YOU BE THE ASSESSOR: UNIT 3 AREAS OF STUDY 1

Question 1
Record the additional information in the Inventory Card provided.

SAMPLE ANSWER A **2 / 5 marks**

As there is no source document recorded in the 'Document' column for the entry on 6 May, students are likely to lose a mark for this question.

The entry recorded on 12 May required students to apply product costing. As a customs duty of $350 was incurred when the seven Tech televisions were purchased, in the absence of any other units of inventory being purchased on Invoice 644, $50 needed to be added to the $475 cost price of each television.

ITEM: Tech television — **Cost method:** First In, First Out

		IN			OUT			BALANCE		
Date	Document	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
01/05	**Balance**							**10**	**500**	**5 000**
05/05	**Inv. 234**	**10**	**550**	**5 500**				**10**	**500**	
								10	**550**	**10 550**
06/05					8	500	4 000	2	500	
								10	550	6 550
12/05	Inv. 644	7	475	3 325				2	500	
								10	550	
								7	475	9 875
17/05	Memo 33				1	500	500	1	500	
								10	550	
								7	475	9 375
19/05	Memo 34				1	500	500	8	550	
					2	550	1 100	7	475	7 725
24/05	C/N 56	1	500	500				1	500	
								8	550	
								7	475	8 225

When recording a Sales Return in an Inventory card, students are to apply FIFO in reverse, namely, the $550 value. The student applied the FIFO cost assignment method rather than the 'FIFO in reverse' approach.

The student has correctly applied the FIFO cost assignment method to the transactions on 17 May and 19 May.

SAMPLE ANSWER B **5 / 5 marks**

ITEM: Tech television									**Cost method:** First In, First Out	
		IN			**OUT**			**BALANCE**		
Date	Document	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
01/05	**Balance**							**10**	**500**	**5 000**
05/05	**Inv. 234**	**10**	**550**	**5 500**				**10**	**500**	
								10	**550**	**10 550**
06/05	Inv. 430				8	500	4 000	2	500	
								10	550	6 550
12/05	Inv. 644	7	525	3 675				2	500	
								10	550	
								7	525	10 175
17/05	Memo 33				1	500	500	1	500	
								10	550	
								7	525	9 675
19/05	Memo 34				1	500		8	550	
					2	550	1 600	7	525	8 075
24/05	C/N 56	1	550	550				9	550	
								7	525	8 625

The student has correctly applied product costing by adding the $50 customs duty per Tech television to the $475 invoice price.

The student has correctly applied 'reverse FIFO' to determine the cost price for the Sales Return on 24 May by using the most recent value in the 'OUT' column.

SAMPLE ANSWER A

A narration is required. **1 / 3 marks**

General Journal

Date	Details	Debit	Credit
31/05	Inventory Loss	475	
	Inventory		475

The student has correctly debited Inventory Loss and credited Inventory, but with the incorrect amount. In order to determine the value of an Inventory Loss using the FIFO cost assignment method, the oldest cost price recorded in the Balance column of the Inventory card is to be used. If the student recorded the Inventory Loss as $500 they would have been consequentially correct.

The question required students to include a narration. A narration requires the quantity of items effected, the type of item effect, a brief description of why the entry is necessary and the source document.

SAMPLE ANSWER B **3 / 3 marks**

General Journal

Date	Details	Debit	Credit
31/05	Inventory Loss	550	
	Inventory		550
	Inventory loss of 1 'Tech TV' per inventory count (Memo 35)		

The correct value of the Inventory Loss has been recorded as per the FIFO cost assignment method.

The narration includes the quantity, the type of inventory item, the reason for the General Journal entry and the source document.

Complete the table provided to show the effect that the release of the new Tech2 television will have on the Balance Sheet.

SAMPLE ANSWER A **1 / 2 marks**

	Increase / Decrease / No Effect	Amount
Assets	Decrease	$2 465
Liabilities	No Effect	$0
Owner's Equity	Decrease	$2 465

The student has correctly completed the effect on the Balance Sheet, but with the incorrect amount. Even though there is 'No Effect' on the Liabilities, the student has correctly recorded $0 in the Amount column.

The calculation of the amount is very complicated. The Net Realisable Value of the Tech television is $360 ($400 estimated selling price less $40 delivery fee to customer) and needs to be compared to the Inventory values after the physical inventory count. This student's values in the Balance column of the Inventory card after the physical inventory count would have been 1 @ $500, 8 @ $550 and 6 @ $475 with a total value of $7 750. After the application of the lower of cost and net realisable value rule, the value of inventory would be 15 @ $360 with a total value of $5 400, being a difference of $2 350. This amount would have been marked consequentially correct. But what this student has done is incorrectly use the quantity of 16 from the Inventory card and not the quantity of 15 from the physical inventory count.

SAMPLE ANSWER B .

2 / 2 marks

	Increase / Decrease / No Effect	Amount
Assets	Decrease	$2 675
Liabilities	No Effect	$0
Owner's Equity	Decrease	$2 675

The movements in the table have been identified correctly.

The trick to this question is to understand that the quantity after the physical inventory count is to be used, and not the balance as per the inventory card above, when applying the lower of cost and net realisable value rule. The correct quantity and valuation of inventory immediately after the physical inventory count would have been 8 @ $550 and 7 @ $425 for a total of $8 075. The business would then apply the lower of cost and net realisable value rule and determine the value of inventory to be 15 @ $360 for a total of $5 400. This identifies a $2 675 difference representing the amount of the inventory write down.

Question 2

SAMPLE ANSWER A **3 / 5 marks**

ITEM: Test Cricket balls								**Cost method:** First In, First Out		
		IN			**OUT**			**BALANCE**		
Date	Document	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
01/06	**Balance**							**48**	**30**	**1 440**
05/06	**Inv. 816**	**24**	**35**	**840**				48	30	
								24	35	2 280
28/06	Inv. 2224				12	30	360	36	30	
								24	35	1 920
29/06	C/N. 45				6	30	180	30	30	
								24	35	1 740

The student has incorrectly applied the FIFO cost assignment method when recording the purchase return of the six test cricket balls on 29 June. The student needed to follow the information provided by the supplier ($35) rather than applying the FIFO cost assignment method to determine the value of a purchase return in an Inventory card.

ITEM: Power Plus cricket bats								**Cost method:** First In, First Out		
		IN			**OUT**			**BALANCE**		
Date	Document	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
01/06	**Balance**							**20**	**220**	**4 400**
30/06	Memo 61				2	220	440	18	220	3 960
30/06	Memo 62				18	80	1 440	18	140	2 520

The Inventory Loss as per the physical inventory count has been recorded correctly.

It is evident that the student has correctly determined that the Net Realisable Value for the Power Plus cricket bats is $140. Unfortunately, the student has thought that all 18 cricket bats are to be valued at the lower of cost and net realisable value rule and recorded the write down accordingly. Only 5 of the cricket bats are damaged and require a $80 write down each. The remaining 13 cricket bat values are to remain unchanged.

SAMPLE ANSWER B. **5 / 5 marks**

ITEM: Test Cricket balls										**Cost method:** First In, First Out
		IN			**OUT**			**BALANCE**		
Date	Document	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
01/06	**Balance**							**48**	**30**	**1 440**
05/06	**Inv. 816**	**24**	**35**	**840**				48	30	
								24	35	2 280
28/06	Inv. 2224				12	30	360	36	30	
								24	35	1 920
29/06	C/N. 45				6	35	210	36	30	
								18	35	1 710

Both entries in the inventory card of the Test cricket balls have been recorded correctly. The entry on 28 June correctly applies the FIFO cost assignment method. The entry on 29 June correctly relies on the information provided by the supplier to allocate a value to the purchase return.

ITEM: Power Plus cricket bats										**Cost method:** First In, First Out
		IN			**OUT**			**BALANCE**		
Date	Document	Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
01/06	**Balance**							**20**	**220**	**4 400**
30/06	Memo 61				2	220	440	18	220	3 960
30/06	Memo 62				5	80	400	5	140	
								13	220	3 560

Similarly to Sample Answer A, the entry required to record Memo 61 in the Inventory card for the Power Plus cricket bats has been recorded correctly.

Unlike Sample Answer A, this student has correctly applied the lower of cost and net realisable value rule to the five damaged cricket bats. As only five of the cricket bats are damaged, their cost in the inventory card needs to be reduced from $220 to down to $140, an adjustment of $80 per damaged bat. The remaining 13 undamaged cricket bats' cost in the inventory card remains unchanged. There is no requirement to record the values in the Balance column in a particular order. Students are allowed to record it as either 5 @ $140 and 13 @ $220 or 13 @ $220 and 5 @ $140.

Question 3

SAMPLE ANSWER A

1 / 2 marks

Invoice Price	$60
Plus: Delivery Charges	$10
Plus: Customs Duties	$9
Plus: Rebadging (Logos)	$2
	$81

This calculation has incorrectly included a $10 Delivery Charge in determining the cost of each scooter. Unfortunately, the total Delivery Charge on the purchase of the 210 items of inventory was $2 100. This lead to students thinking that the total Delivery Charge of $2 100 could be allocated on a logical basis to each of the 210 items of inventory delivered at an amount of $10 per item. However, students need to be mindful that when multiple lines of inventory are purchased, unless specified, any transportation costs are to be treated as a period cost and not included in the cost price of an inventory item.

SAMPLE ANSWER B

Calculate the unit cost at which the scooters should be recorded in the Inventory Card.

2 / 2 marks

Invoice Price	$60
Plus: Customs Duties	$9
Plus: Rebadging (Logos)	$2
	$71

This student has corrected added the Customs Duty and the Rebadging Logos per scooter to the invoice price when calculating the unit cost of each scooter to be recorded in the Inventory card. Pleasingly, the student has omitted the Delivery Charges as it would be incorrect to add an additional $10 to the unit cost of each scooter as multiple lines of inventory were delivered.

Explain your treatment of the following items when determining the unit cost of the scooters.

- **Rebadging cost**
- **GST**

SAMPLE ANSWER A **2 / 3 marks**

The rebadging costs (logos) were treated as a product cost and included in the unit cost of the scooters as it was a cost incurred in getting the scooters into a condition ready for sale.

Whereas, the GST is not included in the unit cost of the scooters as it is not a product or period cost incurred in getting the scooters into a condition or location ready for sale. Rather, the GST reduces the GST liability of the business as it is recorded as a debit entry to the GST Clearing account instead of being included in the Inventory amount reported on the Balance Sheet or reported as an expense under the heading of Cost of Goods Sold in the Income Statement.

This part of the response is excellent. It states why the GST should not be treated as a product cost or a period cost and then provides the correct alternative recording treatment.

The student has correctly identified the rebadging costs as a product cost but has only provided half of the definition. A full response should have added that these rebadging costs can be directly allocated to each scooter on a logical basis.

SAMPLE ANSWER B **3 / 3 marks**

The rebadging costs (logos) were treated as a product cost and included in the unit cost of the scooters as it was a cost incurred in getting the scooters into a condition ready for sale which can be directly allocated to each scooter on a logic basis of $2 per scooter.

Whereas, the GST is not included in the unit cost of the scooters as it is not an expense of the business. Rather, the GST reduces the GST liability of the business as it is recorded as a debit entry to the GST Clearing account instead of being included in the Inventory amount reported on the Balance Sheet or reported as an expense under the heading of Cost of Goods Sold in the Income Statement.

This response is very good. It clearly explains why the rebadging costs (logos) are treated as a product cost. There is no requirement to include '$2 per scooter', although it certainly enhances the quality of the response. Similarly, the explanation of the treatment of the GST clearly explains the alternative treatment compared to it being treated as a product cost or a period cost.

Question 4

SAMPLE ANSWER A **3 / 6 marks**

The slower Accounts Receivable Turnover combined with the faster Accounts Payable Turnover will have a negative effect on the liquidity of the business as they will have less cash available to meet all their short-term debts as they fall due. As the business is waiting longer to collect cash from their outstanding Accounts Receivable balances but paying their outstanding Accounts Payable balances earlier than required, the business will be required to use all their cash available, including using its bank overdraft facility.

Even though this first paragraph reads well, it does not address the actual question. It does not provide any strategies to overcome the cash shortage. Rather, it attempts to explain why there is a cash shortage and why that would be problem.

One strategy the business could implement to overcome the problem would be to offer discounts to their credit customers. This would act as an incentive for credit customers to pay their outstanding balances which would hopefully lead to a faster Accounts Receivable Turnover.

Even though this response does include a strategy to improve the Accounts Receivable Turnover, the strategy to offer discounts would be incorrect as this business already offers discounts to their credit customers. If the student had suggested that the business could increase the discount offered, that would have been a correct strategy. However, the student has consequentially explained why the offering of discounts would improve the Accounts Receivable Turnover and the cash shortage problem the business has. Further to this, the question required students to 'discuss' the strategies. Therefore, students not only need to explain how the suggested strategy will address the cash shortage, responses also need to include a potential disadvantage to the business of employing such a strategy.

Another strategy the business could implement to overcome the problem would be to review their credit facilities. This may involve removing credit facilities altogether or only allowing certain customers to purchase inventory on credit. The purpose of this strategy would be to only sell inventory on a cash basis or to only sell inventory on credit to those customers who have a good history of paying their outstanding balances within the credit terms offered.

Similarly to above, the suggested strategy to review their credit facilities would improve the Accounts Receivable Turnover and, by requiring customers to purchase inventory only using cash, address the cash shortage issue, the potential disadvantage of seeing a decline in credit sales and the profit of the business was not included.

The owner could also make a capital contribution of cash to the business. The inflow of cash will eliminate the cash shortage and improve the liquidity of the business by making it easier to pay their short-term debts as they fall due instead of relying on the bank overdraft facility. By having more cash available the business' Accounts Payable Turnover could be faster and fall below the 26 days in 2015.

Is making a capital contribution of cash a strategy to improve liquidity? Is it just an action? From a long term business strategy point of view, getting the owner to make a capital contribution of cash is not sustainable. In the short term, the access to the owner's cash would attempt to alleviate the business' cash shortage. There are more appropriate strategies the business could implement. Either way, the omission of a disadvantage, such as the time and limit to which the owner can contribute cash, means that the response did not 'discuss' the strategy.

SAMPLE ANSWER B **5 / 6 marks**

The strategy that will provide the business with the most immediate benefit to overcoming a cash shortage would be to delay making payments to their suppliers. A suppliers provide credit terms of 30 days without any discounts for prompt payment, there is no incentive to pay them any earlier than the 30 days. By delaying payment until the due date, the business will have cash in the business for longer. **However**, the credit terms should not be exceeded as relationships can be damaged, credit facilities removed and cash being required to be used to source inventory which make any cash shortage issues worse.

Another strategy the business could implement to overcome cash shortages would be to alter their credit terms by increasing the discount offered. This could act as an incentive for credit customers to pay their outstanding accounts more promptly, improving the flow of cash into the business. **However**, if more accounts receivable balances are paid within the credit terms the business will see an increase in the Discount Expense which would reduce the Net Profit.

Another strategy the business could implement to overcome cash shortages would be to send out invoices more promptly and make contact with their credit customers as soon as payment is not received by the due date. By carefully monitoring any outstanding account balances, the business can send out reminders with the intent of collecting the cash faster. **But** the potential problem with this renewed approach to accounts receivable management is that additional staff may be required. These additional staff are required so as the business owner and key personnel can focus on generating revenue rather than fulfilling administrative duties. But this all comes at a cost. The payment of wages and its associate outflow of cash, may limit the effectiveness of employing additional staff in improving the liquidity of the business.

This answer reads very well. Each strategy suggested is appropriate in addressing the business' cash shortage. Each strategy provides a justification as to how it would improve the business' liquidity. However, only two out of the three strategies explanations include an accurate disadvantage of improving the liquidity of the business. The explanation of the second strategy - increasing the discount offered – focuses on the negative effect on the business' profitability rather than its negative effect on liquidity. A disadvantage of increasing the discount offered would be that the business actually receives less cash than what is owed. Even though the business would be receiving cash faster, there would be less cash available to meet the business' short term debts as they fall due.