

## **GENERAL COMMENTS**

The 2014 examination was the second time that students have completed a two-hour examination in VCE Accounting. This examination followed a structure similar to the 2013 examination. Students were required to answer 12 questions, many with multiple parts. Students and teachers should never attempt to specialise or anticipate the topics to be examined from year to year.

Completing the examination within the allocated time frame is still an issue for some students. Some students try to find a perfect solution to a particular question. For example, Question 4 required students to prepare a classified Balance Sheet and it appeared that some students may have spent too much time trying to balance this report. There is little point in spending extra time trying to determine why a Balance Sheet doesn't balance. It is advisable that once this type of question has been attempted students should move on to the next question. If they have completed all questions on the examination, then they may go back to other questions where they think that they may have made an error. Students should note that usually there are no marks allocated for getting the correct totals on a Balance Sheet; the marks are allocated for the items within the report, and students should always complete the Balance Sheet to the best of their ability and then move on. This advice may assist students in managing their time, ensuring that they can actually attempt all questions on the examination.

The 2014 examination had an increase in the marks allocated to theoretical-type questions when compared to previous examinations. Some students did not read some questions carefully, so their responses did not accurately reflect the question. Sometimes this was because the information provided was not fully understood. For example, in Question 3 it was stated that Creditors Turnover was expected to increase from 28 days to 37 days. However, some students read this to mean that the business was paying back their creditors at a faster rate, when in fact it indicates the complete opposite. This type of error is usually caused by one of two things: a lack of knowledge about the topic or not taking sufficient time to read the question carefully. In this case, the error appears to be more likely caused by the second reason, as many students made comments in relation to the data that demonstrated knowledge of accounting, despite misreading the information.

The 2014 examination included a 'discuss'-type question worth six marks. However, some students responded using only two or three lines in the answer booklet. A six-mark question requires a significant response to be awarded high marks. In this case, a discussion of profitability required evaluation of the financial indicators provided. Students should be prepared to state if an indicator shows that profitability has improved, while other indicators may show a decline in profitability. They should support their comments with evidence from the information provided and then perhaps make a conclusion, again supported by evidence. These questions should be seen as an opportunity for students to show their knowledge of accounting and there is no single prescribed way of responding to such questions.

The interpretation of graphs is now expected in the examination and many students could accurately interpret the information presented in relation to depreciation. Although some students found it difficult to fully explain the differences between the straight-line and reducing balance methods, the practical application of recording depreciation showed a clear improvement in their knowledge of the two methods. This was also the case in relation to General Journal entries for returns and the recording of a bad debt. Many students demonstrated sound knowledge of using the General Journal for such entries.

# 2014 Examination Report

## SPECIFIC INFORMATION

This report provides sample answers or an indication of what the answers may have included. Unless otherwise stated, these are not intended to be exemplary or complete responses.

The statistics in this report may be subject to rounding errors resulting in a total less than 100%.

### Question 1

#### 1a.

Marks	0	1	2	3	4	5	Average
%	15	6	7	12	21	38	3.3

#### General Journal

Date 2014	Details	General Ledger		Subsidiary Ledger	
		Debit	Credit	Debit	Credit
16 Feb	Sales Returns	600			
	GST Clearing	60			
	Debtors Control		660		
	D Edger				660
	Stock Control	300			
	Cost of Sales		300		
27 Feb	Bad Debts	6 710			
	Debtors Control		6 710		
	T Wilson				6 710

The five marks available in Question 1a. were allocated as follows.

- one mark for the entries to Sales Returns and GST Clearing
- one mark for both the Debtors Control and D Edger entries
- one mark for the double entry to Stock Control and Cost of Sales
- one mark for the entry to Bad Debts
- one mark for both the Debtors Control and T Wilson entries

Most students used full titles in General Journal entries as required. Very few students used abbreviated titles. Some students thought the first entry was a return to a supplier and consequently prepared the wrong set of entries. In general, this question was well handled by the majority of students.

#### 1b.

Marks	0	1	2	3	Average
%	20	20	29	30	1.7

Either of:

- Accounting principle: Conservatism  
Explanation: The bad debt should be recognised as an expense as soon as possible, as conservatism demands that profit for a reporting period is not overstated. (Alternative statements are so that assets are not overstated or so that expenses are not understated.)
- Accounting principle: Reporting period  
Explanation: The bad debt is an expense for the current reporting period and it should be recognised and matched against the revenue earned within the same reporting period so that an accurate profit can be determined under accrual accounting.

Two alternative answers to this question were accepted. However, in order to gain the maximum marks available, students had to ensure that their responses related to the principle stated. Some students confused their principles and some stated a qualitative characteristic as their response. Some students simply provided a rote-learned definition. The conservatism answer related to not understating expenses or not overstating profit and assets. Some students stated how important it is to not overstate revenue, as this is often part of a full definition of conservatism. However, this has no relevance to the question asked and should not be part of their response. Rote-learned definitions are not appropriate.

# 2014 Examination Report

Students are encouraged to use definitions sparingly and they should use the relevant parts needed to answer the question.

1c.

Marks	0	1	2	3	Average
%	24	14	29	34	1.7

### Debtor – D Edger

Date 2014	Cross-reference	Amount	Date 2014	Cross-reference	Amount
1 Feb	Balance	3 400	7 Feb	Bank/Discount expense	2 050
6 Feb	Sales/GST Clearing	2 640	16 Feb	Sales Returns/ GST Clearing	660
			28 Feb	Balance	3 330
		6 040			6 040
1 Mar	Balance	3 330			

In order to achieve the three marks available, students were required to:

- record all entries accurately
- use correct dates on all entries
- balance the account and carry the balance forward to the new reporting period.

Although this question was well answered by many students, some did not attempt this question. This may have been because they struggled with Question 1a., where the returns entry had to be done. Students are reminded that no matter what they presented in Question 1a., their responses will not be penalised a second time in a subsequent question (for example, Question 1c.). Therefore, if they had an incorrect dollar amount for the return in Question 1a., this will not be penalised again in Question 1c. However, a blank response will not be awarded any marks.

1d.

Marks	0	1	2	3	Average
%	29	23	44	4	1.3

### Ocean Blue Schedule of Debtors as at 28 February 2014

J Bennett	\$ 5 420
D Edger	3 330
F Smith	2 750
Balance as per Debtors Control a/c	\$11 500

This question was not answered well by many students. Students presented a range of responses, some of which were inconsistent with their previous responses. Although Debtor Wilson had been written off as a bad debt, some students then listed this debtor with an amount owing. Other students omitted F Smith, having overlooked the credit sale made to this customer on 23 February. Students are reminded that when preparing accounting records and reports all parts of these items should be included. In the case of a debtors' schedule, the notation 'Balance as per Debtors Control' should always be included as part of the schedule.

# 2014 Examination Report

## Question 2

Marks	0	1	2	3	4	5	Average
%	37	23	17	10	9	5	1.5

	Item(s)	Increase/Decrease/ No Change	Amount(s)
<b>Income Statement</b>	Cost of Sales	Decrease	1 300
	Sales Returns	Increase	2 600
<b>Balance Sheet</b>	Stock Control	Increase	1 300
	Debtors Control	Decrease	2 860
	GST Clearing	Decrease	260
	Capital (net profit)	Decrease	1 300

This question proved to be quite difficult for many students, with some coming up with only two items being affected by the sales returns entry. This was despite the fact that many students had recorded all items correctly for a sales return in Question 1a. With six items required and only five marks available, Debtors Control and GST Clearing were allocated one mark collectively, as GST affects both of these items. The other items were all allocated one mark each. Some students included only one item in the Income Statement section, obviously forgetting that a sales return has two effects on this report: one with the cost price (Cost of Sales) and one with the selling price (Sales Returns).

## Question 3

### 3a.

Marks	0	1	2	3	Average
%	36	34	21	9	1.1

If stock levels are unchanged (or increased) and mark-ups remain unchanged then an increase in stock turnover will lead to an increase in gross profit. This is because more goods will be sold during the reporting period at the same profit margin, thus increasing gross profit. However, if the improvement in stock turnover was achieved by stock levels being decreased and the sales volume remains unchanged, the average mark-up would need to be increased in order to increase gross profit. If the business has decreased stock levels to try to increase turnover, some customers may not be able to purchase what they want and this may lead to a decrease in sales and consequently a decrease in gross profit.

This question was problematic for some students as they confused two key concepts in accounting: gross profit and gross profit margin. Gross profit is a dollar amount and is the result of sales less Cost of Goods Sold. Usually if a business increases stock turnover this means that more goods will be sold during a given time. Unless mark-ups have been drastically reduced this will usually lead to an increase in gross profit. Some students stated that the increase in stock turnover means fewer sales will be made, but this is a difficult point to prove.

### 3b.

Marks	0	1	2	Average
%	9	16	75	1.7

Both of:

- Strategy 1: Hold less stock by eliminating slow-moving stock lines
- Strategy 2: Reduce selling prices to promote more sales.

Other good responses included:

- changing the stock mix to concentrate on fast-moving items
- using 'just-in-time' ordering to reduce stock levels
- trying a new advertising strategy to boost sales.

# 2014 Examination Report

3c.

Marks	0	1	2	Average
%	30	24	46	1.2

Both of:

- Positive effect: This means that cash is being kept within the business for a longer period of time, making it available for other uses, such as paying expenses or other debts on time
- Negative effect: As Creditors Turnover is expected to increase to 37 days, this may exceed the credit terms on offer and may lead Metro Cosmetics' suppliers to restrict or withdraw its credit facility.

Some students indicated that the business might not be taking advantage of discounts on offer, which was a valid response. However, some students indicated that Metro Cosmetics would be charged interest by its creditors, which is not normal business practice. Some students misread the information provided and made comments in relation to the business paying too quickly, whereas the information provided indicated slower payments to creditors.

## Question 4

Marks	0	1	2	3	4	5	6	7	8	Average
%	25	14	15	14	9	8	7	6	3	2.6

### Willow Terrace Balance Sheet as at 1 June 2014

	\$	\$		\$	\$
<b>Current Assets</b>			<b>Current Liabilities</b>		
Bank	46 500		Creditors Control	41 800	
Stock Control	38 000		Sundry Creditor – B Fit	29 000	
Prepaid Rent	5 000		Loan	10 000	80 800
GST Clearing	7 300	96 800			
			<b>Non-current liabilities</b>		
<b>Non-current assets</b>			Loan		10 000
Security Bond	4 000				
Motor Vehicle	24 000		<b>Owner's equity</b>		
Shop Fittings	30 000	58 000	Capital		64 000
Total Assets		154 800	Total Equities		154 800

Students presented a variety of responses and many found it quite difficult. Students should note that they are not required to complete the entire Balance Sheet in order to be awarded some marks. For example, if they just wrote stock control \$38 000 and Prepaid Rent \$5000 under current assets that would earn one mark. If they simply split the loan, as shown above, that would achieve one mark. Students are encouraged to attempt this sort of question as best they can and include any information they know is correct. The eight marks available were allocated as follows:

- one mark for Bank
- one mark for both Stock Control and Prepaid Rent
- one mark for GST Clearing
- one mark for Security Bond as a non-current asset
- one mark for the two non-current assets: Motor Vehicle and Shop Fittings
- one mark for the Loan being split between current and non-current liabilities
- one mark for Creditors Control
- one mark for the Sundry Creditor.

# 2014 Examination Report

The Capital amount became a consequential dollar amount, depending on what items students included in the Balance Sheet. Therefore, incorrect Capital values were not penalised.

## Question 5

### 5a.

Marks	0	1	2	3	Average
%	17	21	32	30	1.8

All of:

- 4 July: Capital contribution by the owner
- 14 July: Purchase return to a supplier
- 22 July: Stock used for advertising purposes.

One mark was allocated for each transaction. A variety of responses was given for each of the three items. Some students ignored the constraint stated in the question, which was 'no stock was withdrawn for personal use'. Therefore, drawings was assessed as an incorrect response.

### 5b.

Marks	0	1	2	3	Average
%	24	19	20	37	1.7

Explanation: A stock loss represents an outflow of economic benefits that will result in a decrease in assets (stock control) and consequently a decrease in capital (through a decreased net profit).

Many students provided a thorough explanation and received full marks; however, rote-learned responses were quite common and included references to reductions in inflows or reductions in liabilities. Stock losses do not cause a reduction in inflows and they do not affect liabilities. Students are strongly advised not to use rote-learned responses based on textbook definitions. Stock losses decrease assets, increase expenses and decrease profit and, therefore, capital. No other items should have been mentioned in relation to this question.

### 5c.

Marks	0	1	2	3	4	Average
%	18	14	24	28	17	2.1

## AX Electronics

### Income Statement (extract) for the month ended 31 July 2014

	\$	\$
<b>Revenue</b>		
Cash Sales	3 210	
Credit sales	4 680	7 890
Less Sales Returns		170
		7 720
Less <b>Cost of Sales</b>		3 860
<b>Gross Profit</b>		3 860
Less Stock Loss		85
<b>Adjusted Gross Profit</b>		3 775

# 2014 Examination Report

The four marks for this question were allocated as follows:

- one mark for correctly determining the Sales
- one mark for Sales Returns and the net sales amount
- one mark for Cost of Sales and the Gross Profit amount
- one mark for the Stock Loss and Adjusted Gross Profit.

Students were expected to use the standard format for the Income Statement, as outlined in the study design. Despite the Stock Loss being mentioned in the previous part of this question, some students did not include it in the Income Statement.

## Question 6

Marks	0	1	2	3	Average
%	29	16	21	34	1.6

### Capital

Date 2014	Cross-reference	Amount	Date 2014	Cross-reference	Amount
30 Jun	P&L Summary	2 300	1 Jun	Balance	51 200
	Drawings	800	30 Jun	Bank	1 250
	Balance	50 350		Computer	1 000
		53 450			53 450
			1 Jul	Balance	50 350

One mark was allocated to each of the following items.

- the two assets on the credit side of the Capital account
- the P&L Summary entry on the debit side
- the Drawings entry on the debit side

In order to determine the Drawings amount, the account had to be balanced correctly, thus making the Drawings amount consequential to the correct balancing procedure being applied.

This question was not answered well by all students. It became obvious that some students thought that they were completing a P&L summary account, as they recorded revenues on one side of the account, with expenses on the other.

Students are reminded again to read every question carefully to ensure that they are clear about what is being asked of them.

# 2014 Examination Report

## Question 7

### 7a.

Marks	0	1	2	Average
%	49	18	32	<b>0.8</b>

### Marv Petroleum General Journal

Date 2014	Details	General Ledger		Subsidiary Ledger	
		Debit	Credit	Debit	Credit
31 Oct	Advertising Expense	120 000			
	Prepaid Advertising Expense		120 000		

Many students found this question difficult. Some recorded entries in relation to vehicles and clearly did not realise that the use of the vehicles was for an advertising campaign. Others who realised it was a prepaid advertising entry had difficulty determining the correct dollar amount.

### 7b.

Marks	0	1	2	Average
%	59	13	28	<b>0.7</b>

### MGH Motors General Journal

Date 2014	Details	General Ledger		Subsidiary Ledger	
		Debit	Credit	Debit	Credit
31 Oct	Prepaid Sales Revenue	120 000			
	Sales Revenue		120 000		

Many students struggled with this question. Students were required to prepare an entry for Marv Petroleum in Question 7a. and then make an entry for a second business (MGH Motors) in Question 7b. Some students found the task of accounting for two different businesses a difficult process.

### 7c.

Marks	0	1	2	Average
%	48	29	24	<b>0.8</b>

### Marv Petroleum

#### Prepaid Advertising Expense

Date 2014	Cross-reference	Amount	Date 2014	Cross-reference	Amount
31 Oct	Bank	300 000	31 Oct	Advertising Expense	120 000

Students were awarded full marks if they could (both of):

- correctly record the cash payment of \$300 000 on the debit side of the Prepaid Advertising Expense Account
- correctly post the journal entry from Question 7a. on the credit side of the Prepaid Advertising Expense Account.

Overall, this was a difficult question for many students.



# 2014 Examination Report

## Question 8

### 8a.

Marks	0	1	2	Average
%	22	28	49	1.3

Depreciation expense for Year 2	\$12 000
Estimated residual value of the computer system	\$ 3 888

This question was well answered by many students. Determining an annual depreciation expense by comparing the carrying value of an asset from year to year is a skill expected of accounting students. Students should be prepared for graphical representations of financial data and also be prepared to analyse graphs, as set out in this question.

### 8b.

Marks	0	1	2	Average
%	31	38	31	1

Justification: A computer is likely to be more efficient in its earlier years of use and therefore can be reasonably expected to generate more revenue in its earlier years. If this is the case, the reducing balance should be used as it allocates more of an asset's cost as a depreciation expense in its earliest years, and less in the later years of an asset's life. By doing this, a more accurate profit will be determined over the life of the asset.

Students were expected to respond with a comment on the revenue-earning pattern of a computer and the related impact of using the reducing balance method. Many students got caught up with comments about whether or not a computer has moving parts and didn't move on to the revenue-earning pattern. Other students wrote detailed notes on how the straight-line method is different, which wasn't necessary in order to answer the question.

### 8c.

Marks	0	1	2	Average
%	48	19	33	0.9

Explanation: Depreciation expense would be higher in Year 5 under the straight-line method as it allocates the same amount of depreciation every year. This amount would therefore be higher than the reducing balance method in Year 5, which means that net profit would be lower using the straight-line method.

A variety of responses were provided to this question. Students were required to explain how the Income Statement would differ under the two depreciation methods. The two major changes were higher depreciation expense and lower net profit.

## Question 9

### 9a.

Marks	0	1	2	3	4	5	6	7	8	Average
%	21	8	7	7	8	10	12	15	12	4

### Debtors Control

Date 2014	Cross-reference	Amount	Date 2014	Cross-reference	Amount
1 July	Balance	32 700	31 July	Sales Returns/ GST Clearing	1 650
31 July	Sales/GST Clearing	222 200		Discount expense	1 500
				Bad debts	2 200

# 2014 Examination Report

				<b>Bank</b>	<b>209 550</b>
				Balance	40 000
		254 900			254 900

Question 9a. was allocated a total of eight marks, with three marks being for the Debtors Control account. One of these marks was awarded for the Sales/GST Clearing entry, one mark was for the Sales Returns/GST Clearing entry, and the final mark was allocated to the entries for discount expense, bad debts and the balance of the account. Having all three of these requirements, students were then able to determine the expected cash inflow of \$209 550.

### Stock Control

Date 2014	Cross-reference	Amount	Date 2014	Cross-reference	Amount
1 July	Balance	72 000	31 Jul	Drawings	3 000
31 July	Cost of Sales	750		Cost of Sales	101 000
	<b>Bank</b>	<b>123 250</b>		Stock Write Down	2 000
				Balance	90 000
		196 000			196 000

This second account reconstruction was also allocated three marks. One of these marks was allocated to Drawings, one mark was for both the Stock Write Down and the balance of the account, and the third mark was for the Cost of Sales entries. It was permissible to have one entry for the net amount of Cost of Sales. If this was done – and many students took this option – the credit entry would simply be \$100 250 ( $\$101\,000 - 750 = \$100\,250$ ). Students should keep in mind that reconstructions are not formal accounts and therefore the strict rules of ledger account recording do not have to be followed.

### Disposal of Equipment

Date 2014	Cross-reference	Amount	Date 2014	Cross-reference	Amount
31 Jul	Equipment	25 000	31 Jul	Accumulated Depreciation of Equipment	15 200
	Profit on Disposal of Equipment	3 700		Bank	13 500
		28 700			28 700

The third account in Question 9a. was allocated two marks: one mark for correctly showing the Equipment and Accumulated Depreciation entries, and the second mark for recording the Profit on Disposal of Equipment on the debit side of the disposal account.

Some students struggled with this question.

# 2014 Examination Report

9b.

Marks	0	1	2	3	4	5	6	7	8	9	Average
%	51	7	6	6	6	5	6	5	4	4	2.2

**Lou's Lighting  
Budgeted Cash Flow Statement for the month ending 31 July 2014**

	\$	\$
<b>Cash Flows from Operating Activities</b>		
Receipts from Debtors	209 550	
Cash Purchases of Stock	(123 250)	
Wages	(28 000)	
Advertising	(12 300)	
Interest paid	(1 100)	
Other Expenses	(14 100)	
GST paid	(17 865)	
<b>Net Cash Flows from Operating Activities</b>		(12 935)
<b>Cash Flows from Investing Activities</b>		
Purchase of Equipment	(30 000)	
Disposal of Equipment	13 500	
<b>Net Cash Flows from Investing Activities</b>		(16 500)
<b>Cash Flows from Financing Activities</b>		
Drawings	(29 000)	
Loan Repayments	(3 750)	
<b>Net Cash Flows from Financing Activities</b>		(32 750)
Net Cash Surplus / Deficit		(36 315)
Balance as per Bank 1 July 2014		27 320
Budgeted Balance as per Bank 31 July 2014		(8 995)

The nine marks available for this question were allocated as follows.

- one mark for Receipts from Debtors and Cash Purchases of Stock
- one mark for Wages
- one mark for Advertising
- one mark for Interest, Other Expenses and GST paid
- one mark for Purchase of Equipment
- one mark for Disposal of Equipment

# 2014 Examination Report

- one mark for Drawings
- one mark for Loan Repayments
- one mark for correctly finishing the report with the calculation of the budgeted bank balance.

This question involved identifying cash flows from the information presented earlier in the reconstructed accounts. Some students did not attempt this question. It is vitally important that students attempt all questions, and be aware that when information is carried forward from previous questions, any errors from that question will not be penalised. Other errors included:

- reporting Credit Sales, rather than Receipts from Debtors
- including alien entries such as discounts, stock write down, sales returns and the profit on disposal.
- omitting the prepaid advertising amount from the cash flow for advertising
- preparing an Income Statement, rather than a Cash Flow Statement.

9c.

Marks	0	1	2	3	4	Average
%	52	17	14	10	7	1

Explanation: Cash and profit are two different concepts. The bank balance will be the result of all cash inflows less all cash outflows. The net profit is the result of revenue earned less expenses incurred. Some cash flows do not affect the Income Statement at all, and some revenue and expense items do not affect the cash flows at all.

Example 1: Purchase of new equipment.

Example 2: Advertising paid was \$12 300, but advertising incurred as an expense was only \$9 300.

This question had a constraint clearly stated in that students could not use the examples of the loan repayments or drawings. However, there was a further constraint in that the question stated that all purchases are made on a cash basis – that is, creditors do not exist for this business. Some students referred to excessive drawings, loan repayments and payments to creditors being greater than cost of sales.

## Question 10

10a.

Marks	0	1	2	3	Average
%	35	39	20	5	1

**Working space:** The Queen  $440 + 10$  delivery =  $450 \times 45$  units = 20 250

The Prince  $180 + 10$  delivery =  $190 \times 30$  units = 5 700

The Wiz NRV  $70 - 10$  coffee pods =  $60 \times 60 =$  3 600

29 550

**Value of stock in the Balance Sheet at 30 June**

**\$29 550**

One mark was allocated for calculating the value of each of the three products in stock. Some students found the question difficult, and it appears that they had difficulty coping with product costing, a stock loss and a stock write down all in the one question. This approach has been used before on examinations, and students and teachers are advised to practise questions featuring all three areas, rather than just dealing with one accounting issue at a time.

# 2014 Examination Report

## 10b.

Marks	0	1	2	3	4	Average
%	31	17	18	19	16	1.7

Stock valuation rule: Lower of cost and net realisable value

Accounting principle: Conservatism

Explanation: Conservatism demands that potential losses are recognised as soon as they are probable so that expenses are not understated and net profit is not overstated. In regards to stock, the necessary adjusting entry also ensures that assets (stock control) are not overstated and therefore owner's equity will also not be overstated.

Once again some students produced rote-learned responses in regards to conservatism, stating that losses should be recognised when probable and profits only when certain. In regards to the Wiz machines, no profit is expected and therefore this statement has no relevance to the question that was asked. Other students stated a qualitative characteristic such as reliability or relevance. Students are encouraged to learn the principles and qualitative characteristics but they must also ensure that they know the two groups are distinct from one another.

## 10c.

Marks	0	1	2	3	4	Average
%	38	16	17	15	15	1.5

## General Journal

Date 2014	Details	General Ledger		Subsidiary Ledger	
		Debit	Credit	Debit	Credit
30 Jun	Stock Write Down	2 400			
	Stock Control		2 400		
	Stock Loss	380			
	Stock Control		380		

Two marks were allocated to the Stock Write Down entry and two marks for the Stock Loss entry. The responses to this part of Question 10 continued the trend established by the first two parts of this question, with some students being challenged by the content.

## Question 11

Marks	0	1	2	3	4	5	6	Average
%	35	22	18	13	7	4	1	1.5

Discussion: While sales have increased by \$160 000, a lower percentage of each sales dollar is being retained as net profit. This could be caused by two possible scenarios. The first cause could be an increase in the cost price of the goods being sold, without a corresponding increase in selling prices. This effectively means that the average mark-up on stock has been decreased, which will lead to a lower net profit margin. The second reason is deteriorating expense control, meaning that more of each sales dollar is consumed by the expenses of the business. This will also lead to a decrease in the net profit margin, which indicates a decrease in profitability. The asset turnover rate has improved, indicating that assets are being used more effectively to generate sales revenue. This is in line with the increase in sales, which were up 20% on the previous reporting period. The return on assets is the result of the effectiveness of assets in generating sales, along with the percentage of the sales dollar that remains as net profit. Therefore, even though assets are generating more sales for every dollar invested in assets, the significant decrease in the net profit margin has resulted in an overall decline in profitability, brought about by increased cost prices and poor expense control.

Although there were different approaches taken to this question, some students found it a difficult task to discuss all the financial indicators provided. Some of the indicators appeared to indicate an improvement in profitability, while others showed it decreasing. This caused confusion for some students. The important thing to keep in mind with a 'discuss'-type question is that there may be a variety of responses that are valid. The important point is that when making a statement, always support it with evidence or a reason supporting the statement. For example, net profit margin decreasing could be caused by either cost prices increasing or poor expense control.

# 2014 Examination Report

This type of question should be seen by students as an opportunity to demonstrate their knowledge of accounting. Quite often the indicators provided may well show conflicting results. This should not be a concern – students should simply discuss the situation and support their responses with logical thinking based on sound accounting knowledge. Most importantly, full marks will not be awarded to very brief responses, which barely start to answer the point of discussion.

## Question 12

Marks	0	1	2	3	Average
%	56	19	17	8	<b>0.8</b>

Explanation: Debt funds may have been used to replace idle assets with more productive assets, which has led to an increase in net profit, leading to an increase in Return on Owner's Investment. If liabilities have increased then the percentage of funds contributed by the owner will be less, thus causing an increase in the Debt Ratio. The owner's investment may have also decreased due to drawings. This would mean that the business is now using liabilities to fund more of its assets and has less reliance on owner's investment. If the profit remains the same, under these conditions the Return on Owner's Investment may still increase.

Some students did not attempt this question. Of the students who did attempt this question, some had trouble fully explaining the changes in the financial indicators.