

## Accounting GA 3: Written examination 2

### GENERAL COMMENTS

The November examination was notable in that it complemented the mid-year examination by covering topics not examined in June. For example, the June paper emphasised profitability whereas the November paper focused on liquidity. The November paper recognised all the extensions to recording and reporting, such as discount, sales allowances, departmental reports. Reporting was a major base for questioning in this examination.

Some students had problems with time management, although this does account for the large percentage of students who left the very last question (3.5.5) unanswered and/or not attempted. Success in Accounting revolves around revision and reflection and students should find time to adequately approach these two tasks in preparation for the examination.

### Change to the study

The revised study 2003–2006 will take effect in 2003 and this will mean that aspects of reports from both examination periods in recent years will be relevant to June 2003 given the reallocation of content in Units 3 and 4. For example, in the current course accounting ratios and the use of that information has been examined in both examinations whereas in 2003 this topic will only be examined in November. Some topics, such as ‘the bank reconciliation process’ in June and ‘departmental accounting’ and ‘functional classification’ in November will disappear. Other items such as GST will be introduced to the November examination.

### SPECIFIC COMMENTS

Question	Marks	%	Response
<b>Question 1</b>	<b>1.1</b>		<b>Posting to the journals</b>
	0/2	42	This was a demanding question in terms of what students were required to supply. Students had to post two documents to journals, one a general journal. They also had to calculate cost of sales, use the correct dates and document numbers. In particular students had difficulty determining the cost of sales of \$800, at 50% of the selling price. Answers of \$600 and \$900 were incorrect.  In the general journal, students confused the sales allowance with a sales return and attempted an entry recognising a selling and cost price with goods being returned to the business. In fact no goods were returned to the business and the correct entry was a debit to sales allowance and a credit to debtor.
	1/2	36	
	2/2	22	
	(Average mark 0.79)		
	<b>1.2</b>		<b>Debtors Control account</b>
	0/3	29	Students were required to complete and balance a Debtors Control account. Consequential errors from 1.1 were allowed. The most frequent error was the double counting of discount with students showing \$1000 in the bank entry and \$50 for discount instead of \$950 and \$50 respectively. Failure to recognise the \$600 for bad debts was another frequent error.
	1/3	34	
	2/3	22	
	3/3	15	
(Average mark 1.23)			
	<b>1.3</b>		<b>Control accounts</b>
	0/2	24	Having to state benefits of maintaining a debtor subsidiary ledger and a control account posed little difficulty for most students. This has been a frequent question in recent years and students appeared well prepared for its inclusion in this examination.
	1/2	34	
	2/2	42	
	(Average mark 1.17)		
	<b>1.4</b>		<b>Accounting elements</b>
	0/2	36	The defining of two elements was required to gain both marks. Students had to show the cost or sacrifice made by the business and why this was made. Acceptable reasons why the expense was incurred included; the early receipt of cash; the generating of revenue; or, encouraging debtors to pay more quickly. Most responses identified that there was a cost involved but generally did not explain why the business undertook that cost.
	1/2	44	
	2/2	20	
	(Average mark 0.83)		
	<b>1.5</b>		<b>Offsetting entries</b>
	0/2	31	This was a relatively straightforward question and one that has appeared in recent years. Not using ‘debtor control’ and ‘creditor control’ in titles caused a loss of one mark and was the most frequent error. Some responses reversed the debit and credit entries. Most students used the word ‘contra’ or ‘offset’ in their narration and gained the mark.
	1/2	29	
	2/2	39	
	(Average mark 1.07)		

	<p><b>1.6.1</b></p> <p>0/2            36</p> <p>1/2            34</p> <p>2/2            30</p> <p>(Average mark 0.93)</p>	<p><b>Calculation of depreciation</b></p> <p>This calculation of accumulated depreciation required the use of the ‘diminishing’ balance method. <b>In the revised course this will be known as the ‘reducing balance method’.</b> This calculation extended over three periods and proved a demanding task. The first period only covered nine months from October 1 2000 to June 30 2001. A further error was the unnecessary deduction of disposal value from the original cost of the asset.</p>
	<p><b>1.6.2</b></p> <p>0/3            12</p> <p>1/3            31</p> <p>2/3            30</p> <p>3/3            27</p> <p>(Average mark 1.71)</p>	<p><b>Disposal of asset</b></p> <p>Most students handled this question quite well. The calculation of accumulated depreciation from the previous question was treated as a consequential error whilst most students recognised the original cost of \$32 000. The ‘balance’ posted to the Profit and Loss summary account made up the third mark for this question.</p>
	<p><b>1.7</b></p> <p>0/2            34</p> <p>1/2            35</p> <p>2/2            31</p> <p>(Average mark 0.96)</p>	<p><b>Accounting principles and concepts</b></p> <p><b>In the revised course ‘concepts’ will be known as ‘qualitative characteristics’.</b> In this question either a concept or a principle was allowed for the correct response. A clear distinction between qualitative characteristics and principles will be required in the revised course.</p> <p>Generally, students responded very well to this question. Most students referred to the principle of conservatism and others responded with the concept of relevance. Both responses earned the first of the 2 marks available. Students had more difficulty with the justification. This was probably due to the fact that the asset decreased in value. More successful answers pointed out that the revalued figures would provide users with information for decision-making.</p>
<b>Question 2</b>	<p><b>2.1</b></p> <p>0/2            30</p> <p>1/2            19</p> <p>2/2            51</p> <p>(Average mark 1.2)</p>	<p><b>Reconstructing the debtors account</b></p> <p>A traditional question and generally well answered. Incorrect responses left out bad debts and reversed the bank and credit sales entries.</p>
	<p><b>2.2</b></p> <p>0/3            35</p> <p>1/3            9</p> <p>2/3            28</p> <p>3/3            28</p> <p>(Average mark 1.49)</p>	<p><b>Reconstructing creditors and stock accounts</b></p> <p>Less successful responses showed difficulty with balances, and in distinguishing between cost of sales and payments to creditors. Drawings of stock was also omitted in some responses.</p>
	<p><b>2.3</b></p> <p>0/2            65</p> <p>1/2            28</p> <p>2/2            8</p> <p>Average mark 0.42)</p>	<p><b>Control of cash</b></p> <p>There were two parts to this question. The first was the deduction of accrued expenses and adding prepaid expenses to operating expenses to find the cash paid for expenses. This initial task is hard and it was pleasing to see how well students handled it. The second part of the activity was the adding back of depreciation and bad debts. These items are both ‘non-cash expenses’ and do not involve an outflow of cash from the business. Few responses obtained full marks in this question.</p>

	<p><b>2.4</b></p> <p>0/2 38</p> <p>1/2 23</p> <p>2/2 39</p> <p>(Average mark 1)</p>	<p><b>Statement of cash flows (extract)</b></p> <p>Data had to be drawn from 2.1, 2.2 and 2.3 in order to complete this partial report. Consequential errors were frequent and their recognition enabled students to gain marks where they otherwise may not. Students were rewarded for 'having a go' by stating the fundamentals rather than simply giving up. Marks were lost for incorrect titles such as credit sales instead of receipts from debtors. Items such as capital accrued and prepaid expenses were considered aliens and incurred the loss of a mark.</p>
	<p><b>2.5</b></p> <p>0/2 35</p> <p>1/2 30</p> <p>2/2 35</p> <p>(Average mark 0.99)</p>	<p><b>Cash flows</b></p> <p>Students had to identify capital as a cash inflow from financing and then justify that decision. The first part to the question was straightforward, and was successfully answered by most students. Those who erred saw capital as an investing item, perhaps picking up on the phrase 'that capital is the owner's <i>investment</i> in the business'. Students who correctly identified capital as a financing item frequently chose to justify their selection by describing it as an investing item but this was incorrect.</p>
	<p><b>2.6.1</b></p> <p>0/4 18</p> <p>1/4 8</p> <p>2/4 5</p> <p>3/4 10</p> <p>4/4 59</p> <p>(Average mark 2.84)</p>	<p><b>Profit and Loss statement</b></p> <p><b>In the revised course, Profit and Loss statements are to be titled Statements of Financial Performance and Balance sheets will be called Statements of Financial Position.</b></p> <p>There were three questions in the examination requiring a Profit and Loss statement type response. This question required a departmental Profit and Loss statement and these statements are not part of the revised course.</p> <p>Dealing with percentage calculations posed a problem for many students but overall, students handled this question fairly well.</p>
	<p><b>2.6.2</b></p> <p>0/2 42</p> <p>1/2 39</p> <p>2/2 19</p> <p>(Average mark 0.77)</p>	<p><b>Expense allocation to departments</b></p> <p>Students responding in the positive had a better chance of gaining full marks. To gain the second mark students had to say why the effect was adverse and more successful responses pointed out that bad decisions may be made if the contribution margin is overstated and the effectiveness of advertising not considered.</p>
	<p><b>2.6.3</b></p> <p>0/2 59</p> <p>1/2 29</p> <p>2/2 12</p> <p>(Average mark 0.52)</p>	<p><b>Loss on sale and under depreciation</b></p> <p>In previous examinations students have only had to identify that a loss on sale was the result of under-depreciation. Responses had to explain why this was the case. More successful responses pointed to depreciation, and related aspects such as 'residual value', 'life' and 'nature of use' being only estimates.</p>
<b>Question 3</b>	<p><b>3.1</b></p> <p>0/2 4</p> <p>1/2 10</p> <p>2/2 86</p> <p>(Average mark 1.82)</p>	<p><b>Variances in the Profit and loss statement</b></p> <p>A fairly simple task requiring students to mark unfavourable variances and it was handled very well.</p>
	<p><b>3.2</b></p> <p>0/2 20</p> <p>1/2 34</p> <p>2/2 46</p> <p>(Average mark 1.25)</p>	<p><b>Reasons for exceeding budget expectations yet owner unhappy</b></p> <p>The most obvious reason for the business exceeding budget expectations was the unexpected profit on the sale of the motor vehicle. This was readily seized on by most students, who then went on to point out that this type of profit is not recurring and would have overstated the business performance.</p> <p>The alternate response as to why the owner may be unhappy is due to the cost of sales increasing at a faster rate than sales. More successful responses also pointed out the dollar amounts involved.</p>
	<p><b>3.3.1</b></p> <p>0/4 12</p> <p>1/4 12</p> <p>2/4 27</p> <p>3/4 30</p> <p>4/4 19</p> <p>(Average mark 2.32)</p>	<p><b>Budgeted Profit and loss statement</b></p> <p>Responses had to calculate percentage amounts. The amounts for cost of sales and gross profit were often reversed. Items were included in cost of goods sold that belonged in the general expenses. Apart from that the general expenses were well handled. There was some difficulty either in classifying rent revenue or determining the amount. Many responses sought to treat rent revenue as an expense or calculated the amount at \$3000 or \$1000, not the correct amount of \$2000.</p>

<p><b>3.3.2</b></p> <p>0/2            25</p> <p>1/2            44</p> <p>2/2            31</p> <p>(Average mark 1.05)</p>	<p><b>Using a budget</b></p> <p>This question, similar to many in the past, was a good reward to diligent students who use past papers to prepare for examinations. The only problem for students was to make two points, extend the first point or provide an example or illustration, in order to gain the 2 marks.</p>
<p><b>3.4.1</b></p> <p>0/2            48</p> <p>1/2            29</p> <p>2/2            23</p> <p>(Average mark 0.74)</p>	<p><b>Working capital</b></p> <p>A definition of working capital followed by a description of the change in current assets and current liabilities and the dollar amounts involved would have served as the perfect response. Most responses only provided parts of that scenario.</p>
<p><b>3.4.2</b></p> <p>0/1            75</p> <p>1/1            25</p> <p>(Average mark 0.25)</p>	<p><b>Limitations in the use of the working capital ratio as an indicator of liquidity</b></p> <p>This question drew varied but many excellent answers. The expected answers related to the uncertainties in collecting outstanding debts or converting stock into cash at short notice. However, other correct answers considered the unreliability of using percentage figures alone, the ability of the business to borrow quickly against non-current assets and the access of the owner to cash capital.</p>
<p><b>3.5.1</b></p> <p>0/2            44</p> <p>1/2            30</p> <p>2/2            26</p> <p>(Average mark 0.82)</p>	<p><b>Stock write-down</b></p> <p>This question required a general journal response with stock write-down debited and stock control credited. The amount involved was \$1000. Difficulty in determining the amount of the stock write-down was a significant error. Reversing the debit and credit entries and incorrect titles were other errors. The term ‘loss on realisation of stock’ instead of stock write-down was not accepted.</p>
<p><b>3.5.2</b></p> <p>0/2            37</p> <p>1/2            34</p> <p>2/2            29</p> <p>(Average mark 0.92)</p>	<p><b>Calculate stock on hand</b></p> <p>To gain full marks all three stock amounts had to be determined correctly and the calculation of the amount for item B of \$600 was the more common error. Arithmetic errors (thought not penalised) were common.</p>
<p><b>3.5.3</b></p> <p>0/2            59</p> <p>1/2            17</p> <p>2/2            24</p> <p>(Average mark 0.64)</p>	<p><b>Lower of cost and net realisable value rule</b></p> <p>When asked to justify not applying the rule many responses failed to provide an adequate answer. The simple response was that cost was less than net realisable value. This gained 1 mark and the second was earned by stating that the cost was \$25 and the net realisable value was \$50.</p>
<p><b>3.5.4</b></p> <p>0/2            34</p> <p>1/2            39</p> <p>2/2            27</p> <p>(Average mark 0.92)</p>	<p><b>Calculation of the value of stock</b></p> <p>Students were basically required to produce a stock card for item A without the structure. Very few responses reconstructed the structure, instead used rough calculations. Despite that, most students gained at least 1 of the 2 marks, usually by determining that the 200 units at \$30 were still on hand. Some students erred by using identified cost. Lack of time may also have been an issue for some students.</p>
<p><b>3.5.5</b></p> <p>0/2            59</p> <p>1/2            21</p> <p>2/2            19</p> <p>(Average mark 0.59)</p>	<p><b>Statement of Gross profit</b></p> <p>Statistically this would appear to be the most difficult question on the paper. In fact that was not the case. Many students simply did not attempt the question perhaps believing they had completed the paper with 3.5.4. The instruction to ‘TURN OVER’ was quite clear but seemed to go unnoticed.</p> <p>The first mark was awarded for determining that cost of goods sold was \$11 300. The second mark was for assessing the stock loss to be \$208. The main error resulted from students substituting the stock loss of \$208 with drawings of \$52.</p>

## Answers

### Question 1 – The Happy Camper

#### 1.1 Extracts from Journals of The Happy Camper

CREDIT SALES JOURNAL				SJ1
Date 2002	Particulars	Invoice No.	Cost of Sales \$	Sales \$
9 Nov	Outdoors Australia	27	2 000	3 000
12 Nov	Mountain Range Gear	28	800	1 200
	Total		2 800	4 200

GENERAL JOURNAL			GJ1
Date 2002	Accounts	Debit \$	Credit \$
17 Nov	Sales Returns and Allowance	100	
	Debtor – Mountain Range Gear		100

2 marks

**1.2 General Ledger (extract only) of The Happy Camper  
Complete and Balance**

DEBTORS CONTROL					
Date 2002	Particulars	Amount \$	Date 2002	Particulars	Amount \$
1 Nov	Balance	5 500	30 Nov	Sales Ret. and Allow.	100
30 Nov	Credit Sales	4 200		Bank	950
				Discount Exp.	50
				Bad Debts	600
				Balance c/d	8 000

3 marks

**1.3 Identify two benefits of maintaining a Debtors subsidiary Ledger and the Control Account**

<p><b>Benefit 1</b> <i>Keeps itemised records of individual debtors</i> <i>Removes individual detail from General Ledger</i> <i>Serves as a cross checking mechanism</i></p> <p><b>Benefit 2</b> <i>Separation of duties</i> <i>close monitoring of individual debtors</i> <i>Ease of reporting – gives a figure for the Balance Sheet</i></p>
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2 marks

**1.4 Explain why Discount Allowed is treated as an expense**

<p><b>Explanation</b> <i>A cost incurred in obtaining early receipt of cash from a credit sale transaction. Seen as a reduction in revenue earned and a cost associated in generating that revenue.</i></p>
<p><b>OR</b> <i>Because it is an amount that the business sacrifices in order to make debtors pay early</i></p>

2 marks

**Narration Required**

**1.5**

**GENERAL JOURNAL**

Date 2003	Accounts	Debit \$	Credit \$
30 June	<i>Creditor – Mt Buller Supplies</i>	500	
	<i>Debtor – Mt Buller Supplies</i>		500
	<i>A contra entry for business transactions</i>		

2 marks

**1.6.1**

<b>Calculation</b>		
<i>Oct 1 2000 – June 30 2001</i>	<i>July 1 2001 – June 30 2002</i>	<i>July 1 2002 – June 30 2003</i>
=25% * \$32 000	= 25% * \$26 000	=25% * \$19 500
= \$8 000 * 9/12	=\$6 500	=\$4 875
=\$6 000		
<b>OR \$4687.50 , \$6250 OR \$2,000 = 1</b>	Total Accumulated Depreciation	\$ 17 375

2 marks

**1.6.2 General Ledger (extract only) of The Happy Camper**

**Complete the account**

**DISPOSAL OF TRUCK**

Date 2003	Particulars	Amount \$	Date 2003	Particulars	Amount \$
30 June	<i>Truck</i>	32 000	30 June	<i>Acc. Dep. Trunk</i>	17 375 c
				<i>Creditors/Bank/Truck</i>	12 000
				<i>Loss on Sale</i>	2 625
		32 000			32 000

**DISPOSAL OF TRUCK/CARRYING COST**

Date 2003	Particulars	Amount \$	Date 2003	Particulars	Amount \$
30 June	<i>Truck</i>	32 000	30 June	<i>Acc. Dep. Trunk</i>	17 375 c
				<i>P/L Summary</i>	14 625

**PROCEEDS FORM SALE OF ASSSET**

Date 2003	Particulars	Amount \$	Date 2003	Particulars	Amount \$
30 June	<i>P/L Summary</i>	12 000	30 June	<i>Truck/Creditors</i>	12 000

3 marks

**1.7 State one accounting principle/concept which would support the business revaluing the land. Justify your answer.**

<b>Accounting Principle or Concept</b> <i>Conservatism/Relevance</i>
<b>Justification</b> <i>Anticipating a loss</i>
<i>Must state WHY – more relevant for decision making OR more relevant to the user or relate to ratios</i>

2 marks

**Total 18 marks**

## Question 2 – Soap ‘n’ Suds

2.1

Calculation		Debtors		
<i>Bal</i>	35 000	<i>Bad Debts</i>	2 000	
<i>Cr. Sales</i>	240 000	<i>Bank</i>	239 000	
		<i>Bal</i>	34 000	
			Cash received from debtors	\$ 239 000

2 marks

2.2

Calculation		Creditors		Inventory		
<i>Bank</i>	501 000	<i>Bal</i>	45 000	<i>Bal</i>	80 000	
<i>Bal</i>	32 000	<i>Inv.</i>	488 000	<i>Cred</i>	488 000	
				<i>Cogs</i>	500 000	
				<i>Drawings</i>	3 000	
				<i>Bal</i>	65 000	
					Cash paid to creditors	\$ 501 000

3 marks

2.3

Calculation		
	<i>Operating Ex.</i> 190 000	
	<i>less Bad Debts</i> 2 000	
	<i>less Depreciation</i> 4 000	
	<i>less Acc. Expenses</i> 1 000	
	<i>plus Prepaid Exp.</i> 3 500	
	Cash paid for operating expenses	\$ 186 500

2 marks

2.4

### Soap n Suds Cash Flow from Operations for Year Ended 31 December 2001

Inflows		
<i>Receipts from Cash Sales</i>	560 000	
<i>Receipts from Debtors</i>	239 000 c	799 000
Outflows		
<i>Payments to Creditors</i>	501 000 c	
<i>Payments to expenses</i>	186 500 c	687 500
<b>Net Cash Flow from Operating Activities</b>		<b>111 500</b>

2 marks

2.5 State how the capital contribution would be treated in the Cash Flow Statement. Justify your answer.

**Classification** *Cash inflow from Financing*

**Justification** *Capital contributions to the business by the owner is one form of (equity) finance – to help finance the operations of the business OR changes in financial structure OR how the business is financed OR change in equity.*

2 marks

**2.6.1 Soap 'n' Suds Profit and Loss Statement for Year Ended 31 December 2002**

	<b>Dishwasher Sales</b>	<b>Service Centre</b>	<b>Total</b>
Sales/Service Fees	900 000	100 000	1 000 000
Less Cost of Sales/Materials	560 000	27 000	587 000
<b>Gross Profit/Margin on Service</b>	<b>340 000</b>	<b>73 000</b>	<b>413 000</b>
<i>Less DIRECT EXPENSES</i>			
<i>Wages</i>	<i>108 000</i>	<i>36 000</i>	<i>144 000</i>
<i>Occupancy</i>	<i>24 000</i>	<i>3 000</i>	<i>27 000</i>
<i>Vehicle Expenses</i>	<i>4 200</i>	<i>9 800</i>	<i>14 000</i>
<i>Loss on Sale of Vehicle</i>	<i>6 000</i>		<i>6 000</i>
			<i>191 000</i>
<b>Contribution Margin</b>			<i>222 000</i>
<i>Less INDIRECT EXPENSES</i>			
<i>Wages</i>			<i>36 000</i>
<i>Advertising</i>			<i>15 000</i>
<i>Occupancy</i>			<i>3 000</i>
<i>Office Administration</i>			<i>16 000</i>
			<i>70 000</i>
<b>Net Profit</b>			<i>152 000</i>

2 + 2 = 4 marks

**2.6.2 Explain how not allocating the advertising expense may affect the usefulness of the Contribution Margin as an indicator of departmental performance.**

**Explanation** *The non inclusion of advertising as a direct expense could lead to a distorted reported contribution margin for each department. This may lead to inequity when judging performance (i.e. will result in an overstated margin).*

2 marks

**2.6.3 Explain the comment that the Loss on Sale of Vehicle is the result of under depreciation**

**Explanation** *As depreciation is the allocation of the cost of an asset over its useful life, this statement is correct in that the allocation – calculated at the time of purchase – proved to be incorrect. This will only be proved/identified at the time of the disposal of the asset.*

**OR** *the asset was sold for less than its book value/carrying cost*

**OR** *due to the fact that depreciation is based on estimated*

**OR** *scrap value was overestimated OR overestimate the life of the asset*

2 marks

**Total 19 marks**



### Question 3 – Office Essentials

#### 3.1 Office Essentials Profit and Loss Statement for Year Ended 30 June 2002

	Budget	Actual	Variance	F/U*
Sales	450 000	470 000	20 000	
Cost of Sales	<u>250 000</u>	<u>290 000</u>	40 000	U
Gross Profit	200 000	180 000	20 000	
Stock Loss	<u>4 500</u>	<u>1 500</u>	3 000	
<b>Adjusted Gross Profit</b>	<b>195 500</b>	<b>178 500</b>	<b>17 000</b>	
<b>less Expenses</b>				
Wages	55 000	49 000	6 000	
Advertising	10 000	10 500	500	U
Rent	20 000	20 000	–	
Office	8 000	7 000	1 000	
Depreciation – Vehicle	<u>10 000</u>	<u>7 000</u>	3 000	
<b>Total Expenses</b>	<b>103 000</b>	<b>93 500</b>	<b>9 500</b>	
Operating Profit	<b>92 500</b>	<b>85 000</b>	<b>7 500</b>	
Other Revenue				
Profit on Sale of Vehicle	–	<u>9 000</u>	9 000	
Net Profit	92 500	94 000	1 500	

\* F = Favourable U = Unfavourable

2 marks

3.2 The owner is pleased that the business has exceeded budget expectations. **Explain** one reason from the **information provided** why the owner should **not** be happy.

**Explanation** Operating profits were below because Gross profit was down **because** despite the increase in sales (\$20 000), COGS increased a lot more (\$40 000) **OR** The net profit was achieved due to the profit on sale of asset which was not expected as is not recurrent As they had not budgeted for the sale of an asset

2 marks

#### 3.3.1 Office Essentials Budgeted Profit and Loss Statement for Year Ended 30 June 2003

Sales		510 000
Less Cost of Sales		306 000
<b>Gross Profit</b>		<b>204 000</b>
<b>Less Expenses</b>		
Wages	51 000	
Advertising	15 300	
Depreciation – Vehicle	11 000	
Rent	20 000	
Office Expense	7 000	104 300
<b>Operating Profit</b>		<b>99 700</b>
<b>Other Revenue</b>		
Office Rent Revenue		2 000
<b>Net Profit</b>		<b>101 700</b>

4 marks

**3.3.2 Explain how this budget should be used by the business during the year.**

**Explanation** As a basis for comparison with actual results to identify trends and allow remedial action where appropriate. To check/assess against targets set.

2 marks

**3.4.1 Explain why the decline in WCR may indicate a deterioration in the liquidity of the business.**

**Explanation** The WCR indicates the value of short-term assets available to meet short-term liabilities. Over the course of the year in question: the availability of short-term (liquid) assets ready to meet short-term financial obligations has declined.

2 marks

**3.4.2 State one limitation of using the working capital ratio as an indicator of business liquidity.**

**Limitation** May not easily be able to convert current assets (debtors and stock) into cash at short notice in order to meet short-term commitments/obligations **OR** difficulty of only relying on ratios **OR** ratios based on historical data **OR** timing issue – re cash cycle or debtors and creditors terms or buy on credit and sell for cash

1 mark

**3.5.1 GENERAL JOURNAL**

Date 2002	Accounts	Debit \$	Credit \$
31 July	Stock write down	1 000	
	Stock		1 000

2 marks

**3.5.2**

<b>Calculation</b>		
	Item A 400 @ \$25 = \$10 000	
<b>Consequential for 3.5.1</b>	Item B 100 @ \$6 = \$600	
<b>1600 – 3.5.1 response for Item B</b>	Item C 2000 @ \$8 = \$16 000	
	Value of stock	\$ 26 600

2 marks

**3.5.3 Explain your valuation of Stock Item A**

**Explanation** Stock is valued at the Lower of Cost and Net Realisable Value, applying the principle of Conservatism. In the case of stock item A, cost is clearly less than selling (net realisable) value.

2 marks

**3.5.4**

<b>Calculation</b>		
	Open Bal 400 @ \$25 = \$10 000	
OR 198 @ 30	7/8 Purch. 100 @ \$26 = \$2 600	
42 @ 26 = 1 mark	19/8 Sold 400 @ \$25	
	50 @ \$26 = \$11 300	
	23/8 Purch 200 @ \$30 = \$6 000	
	27/8 Draw 2 @ \$26 = \$52	
When in doubt – 1 mark for each error the student makes	31/8 Loss 8 @ \$26 = \$208	
	31/8 Bal 40 @ \$26	
	200 @ \$30 = \$7 040	
	Value of stock	\$ 7 040

2 marks

**3.5.5****Statement of Gross Profit (adjusted) on Stock Item A for August 2002**

	\$	\$
<i>Sales</i>		<i>22 500</i>
<i>Less Cost of Goods Sold</i>		<i>11 300</i>
<i>Gross Profit</i>		<i>11 200</i>
<i>Less Stock Loss</i>		<i>208</i>
<i>Adjusted Gross Profit</i>		<i>10 992</i>

2 marks

**Total 23 marks**