2010 Accounting GA 3: Written examination 2

GENERAL COMMENTS

The November 2010 Accounting examination had two distinct questions, each worth 45 marks. Students had 90 minutes to complete the paper. The questions were based on different small businesses operating as trading firms, and students were required to answer questions relating to these businesses. Question 1 included practical-type questions worth 25 marks and theoretical-type questions worth a total 20 marks. In Question 2, 31 of the 45 marks available were allocated to practical-type questions. Teachers and students are reminded that there is no pre-determined weighting between practical and theoretical-type questions.

Some students had difficulty completing the examination. It is vital that students plan their examination time effectively so that every question can be attempted. There were some questions that proved to be quite problematic for some students. A significant number of students did not complete accounting reports such as the Cash Flow Statement and the Profit and Loss Statement. Students are advised to complete past examinations against the clock to ensure that they can use their time effectively and finish the examination within the 90-minute time frame.

Students were generally well versed in using the correct titles in journals, ledger accounts and accounting reports. However, many students used titles such as Debtors Control and Stock Control in Cash Flow Statements. The titles used in a Cash Flow Statement should be descriptive in relation to the item under consideration. For example, rather than Debtors Control, ‘Cash collected from debtors’ should be used. Instead of Stock Control, the title ‘Cash purchases of stock’ should be used. The titles used should describe the nature of the cash flow being reported. Another area of concern was in relation to the general ledger recording of a disposal of a non-current asset. Depreciation expense is not an acceptable entry; rather, Depreciation of Computer should be used. ‘Sundry Creditor – Business Computing’ is the correct title for the entry to record the purchase of the computer on credit. Full titles must be used at all times or marks may not be awarded.

Students are not penalised for consequential errors. In Question 1.1.1, students had to determine the value of Accumulated Depreciation. In Question 1.1.2, they then had to calculate the depreciation of the computer for the current reporting period. Having answered these first two questions, students then had to prepare ledger accounts using the values determined in Questions 1.1.1 and 1.1.2. If a student made calculations in a previous question and these values were then used in a subsequent question, such values must be used, regardless of whether they are correct or not. Students should be assured that they will not continue to be penalised for an incorrect calculation of financial data.

SPECIFIC COMMENTS

For each question, an outline answer (or answers) is provided. In some cases the answer given is not the only answer that could have been awarded marks.

Question 1 – Greenfinger Nursery

1.1.1

Marks	0	1	Average
%	59	41	0.4

$5 000 x 30% x 1.5 years = $2 250

Accumulated Depreciation $ 2 250

The response to this question was disappointing as many students could not determine that the asset had been owned for 1.5 years. Students should note that basic depreciation and accumulated depreciation calculations may be required on both the June and November examinations.

1.1.2

Marks	0	1	2	Average
%	51	22	27	0.8

\$25 000 x 30% = \$7 500	
+ \$4 000 x 30% x 9/12 = \$900	\$7 500 = \$900 = \$8 400
	Depreciation expense \$8 400

This question proved to be quite challenging for many students. The first calculation was dependent on students recognising that \$25 000 worth of computers had been owned for the full 12 months of the reporting period. The second calculation related to the new computer equipment purchased during the period, which had been owned for nine months of the year. One mark was allocated for each of the two calculations; however, many students failed to achieve full marks as they were unable to distinguish between the two time periods, which was crucial to the calculation of the depreciation expense.

1.1.3

Marks	0	1	2	3	4	5	6	7	Average
%	31	9	7	6	7	10	13	18	3.2

COMPUTER SYSTEM

Date 2011	Cross reference	\$	Date 2011	Cross reference	\$
1 Jan	Balance	30 000	31 Dec	Disposal of Computer System	5 000
31 Dec	Sundry Creditor – Business Computing	4 000			

ACCUMULATED DEPRECIATION – COMPUTER SYSTEM

Date 2011	Cross reference	\$	Date 2011	Cross reference	\$
31 Dec	Disposal of Computer System	2 250	1 Jan	Balance	16 000
			31 Dec	Depreciation of Computer System	8 400

DISPOSAL OF COMPUTER SYSTEM

Date 2011	Cross reference	\$	Date 2011	Cross reference	\$
31 Dec	Computer System	5 000	31 Dec	Accum. Dep'n – Computer System	2 250
				Bank	2 000
				Loss on Disposal of Computer System	750

This question was worth a total of seven marks, spread over the three general ledger accounts. The Computer System account was allocated two marks. One mark was allocated to the Disposal entry on the credit side; this required students to identify the historical cost of the asset being sold (\$5000) and use the correct title. The second mark was in relation to the cost of the new computer purchased on credit from the supplier named as Business Computing. The less successful students used either incorrect or incomplete titles for both of these entries and some students omitted the entry on the debit side of this account.

Two entries were required in this ledger account and one mark was allocated to each entry. The dollar amounts for these two entries came directly from Questions 1.1.1 and 1.1.2. Some students did not gain marks on this question because they failed to carry down the amounts that they had calculated in the first two questions on the examination. It is important to note that such errors will not be penalised twice. Students are reminded to use correct titles in ledger accounts. The less successful responses simply wrote 'Depreciation' as the credit entry; however, this was not a correct entry.

The final three marks in Question 1.1.3 were allocated to the Disposal account. One mark was awarded for each of:

- both the Computer System entry and the Accumulated Depreciation entry. These two entries had already been made in the previous ledger accounts and should have simply been transferred down to the Disposal account.
- the Bank entry on the credit side
- correctly determining the Loss on Disposal entry.

In general, most students achieved a reasonable score on this question, but many marks were lost through incomplete entries, omitted entries or through the use of incorrect ledger account titles.

Some students did not recognise that the cash receipt of $2000 had to be recorded on the credit side of the Disposal account. Other students did not recognise the need to record the Loss on Disposal value of $750. This entry brought the credit side to the total of the debit side ($5000) and was a crucial entry in this account.

1.1.4

Marks	0	1	2	Average
%	44	22	34	0.9

Explanation: A profit will occur through over-depreciating the asset. This may occur if either the useful life or the residual value of the asset was underestimated. A loss will occur through under-depreciating the asset. This may occur if either the useful life or the residual value of the asset was overestimated.

Students had to provide a full explanation to receive full marks. The less successful responses stated that profits/losses result from under-/over-depreciation but were not clear as to which scenario existed for a profit or a loss. With this type of question, students are advised to deal with the profit scenario first, followed by the loss scenario.

1.1.5

Marks	0	1	2	3	Average
%	17	16	38	30	1.8

Cash Flow Statement (state effect) – There is no effect; it is not a cash flow
Balance Sheet (state effect) – Decrease assets (through an increase in Accumulated Depreciation); decrease Owners Equity (through lower net profit)

Most students responded quite well to this question. Students are advised to always look for the two effects on a Balance Sheet.

1.2.1

Marks	0	1	Average
%	43	57	0.6

Cash Receipts Journal

Date 2010	Details	Rec. No.	Bank	Disc. Exp.	Debtors Control	Cost of Sales	Sales	GST	Sundries
31 Dec	Prepaid Rent Revenue	67	5 500					500	5 000

Most students could complete the entry accurately, but some failed to use the correct title for Prepaid Rent Revenue. Other students recorded the $5500 in the Bank column but then did not complete the entries required in the GST and

Sundries columns. Students are advised to take great care when recording in journals as only complete entries will be awarded marks.

1.2.2

Marks	0	1	2	Average
%	41	52	7	0.7

General Journal

Date 2010	Particulars	General Ledger Debit $	General Ledger Credit $	Subsidiary Ledger Debit $	Subsidiary Ledger Credit $
31 Dec	Prepaid Rent Revenue	30 000			
	Rent Revenue		30 000		

One mark was allocated for each entry in the General Journal. Although many students recorded the correct double entry, some had difficulty determining the dollar amount of the entry and therefore only achieved one of the two marks available. As the Rent being charged was $5000 per month, students had to recognise that 6 months rent would be earned by 31 December 2010 – therefore 6 x $5000 = $30 000.

1.2.3

Marks	0	1	2	3	Average
%	58	27	11	4	0.6

RENT REVENUE

Date 2011	Cross reference	$	Date 2011	Cross reference	$
31 Dec	Profit and Loss Summary	60 000	31 Dec	Prepaid Rent Revenue	55 000
			31 Dec	Accrued Rent Revenue	5 000
		60 000			60 000

This question proved to be one of the more difficult questions on the examination and it involved three distinct steps worth one mark each:

- transferring the 11 months of Prepaid Rent Revenue that had been received (11 x $5000 = $55 000)
- recording the one month of rent that had not been received for the current reporting period ($5000)
- closing the revenue account off to the Profit and Loss Summary account.

It was obvious that students had difficulty dealing with a question that featured both prepaid revenue and accrued revenue within one account. A number of different dollar values were offered as possibilities. Students are reminded that no matter what entries were made on the credit side, the closing entry should still have been made on the debit side to close off this ledger account.

1.2.4

Marks	0	1	2	3	Average
%	28	29	21	22	1.4

Accounting principle: Reporting period principle
Explanation: Under accrual accounting, revenue earned should be matched against expenses incurred in order to determine an accurate profit. Balance day adjustments recognise that not all revenues are received and not all expenses are paid in the same reporting period as they are earned and incurred.

It was concerning that some students confused qualitative characteristics with accounting principles. Some explanations were very good but were supported by 'relevance', which is clearly not an accounting principle.

1.3.1

Marks	0	1	2	Average
%	32	35	33	1

Explanation: Profit is simply defined under accrual accounting as revenue earned, less expenses incurred, and is expressed as a dollar amount. Profitability, however, can be measured by a comparison of this profit figure against an investment base such as owner's investment or total assets, and can therefore be used to examine how well a business has used its investment in assets.

This question produced some incorrect responses, such as:

- profit is how much money the business made
- profit is the amount of money you have in the bank
- profit is how much you made this year and profitability is how much you expect to make.

Students are expected to know definitions of accounting terms and be able to explain them.

1.3.2

Marks	0	1	2	Average
%	68	18	14	0.5

Explanation: Return on Assets increases when the Net Profit ratio has increased at a greater proportion than the decrease in Asset turnover. This may have been achieved through better expense control or a better profit margin, which would lead to an increase in the Net Profit ratio.

This question produced some poor responses, with many students not recognising that the Return on Assets is affected by the relationship of two other financial indicators – Asset turnover and the Net Profit ratio.

1.3.3

Marks	0	1	2	Average
%	25	32	43	1.2

Possible benchmarks included:

- budgeted goals or budgeted objectives
- returns on alternative investments
- industry averages for similar businesses.

One mark was allocated for each benchmark identified; however, many students failed to correctly identify two distinct benchmarks. Some students stated that this year's results should be compared to previous periods. Trend analysis was stated as a constraint in the question and was therefore not acceptable. Some students used different descriptions or expressions. Responses such as inter-firm comparisons with similar businesses were accepted to mean the same as industry averages. However, stating industry averages as the first response and then comparisons with similar businesses as a second response is unacceptable. These two responses would be assessed as one benchmark only and would be awarded one mark.

1.4.1

Marks	0	1	2	3	4	Average
%	6	6	9	22	57	3.2

1.4.2

Marks	0	1	2	Average
%	47	22	31	0.9

Stock Card: English Red Rose

Date	Details	IN			OUT			BALANCE		
June 2011		Qty	Unit Cost $	Total Cost $	Qty	Unit Cost $	Total Cost $	Qty	Unit Cost $	Total Cost $
1 Dec	Balance							20 80	12 15	1 440
12 Dec	Inv. GN456				20 30	12 15	690	50	15	750
18 Dec	C/N 9	10	15	150				60	15	900
23 Dec	C/N X18				10	15	150	50	15	750
31 Dec	Memo 14				2	15	30	48	15	720
31 Dec	Memo 15				48	6	288	48	9	432

1.4.1
This question was handled very well by the majority of students, with many students scoring full marks. A common error made was the omission of document numbers in the Details column of the Stock Card. One mark was allocated to each of the four entries required.

1.4.2
After most students completed the Stock Card with great success, it was surprising that some students did not attempt this question. Students may have overlooked the stock write-down in the Stock Card and moved straight on to the adjusting entry in the General Journal. Students are reminded to read all questions carefully. Two marks were allocated to this write-down entry: one for accurately recording the entry in the 'Out' column, the other for correctly adjusting the balance of the Stock Card.

1.4.3

Marks	0	1	2	Average
%	15	21	63	1.5

General Journal

Date 2011	Particulars	General Ledger Debit $	General Ledger Credit $	Subsidiary Ledger Debit $	Subsidiary Ledger Credit $
31 Dec	Stock Write-down	288			
	Stock Control		288		

Despite not recording the stock write-down in the Stock Card, many students were still able to prepare the correct double entry in the General Journal. One mark was allocated for each entry in the General Journal, and the amount should have been the same as that shown in the 'Out' column of the Stock Card. Many students provided the correct amount, despite not completing the entry in the Stock Card.

1.4.4

Marks	0	1	2	Average
%	62	21	17	0.6

Method: Stock is valued at the lower of cost ($15 per unit) and net realisable value ($9 per unit). As the stock is expected to be sold for less than its cost price, its net realisable value should be used. This is done so that the loss on the stock is recognised as soon as it is probable.

Many responses to this question were disappointing. Some students offered FIFO as the method used, whereas others simply stated that the method used was a physical stocktake. Other students stated a definition of Net Realisable Value, which did not answer the question. The key was the comparison of cost price with Net Realisable Value, with the result being that the lower of the two values should be used.

1.5.1

Marks	0	1	Average
%	51	49	0.5

$20 + ($200/1000 units) + $1
= $21.20 per unit

Cost per unit $21.20

This question specified that all costs should be treated as product costs, therefore students needed to calculate the three costs involved in the purchase of the stock. All three items had to be included. The less successful responses excluded the Transport Costs of $0.20 per unit, despite the question stating that all costs were to be treated as product costs.

1.5.2

Marks	0	1	2	3	4	Average
%	30	9	20	13	27	2

Period costs – As all costs are expensed in the period in which they are incurred regardless of the number of roses sold, profit will be lower if treated as period costs.
Product costs – Costs are treated as part of the cost price of each unit and are only expensed once the goods are sold. Therefore, costs written off as expenses will be lower than when treated as period costs, and the end result would be a higher profit if treated as product costs.

This question required students to fully explain the effect on profit and how the difference occurs. The less successful responses provided textbook definitions of product and period costs and the reasons why some items should or should not be treated as product costs; however, this did not answer the question.

Question 2 – Total Towels

2.1.1

Marks	0	1	2	3	4	5	6	Average
%	14	7	8	10	11	23	27	3.8

CREDITORS CONTROL

Date 2011	Cross reference	$	Date 2011	Cross reference	$
31 Dec	Bank	60 000	1 Jan	Balance	6 000
	Stock Control	1 000	31 Dec	Stock Control	59 000
	Balance	4 000			
		65 000			65 000

STOCK CONTROL

Date 2011	Cross reference	$	Date 2011	Cross reference	$
1 Jan	Balance	23 000	31 Dec	Creditors Control	1000
31 Dec	Creditors Control	59 000		Stock Loss	950
	Bank	30 000		Drawings	1200
				Cost of Sales	79 850
				Balance	29 000
		112 000			112 000

Students handled this question quite well. With a total of 12 entries required to complete both accounts (one entry was duplicated – $59 000 for the credit purchases), one mark was awarded for every two correct entries made. It is therefore imperative that students complete every entry that they know. Marks can be awarded for partially completed answers, provided students make the entries on the appropriate sides of the accounts.

2.1.2

Marks	0	1	2	3	Average
%	23	9	17	51	2

DEBTORS CONTROL

Date 2011	Cross reference	$	Date 2011	Cross reference	$
1 Jan	Balance	8 500	31 Dec	Bad Debts	550
Dec 31	Credit Sales	55 000		Discount Expense	825
				Bank	57 925
				Balance	4200
		63 500			63 500

The three marks available for this question were awarded for:

- the debit entry for Credit Sales
- the credit entry for Bad Debts
- the credit entry for Discount Expense.

One mark was deducted if the opening and closing balances were not included in the account.

Most students handled this account reconstruction very well. Students were well prepared in relation to ledger account templates.

2.1.3

Marks	0	1	2	3	4	5	6	7	8	9	10	Average
%	23	4	5	5	6	7	10	12	14	9	5	4.7

Total Towels
Budgeted Statement of Cash Flows for Year Ended 31 December 2011

	$	$
Cash Flows from Operating Activities		
Cash Sales	135 000	
Receipts from Debtors	57 925	192 925
Payments to Creditors	(60 000)	
Advertising	(13 500)	
Wages	(38 000)	
Cash Purchases of stock	(30 000)	
Other Expenses	(19 000)	

Interest	(700)	(161 200)
Net cash provided by Operating Activities		31 725
Cash Flows from Investing Activities		
Disposal of Fixtures and Fittings	1 500	
Purchase of Fixtures and Fittings	(5 000)	
Net Cash used by Investing Activities		(3 500)
Cash Flows from Financing Activities		
Loan	8 000	
Loan Repayments	(6 000)	
Drawings	(33 800)	
Net Cash used by Financing Activities		(31 800)
Net Increase/(Decrease) in Cash		(3 575)
Cash at Bank (1/1/2011)		3 000
Cash at Bank (31/12/2011)		(575)

This question was handled reasonably well by most students. It is important that students are very familiar with the format of accounting reports. Ten marks were allocated to this question, with 13 items needing to be listed and classified correctly. One mark each was allocated for:

- Cash Sales, collections from debtors and payments to creditors
- the Advertising payment
- Wages, Cash purchases of stock and Other expenses
- the Interest payment
- the Disposal of Fixtures and Fittings
- the Purchase of Fixtures and Fittings
- the Loan (increase during year)
- the Loan repayments
- Drawings
- completing the final section of the report, including the opening and closing balances.

Common errors made by students included:

- the inclusion of alien entries, such as Credit Sales, Cost of Sales and Depreciation
- reporting accrued Wages at the end of the period, despite the fact they have not been paid
- reporting Interest as a financing activity
- not indicating outflows through the use of brackets or a sub-heading
- not including the summary statement for each of the three sections of the report (net cash used or net cash provided).

2.1.4

Marks	0	1	2	3	4	5	6	Average
%	27	9	11	16	14	13	9	2.6

Total Towels
Budgeted Profit & Loss Statement for Year Ended 31 December 2011

	$	$
Cash Sales	135 000	
Credit Sales	55 000	190 000
less Cost of Sales		79 850
Gross Profit		110 150
less Stock Loss		950
Adjusted Gross Profit		109 200
plus Profit on Disposal of Fixtures and Fittings		200
		109 400
less Other Expenses		
Wages	40 400	
Advertising	12 000	
Other Cash Expenses	19 000	
Depreciation	4 000	
Interest	700	
Bad Debts	550	
Discount Expense	825	77 475
Net Profit		31 925

This was the second full accounting report on this examination and most students struggled to gain full marks. For full marks, a total of 16 items had to be listed in this report. One mark each was awarded for:

- completing Sales, Cost of Goods sold and Gross Profit
- correctly reporting the Stock Loss and calculating the adjusted Gross profit
- adding the Profit on Disposal and determining the sub-total
- correctly reporting Wages as $40 400
- any three correct expenses
- listing the other three expenses.

Common errors with this question included:

- not adjusting the Wages expense for Accrued Wages
- including aliens such as ‘Cash at beginning’, which shows obvious confusion with the statement of cash flows
- the omission of Stock Loss, Profit on Disposal, Interest and Depreciation.

2.1.5

Marks	0	1	2	Average
%	39	25	36	1

Explanation: Budgeted amounts can be compared to actual amounts during a budget period and can be used to identify areas of concern. Corrective action can then be taken to improve performance. By setting targets, control may be achieved over expenses thus improving performance.

This question provoked a variety of responses, with some students gaining full marks. However, many students did not attempt this question.

2.1.6

Marks	0	1	2	Average
%	50	28	22	0.7

Explanation: Figures calculated in a budget are often dependent on the level of activity predicted for the budget period. Therefore, the estimate for sales will be used to help predict other budget items such as cost of sales, stock orders and bad debts.

This question required students to think about the role of budgets rather than simply prepare them. The more successful responses made the link between sales and other items and how they may be predicted. The less successful responses simply stated that sales were important to profit or that without a good level of sales a business will struggle. The key point that had to be made was that the level of sales is a key budget figure because of its link to so many other budget items.

2.2.1

Marks	0	1	2	Average
%	29	27	45	1.2

Explanation: Liquidity is the ability of a business to meets its short-term obligations as they fall due.

Many students responded very well to this question. Students' responses needed to be precise in order to gain full marks. The less successful students simply stated the ability to meet debts. Students are reminded to always check the number of marks available and ensure that their responses are detailed enough to be considered for full marks.

2.2.2

Marks	0	1	2	Average
%	56	18	26	0.7

Explanation: Stock and pre-payments are both included in the Working Capital ratio but are excluded from the Quick Asset calculation. An increase in stock levels may lead to a higher Working Capital ratio without affecting the Quick Assets ratio.

This question proved to be problematic for many students. The key to the question was recognising that the difference between the two indicators was probably a change in stock on hand; the less successful students failed to recognise this point.

2.2.3

Marks	0	1	2	Average
%	40	35	24	0.9

The more successful responses offered ideas such as:

- reduce the average level of stock by discontinuing slow-moving lines
- introduce just-in-time ordering to ensure that excess stock is not carried
- improve the stock mix by concentrating on fast-moving lines.

The less successful responses included:

- have a sale
- offer special promotions
- buy in bulk.

Students should always ensure that they read all the information given in the question booklet. Answers such as 'have a sale' and 'offer special promotions' breached the two constraints stated in the question – 'excluding advertising' and 'without affecting the profit margin'.

2.2.4

Marks	0	1	2	Average
%	38	25	37	1

Explanation: The creditors turnover trend is unfavourable as cash is leaving the business earlier, which could lead to future liquidity problems. This may occur as there is no discount being gained for early payment and the debtors turnover is much longer than the creditors turnover. Therefore, the business may run out of cash and may struggle to meet their debts in the future.

The less successful responses included statements that the discount was not good enough, despite the fact that there was no discount. Other less successful responses stated that credit terms were being breached, which was clearly not the case. Comments such as creditors may cut off supply were inaccurate. It was obvious that some students had not read all of the information provided in the question booklet.

2.2.5

Marks	0	1	2	Average
%	29	47	24	1

Strategies included:

- improved invoicing procedures – for example, weekly rather than monthly
- improved follow-up procedures when accounts become overdue
- tightening up on credit approval procedures
- refusing further credit to slow paying debtors.

The less successful responses provided vague answers or repeated strategies. For example, responses such as 'call them', 'write to them', 'she introduced discounts' and 'she changed the credit terms' were not awarded full marks. Such responses directly contradicted the fact that the discounts and credit terms had not changed since 2007.

2.3.1

Marks	0	1	Average
%	60	40	0.4

Cash Receipts Journal

Date 2011	Details	Rec. No.	Bank	Disc. Exp.	Debtors Control	Cost of Sales	Sales	GST	Rent Rev.	Sundries
20 Jan	Prepaid Sales Revenue	346	400							400

This was the second receipt of prepaid revenue to be recorded in the Receipts Journal in this examination. However, the responses to this question were not as strong as in Question 1.2.1. For one mark, the entire line in the journal had to be correct. The less successful responses usually lost this mark through an incorrect title such as 'Deposit', while others failed to show the $400 in the Sundries column.

2.3.2

Marks	0	1	2	3	4	5	Average
%	34	11	14	12	15	15	2.1

General Journal

Date 2012	Particulars	General Ledger		Subsidiary Ledger	
		Debit $	Credit $	Debit $	Credit $
20 Jan	Prepaid Sales Revenue	400			
	Sales		400		
	Debtors Control	5 100			
	Motel Vegas			5 100	
	Sales		4 600		
	GST Clearing		500		

A total of five marks were available for this question. One mark each was allocated to:

- Prepaid Sales Revenue
- Sales
- Debtors Control and the entry to Motel Vegas in the subsidiary ledger
- Sales
- GST Clearing.

As an alternative, the two entries to the Sales account could be joined together to make one entry of $5000.