

2021 ASSESSMENT REPORT

ACC315116 - ACCOUNTING

Section A

Sample Answers

Question 1

a) (4 x 3=12 marks)

- i. The 'nature' of an account refers to the side where transactions that increase the amount in that account are recorded. A ledger account has a credit nature if an increase in the value of the item being recorded in the account is recorded as a credit entry. For example, increases in Liabilities such as accounts payable or a bank loan; increases in Owner's Equity through a capital injection and/or retained profits; and Revenues such as sales or commission earned.
- ii. A source document is the original physical evidence that a transaction has occurred. It is from this document that the transaction is first recorded in the accounting system of a business, through journal entries. Examples of source documents include: tax invoice, receipts, cheque butts, cash register summaries, purchase orders, payment advice, EFT documents etc.
- iii. The trial balance is a list of all account balances taken at a particular point in time, such as on balance day. The debit and credit balances are totalled and, if bookkeeping has been accurate, the debits should equal the credits – hence a trial 'balance'. The purpose of the trial balance is to check the accuracy of posting transactions to the ledger accounts. However, it must be remembered that even if a trial balance balances there may still be posting errors. The trial balance is also used to prepare financial reports, primarily the Income Statement and Balance Sheet.
- iv. The main reason for the difference is due to timing differences between the recording of cash transactions in the business records and their appearance in the bank's records. Examples include cheques which have been written and recorded in the cash at bank account in the business records but have not yet been presented into the banking system. Also, some cash transactions are recorded in the bank records which are unknown to the business until the bank statement is received - for example the charging of bank fees and direct deposits.

b) (1x3=3 marks)

- i. The cash flow statement is a financial report which records the cash received (inflows) from and the cash paid (outflows) to external parties over the accounting period. It identifies cash flows from operating, investing and financing, and the change in cash position of the business over the period. Its purpose is to review the sources and uses of cash to see if the business' cash position is healthy and sustainable over the longer term.

- ii. The use of ratios provides figures that are comparable between accounting entities and over time. Raw data does not allow such comparability as it does not account for scale; that is, the size of the accounting entity. For example, the net profit ratio is net profit expressed as a proportion of net sales, allowing comparison of performance of accounting entities regardless of difference in the level of net sales. Also, that same measure allows profit performance to be compared over time despite the level of net sales increasing or decreasing.
- c) (2x4=8 marks)
- i. Financial information relates to that information derived directly or indirectly from the accounting reports. For example: the level of expenses, level of net profit, trends in profit, asset and liability values etc.
Non-financial information relates to information derived from outside the accounting reports. For example: reports on current economic conditions, interest rates, market size, market share, industry averages etc.
 - ii. When a business finances through further equity it is sourcing funds from either obtaining further capital contributions from existing owners, or from the introduction of assets contributed by new owners/partners/shareholders.
When financing through borrowing funds are obtained from financial institutions such as banks or finance companies.
Two sources of borrowing: from banks (credit cards, loans, overdrafts), finance companies, from family members or friends etc.
 - iii. Accrued revenues are those revenues to which the accounting entity has a legal right (have been earned by the business) but which have not yet been received or recorded on balance day. They are current assets. For example, commissions earned but not yet paid.
Unearned revenues are those received and recorded by the accounting entity on balance day but which the business has not yet earned. They are current liabilities. For example, deposits made in advance of sales, commissions paid but not yet earned.
 - iv. Capital expenditure is that which results in the acquisition and installation of a non-current asset whose life extends beyond the current accounting period. It is recorded in the balance sheet as an asset. Capital expenditure includes any significant cost that increases the value of a non-current asset; for example, the cost price of a non-current asset such as a machine, its delivery and installation costs are all capital expenditures.
Revenue expenditure is any cost relating to non-current assets that is incurred to maintain, but not extend, the useful life of the asset. It is expenditure consumed in the current accounting period and is recorded as an expense in the income statement. Examples include: maintenance and repairs on a machine, fuel and servicing costs for a vehicle.

Question 2

a) (1x6=6 marks)

- i. Balance day adjustments are general journal entries, made on balance day, in order to compare (match) the revenues and expenses accurately so that the profit (loss) can be determined for a given accounting period. They adjust account balances to ensure that revenue and expense transactions are recorded in the period to which they relate (matching principle).

They are entries made on balance day to match revenues and expenses accurately so that profit can be determined and to bring into account assets and liabilities not previously recorded. (Stanley et al)

General journal entries made on balance day are required to record revenues and expenses accurately so that profit or loss can be determined. (Greig et al)

Examples could include: accrued wages, prepaid insurance, depreciation, doubtful debts etc.

- ii. Depreciation expense is the allocation of the cost of an asset to the accounting periods in which that asset contributes to the production of revenue. (Greig et al) It is necessary to allocate depreciation as a balance day adjustment so that profit can be estimated as accurately as possible for each accounting period. For example, a delivery van costing \$50 000 with no residual value and an expected life of 5 years (under SLD) would be depreciated at a rate of \$10 000 per year. Thus the \$10 000 depreciation expense allocated each year would be matched against the revenue the delivery van helped to generate, thereby ensuring that the business did not overstate its profits or asset values. This allocation is made each balance day through a balance day adjustment.
- iii. The provision for bad and doubtful debts is a negative asset account. It records the value of those accounts receivable owing on balance day which it is anticipated will not, or are unlikely to, pay their debt. It offsets accounts receivable in the balance sheet as to more accurately reflect the value of the asset. It also allows for the more accurate matching of revenue and expenses as it records the expense, bad and doubtful debts (finance expense), which ensures profits for a given accounting period are also not overstated.

b) (2x3=6 marks)

- i. Decision makers within the business organization have available to them financial information such as budgets and financial reports such as Income Statements and Balance Sheets. However, they cannot afford to ignore qualitative information derived from changing social attitudes. Failure to do so may have the following effects;

Businesses need to sell their product. If a business loses support of the community then sales may suffer resulting in a reduction in net profit. Businesses also rely upon the actions of their employees. If the business is seen to run counter to current opinion, then they may be seen as an undesirable employer and fail to attract quality employees. Also, financial institutions may not wish to be associated with the organization and finance may become more difficult.

- ii. Under the Historic Cost Assumption, historic cost is used to value assets in the balance sheet because it is an objective and verifiable value. It assists the financial reports to provide reliable information to the reader. If the accounting entity revalued assets each reporting period, then the reliability of the reports would be compromised as the basis of valuation could vary year to year. There would be a problem in verifying the valuation.

If assets are revalued, then this needs to be done objectively by a registered valuer. It is therefore a costly exercise likely to only be applied to high value assets like real estate. By not getting these classes of assets revalued (i.e. following the Historic Cost assumption) you are likely to have unrealistic values on your balance sheet. So getting valuations done should make your balance sheet more accurate etc.

- iii. The effect on the Income Statement is to understate expenses and hence overstate net profit. The effect in the Balance Sheet is to understate current liabilities as an accrued expense would have been recorded there and also to overstate Owner's Equity. For example - any suitable example.

Markers Comments

Students are reminded to include examples, especially when the question asks that these be provided, for example: "Using two (2) examples, explain" Or "Using one (1) example of each, distinguish"

Failure to do so resulted in a loss of marks.

Question 1 (a)

- i. This question was poorly answered, with a very small proportion of students being able to effectively explain the meaning of a ledger account having a 'credit nature'. Those who did provided at least two relevant examples from either revenue, liability or owner's equity accounts.
- ii. Many students explained what 'credit' means and/or erroneously stated that all accounts with a credit nature were amounts owed by the business.
- iii. Most students were able to provide examples of source documents and explain their function in the accounting process.
- iv. Students need to revisit the purpose of the Trial Balance as many are still claiming that if the Trial Balance balances, then the ledger accounts are accurate/correct. Better answers pointed out that there could still be errors in the ledger and provided a couple of examples as to why this could be the case.
- v. Most students were able to satisfactorily explain why the Bank Statement and Cash at Bank ledger account of a business would have different balances and provided two examples.

Question 1 (b):

Most students answered (i) the cash flow statement question. Less than 25% of students attempted (ii).

(i) It is important that students know the difference between a Cash Flow Statement (an historical report) and a Cash Budget (a future forecast). Many students explained that a CFS would show how much cash a business could expect to be available for them to use in the future.

Students also need to be careful when talking about surplus cash or shortages/shortfalls/deficits in the areas of operations, investment and finance and not to confuse these with profit/loss. A Cash Flow Statement does **not** show profit or loss. Students should be encouraged to avoid using these terms when discussing a CFS (and a Cash Budget).

Students also need to become 'exam smart'. Those students who could not remember what information was contained in a CFS only needed to look at the one provided in Question 10 to help them with their theory answer.

(i) Most students were able to explain the benefits of using ratios to analyse business performance rather than raw data, mentioning comparability within a business over time as well as with its competitors. The use of ratios also allows for increased understanding of accounting reports/data.

Question 1 (c):

- i. Students are reminded to include examples when requested to support their explanations. Many included examples of non-financial information but failed to provide a direct example when explaining financial information.
- ii. A well answered questions with most students providing appropriate examples. Equity financing can include capital contributions made by both the current and/or new owners.
- iii. To be clearer in demonstrating their understanding of accruals/prepayments, students should refer to balance day in their explanations. For example, accrued revenues are amounts a business has earned in the current accounting period but have not yet been received or recorded on balance day. They are current assets and are recorded in the Balance Sheet. An example of accrued revenue is commission earned but not received by balance day.
- iv. A surprising number of students totally confused the two.
- v. The majority of students were able to explain the difference between capital and revenue expenditure and provide an appropriate example to highlight their answer.

Question 2 (a):

- i. Most students were able to explain what balance day adjustments are, why they are necessary in accrual accounting and provide two appropriate examples. Better answers explained accrual accounting and the 'matching principle' in detail, and also included in their explanations the creation of temporary asset and liability accounts to be awarded the full 6 marks.
- ii. Students still struggle with the concept of depreciation and are reminded that the purpose of depreciation in Accounting is to allocate the cost of the non-current asset over its useful life. That is, when the asset is used to help generate revenue. Depreciation is allocated on balance day to ensure a proper matching of revenue and expenses takes place in the correct accounting period. It is not to account for a loss in value of the asset as stated by many students (despite the recording of Accumulated Depreciation in the Balance Sheet providing a written down value for an asset).
- iii. This question was answered more clearly and comprehensively than in recent years. Better answers included the impact of Bad and Doubtful Debts on profits in the Income Statement in the current accounting period (matching principle) and the reduction in assets values in the Balance Sheet through the Provision for Doubtful Debts.

Question 2 (b):

- i. Most students were able to successfully provide two possible negative impacts. Better answers explained in more detail how these might affect the profitability of a business, with a couple of students also mentioning a possible decline in asset values (Goodwill) through a loss of business reputation.
- ii. This question was, in the main, well answered with students including the need for reliability, objectivity and/or verifiability in their explanations.
- iii. Most students were able to clearly explain the effect of not recording accrued expenses in the current accounting period on both the Income Statement and Balance Sheet and provide an appropriate example.

Section B

Sample Answers

Question 3

Date	Particulars	Debit	Credit	Marks
2020				
August 27	Cash at Bank (United)	200 000		1
	Ford Utility	42 000		1
	Computing Equipment	3 700		1
	Capital J & J Wilson		245 700	1
	(Owner commenced business with assets as capital)			
Sept 23	Inventory	2 600		1
	GST Clearing	260		1
	Williams Brothers		2 860	1
	(Purchased GST inclusive inventory on account – invoice X2785)			
Oct 4	Cash at Bank	858		1
	Sales		780	1
	GST Clearing		78	1
	(Cash Sale of GST inclusive inventory, Invoice A0002)			
Oct 4	Cost of Goods Sold	520		1
	Inventory		520	1
	(Cost price of inventory sold)			
Nov 30	Insurance	2 700		1
	GST Clearing	270		1
	Cash at Bank		2 970	1
	(Paid insurance (direct deposit), GST inclusive)			
Dec 5	Sales Returns	70		1
	GST Clearing	7		1

Date	Particulars	Debit	Credit	Marks
	Cash at Bank		77	1
	(Sales return of GST inclusive inventory - full refund Credit Note CN001)			
Dec 5	Inventory	63		1
	Cost of Goods Sold		63	1
	(Cost price of returned inventory)			
2021				
Feb 26	Cash at Bank	473		1 mark for entry
	GST Clearing		43	
	Inventory		430	
	(Reversal of incorrect entry) *			
Feb 26	Equipment Hire	430		1 mark for entry
	GST Clearing	43		
	Cash at Bank		473	
	(Correcting entry)*			
	* alternate answer below			
March 18	Drawings	255		1
	Cash at Bank		200	1
	Inventory		55	1
	(Drawings of cash and GST free inventory)			
April 5	Cash at bank	500		1
	Scouts Association		500	1
	(Cash received from debtor – Receipt 04)			
June 30	Inventory adjustment	40		1
	Inventory		40	1
	(Adjustment after stocktake)			
June 30	Prepaid expense	1 125		1
	Insurance		1 125	1
	(Balance day adjustment for five months of prepaid insurance, GST inclusive)			
			TOTAL:	31
	* alternate answer			
Feb 26	Equipment Hire	430		1
	Inventory		430	1
	(Error correction)			

Marking Scheme:

Entries: Marks for correct accounts totalled 31 (1 mark per line – the complete line to be correct to earn 1 mark, half marks given at marker's discretion).

Layout: 2 marks for narrations and 2 marks for layout.

Total Marks: / 20 (score x 20 and divide by 35, rounded up or down to the nearest half mark).

Question 4

a) The excavator was purchased through a finance company with a \$20,000 cash deposit.
2 marks – one mark for mentioning the loan and 1 mark for mentioning the cash deposit of \$20,000

b) Loss on disposal of \$24 000 (WDV is \$99 000)

Calculation:

Cost price of asset = \$220,000

Accumulated Depreciation = \$110,000 + an additional \$11,000 (3 months' worth) = a total of \$121,000

Book Value of asset = \$220,000 - \$121,000 = \$99,000

Sale price \$75,000, therefore \$99,000 - \$75,000 = \$24,000: A loss of \$24,000

3 marks – 2 marks for coming up with a loss of \$35,000 (not taking into account the extra 3 months of depreciation), and 3 marks if the extra depreciation was taken into account).

Calculations:

Question 5

Cash Receipts			Cash Payments				
Date	Details	\$	Date	Details	Chq.No.	\$	
Jul 2	Cash Sales	48	Jul 5	Owner wages		2 000	
Jul 3	EFT Sales	840	Jul 7	Outback Windscreens		680	
Jul 7	Direct Deposit	1 690	Jul 10	Tyres R Us	620	2 340	
Jul 12	ATO refund	200		WW Caltex (ERROR)		165	1.5
	Deposit	4 500	Jul 16	Home Supplies Pty Ltd		2 600	
Jul 19	Cash Sales	2 490		Vicbush Hotel	621	45	
July 22	EFT Sales	700		Com Insurance	622	2 290	
	Deposit	157	Jul 19	Owner wages		2 000	
Jul 23	EFT Sales	800	Jul 20	Spears Printing		420	
Jul 25	Direct deposit	56		Backwoods Mechanical		1 680	
Jul 29	EFT Sales	220	Jul 30	Office Supplies		103	

Cash Receipts				Cash Payments			
Date	Details	\$		Date	Details	Chq.No.	\$
					Black Stump Caltex	623	137
		<i>\$11 701</i>					<i>\$14 457</i>
	EFT Sales	400	1		General Fee		47
	Deposit	250	1		Interest		830
					Merchants Fee		57
Jul 31	Total	<u>\$12 351</u>	1	Jul 31	Total		<u>\$15 394</u>

Cash Receipts: 3 marks – 1 mark for each additional receipt and one mark for the correct total

Cash Payments: 4 marks – 0.5 marks for each additional receipt, 1.5 marks for picking up and correcting the error and 1 mark for the correct total

c) Cash at Bank account.

Cash at Bank A/c

Jul 31	Cash Receipts	12 351	Jul 1	Balance b/d	1 029	0.5 + 1
Jul 31	Balance c/d	4 072	Jul 31	Cash Payments	15 394	0.5
		\$5 149			\$5 149	
			Jul 31	Balance b/d	4 072	1

OR

Cash at Bank A/c

Jul 31	Cash Receipts	12 351	Jul 1	Balance b/d	1 029	0.5 + 1
			Jul 31	Cash Payments	15 394	0.5
				\$4 072		1

OR

Cash at Bank A/c

Date	Particulars	Debit	Credit	Balance \$	
Jul 1	Balance			1 029 Cr	1
Jul 31	Cash Receipts	12 351		11 322 Dr	0.5
Jul 31	Cash Payments		15 394	4 072 Cr	0.5 + 1

3 Marks

Bank Reconciliation for Harry's Mobile Hardware 0.5
as at 31 July 2021 0.5

Bank Statement balance:		3 753 DR	0.5 + 0.5
Add: Unpresented Cheques #619	137		0.5
#621	45		0.5
#623	<u>137</u>	<u>319</u>	0.5 + 0.5
Balance of Cash at Bank Account:		<u>4 072</u> CR	0.5 + 0.5

OR

Bank Reconciliation for Harry's Mobile Hardware 0.5
as at 31 July 2021 0.5

Debit balance as per Bank Statement		3 753	0.5 + 0.5
Add Unpresented Cheques #619	137		0.5
#621	45		0.5
#623	<u>137</u>	<u>319</u>	0.5 + 0.5
Credit Balance as per Cash at Bank A/c		<u>\$4 072</u>	0.5 + 0.5

Markers Comments

Most students handled the General Journal (Q. 3) and the Bank Rec. (Q. 5) fairly well. Many students had difficulty with working out additional depreciation for Q. 4 and didn't seem to understand that the purpose of the question was to compare the Book value with the sale price to determine a loss or gain. Students also had difficulty in interpreting the account entry for the purchase of the asset.

Section C

Sample Answers

Question 6 (a)

Heading (0.5 marks for identifying Income Statement and 0.5 marks for identifying correct period/dates)

Woodies Heaters Income Statement for the Period Ending 30 June, 2021 Marks
0.5 + 0.5

	\$	\$	\$	
Net Sales				
Sales		1 200 000		1
Less Sales returns		<u>14 200</u>	1 185 800	1 + 1
Less Cost of Sales				
Cost of Goods Sold		422 000		1
Inventory Adjustment		<u>2 000</u>	<u>424 000</u>	2
GROSS PROFIT			761 800	1
Add Other revenue				
Dividend Received		13 000		1
Safety Check Receipts		<u>21 600</u>	<u>34 600</u>	2 + 1
			796 400	1
Less Other Operating Expenses				
Selling & Distribution Expenses				
Advertising	43 000			1
Sales Wages	92 000			1
Delivery Truck Expenses	31 000			1
Delivery Wages	<u>78 000</u>	244 000		1
General & Administrative Expenses				
Sundry Administrative Costs	17 000			1
Insurances	21 850			3
Office Wages	150 000			1
Depreciation	<u>13 450</u>	202 330		3
Finance Expenses				
Mortgage Interest	6 700			1
Bank Charges and Fees	550			1
Truck lease Costs	<u>68 800</u>	<u>76 050</u>	<u>522 380</u>	1 + 1 (Total Other Operating Expenses)
Net Profit			<u>\$274 020</u>	1 Total: 30

Marking Scheme

Guiding Principal: any entry can't have less than 0 marks

- **Entries:**
1 mark for correct title (0.5 for identifying the report and 0.5 for the dates), 1 mark per correct entry, 2 marks for simple correct BDA, 3 marks for complex correct BDAs.
If the item is there but remains unadjusted – allocate a mark of 0.5.
For an adjustment attempted but incorrect, allocate 1 mark for a simple adjustment and 1.5 marks for a complex adjustment.
 - Minus 0.5 if correct statement but wrong classification (e.g. if worth 3 marks, would be 2.5, 2 marks 1.5 etc)
 - 0 marks if incorrect statement
 - Minus 0.5 if transfer of incorrect amount from trial balance (e.g. if worth 1 mark, would be 0.5 (or 0 if also wrong classification))
- **Formatting:**
Correct use of columns for sub-totalling, sub-totals and ruling = /3 marks allocated overall
Final score is out of 33 (30 + 3). Calculation of FINAL MARK / 25 (score x 25 ÷ 33, rounded up or down to the nearest half mark).

Question 6 (b)

Heading 0.5 + 0.5 (0.5 marks for identifying Balance Sheet and 0.5 marks for correct period/dates)

Woodies Heaters 0.5
Balance Sheet as at 30 June, 2021 0.5

	\$	\$	\$	\$	Marks
Current Assets					
Cash at Bank		36 000			1
Accounts Receivable		44 800			1
Inventory		138 000			2
Accrued Revenue		1 600			2
Prepaid Expense		<u>3 150</u>	223 550		3 + 0.5
Non-current Assets					
Other Financial Assets					
Shares in Wasfield		32 000			1
Term Deposit		<u>100 000</u>	132 000		1 + 0.5
Property Plant and Equipment					
Workshop Equipment	67 400				1
Less Accumulated Depreciation	<u>45 580</u>	21 820			3
Land and Buildings		<u>456 000</u>	477820		1 + 0.5
Intangible Assets					
Manufacturer Licence			<u>40 000</u>		1
Total Assets				\$873 370	1
Less Current Liabilities					
Accounts Payable		76 800			1
GST Clearing		<u>32 100</u>	108 900		1 + 0.5
Non-Current Liabilities					
Mortgage Loan			<u>200 000</u>		1
Total Liabilities				<u>\$308 900</u>	0.5
NET ASSETS				<u>\$564 470</u>	1
Owner's Equity					
Capital (July 1, 2020)		415 450			1
Add Net profit		<u>274 020</u>	689 470		1 + 0.5
Less Drawings			125 000	\$564 470	1 + 1
				<u>\$564 470</u>	
				TOTAL:	30 Marks

OR

Woodies Heaters Balance Sheet as at 30 June, 2021 0.5 + 0.5 (0.5 marks for identifying Balance Sheet and 0.5 marks for identifying correct period/dates)

Current Assets

Cash at Bank	36 000		1
Accounts Receivable	44 800		1
Inventory	138 000		2
Accrued Revenue	1 600		2
Prepaid Expense	<u>3 150</u>	223 550	3 + 0.5

Non-current Assets

Other Financial

Shares in Wasfield	32 000		1
Term Deposit	<u>100 000</u>	132 000	1 + 0.5

Property Plant and Equipment

Workshop Equipment	67 400		1
Less Accumulated Depreciation	<u>45 580</u>	21 820	3
Land and Buildings	<u>456 000</u>	477820	1 + 0.5

Intangible Assets

Manufacturer Licence		<u>40 000</u>	<u>649 820</u>	1
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Total Assets **873 370** **1**

Less Current Liabilities

Accounts Payable	76 800		1
GST Clearing	<u>32 100</u>	108 900	1 + 0.5

Non-Current Liabilities

Mortgage Loan		<u>200 000</u>	1
Total Liabilities		<u>308 900</u>	0.5
Net Assets		<u><u>564 470</u></u>	1

Owner's Equity

Capital as at July 1, 2020	415 450		1
Add Net profit	<u>274 020</u>	689 470	1 + 0.5
Less Owners Drawings		<u>125 000</u>	1 + 1

TOTAL: 30 Marks

Marking Scheme:

Guiding Principal: any entry can't have less than 0 marks

- **Entries:**

1 mark for correct title, 1 mark per correct entry, 2 marks for simple correct BDA, 3 marks for complex correct BDAs – part marks for adjustment attempted but incorrect,

1 mark for a simple BDA and 1.5 marks for a “complex” BDA.

If adjustment is not attempted but the item is included, allocate 0.5 marks.

Minus 0.5 if correct statement but wrong classification (e.g., if worth 3 marks, would be 2.5, 2 marks 1.5 etc)

0 marks if incorrect statement

Minus 0.5 if transfer of incorrect amount from trial balance e.g. if worth 1 mark, would be 0.5 (or 0 if also wrong classification)

- **Formatting:**

Correct use of columns for sub-totalling, sub-totals and ruling = /3 marks allocated overall

Final score is out of 33 (30 + 3)

Calculation of FINAL MARK / 20 (score x 20 ÷ 33 rounded up or down to the nearest half mark).

Question 7

Statement of Estimated Receipts from Accounts Receivable				
Month of Credit Sales	Amount \$	Estimated Cash to be Received In:		
		February	March	April
November	31 000	1 550		
December	42 000	6 300	2 100	
January	47 000	37 600	7 050	2 350
February	28 000		22 400	4 200
March	30 000			24 000
Total		\$45 450	\$31 550	\$30 550

Marking scheme: 0.5 marks each calculation (including totals)

6 Marks

Cash Budget

Cash Budget for three months ending April 2022				
	February	March	April	Marks
Estimated Cash Receipts	\$	\$	\$	
Receipts from Accounts Receivable (Credit Sales)	45 450	31 550	30 550	1
Online Sales	-	9 000	15 000	2
Proceeds from Bank Loan	60 000	-	-	1
Total Estimated Receipts	105 450	40 550	45 550	0.5
Estimated Cash Payments				
Food Preparation Equipment		35 000		0.5 each or 1.5 if total used
Computer Software and Hardware		18 000		
Staff Training and Development		7 000		
Insurance		6 500		4 (deduct 0.5 marks for each incorrect transposition)
Wages	8 000	11 000	13 000	
Rent	2 800	2 800	2 800	
Raw Materials	13 000	19 000	24 000	
Other Operational Payments	2 300	3 100	4 700	
Drawings	1 800	1 800	2 000	
Total Estimated Payments	27 900	104 200	46 500	
Bank Balance at the start of the month	2 500	80 050	16 400	1
Excess of receipts over payments	77 550			1
Excess of payments over receipts		(63 650)	(950)	
Bank Balance at the end of the month	\$80 050	\$16 400	\$15 450	1

14 Marks

Markers Comments

Question 6: Very few students were able to produce the correct profit figure, which meant equally few balanced the 'Balance Sheet'. There wasn't one consistent reason for this. Overall, a pretty straight forward question.

Question 7: Students did the cash budget well, as a general rule.

Section D

Sample Answers

Question 8

Current ratio:

<u>Current Assets</u>	<u>19 860</u>	
<i>Current Liabilities</i>	12 610	1.57:1

Quick ratio:

<u>Cash + Accounts Receivable</u>	<u>14 520</u>	
<i>Current Liabilities</i>	12 610	1.15:1

Debt ratio:

<u>Total Liabilities</u>	<u>132 610</u>	
<i>Total Assets</i>	159 860	82.95%

Question 9

a) Profitability

Four sources of information are available- raw data from the Income Statement, gross profit ratio, net profit ratio and rate of return on Owners' Equity.

Raw data

Gross profit has increased in the 2021 financial year over that of both 2019 and 2020. Net profit has improved over the 2020 figure but is significantly less than the 2019 financial year.

Gross profit ratio (gross margin)

The difference between sales revenue and the cost of goods sold.

The gross profit ratio has declined from 83.11% in 2018 to 77.18% in 2021 a decrease of 5.93%. This indicates a reduced capacity for the business to create funds to cover expenses other than cost of goods sold.

The industry average of 82.17% indicates that Golden Valley Crafts (GVC) at 77.18% is less profitable than other like businesses. Perhaps indicates a lower price structure or less capacity to control cost of goods sold.

Net profit ratio

The proportion of sales revenue remaining after all other expenses are taken into account.

The net profit ratio has declined in each year from 34.94% in 2018 to 27.85 in 2021 a decrease of 7.09 percentage points. This suggests that the business is experiencing a proportionate increase in the level of expenses.

The industry average of 33.45% in 2021 indicates that Golden Valley Crafts is performing at 5.6 percentage points below average. The Industry average for spending on Other Operating Expenses is 48.72% (of each Sales dollar) (in 2021) whereas GVC is slightly over this at 49.33%.

Return on Owner's Equity

The relationship of net profit (return to owners) to the value of Owner's Equity. That is the return to owners given their investment in the business (the value of capital).

Return on Owner's Equity for Golden Valley Crafts is decreasing from 2019 to 2021 but remains significantly above the industry average of 42.45%. This situation arises from the low value of capital invested - caused by the very high level of debt held by Golden Valley Crafts. Overall, GVC should first look to improving their GPR (by looking for a cheaper price for their goods or increasing their selling price) and look to a further increase in Sales to assist with reducing spending on Other Operating Expenses (as a percentage of Sales dollars).

9 Marks

b) Liquidity

Capacity to meet debts as they fall due.

Two sources are available- the quick asset ratio and the current ratio.

Quick asset ratio

There is a noticeable decline in the capacity of Golden valley Crafts to meet its debt in the very short term. The value of the quick ratio declines from 0.96:1 in 2018 to 0.70:1 in 2021. This suggests that should short term debt (current liabilities) need to be paid, only 70 cents in the dollar is available (from Quick Assets) in the short term. Golden Valley Crafts is well below the industry average of 1.2:1 (\$1.20 for each \$1 required).

Current ratio

Golden Valley Crafts has a current ratio which has decreased from 2.5:1 in 2018 to 2.32 in 2021- a value just below the industry standard for 2021 of 2.4:1.

This suggests that Golden Valley Crafts has satisfactory cover for debts falling due within 12 months- that is, current liabilities.

Overall, GVC has quite low CA's and CL's, so a simple solution to their liquidity problem would be a cash injection. This is unlikely to come from a loan due to their already high level of borrowing, but the Owner(s) may be able to solve the problem with a Cash contribution as Capital, or to reduce any regular cash drawings.

Therefore, Golden Valley Crafts is not in a satisfactory liquidity position in the very short term (cash and receivables the most liquid assets do not cover current liabilities).

However, in the longer-term liquidity is satisfactory.

6 Marks

c) Stability

Long term financial viability.

The available measure is the debt ratio which indicates the proportion of assets funded by debt.

Golden Valley Crafts is showing a high debt level with the debt ratio declining from 96.21% in 2019 to 89.12% in 2021. This means that by 2021, 89.12% of assets are funded by debt. This is much higher than the industry average of 32.65% suggesting that Golden valley Crafts does not have the same degree of long-term financial stability as similar businesses.

It is a highly geared business which may struggle to borrow further in the event of a short-term financial difficulty requiring a cash injection from borrowed funds.

3 Marks

d) **Management Effectiveness**

Two measures are available - Inventory Turnover and Debtors Collection Period.

Inventory turnover measures the number of times that inventory is turned over in the year (that is completely sold). Golden Valley Crafts is seeing a slight improvement – from 3 times a year in 2018 to 3.45 times in 2021. This suggests that management is becoming more effective in moving their inventory. However, they remain below industry average. Similar businesses on average can turn their inventory over 5.5 times in the year which is significantly faster than Golden Valley Crafts.

Debtors Collection period refers to the number of days it takes on average for a business to collect payment from its trade debtors (accounts receivable).

For Golden Valley Crafts the collection period has worsened marginally from 6.91 days to 7.71 days. This remains significantly less than similar businesses, which almost certainly reflects the strict trading terms applied by Golden Valley Crafts of payment within 7 days of purchase.

3 Marks

e) **Overall Summary Assessment - Brief**

Draw sensible conclusions from above analysis. Answers might include the following:

- i. Financial Stability The Debt Ratio is now dangerously high. If interest rates rise or the business experiences a downturn in sales, will the business be in a position to meet its loan repayments.
- ii. Was the development of the visitor centre a sound business decision? Profitability is on the decline. Both the Gross Profit and Net Profit ratios are deteriorating. Is this decline due to new/higher expenses associated with the larger premises which are yet to translate into increased sales? What strategies has/should the business put in place to improve its profitability?

3 Marks

Question 10

- a) The change in cash position over the financial year is an increase in cash of \$8 580 from \$8 700 to \$17 280.

2 Marks

- b) The business has sold non-current assets for \$16 800 (the old production line equipment) and purchased new equipment. They have also purchased debentures for \$90 000.

2 Marks

- c) The business has borrowed \$80 000 for the upgrade of equipment and repaid \$6 000. The owners have drawn \$120 000 from the business.

2 Marks

- d) Interest is a finance expense- a cost of running the business which is recorded as an expense in the income statement. It is an operating expense. The payment of principal reduces the debt obligation of the business- it is reduction in the value of a liability, and the effect is reflected in the balance sheet.

4 Marks

Markers Comments

Question 8

Many students had difficulty classifying accounts. They did not appear to be able to identify the difference between Current Assets, Non-Current Assets, Current Liabilities and Non-Current Liabilities.

All calculations should be to x2 decimal places. Some students did not know how to round off.

The QAR and CR should have been expressed as a ratio :1. The Debt Ratio needed to be expressed as a %.

Question 9

It was disappointing that a number of students did not discuss the correct ratios for each part of this question. This should not have been difficult as the ratios are listed under the headings indicating what they measure on the Formula Sheet e.g., Measures Profitability heads the appropriate x5 ratios

Students need to include the numbers and a comment if they are increasing or decreasing when they are discussing each ratio. IT IS VITAL THAT THEY COMPARE THE RATIOS WITH THE INDUSTRY AVERAGES. It helps if they can explain what the ratio is actually telling us e.g., NPR shows the proportion of sales revenue remaining after all other expenses are taken into account.

References to raw data will help with explanations.

Students should attempt to suggest how each ratio could be improved.

It is important that students pay attention to the general information given at the start of the question. For instance, this business had credit terms of 7 days. Therefore, even though their debtor's collection period was way below industry averages it had exceeded their own terms.

It is also important that students understand that the higher the inventory turnover the better. Many thought this should be a low figure.

Students only had to discuss x1 ratio in relation to efficiency in management – even though they were provided with x2.

The high ROROE figures caused a number of confusions.

Question 10

Many students did not fully attempt this question. This may have been because it was the last question on the paper and they ran out of time. However, Parts a, b and c were relatively straightforward.

It is important that students use \$ when discussing monetary amounts.

Students found Part d difficult to answer.