registration Expense	200	
	Loan – ABC Bank		30 000
	Capital		35 200

5 marks

4 marks – for debit entries (1 mark each)

1 mark - for credit entries (1 mark for both overall)

- b. Referring to an accounting assumption, explain why Tony prepared the General Journal entry on 1 July 2020.

The Accounting Entity assumption states that the records of the assets, liabilities and business activities of the entity are kept completely separate from those of the owner of the entity as well as from those of other entities. When the owner contributes assets and liabilities to the business they need to be kept separate from the owner's records.

3 marks

1 mark - for accounting assumption

2 marks - for explanation (1 mark for a brief outline or lack of link to accounting assumption)

- c. Tony initially received a valuation of \$15 000 for the delivery van and continued to seek out more valuations. Eventually he found a valuer who provided a valuation of \$35 000 which allowed him to transfer the entire loan to the business.

Referring to qualitative characteristics and ethical considerations, discuss the decision to use the higher valuation.

The business is required to use fair value when the delivery van is contributed to determine its cost value. The fair value is determined by providing a valuation of the delivery van at the date it is contributed to the business. The cost price will result in an increase in capital and an increase in owners' equity which would impact on decisions made through using the Balance Sheet of Corner. If the valuation is excessive and the result of the owner pressuring the valuer to overstate the value of the delivery van it could result in incorrect decision, making the valuation not as relevant or useful. The owners would need to consider the ethical considerations around who is chosen to prepare a valuation because the valuation needs to be the result of an impartial analysis of the asset's value. Otherwise, the asset's value is not faithfully represented as much as possible. Additionally, an inaccurate valuation could benefit the business at the expense of society at large. For instance, if the valuation given was higher than what it should have been, then the asset could later on be disposed of for an exaggerated price at the expense of another person or business. Moreover, since he is transferring a loan, he is trying to use the valuation to be dishonest with lenders who otherwise may not transfer it.

6 marks

Mark this question globally. High range answers need to include detailed links to both qualitative characteristics and ethical considerations, along with linking the discussion to the higher valuation scenario.

Question 2 [19 marks]

Steve is the owner of Tennis World, a small business that specialises in elite tennis rackets. All tennis rackets are sold for \$1 200 (plus GST) each. Customers are offered 2/10, n/30 credit terms. Steve has provided you with the following inventory card that he has prepared up to the 12th of March 2020.

Product: Centre Court Racket					Supplier: Smashd					
Cost Assignment method: ?										
		IN			OUT			BALANCE		
Date March	Reference	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
1	Balance							7	300	2 100
								4	400	1 600
5	Inv 90				3	400	1 200	7	300	2 100
								1	400	400
12	Inv 34	4	300	1 200				11	300	3 300
								1	400	400

The following transactions occurred during March:

- 18 Tennis World returned two of the Centre Court rackets purchased on 12 March to their supplier (CN 22)
- 21 Sold 4 Centre Court rackets that cost \$300 (plus GST) each to Volleyed (EFT 19)
- 24 Purchased 3 Junior Tennis Rackets for \$200 each (plus GST) (Inv 92)
- 25 Sold 1 Centre Court Racket that cost \$400 (plus GST) each to Served (Inv 91)
- 30 A stocktake found that Tennis World had 6 \$300 Centre Court Rackets on hand (Memo 21)
- 30 One of the Centre Court Rackets was damaged and advertised for sale for \$100 (plus GST) (Memo 22)

a. Identify the cost assignment method that is being used by Tennis World.

Identified Cost

1 mark – stating the method

1 mark

b. Complete the inventory card for Centre Court Rackets for March 2020.

Product: Centre Court Racket					Supplier: Smashd					
Cost Assignment method: ?										
		IN			OUT			BALANCE		
Date	Reference	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
1	Balance							7	300	2 100
								4	400	1 600
5	Inv 90				3	400	1 200	7	300	2 100
								1	400	400
12	Inv 34	4	300	1 200				11	300	3 300
								1	400	400
18	CN 22				2	300	600	9	300	2 700
								1	400	400
21	EFT 19				4	300	1 200	5	300	1 500
								1	400	400
25	Inv 91				1	400	400	5	300	1 500
30	Memo 21	1	300	300				6	300	1 800
	Memo 22				1	200	200	1	100	100
								5	300	1 500

5 marks

1 mark - for each transaction

- c. Record the transaction on the 12th of March in the General Journal.
A narration is not required.

General Journal

Date	Details	Debit	Credit
2020			
12 March	Inventory	1 200	
	GST Clearing	120	
	Accounts Payable		1 320

3 marks

1 mark - for each line

- d. Record the transaction on the 21st of March in the General Journal.
A narration is not required.

General Journal

Date	Details	Debit	Credit
2020			
21 March	Bank	4 800	
	GST Clearing	480	
	Sales		5 280
	Cost of Sales	1 200	
	Inventory		1 200

3 marks

2 marks – ‘bank’ through to ‘sales’ (1 mark if at least half is answered correctly)

1 mark – ‘cost of sales’ to ‘inventory’

- e. Explain the effect on the accounting equation of the transaction on the 5th of March.

The transaction on the 5th of March is a credit sale of \$3 600 which would result in an increase in assets of \$3 960 of accounts receivable and a decrease of \$1 200 of inventory which is an overall increase of \$2 760 in assets. There is an increase of \$360 of liabilities due to the GST owed to the ATO. Owners' equity would increase by \$2 400 of net profit.

3 marks

1 mark - for the effect on assets

1 mark - for the effect on liabilities

1 mark - for the effect on owners' equity

- f. Prepare an Income Statement for the month ended 31 March 2020 up to and including adjusted Gross Profit.

Tennis World
Income Statement (extract) for the month ended 31 March 2020

Revenue		
Sales		9 600
Less Cost of Goods Sold		
Cost of Sales		2 800
Gross Profit		6 800
Add Inventory Gain	300	
Less Inventory Write-down	200	100
Adjusted Gross Profit		6 900

4 marks

1 mark - for sales

1 mark - for cost of sales and gross profit

1 mark - for inventory gain

1 mark - for inventory write-down

Question 3 [8 marks]

Lucas operates an online business that sells cricket bats.

The business uses a 100% markup to determine the selling price of its inventory.

As at 31 July 2020, the business' records revealed the following inventory on hand:

	Quantity	Cost Price per bat (excl. GST)
Junior Bat	7	\$100
Youth Bat	15	\$200
Senior Bat	9	\$300

The bats are purchased from *Premium Cricket Suppliers* who charge \$10 delivery for each bat. All bats are delivered to customers within 24 hours for a delivery fee of \$20 per purchase paid by the customer.

The Junior bats have not been as popular as they thought and have been discounted to \$90 each (plus GST)

All purchases come with a free Duke Cricket Ball that cost \$15 (plus GST) each.

- a. Calculate the value of closing inventory of the inventory on hand on 31 July 2020 prior to applying the lower of cost and net realisable value.

$$= + (7 * 110) + (15 * 210) + (9 * 310)$$

$$= \$6\,710$$

3 marks

1 mark - for each item

Deduct 1 mark if final answer is incorrect

- b. Prepare the General Journal entry required on 31 July 2020.
(A narration is not required)

Date 2020	Details	Debit	Credit
31 July	Inventory Write-down	245	
	Inventory		245

2 marks

1 mark - for each line

- c. With reference to one accounting assumption, explain why inventory should be valued according to the Lower of Cost and Net Realisable Value rule.

The accrual basis assumption requires a business to recognise expenses when they incur and revenues when they are earned in order to calculate an accurate net profit. If the net realizable value of inventory falls below its cost price the business needs to recognise the expense incurred as an inventory write-down as a loss will occur when the inventory is sold by the business.

3 marks

1 mark - for accounting assumption

2 marks - for explanation (1 mark for a brief outline or lack of link to accounting assumption)

Question 4 (12 marks)

Sally is the owner of Everything Office, a small business that sells office supplies. The business prepares its financial reports on a quarterly basis and all Non-Current Assets are depreciated at 10% using the reducing balance method.

When purchased, the equipment was fitted with \$2 000 of safety guards to protect users.

The business has provided the following information as at 30 June 2020.

Everything Office
Balance Sheet (extract) as at 30 June 2020

Non Current Assets		
Equipment	27 000 (a)	
Less Accumulated Depreciation	3 500(b)	23 500 (c)

- a. Explain what the amount labelled (a) represents.

The historical cost of the equipment which represents all costs to get the equipment into condition and location ready for use that will provide economic benefit over the life of the asset. This includes the initial purchase price plus the cost of the safety modifications.

2 marks

1 mark - for definition

1 mark - for costs

- b. Explain what the amount labelled (b) represents.

The accumulated depreciation represents the cost of the asset that has been consumed by the business over its useful life to 30 June 2020.

2 marks

1 mark - for cost consumed

1 mark - for over its useful life

- c. Explain what the amount labelled (c) represents.

The carrying value represents the cost of the asset that is yet to be consumed by the business plus any residual value.

2 marks

1 mark - for carrying value

1 mark - for definition

- d. Sally has been using the straight-line method of depreciation for the Delivery Van. Her accountant has suggested that she changes to the reducing balance method on 1 July 2020.

Referring to accounting assumptions and qualitative characteristics, discuss the proposal.

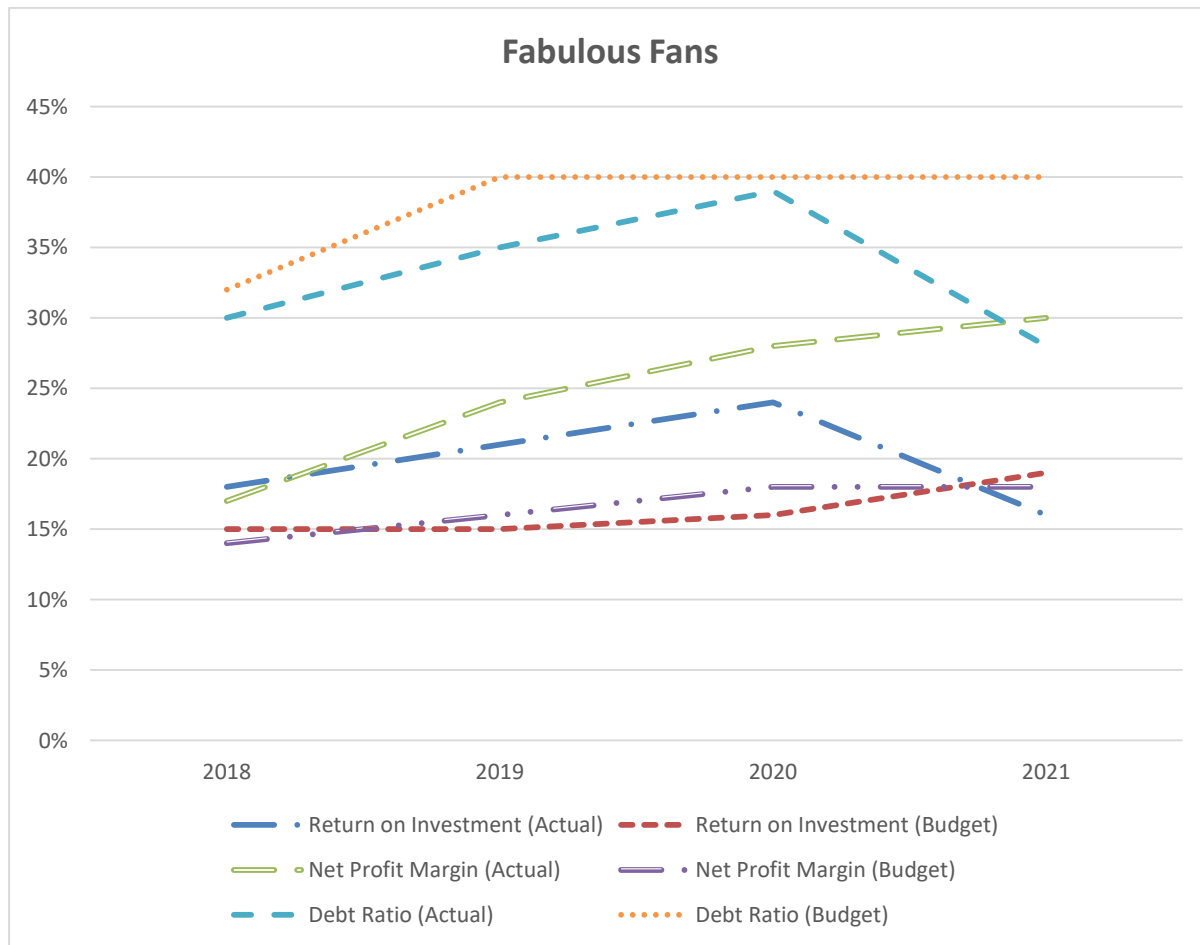
Sally's accountant is right to consider the revenue earning pattern when determining the depreciation rate used to allocate the cost of the Delivery Van over its useful life. If the Delivery Van is likely to contribute more to earning revenue over the earlier stages of its life it would not make sense to use the straight-line method which allocates the cost of the Delivery Van consistently over its life, as it would go contrary to properly understanding the nature of the asset and its contribution to the business. However, the decision to change methods, which may support the accrual basis and relevance, could be seen to breach comparability as it will require the business to change accounting methods during the life of the equipment. This can make it hard to compare periods from before the change and after change, which can then impair the ability of the business to make decisions based on the data.

6 marks

Mark this question globally. High range answers need to include detailed links to both qualitative characteristics and accounting assumptions, along with linking the discussion to the proposal.

Question 5 (9 marks)

The following chart has been prepared for Phil from Fabulous Fans.



Phil commented that he can't see how the information can be accurate. "In 2020 our Net Profit increased but the return on investment has dropped significantly".

- a. Referring to a qualitative characteristic, explain why a chart would be prepared for Phil.

A graph would be prepared for Phil to improve the understandability of the information. While financial reports provide information for users to analyse, the graph allows for the information to be comprehensible to users with a reasonable understanding of business and economic activities. Phil will be able to use the graph to identify trends in the data.

3 marks

1 mark - for qualitative characteristic

2 marks - for explanation (1 mark for a brief outline)

- b. Discuss the performance of Fabulous Fans over the period provided taking into consideration Phil's concerns.

Fabulous Fans have not provided their net profit which makes it difficult to analyse his statement regarding profit. The information provided indicates that the net profit margin performed better than budgeted throughout the period provided which generally leads to a similar result for the business' return on investment. Phil is concerned by the significant fall in the return on investment in 2021 which he finds does not correlate to the net profit of the business. The return on investment, while reliant on the profit of the business is also dependent on the capital contributions and borrowings made by Phil and the Fabulous Fans. The decline in the debt ratio can be seen as a positive as it lowers the risk of the business although it does require Phil to invest more of his own funds into Fabulous Fans.

Mark this question globally. High range answers need to include detailed links to both the performance (based on the data) along with Phil's concerns

6 marks

Question 6 (15 marks)

Shelley owns a shoe store, Classic Footwear, which sells shoes from its online store. All shoes are sold at a 200% markup with terms of n30.

The following transactions occurred during October 2020:

On 12 October 2020 Shelley received an order for 25 pairs of shoes from *Shoes on Chapel* for \$150 each (plus GST). Shoes on Chapel paid a \$600 deposit (EFT 11)

On 14 October 2020 Classic Footwear delivered 15 pairs to *Shoes on Chapel* (Inv 91)

On 21 October 2020 Classic Footwear delivered the remaining pairs of shoes. (Inv 98)

On 28 October 2020 *Shoes on Chapel* paid the amounts owing. (EFT 104)

- a. Prepare the General Journal entries for the above transactions
(Narrations are not required)

Date 2020	Details	Debit	Credit
12 October	Bank	600	
	Unearned Sales Revenue		600
14 October	Unearned Sales Revenue	600	
	Accounts Receivable	1 875	
	Sales		2 250
	GST Clearing		225
	Cost of Sales	750	
	Inventory		750
21 October	Accounts Receivable	1 650	
	Sales		1 500
	GST Clearing		150
	Cost of Sales	500	
	Inventory		500
28 October	Bank	3 525	
	Accounts Receivable		3 525

10 marks

- 2 marks - for first entry
3 marks - for second entry
3 marks - for third entry
2 marks - for fourth entry

- b. Explain the accounting element that is used to classify the account Unearned Sales Revenue.

Unearned Sales revenue is a current liability as a liability is a present obligation of the entity to transfer an economic resource (inventory) as a result of past events (receipt of a deposit). It is an obligation of the business that is reasonably expected to be settled within 12 months after the end of the reporting period.

2 marks

1 mark - for unearned sales revenue and current liability**1 mark - for explanation**

- c. Explain the impact on the accounting equation of the transaction on 14 October 2020.

Assets will increase by \$1 125 which represents an increase in accounts receivable of \$1 875 and a decrease in inventory of \$750. Liabilities will decrease by \$375 which is due to a decrease in Unearned Sales Revenue of \$600 and an increase of GST owing to the ATO of \$225. Owner's equity will increase by \$1 500 due to the increase in net profit (Sales Revenue increased by \$2,250 and Cost of Sales expense increased by \$750.

3 marks

1 mark - for the effect on assets**1 mark - for the effect on liabilities****1 mark - for the effect on owners' equity****Question 7 [15 marks]**

Zootopia Sanitiser have purchased a larger Delivery Van to handle the recent demand for their products.

The new van was purchased on 30 September 2020 for \$30 000 (plus GST) from *Custom Vans*. An additional \$1 200 (plus GST) was paid for annual insurance and \$4 400 (including GST) of modifications were required to have it ready to delivery their products.

The old delivery van had a carrying value of \$12 000 on 30 September 2020 and was initially purchased for \$28 000 (plus GST). It was traded in for \$5 000. The balance owing was paid with a loan from *South Bank*.

- a. Prepare the General Journal entries required on 30 September 2020.
(Narrations are not required)

Date 2020	Details	Debit	Credit
30 September	Disposal of Delivery Van	28 000	
	Delivery Van		28 000
	Accumulated Depreciation of Delivery Van	16 000	
	Disposal of Delivery Van		16 000
	Delivery Van	5 000	
	Disposal of Delivery Van		5 000
	Loss on Disposal of Delivery Van	7 000	
	Disposal of Delivery Van		7 000

	Loan	33 720	
	Bank		33 720
	Delivery Van	29 000	
	Prepaid Insurance	1 200	
	GST Clearing	3 520	
	Bank		33 720

8 marks

- 1 mark - for first entry**
1 mark - for second entry
1 mark - for third entry
1 mark - for fourth entry
1 mark - for fifth entry
3 marks - for sixth entry

b. Complete the following General Ledger Accounts for September 2020

Disposal of Delivery Van

Delivery Van

Disposal of Delivery Van

Date 2020	Cross- reference	Amount	Date 2020	Cross- reference	Amount
30/9	Delivery Van	28 000	30/9	Accumulated Depreciation of Delivery van	16 000
			30/9	Delivery Van	5 000
			30/9	Loss on Disposal of Delivery Van	7 000
		28 000			28 000

Delivery Van

Date 2020	Cross- reference	Amount	Date 2020	Cross- reference	Amount
30/9	Balance	28 000	30/9	Disposal of Delivery van	28 000
30/9	Disposal of Delivery Van	5 000	30/9	Balance	34 000
	Bank	29 000			
		62 000			<u>62 000</u>
1/10	Balance	<u>34 000</u>			

4 marks

2 marks - for disposal of delivery van**2 marks - for delivery van**

- c. Explain how a loss on disposal could be incurred by a business.

A loss on disposal occurs when a business under depreciates a non-current asset. This occurs when a business overstates the residual value of the non-current asset which can be done through simple error. Alternatively, it could involve overstating the useful life of the asset.

3 marks

1 mark - for underdepreciation**1 mark - for overstating useful life****1 mark - for overstating residual value****Question 8 [8 marks]**

Home Highlights is a lighting store that sells interior lighting from its Hawthorn store. The owner has provided you with the following information regarding rent paid for the store.

Date of Payment	Amount Paid	Period Covered
15 June 2020	\$1500 (plus GST)	Quarter ended 30 September 2020
15 September 2020	\$2 200 (plus GST)	Four months ending 31 January 2021

Home Highlights reports six monthly with the most recent reports being prepared on 30 June 2020.

- a. Complete the Prepaid Rent General ledger account in the General Ledger of Home Highlights as at 31 December 2020.

Prepaid Rent Expense

Date 2020	Cross- reference	Amount	Date 2020	Cross- reference	Amount
1/7	Balance	1 500	30/9	Rent Expense	3 150
15/9	Bank	2 200	31/12	Balance	550
		3 700			3 700
1/1	Balance	<u>550</u>			

4 marks

1 mark - for bank**1 mark - for rent expense****2 marks - for balances**

- b. Referring to two accounting assumptions explain your treatment of the rent incurred during the six months ended 31 December 2020.

Home Highlights needs to recognise their rent expense when it is incurred rather than when it is paid as the accrual basis requires the business to recognise expenses when they are incurred in order to allow them to be matched against revenue incurred in order to calculate an accurate net profit. The adjustment is required to be made at the end of each reporting period (for the period assumption) as the business is required to prepare its reports on a regular basis in order to determine profit for a designated period of time.

4 marks

1 mark - reference to one accounting assumption**1 mark - reference to another accounting assumption****2 marks - for explanation (1 mark for a brief outline)**