



2005

Accounting GA 3: Written examination 2

GENERAL COMMENTS

The November examination was comprised of two questions, with multiple parts to each question. The questions and subsequent parts graduated in difficulty, and this format will continue. Each question dealt with one scenario and was worth 45 marks.

The balance between theory and practice was again approximately 40:60 and this is expected to continue. This balance covers the whole examination, but is not necessarily the case for each scenario.

Students are reminded to read the information provided in the scenarios carefully and use the reading time constructively.

A pleasing trend over the past few examinations has been an increase in the number of students who complete the examination. The parts of the examination that students do not finish are not necessarily the last questions on the paper. This suggests that some students are reading the paper carefully during reading time, identifying the questions that they are confident in and answering those questions first.

Another pleasing aspect was that students appeared to have consulted previous Assessment Reports and made fewer errors with regards to titles, narrations and posting references.

Question 1 – Wazza’s Tent World

Question 1 was worth a total of 24 marks and required students to record transactions into General and Special Journals and then post information into General and Subsidiary Ledgers.

Question 1.1

1.1.1 Record the four receipts in the Cash Receipts Journal. (Total the Cash Receipts Journal.)

Marks	0	1	2	3	4	Average
%	8	7	14	25	46	3.0

Cash Receipts Journal

CRJ 24

Date 2005	Details	Post Ref.	Rec. No.	Bank	Disc. Exp.	Debtors	Cost of Sales	Sales	Sundries
7 Dec	Cash Sale		83	1320			780	1320	
8 Dec	North Park Primary		84	2496	104	2600			
11 Dec	Cash Sale		85	940			460	940	
12 Dec	Hurley Sports Club		86	2250		2250			
				7006	104	4850	1240	2260	–

Students handled this question particularly well. Students’ treatment of the debtor who received a discount was good and showed that comments on this area in previous Assessment Reports had been noted.

Common mistakes made by students were:

- a failure to total the Journal, which was specifically asked for. All columns needed to be totalled.
- incorrect calculation of cost and/or selling price for the cash sales.

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1.1.2 Prepare the General Journal entry to record the information contained on Memo 31.

Marks	0	1	2	3	4	Average
%	21	11	15	10	43	2.5

GENERAL JOURNAL

GJ8

Date 2005	Particulars	Post Ref.	General Ledger		Subsidiary Ledger	
			Debit \$	Credit \$	Debit \$	Credit \$
12 Dec	Creditor Control		900			
	Creditor – A. Johnson				900	
	Debtor Control			900		
	Debtor – A. Johnson					900
	Bad Debt		1400			
	Debtor Control			1400		
	Debtor – A. Johnson					1400

Students performed well on this question. The use of correct titles (for example, Debtors Control) was pleasing.

Common mistakes made by students were:

- leaving out one of the two required entries. A number of students did not read the document carefully and failed to record the Bad Debt component of the question.
- writing off the whole amount (\$2300) as a contra entry. This was again due to students not reading the material correctly.

1.1.3 Show how the Debtors Control account would appear in the General Ledger after all the above information has been recorded. Balance the Debtors Control account at 12 December 2005.

Marks	0	1	2	3	4	5	6	7	Average
%	17	7	6	7	8	12	18	27	4.4

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DEBTORS CONTROL

Date 2005	Cross Reference	Post Ref.	\$	Date 2005	Cross Reference	Post Ref.	\$
5 Dec	Balance		9 800	12 Dec	Bank/Disc Exp	CRJ24	4 850
12 Dec	Credit Sales	SJ23	3 150		Sales Returns	GJ8	880
					Creditors Control	GJ8	900
					Bad Debts	GJ8	1 400
					Balance		4 920
			12 950				12 950

There was a lot of information required for this question and students needed to refer to their responses for Questions 1.1.1 and 1.1.2.

Common errors were:

- not calculating the closing balance, despite specific instructions to do so. The amount calculated was consequential to entries made earlier in Questions 1.1.1 and 1.1.2. Although one mark was allocated to the closing balance, students need to be aware that in questions like this, the process is more important than obtaining the correct answer.
- the use of incorrect titles, particularly using the term 'Contra' instead of 'Creditors Control'.
- incorrect use of, or leaving out, posting references. One mark is allocated for posting references when these are required, therefore students were penalised one mark if they did not use posting references correctly or left them out.

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1.1.4 Show how North Park Primary's account in the Debtor's Subsidiary Ledger would appear after all the above information has been recorded.

Marks	0	1	2	3	Average
%	21	15	27	37	1.9

D2 DEBTOR – North Park Primary

Date 2005	Cross Reference	Post Ref.	\$	Date 2005	Cross Reference	Post Ref.	\$
5 Dec	Balance		2 600	8 Dec	Bank / Disc exp		2600
9 Dec	Credit sales		880	10 Dec	Sales Return		880

This question was handled well by students. They were able to sort through a lot of data and select the data relevant to the individual debtor.

Common errors were:

- recording the credit entries in the incorrect order. Subsidiary Ledger accounts require individual entries to be recorded and as such need to be recorded in correct date order.

1.1.5 Show how the Stock Control account would appear in the General Ledger after all the above information has been recorded.

Marks	0	1	2	3	4	Average
%	26	10	14	23	27	2.3

103 STOCK CONTROL

Date 2005	Cross Reference	Post Ref.	\$	Date 2005	Cross Reference	Post Ref.	\$
5 Dec	Balance		36 000	12 Dec	Cost of Sales		1 730
12 Dec	Creditors Control		6 300		Cost of Sales		1 240
12 Dec	Cost of Sales		450				

This type of question has been asked regularly and students generally do well. Unfortunately the same errors continue to be seen.

Common errors were:

- failing to separate the two credit entries. As the information came from two journals, two entries in the Ledger Account were required.
- placing individual entries into the Ledger Account rather than the journal total.

1.1.6 Explain how the use of the Debtors Control Account and Debtors Subsidiary Ledger assists in managing debtors.

Marks	0	1	2	Average
%	27	48	25	1.0

- the Subsidiary Ledger provides the detail required for each individual debtor
- allows for the preparation of a Debtors Ageing Analysis
- provides a cross-checking mechanism to ensure that recording is accurate
- allows for separation of duties, enabling staff to manage debtors

This question was not handled well. Students tended to use only one of the suggested solutions and did not adequately explain how that answer assisted in managing debtors. As with the June examination, this question drew a lot of rote-learned answers that did not answer the question asked.

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Question 1.2

1.2.1 Explain why the \$800 delivery cost is treated as a period cost.

Marks	0	1	2	Average
%	37	37	26	1.0

- because it cannot be directly linked or assigned to a particular line of stock
- the value is less than 10 per cent of the invoice price of the item of stock
- the amount is immaterial to the cost of the stock

The question itself identified the \$800 as a period cost and although students were able to provide a reason as to why, they often did not go far enough with their responses. As the question was worth two marks, students should have provided two points in their explanation or one point that was explained further.

1.2.2 State the cost at which the new tents should be recorded in the stock cards.

Marks	0	1	2	3	Average
%	17	11	20	52	2.1

Suppliers invoice price	460
Water proofing	30
Packaging	<u>10</u>
	\$ 500

Given the material provided, this was a difficult question. Responses to this question were read in conjunction with responses to Question 1.2.3., which allowed assessors to identify how students had approached each of the items listed.

Common errors were:

- using the selling price of the item as part of the cost price.
- if including the advertising costs, using the full amount rather than dividing the amount by the number of items.
- including items that were identified as period costs in Question 1.2.3.

1.2.3 Justify your treatment of the packaging costs and advertising costs. You must distinguish between period and product costs.

Marks	0	1	2	3	4	Average
%	18	8	18	15	42	2.7

Packaging costs

- Product costs: costs involved in getting the product into a position ready to sell which can be directly linked to the stock item.
- Period costs: as the value is less than 10 per cent of the value of the stock item.

Advertising costs

- Selling expense: not a cost associated with the purchase/buying of stock.
- Period cost: will be fully expensed in the period it was incurred.

Students handled this question well. While it was expected that students would identify the packaging costs as a product cost and the advertising costs as a period cost, students were awarded marks according to their justification. The justification was the crucial element in determining marks.

Students who identified the advertising costs as a selling expense were not penalised.

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1.2.4 State the effect on reported Net Profit, of treating the delivery cost of \$800 as a period cost, if all stock has not been sold by the next reporting date. Explain your answer.

Marks	0	1	2	3	Average
%	15	37	26	23	1.6

Item	Increase/Decrease
Net Profit	Decrease

As it is regarded as a period cost, the entire expense is written off in the reporting period in which it was incurred, regardless of the quantity of stock sold.

This question was very difficult; however, a variety of alternative approaches were accepted in answering the question.

It was expected students would examine the effect on profit of treating the expense as a period cost compared to a product cost. If this was not done, it was difficult to adequately explain why profit has decreased.

Question 1.3

1.3 Explain how the change in stock turnover (61 days to 74 days) could have a negative effect on liquidity and a positive effect on net profit

Marks	0	1	2	3	4	Average
%	29	22	33	8	8	1.5

Liquidity

- will deteriorate as cash is tied up in stock not being sold
- less sales, therefore less cash being received through cash sales and receipts from debtors
- the business bought more stock for cash, therefore increasing cash outflows

Net Profit

- could improve if longer stock turnover is due to carrying a better stock mix/variety of stock which leads to an increase in sales
- bought stock cheaper in bulk and able to earn a greater profit margin on sales

Some students misinterpreted the movement in the stock turnover and believed that turnover had improved.

Students generally did not link a worsening stock turnover with a decrease in cash sales and/or a reduction in receipts from debtors.

The effect on Net Profit was not handled well. Many students who identified the turnover as worsening when discussing liquidity now stated that the turnover had improved in order to provide a reason why Net Profit may also have improved.

Question 1.4

1.4.1 Explain what is meant by the term profitability.

Marks	0	1	2	Average
%	52	32	17	0.7

- Profitability measures the performance of the business's profit against the assets, sales and owner's equity.
- Profitability is the ability of the business to make a profit.

This question was handled poorly, with students tending to provide a definition of profit. The correct response needed to state that profitability was a measure of profit against some other item.

1.4.2 Identify two possible reasons for the improvement in profitability.

Marks	0	1	2	Average
%	21	44	35	1.2

- increase in sales
- increase in profit margin
- cheaper stock purchases; that is, lower cost of sales

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Students generally handled this question well, with most able to identify one correct reason. The students who did not perform well did not fully understand that the second set of figures related to a quarter rather than a full reporting period and attempted to argue that profitability was worse as Net Profit was lower than last period.

1.4.3 State one reason why Warren should be happy with the level of sales for the quarter.

Marks	0	1	Average
%	34	66	0.7

- significant increase (30 per cent) in sales compared to the previous period.
- sales are higher than the previous quarter
- NPR has increased
- GPR has increased
- expenses have remained proportional to sales, causing net profit to increase
- only a quarter of the way through the year and have already earned 30 per cent of last year's sales

Question 2 – Bed Sitters

Question 2.1

2.1.1 State how the GST Clearing Account would be classified in the Statement of Financial Position at 30 November 2005. Justify your answer.

Marks	0	1	2	Average
%	39	30	31	1.0

Current asset

- It represents a future economic benefit that will be received within 12 months.
- The business has collected/received/earned less GST than it has incurred/paid out.

While a lot of students were able to identify the balance as an asset, many of these failed to fully classify the item as a current asset. In this case, no mark was awarded for this part of their answer. Once classified, students were expected to provide a definition of a current asset or an explanation of how a business may pay/incur more GST than what it collects/earns.

2.1.2 Prepare the GST Clearing Account in the General Ledger at 31 December 2005 after all journals have been posted. Balance the account at 31 December 2005.

Marks	0	1	2	3	4	5	Average
%	14	3	8	15	24	36	3.5

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GST Clearing Account

Date 2005	Cross Reference	Post Ref.	\$	Date 2005	Cross Reference	Post Ref.	\$
30 Nov	Balance		600	31 Dec	Bank		4 700
31 Dec	Bank		2 000		Debtors Control		2 300
	Creditors Control		2 900				
31 Dec	Balance		1 500				
			7 000				7 000

While this question was handled well, a few common errors continued to appear, such as:

- the account was not balanced.
- the debit and credit entries were confused.
- incorrect titles were used for Creditors Control (Purchases) and Debtors Control (Sales).

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2.1.3 Explain why the GST on sales is not treated as revenue in the Statement of Financial Performance.

Marks	0	1	2	Average
%	31	36	32	1.1

- GST is not a revenue because it does not increase owner's equity, even though it may increase assets or decrease liabilities.
- GST is not revenue as the business has collected GST on behalf of the ATO and now owes the ATO the money.

This question demonstrated that students did not fully understand GST and its impact upon recording and reporting. Given the limited nature of GST as part of the course, there is little variety in the type of questions that may be asked. Students should be aware of these possibilities and prepare for them.

Most student responses focused on the second suggested solution – that the business collects GST on behalf of the ATO. Poorer answers did not continue on and state that the business is now a debtor of the ATO.

Question 2.2

2.2.1 Prepare a Cash Budget for the quarter ended 31 March 2006.

Marks	0	1	2	3	4	5	6	7	8	Average
%	21	11	13	12	12	13	12	5	1	3.1

BED SITTERS CASH BUDGET FOR QUARTER ENDED 31 MARCH 2006

Estimated Receipts	\$	\$
Cash Sales	161 000	
Receipts from Debtors	57 000	218 000
less Estimated Payments		
Stock Purchases	30 000	
Payments to Creditors	130 000	
Drawings	22 000	
Customs duty	1 000	
Interest	6 000	
Office expenses	4 000	
Wages	28 500	
Accrued Wages	800	
Loan	15 000	237 300
equals Cash Surplus/(Deficit)		(19 300)
plus Cash at Bank (1/1/06)		(16 000)
equals Cash at Bank (31/03/06)		(35 300)

This question was not handled well because students did not pay enough attention to the detail. Titles, aliens and balances are the items that caused students to perform poorly. Common mistakes in this report were:

- not separating the amounts for Wages and Accrued Wages and/or not calculating the amounts correctly.
- including Cost of Sales as a cash payment.
- including other non-cash items, such as Bad Debts and Depreciation.
- not calculating the Surplus/Deficit.
- not considering Bad Debts when calculating Receipts from Debtors.



2.2.2 Prepare a Budgeted Statement of Financial Performance, for the quarter ended 31 March 2006, which shows budgeted gross profit and budgeted net profit.

Marks	0	1	2	3	4	5	6	Average
%	18	8	12	16	21	17	9	3.1

**BED SITTERS
BUDGETED STATEMENT OF FINANCIAL PERFORMANCE
FOR QUARTER ENDED 31 MARCH 2006**

Revenue	\$	\$
Cash sales	161 000	
Credit sales	<u>69 000</u>	230 000
Less Cost of Goods Sold		
Cost of Sales	115 000	
Customs Duty	<u>1 000</u>	<u>116 000</u>
Gross Profit		114 000
less Other Expenses		
Depreciation on Furniture and Fittings	4 000	
Bad debts	2 000	
Interest on loan/overdraft	6 000	
Wages	29 000	
Office expenses	<u>4 000</u>	<u>45 000</u>
Net Profit		69 000

Although Budgets have appeared in the past three November Accounting exams, students have rarely been asked to complete two budgets. These questions highlighted the fact that when given two different reports to complete many students were unable to distinguish between items that appear in both reports and those that appear in only one. However, students generally performed better in this question than in Question 2.2.1, primarily because consequential errors from the previous question were ignored.

Common errors were:

- Customs Duty not included as part of Cost of Goods Sold.
- incorrect title used for Cost of Sales.
- incomplete title for Depreciation – this must include the name of the asset.
- incorrect figure for Wages.
- Drawings and Loan Repayments included as expenses.

Question 2.3

2.3.1 Apart from the increasing overdraft, explain why the accountant is concerned about business liquidity.

Marks	0	1	2	Average
%	48	28	24	0.8

- The Quick Asset Ratio has decreased unfavourably **and/or** is below 1:1 **and** is unable to meet immediate liabilities.
- The increase in the Working Capital Ratio suggests that the business has a large investment in stock which cannot be converted into cash quickly.

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Although one ratio improved and the other deteriorated, students should still have been able to provide a suitable response to this question. Depending upon the student's interpretation, either Current Assets or Quick Assets had deteriorated in relation to Current or Quick Liabilities.

2.3.2 Explain why stock and prepayments are excluded from the calculation of the Quick Asset Ratio.

Marks	0	1	2	Average
%	59	26	15	0.6

- Stock is not always able to be converted into cash quickly.
- Prepaid items (expenses) are not able to be recovered.

This question required students to state that the two items are difficult to recover for their full reported value.

2.3.3 Excluding the ratios shown in 2.3, identify two other ways of monitoring business liquidity.

Marks	0	1	2	Average
%	55	29	17	0.7

- timing of cash flows resulting from stock turnover
- cash budget or variance report
- debtors turnover and how quickly debtors are paying their debts
- what percentage of total sales are cash sales **or** Cash Cycle **or** Cash Flow Indicator
- creditors turnover

This question allowed students to identify a variety of measures available for monitoring liquidity. The most common mistake was for students to identify the amount in the bank or value of bank overdraft. To be accepted, this item needed to be mentioned in terms of the trend in the item.

This question was very poorly handled by students. While students may have been confused by the unconventional layout of the ratios, they should still have been able to draw logical conclusions from the information.

Question 2.4

2.4.1 Record the purchase return in the stock card.

Marks	0	1	2	Average
%	15	32	53	1.4

Stock Item 64: Pillow Slips

Date April 2006	Details	IN			OUT			BALANCE		
		Qty	Unit Cost	Total Cost	Qty	Unit Cost	Total Cost	Qty	Unit Cost	Total Cost
1	Balance							20	5	100
8	Inv. 2441	12	6	72				20 12	5 6	172
12	Inv. 126				14	5	70	6 12	5 6	102
18	C/N 44				3	6	18	6 9	5 6	84

Students generally answered this question well. Common errors were:

- treating the item as a Sales Return.
- not using the document number in the details column.
- using an incorrect cost price.

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2.4.2 Record the purchase return in the General Journal.

Marks	0	1	2	3	Average
%	24	15	17	44	1.9

GENERAL JOURNAL GJ5

Date 2005	Particulars	Post Ref.	General Ledger		Subsidiary Ledger	
			Debit \$	Credit \$	Debit \$	Credit \$
18 Apr	Creditor control		18			
	Creditor – P. J. Liner				18	
	Stock control			18		

Purchase Returns have not been examined in some time and it was pleasing to see that students dealt with the question well. The most common error was the use of the title 'Purchase Returns' in place of Creditors Control. Consequential errors were overlooked when marking this question.

Question 2.5

2.5.1 State the total value of this stock item at 30 April if the 'lower of cost or net realisable value' rule is applied correctly.

Marks	0	1	Average
%	60	40	0.4

$$14 \times (\$220 - \$20) = \$2\,800$$

Students did not perform well on this question. Most incorrect responses only identified the cost of one item rather than 14. Partial marks could not be given, as the question was only worth one mark, therefore, students need to ensure they read the question carefully.

2.5.2 Prepare the General Journal entry required on 30 April 2006 to adjust the stock records.

Marks	0	1	2	Average
%	36	19	45	1.2

GENERAL JOURNAL GJ5

Date 2005	Particulars	Post Ref.	General Ledger		Subsidiary Ledger	
			Debit \$	Credit \$	Debit \$	Credit \$
April 30	Stock write down		700			
	Stock control			700		

Students have performed well on this type of question in recent examinations. The major error was the amount students recorded—the most common incorrect number used was \$2800.

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2.5.3 Complete the table to show the effect on net profit, assets and owner's equity in the

- Statement of Financial Performance for year ended 30 April 2006
 - Statement of Financial Position as at 30 April 2006
- if the General Journal entry in 2.5.2 was not made.

Marks	0	1	2	3	Average
%	29	16	20	34	1.7

Item	Increase/Decrease	Amount \$
Net Profit	Increase	700
Assets	Increase	700
Owner's Equity	Increase	700

This question was different from previous questions in that the effect of not recording the transaction was required for two reports. Therefore, the use of consequential marking did not apply for the whole question – only for the items in the Statement of Financial Position.

Question 2.6

2.6 On 1 May 2006, Belinda rented part of her showroom to another business for \$1000 per month. On 12 May, she received three months rent in advance. Assuming reports are prepared on a monthly basis, prepare the General Journal entry required to be made at 31 May 2006.

Marks	0	1	2	Average
%	62	20	18	0.6

GENERAL JOURNAL

GJ5

Date 2005	Particulars	Post Ref.	General Ledger		Subsidiary Ledger	
			Debit \$	Credit \$	Debit \$	Credit \$
31 May	Prepaid rent revenue		1 000			
	Rent revenue			1 000		

Students did not handle this question well. The most common errors were:

- using incorrect titles – not identifying the item as revenue.
- recording the incorrect amount – \$3000.
- treating the item as an expense.

Question 2.7

2.7 State whether this change in the gearing ratio indicates an improvement or deterioration in the long-term financial stability of the business. Explain your answer.

Marks	0	1	2	3	Average
%	24	20	27	28	1.7

Deterioration

- higher (increased) gearing ratio reflects higher risk
- increased reliance on borrowed funds
- commits the business to long-term interest and principal repayments

Generally students were able to identify that the change in the ratio reflected a deterioration in long-term stability; however, many were unable to explain the consequences fully. Many students referred to an increase in liabilities but did not conclude that this led to greater risk and increased interest and principal repayments.