# BONUS EXAM SUGGESTED SOLUTIONS (100 MARKS)

**Question 1** (10 marks)

1. **Prepare a classified Balance Sheet for Marie’s Mirrors as at 1 January 2019.**

**6 marks**

**Marie’s Mirrors**

**Balance Sheet as at 1 January 2019**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **$** | **$** |  | **$** | **$** |
| **Current Assets** |  |  | **Current Liabilities** |  |  |
| Bank | 43 400 |  | Accounts Payable | 18 150 |  |
| Inventory | 16 500 |  | Loan – MNC Bank | 6 000 | 24 150 |
| Prepaid Rent Expense | 6 000 |  |  |  |  |
| GST Clearing | 2 250 | 68 150 |  |  |  |
| **Non-Current Assets** |  |  | **Non-Current Liabilities** |  |  |
| Van |  | 18 500 | Loan – MNC Bank |  | 24 000 |
|  |  |  | **Owner’s Equity** |  |  |
|  |  |  | Capital |  | 38 500 |
| **Total Assets** |  | 86 650 | **Total Equities** |  | 86 650 |

**1 mark –** Bank

**1 mark –** Inventory and Accounts Payable

**1 mark –** Prepaid Rent Expense

**1 mark –** GST Clearing

**1 mark –** Van and Capital

**1 mark –** Loan – MNC Bank split

**1 mark deducted –** incorrect formatting such as Total Assets and Total Equities labels missing

1. **Referring to two qualitative characteristics, explain why fair values should be used when non-cash assets are contributed to the business by an owner.**

**4 marks**

The qualitative characteristic of relevance supports the use of fair values. Relevance outlines that information is relevant when it is capable of making a difference to the decisions made by users. **(1 mark)**

Fair values are more relevant than an asset’s original cost as it provides an estimate of the future economic benefits the asset is expected to provide the business from the date it is contributed by the owner. **(1 mark)**

The qualitative characteristic of faithful representation also supports the use of fair values. Faithful representation outlines that the amount recorded is complete, free from material error and neutral without bias. **(1 mark)**

As the fair value is the price that would be received if the asset was sold at the time it was transferred to the business, in the absence of a professional valuation, a market value estimate would be appropriate as the amount would be deemed to be free of material error. **(1 mark)**

1. **Referring to the definition of a liability, explain how the loan balance owing to MNC Bank would be treated differently to the bank overdraft limited on the Balance Sheet of Marie’s Mirrors as at 1 January 2019.**

**4 marks**

The loan owing to MNC Bank would be treated as a liability on the Balance Sheet of Marie’s Mirrors as at 1 January 2019 as it represents a present obligation as a result of past events. **(1 mark)**

Under the heading of Current Liabilities, $6 000 would be reported as this amount represents the amount reasonably expected to be repaid within the next 12 months. **(1 mark)**

The remaining amount owing on the loan of $24 000 would be reported under the heading of Non-Current Liabilities as it represents the amount reasonably expected to be repaid in a period greater than the next 12 months. **(1 mark)**

However, the bank overdraft limit would not be included in the Balance Sheet as at 1 January 2019 as it is not an outstanding balance owing to the bank. It does not satisfy the definition of a liability as it is not a present obligation and is only an agreement with the bank to provide an overdraft if required. **(1 mark)**

**Question 2** (14 marks)

1. **Using product costing, record all information provided for the ‘Kensington’ tent in the General Journal.**

**Narrations are not required.**

**12 marks**

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Details** | **Debit** | **Credit** |
| 09/02 | Inventory | 900 |  |
|  | GST Clearing | 90 |  |
|  | Accounts Payable |  | 990 |
| 09/02 | Inventory | 60 |  |
|  | GST Clearing | 6 |  |
|  | Bank |  | 660 |
| 14/02 | Accounts Receivable | 1 815 |  |
|  | Credit Sales |  | 1 650 |
|  | GST Clearing |  | 165 |
|  | Cost of Sales | 492 |  |
|  | Inventory |  | 492 |
| 18/02 | Sales Returns | 330 |  |
|  | GST Clearing | 33 |  |
|  | Accounts Receivable |  | 363 |
|  | Inventory | 96 |  |
|  | Cost of Sales |  | 96 |

**1 mark –** First Inventory and GST Clearing entries on 09/02

**1 mark –** Accounts Payable entry on 09/02

**1 mark –** Second Inventory and GST Clearing entries on 09/02

**1 mark –** Bank entry on 09/02

**1 mark –** Accounts Receivable entry on 14/02

**1 mark –** Credit Sales and GST Clearing entries on 14/02

**1 mark –** Cost of Sales entry on 14/02

**1 mark –** Inventory entry on 14/02

**1 mark –** Sales Returns and GST Clearing entries on 18/02

**1 mark –** Accounts Receivable entry on 18/02

**1 mark –** Inventory entry on 18/02

**1 mark –** Cost of Sales entry on 18/02

1. **Explain the effect on the Income Statement for the month ended 28 February 2019 if Tom’s Tents used period costing instead of product costing assuming not all the items are sold.**

**2 marks**

If Tom’s Tents used period costing instead of product costing, Cost of Goods Sold would be higher and Profit would be lower. **(1 mark)**

Under period costing, the additional delivery costs are reported in the Income Statement under the heading of Cost of Goods Sold in the period the expense was incurred, regardless of the quantity of item sold. **(1 mark)**

**Question 3** (6 marks)

**Discuss whether the introduction of offering credit terms to customers and borrowing money from a bank will improve the profitability of James’ Jackets.**

Suggested Approach

It is important for responses to address the potential positive and negative impacts on profitability of offering credit to customers **and** borrowing money from a bank.

Sample Answer

The offering of credit to customers could have a positive impact on the profitability of James’ Jackets. The ability of customers to purchase on credit may act as an incentive for new customers to purchase inventory or current customers may purchase inventory in larger quantities leading to increased revenue and net profit.

However, the offering of credit to customers could also have a negative effect on the profitability of James’ Jackets due to the incurring of bad debts and the additional wages costs associated with the debt collection process.

The borrowing of money from a bank could also have a positive impact on the profitability of James’ Jackets. Should the borrowing of funds be used to purchase additional revenue generating non-current assets, James’ Jackets would expect to see an increase in Sales. Further to this, a reliance on external debt rather than owner’s capital would result in an increase in the Return on Owner’s Investment indicator.

But just like offering credit to customers has a negative effect on the profitability of James’ Jackets, so too does borrowing money from a bank. As outlined above, should the funds be used to purchase non-current assets, the business will also report depreciation expense. This depreciation expense, together with the associated interest expense that accompanies a loan, may decrease the profitability of James’ Jackets.

**Question 4** (10 marks)

1. **Show how the Accounts Payable ledger account would appear in the General Ledger of Williamson’s Windows as at 31 March 2019.**

**You are required to balance the ledger account.**

**6 marks**

**Accounts Payable**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross-reference** | **Amount** | **Date** | **Cross-reference** | **Amount** |
| 04/03 | Bank / Discount Revenue | 6 600 | 01/03 | Balance | 6 600 |
| 11/03 | Inventory / GST Clearing | 550 | 09/03 | Inventory / GST Clearing | 10 560 |
| 29/03 | Bank | 2 000 |  |  |  |
| 31/03 | Balance | 8 010 |  |  |  |
|  |  | 17 160 |  |  | 17 160 |
|  |  |  | 01/04 | Balance | 8 010 |

**1 mark –** per entry in ledger account

**1 mark –** balancing ledger account

1. **Explain how the Statement of Account could assist internal control for Williamson’s Windows.**

**2 marks**

Williamson’s Windows could use the Statement of Account as a cross checking mechanism against the balance of Accounts Payable. **(1 mark)**

The Statement of Account will assist the internal control of Williamson’s Windows as the balance in the ledger must equal the final balance on the Statement to ensure that the transactions have been recorded correctly and any errors can be followed up with the supplier. **(1 mark)**

1. **Ethical one ethical issue Williamson’s Windows should consider when agreeing to sell windows on behalf of Kamala in Australia.**

**2 marks**

Ethical considerations refer to the impact choices made by the business have on society and the environment. **(1 mark)**

Williamson’s Windows should consider the supplier’s use of sustainable materials from renewable resources / the impact of the supplier’s packaging of the mattresses has on the environment / the supplier’s treatment of their employees. **(1 mark)**

**Question 5** (11 marks)

1. **Reconstruct the accounts provided in the Answer Booklet to calculate the budgeted cash purchase of Equipment for the year ended 30 June 2020.**

**7 marks**

**Accumulated Depreciation - Equipment**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross-reference** | **Amount** | **Date** | **Cross-reference** | **Amount** |
|  | Disposal of Equipment | 8 060 |  | Balance | 13 940 |
|  | Balance | 9 800 |  | Depreciation - Equipment | 3 920 |
|  |  | 17 860 |  |  | 17 860 |

**Disposal of Equipment**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross-reference** | **Amount** | **Date** | **Cross-reference** | **Amount** |
|  | Equipment | 12 400 |  | Accumulated Depreciation – Equipment | 8 060 |
|  |  |  |  | Bank | 1 750 |
|  |  |  |  | Loss on Disposal  – Equipment | 2 590 |
|  |  | 12 400 |  |  | 12 400 |

**Equipment**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross-reference** | **Amount** | **Date** | **Cross-reference** | **Amount** |
|  | Balance | 24 100 |  | Disposal of Equipment | 12 400 |
|  | Bank | 16 500 |  | Balance | 28 200 |
|  |  | 40 600 |  |  | 40 600 |

**1 mark –** Opening Balance and Closing Balance entries in Accumulated Depreciation – Equipment

account

**1 mark –** Depreciation – Equipment entry in Accumulated Depreciation – Equipment account

**1 mark –** Disposal of Equipment entry in Accumulated Depreciation – Equipment account and

corresponding entry

**1 mark –** Bank entry in Disposal of Equipment account

**1 mark –** Loss on Disposal – Equipment in Disposal account

**1 mark –** Equipment entry in Disposal of Equipment account and corresponding entry

**1 mark –** Opening Balance and Closing Balance entries in Equipment account

1. **Explain why Andrew’s Air Conditioners would have a budgeted Loss on Disposal – Equipment.**

**2 marks**

Andrew’s Air Conditioners would have a budgeted Loss on Disposal – Equipment as it is estimated that when the Equipment is sold the proceeds from disposal is expected to be less than its carrying value. **(1 mark)**

This might be due to under depreciating the Equipment due to over estimating the useful and/or residual value or the Equipment will be in poorer condition than expected when sold. **(1 mark)**

1. **Explain how the preparation of a Budgeted Cash Flow Statement can assist Andrew’s Air Conditioners with controlling their future cash flows.**

**2 marks**

The preparation of a Budgeted Cash Flow Statement can assist Andrew’s Air Conditioners with controlling their future cash flows as the report provides an indicated limit of expenditure for the business for the year ended 30 June 2019. **(1 mark)**

The Budgeted Cash Flow Statement provides a benchmark against which actual performance can be compared, problems can be identified and corrective action taken in order to analyse and improve any areas of excessive spending. **(1 mark)**

**Question 6** (24 marks)

1. **Explain the benefit of preparing a Pre-adjustment Trial Balance.**

**2 marks**

The purpose of preparing a Pre-adjustment Trial Balance is to ensure the total of the debit balances from the General Ledger equal the total of the credit balances. **(1 mark)**

The benefit is to assist in ensuring that the double entry process has been done accurately, identifying any recording errors and taking corrective action prior to reports being prepared. **(1 mark)**

1. **Calculate the carrying value for the Equipment as at 30 June 2019.**

**4 marks**

**Existing Equipment**

($14 900 - $4 400) x 20% = $2 100 per annum

$2 100 = $175 per month

12

$175 x 6 months = $1 050 (January to June)

**New Equipment**

$9 000 x 20% = $1 800 per annum

$1 800 = $150 per month

12

$150 x 3 months = $450 (April, May and June)

Depreciation expense for the six months ended 30 June 2018: $1 050 + $450 = $1 500

Equipment Cost $23 900 less Accumulated Depreciation ($4 400 + $1 500) = **$18 000**

**1 mark –** both annual amounts

**1 mark –** both monthly amounts

**1 mark –** correct allocation of months for both existing and new Equipment

**1 mark –** deduction of Accumulated Depreciation from Historical Cost

1. **Justify Tulsi’s choice of depreciating the Equipment using the reducing balance method.**

**2 marks**

The Equipment is likely to be more efficient in its earlier years of use and can be expected to generate more revenue in its earlier years. **(1 mark)** Therefore, the reducing balance method is used as it allocates more of the Equipment’s cost as depreciation expense in its earliest years to match the revenue earning pattern of the Equipment to enable the most accurate calculation of profit. **(1 mark)**

1. **Prepare the General Journal entry required to close the Revenue accounts on 30 June 2019.**

**A narration is not required.**

**5 marks**

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Details** | **Debit** | **Credit** |
| 30/06 | Cash Sales | 28 970 |  |
|  | Credit Sales | 51 480 |  |
|  | Discount Revenue | 506 |  |
|  | Interest Revenue | 900 |  |
|  | Sales Returns |  | 3 700 |
|  | Profit and Loss Summary |  | 78 156 |

**1 mark –** Cash Sales and Credit Sales

**1 mark –** Discount Revenue

**1 mark –** Interest Revenue

**1 mark –** Sales Returns

**1 mark –** Profit and Loss Summary

1. **Apart from determining profit, state one reason why Revenue accounts are required to be closed.**

**1 mark**

Return the revenue accounts to zero in readiness for the commencement of the next reporting period.

1. **Show how the Prepaid Rent Expense and Capital accounts would appear in the General Ledger after all adjusting, closing and transfer entries have been posted.**

**You are not required to balance either account.**

**7 marks**

**Prepaid Rent Expense**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross-reference** | **Amount** | **Date** | **Cross-reference** | **Amount** |
| 01/01 | Balance | 5 000 | 30/06 | Rent Expense | 16 200 |
| 28/02 | Bank | 33 600 |  |  |  |

**Capital**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross-reference** | **Amount** | **Date** | **Cross-reference** | **Amount** |
| 30/06 | Drawings | 9 690 | 01/01 | Balance | 43 290 |
|  |  |  | 30/06 | Bank | 15 000 |
|  |  |  |  | Profit and Loss Summary | 22 046 |

**1 mark –** per entry in ledger

1. **Explain the effect on the Accounting equation of recording cheque 197.**

**3 marks**

The recording cheque 197 will decrease Assets (Cash at Bank) by $1 800. **(1 mark)**

Liabilities (Accrued Wages) would decrease by $1 500. **(1 mark)**

Owner’s Equity would decrease by $300 as this amount represents Wages expense for the current reporting period which will decrease profit. **(1 mark)**

**Question 7** (6 marks)

1. **Discuss whether Peter would be happy with the profitability of his business.**

**5 marks**

Suggested Approach

It is important for responses to define the concept of profitability and that the two profitability indicators have deteriorated. This approach would allocate 3 marks. In order to achieve full marks, students need to use the Total Sales and Assets amounts to provide an explanation of additional profitability indicators not calculated in the question.

**Suggested Response**

Profitability measures how the business has earned a profit compared to a base figure such as sales, assets or owner’s equity.

The decline in the Gross Profit Margin initially indicates that the profitability of Peter’s Plates has worsened as for every $1 of sales in 2019 the business retained on 45 cents to cover Other Expenses compared to 55 cents in 2018. However, this may be due to Peter’s Plates reducing their selling prices resulting in the increase in Sales.

Further to this, the Net Profit Margin has also decreased unfavourably to 7% in 2019 compared to 8% in the previous reporting period. This means that for every $1 of Sales the business has made 7 cents of Net Profit. This would indicate that the profitability of Peter’s Plates has not improved.

However, given that the Sales have increased by 50%, both the Gross Profit and Net Profit actually increased. The owner would view these increases as favourable. But in order to assess profitability, these increases in Sales and Net Profit need to be compared to the Assets needed to generate them.

As Sales have increased by a greater percentage than the percentage increase in Assets, the Asset Turnover profitability indicator has improved. In addition to this, as the actual Net Profit has increased by a greater percentage than the percentage increase in Assets, the Return on Assets profitability indicator has also improved.

1. **State one non-financial indicator the owner could use to assess the performance of her business.**

**1 mark**

* customer satisfaction surveys / number of repeat customers
* number of sales returns / quality of products
* number of hits on business website
* hours she works in the business

**Question 8** (9 marks)

1. **Prepare the Net Cash from Operations extract from the Cash Flow Statement for the month ending 31 August 2019.**

**6 marks**

**Graham’s Gates**

**Cash Flow Statement for the month ending 31 August 2019**

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
| **Cash Flows from Operating Activities** |  |  |
| Cash Sales | 12 800 |  |
| GST Collected | 1 280 |  |
| Receipts from Accounts Receivable | 3 300 |  |
| Payments to Accounts Payable | (6 600) |  |
| Purchase of Inventory | (4 800) |  |
| Advertising | (600) |  |
| Cartage Inwards | (1 030) |  |
| Cartage Outwards | (550) |  |
| Interest | (140) |  |
| Prepaid Rent Expense | (15 000) |  |
| Wages | (4 500) |  |
| GST Settlement | (984) |  |
| GST Paid | (4 197) |  |
| **Net Cash Flows from Operations** |  | (21 021) |

**1 mark –** Cash Sales and GST Collected

**1 mark –** Receipts from Accounts Receivable and Payments to Accounts Payable

**1 mark –** per any three remaining Operating outflows (3 marks in total)

**1 mark –** Net Cash Flows from Operations label and total

1. **Explain to Graham, with the use of an example, how the Cash Flow Statement reported a negative Net Cash from Operations but the Income Statement reported a Net Profit.**

**3 marks**

Graham’s Gates reported a negative Net Cash from Operations as the cash outflows relating to the day-to-day trading activities were greater than the cash inflows relating to the day-to-day trading activities. **(1 mark)**

Whereas, the Income Statement reported a Net Profit as the revenues earned were greater than the expenses incurred. **(1 mark)**

A contributing factor towards this is the amount of the Prepaid Rent Expense payment. It can be assumed that the amount of the payment would decrease Net Cash from Operations by more than what the Rent Expense would have decreased the Net Profit. **(1 mark)**

Payments to Accounts Payable and cash purchase of inventory may be significantly larger than Cost of Sales due to high mark-up.

**Question 9** (6 marks)

1. **Explain the impact of the trends on the liquidity and stability of Schwerkolt’s Shoes.**

**4 marks**

**Suggested Approach**

**1 mark –** Identifying and explaining worsening Inventory Turnover and Accounts Receivable Turnover trends

**1 mark –** Impact on liquidity

**1 mark –** Identifying and explaining trend in Accounts Payable Turnover

**1 mark –** Impact on stability

**Suggested Response**

The trend in the Inventory Turnover indicates that the business is taking longer to sell their inventory and the trend in the Accounts Receivable Turnover indicates that the business is taking longer collecting the cash from their credit customers. **(1 mark)**

As the business is effectively taking longer to convert its inventory into cash, the business’ liquidity has deteriorated as they are now in a worse position to meet their short-term debts as they fall due. **(1 mark)**

From an Accounts Payable perspective, the business is paying their average suppliers faster than previous reporting periods and well within the credit terms offered, but not quickly enough to be entitled to the discount offered. **(1 mark)**

If this trend continues, the timing difference between the Accounts Payable Turnover and then the Inventory Turnover and Accounts Receivable Turnover combined will require an additional cash capital contribution or a loan to enable Schwerkolt’s Shoes to continue to meet their short-term debts as and when they fall due and ultimately worsen the stability of the business. **(1 mark)**

1. **State one strategy the owner could introduce to improve the Inventory Turnover in 2020.**

* employ strategies to increase sales, like advertising, changing selling prices, or changing the inventory mix
* decreasing the level of inventory on hand by ordering less, ordering smaller amounts more frequently, replacing slow moving inventory lines
* reducing the selling price of slow-moving items
* relocating inventory within the store to highlight particular goods

**1 mark**

1. **State one strategy the owner could introduce to improve the Accounts Receivable Turnover in 2020.**

* increase the discounts offered
* sending reminders to credit customers / monthly statements
* threatening not to provide credit in the future
* employing a debt collector
* taking legal action to recover the debt

**1 mark**

**END OF SUGGESTED SOLUTIONS**