2018 VCE Accounting examination report

General comments

The 2018 Accounting examination consisted of eight questions, with most containing several parts. One graph was presented for interpretation in 2018. There was also one 'discuss' question, where students had to use a range of financial indicators to discuss why a business was experiencing a shortage of cash. Accounting processes such as recording in journals, ledger accounts and the preparation of reports were all covered, and a full Cash Flow Statement and a full Income Statement were both required. However, this should not be viewed as a guide for subsequent examinations. Students should always prepare thoroughly, ensuring that they revise all parts of the study design.

It appeared that most students managed their time well and were able to attempt all questions.

A major issue requiring further attention is ensuring students carefully read the question scenarios and note the full details of every question before answering. In Question 1 the business was clearly identified as Aaron's Auto, and this business returned goods to a supplier on 30 September. However, some responses included a sales return from a business named Aaron's Auto, which was the business discussed in the question. Similarly, in Question 2 there was a question relating to the undamaged cricket bats; however, some students explained how the damaged bats should be reported. Basic errors such as this can cause students to miss out on marks even when they have sound knowledge of a topic.

Another issue that needs to be addressed is the interpretation of financial indicators in relation to turnover of debtors, creditors and stock. In Question 4 stock turnover changed from 91 days to 111 days. However, in some responses this change was seen to be an increase in stock turnover. It is actually the opposite, as it has taken the business more days to turn its stock into sales. When commenting on turnover rates, students are reminded to use the terms slower or faster. In the above example, stock turnover was slower in the second period, which means that the business is taking longer to convert its stock into sales and therefore it is receiving cash at a slower rate.

Students should also be conscious of the importance of reading theoretical questions very carefully to ensure that the question posed is addressed adequately. Question 6 asked for an explanation of the implications for profitability and liquidity of an increase in the debt ratio. Some responses included a detailed explanation of the terms 'profitability' and 'liquidity', but this approach did not address the question being posed. Full definitions were not required and this had a negative impact on the marks being awarded.

Specific information

This report provides sample answers or an indication of what 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 resulting in a total more or less than 100 per cent.

Question 1a.

Marks	0	1	2	3	Average
%	20	12	14	53	2

Aaron's Auto
General Journal

Date 2018	Details	General Ledger Debit	General Ledger Credit	Subsidiary Ledger Debit	Subsidiary Ledger Credit
Jan 30	Creditors Control	2 420			
	Gap Supplies			2 420	
	Stock Control		2 200		
	GST Clearing		220		

One mark each was allocated for:

- the entries to Creditors Control and the Gap Supplies subsidiary account
- the Stock Control entry
- the GST Clearing entry.

Most students handled this question well, but common errors included:

- treating the entry as a sales return, rather than a purchases return
- omitting the subsidiary entry
- making a debit to Creditors Control, but then making a credit entry to Gap Supplies.

Question 1b.

Marks	0	1	2	Average
%	9	59	32	1.3

Working space

GST Clearing a/c. 500 + 410 + 180 + 220 – 41 = 1269

Balance of the GST Clearing account at 31 January 2018 **$** 1269 Cr

This question could have been approached in two ways. Some responses included a calculation as shown above, whereas others drew up a T-form ledger account to determine the balance of GST Clearing. Students are reminded that it is vital that working is shown in the box provided, as some students did not determine the correct answer but received a mark for their working.

Question 1c.

Marks	0	1	2	3	Average
%	35	22	23	20	1.3

Explanation: The Creditors Control account contains summarised information from the totals of the journals for the month, while the Schedule of Creditors is prepared from the individual creditors accounts in the subsidiary ledger. This schedule is used as a checking device to verify that the two sets of records agree. The total of the schedule should equal the balance of the Creditors Control account. If it doesn't, it indicates that a recording error has been made, and this needs to be identified and rectified before reports are prepared.

Many responses correctly described the relationship between the two sets of records. However, some confused the different records and indicated that the Control account reported the amounts owed to individual creditors, which is incorrect.

Question 1d.

Marks	0	1	2	3	Average
%	57	15	20	8	0.8

Explanation: Sales Returns is treated as a negative revenue item in the Income Statement because it reduces the sales revenue for a period. Sales is a revenue item because it causes an inflow of economic benefits, thereby increasing Owner's Equity. Sales Returns brings about a reduction in these inflows and is therefore a negative revenue that will cause a decrease in Owner's Equity because a lower profit will be reported for the period as a result of Sales Returns made.

This question required students to select one of the five elements of accounting, with the correct answer being revenue. Rather than explaining that Sales Returns is a negative revenue item, some students attempted to explain it as an expense item. When a sale is made, revenue is deemed to be earned. If a return is attempted by a debtor, it is at the discretion of the business whether or not the return will be accepted. If it is accepted, the revenue earned is then cancelled by the issuing of a credit note. For this reason, a sales return is classified as being a negative revenue item, rather than an expense item.

Question 2a.

Marks	0	1	2	3	4	5	Average
%	4	5	13	28	31	18	3.3

Stock Cards

Product: Test Cricket balls										Cost Assignment Method: FIFO
Date 2018	Details		IN			OUT			BALANCE	
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
1 June	Balance							48	30	1 440
5 June	Inv. 816	24	35	840				48 24	30 35	2 280
28 June	Inv. 2224				12	30	360	36 24	30 35	1 920
29 June	CN 45				6	35	210	36 18	30 35	1 710

Product: Power Plus cricket bats										Cost Assignment Method: FIFO
Date 2018	Details		IN			OUT			BALANCE	
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
1 June	Balance							20	220	4 400
30 June	Memo 61				2	220	440	18	220	3 960
	Memo 62				5	80	400	13 5	220 140	3 560

Five marks were available for the two Stock Cards and were allocated as one mark for each of the five entries: the correct date, the relevant document details, a correct entry in the IN or OUT column and the updated balance. However, some students did not realise that the first entry in the top Stock Card was incomplete and the balance had to be entered prior to recording the transactions provided. Another common error was not repeating the balance on hand at the start of the month (that is, 48 units at a cost of $30 each). An area of difficulty for some was the recording of the stock writedown, using the details of Memo 62. Most responses showed a full understanding of the entries required in Stock Cards.

Question 2b.

Marks	0	1	2	3	4	Average
%	21	25	23	18	13	1.8

Explanation and justification: The $400 selling price is simply what is hoped will be gained when the cricket bats are sold. However, this is not a reliable valuation as the bats may not be sold at this price. They may be sold for less or not sold at all. It is also possible that they may be sold for a higher price if there is an increase in demand. Under the accounting principle of conservatism, gains should not be recognised until they are certain. This is followed to ensure that both assets and profit are not overstated. As it is not certain that the bats will be sold, the only reliable figure to be used is the actual cost price, as source documents can verify this amount.

Some students made a crucial error when reading this question. The question referred to 'undamaged bats', but some responses referred to 'damaged bats'. These responses often discussed stock writedowns and looked at why a writedown should be recorded. This was not what the question required.

Question 3a.

Marks	0	1	2	3	4	5	6	7	8	Average
%	20	6	6	5	4	4	7	11	36	4.8

Debtors Control

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	37 000		**Bank**	**522 700**
	Sales/GST Clearing	528 000		Discount Expense	800
				Bad Debts	1 500
				Balance	40 000
		565 000			565 000

Stock Control

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	95 000		Cost of Sales	300 000
	Creditors Control	**306 000**		Balance	101 000
		401 000			401 000

Creditors Control

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank	**332 000**		Balance	50 500
	Balance	55 100		Stock Control/GST Clearing	336 600
		387 100			387 100

The reconstruction of ledger accounts is a particular skill that relies on knowledge of ledger templates. While different from the formal preparation of a ledger account, a reconstruction requires students to demonstrate knowledge of the double entry system in order to find some missing information. Students are strongly advised to revise templates for key areas such as debtors, creditors, stock and capital. Many responses to this question showed a full understanding of these templates.

Question 3b.

Marks	0	1	2	3	4	5	6	7	8	9	10	11	12	Average
%	35	11	8	7	6	5	4	4	4	4	4	3	3	3.4

Dynamic Traders

Cash Flow Statement for the year ended 30 June 2018

	$	$
Cash Flows from Operating Activities		
Receipts from debtors	522 700	
Payments to creditors	(332 000)	
Wages	(86 500)	
Insurance	(7 000)	
Interest	(2 000)	
Advertising	(10 800)	
GST paid	(2 780)	
GST settlement	(2 000)	
Net Cash Flow from Operating Activities		79 620
Cash Flows from Investing Activities		
Purchase of equipment	(10 000)	
Net Cash flow From Investing Activities		**(10 000)**

Cash Flows from Financing Activities		
Loan	16 000	
Loan repayments	(4 000)	
Drawings	(77 320)	
Net Cash Flow from Financing Activities		**(65 320)**
Net increase (decrease) in cash held		4 300
Balance as at 1 July 2017		4 100
Balance as at 30 June 2018		8 400

A variety of responses was given to this question. Some students confused a Cash Flow Statement with an Income Statement. It was also apparent that others were not sure how to deal with financing cash flows. The information provided included a loan under the heading of current liabilities and a statement indicated that scheduled loan repayments were made during the year. As current liabilities are due for settlement within the next 12 months, this current liability should have been included as a cash flow under financing activities. Many responses did not include this item.

Question 4a.

Marks	0	1	2	3	4	5	6	Average
%	15	14	20	20	14	10	7	**2.6**

Discussion: A business's cash position largely depends on having sufficient working capital, which is determined by deducting current liabilities from current assets. The management of current assets includes the ability of management to convert both stock and debtors into cash in a timely manner. While the Working Capital ratio has increased, it is likely to have been the result of increased stock levels, which would also account for the fall in the Quick Asset ratio. A higher proportion of stock, which is generally less liquid than debtors, leads to a slowing of the cash cycle and may be a factor in the cash shortage.

While Debtors Turnover is now faster, it is still well above the stated credit terms of 30 days, indicating issues with prompt invoicing or follow-up procedures. This will obviously make the cash cycle slow down and would lead to a cash shortage.

Stock Turnover has also slowed down and warrants investigation. A possible cause is the over ordering of less popular stock. Another possibility is the expansion of stock levels in anticipation of increased sales levels. Regardless of the cause, the turnover rates indicate that it is taking far too long to turn stock into sales and then debtors into cash. Again, this ties up cash for longer and will contribute to cash shortages.

Creditors Turnover on the other hand is now faster than that of the previous period. It is now only 23 days, which is faster than that required by the credit terms. Although this may be good for the firm's reputation, there is no discount available for such a prompt payment and management should aim to take full advantage of the credit terms available. Keeping in mind that both stock and

Debtors Turnovers are slower, the business should not have faster Creditors Turnover, as this simply increases the likelihood of a cash shortage.

A range of responses was given, with some excellent responses provided. Students are reminded that the above response is a sample answer and alternative approaches to ‘discuss’ questions may be considered and used.

Question 4b.

Marks	0	1	2	3	4	Average
%	10	8	20	21	41	2.8

Strategy 1: Eliminating slow-moving stock items. By focusing on the selling of fast-moving stock lines the average time taken to turn stock into sales will be faster. Therefore, cash will be received earlier by the business.

Strategy 2: Reduce the total amount of stock held. By cutting back on stock levels and using just-in-time ordering, the stock turnover should be faster and stock being converted into cash will be achieved in at a faster rate.

Two marks were awarded for each strategy supported by a justification. Some responses simply stated a strategy without including further comments and were not awarded full marks.

Question 5a.

Marks	0	1	2	3	4	5	6	7	8	9	10	Average
%	5	7	9	10	11	10	10	9	9	11	9	5.3

DC Computing

Cash Receipts Journal

Date 2018	Details	Rec. No.	Bank	Disc. Exp.	Debtors Control	Cost of Sales	Sales	Sundries	GST
6 Sep	Sales	345	3 900			2 000	3 500		400

Cash Payments Journal

Date 2018	Details	Chq. No.	Bank	Disc. Rev.	Creditors Control	Wages	Stock Control	Rent Expense	Sundries	GST
3 Sep	Wages	314	4 500			2 000				
	Accrued wages								1 300	

General Journal

Date 2018	Details	General Ledger		Subsidiary Ledger	
		Debit	Credit	Debit	Credit
5 Sep	Bad debts	960			
	Debtors Control		960		
	B Smith				960
6 Sep	Prepaid Sales Revenue	500			
	Sales Revenue		500		

Ten marks were allocated to this question, as follows:

- four marks for the Cash Receipts entry, including correct amounts for Bank, Cost of Sales, Sales and GST received.
- two marks for Wages and Accrued wages being recorded correctly
- two marks for the Bad Debts entry
- two marks for the adjusting entry for Prepaid Sales Revenue.

A variety of responses were provided, with a range of marks being awarded. Common errors included:

Cash Receipts Journal:

- an incorrect amount for Sales
- omission of the GST
- recording the sale in the debtors column, rather than the sales column

Cash Payments Journal:

- recording the entire payment as Wages and omitting the Accrued wages amount
- recording two separate amounts in the Bank column

General Journal:

- recording $240 as the bad debt, rather than the $960
- omitting the Subsidiary Ledger entry
- omitting the adjusting entry for the Prepaid Sales Revenue.

Question 5b.

Marks	0	1	2	3	Average
%	26	16	18	40	1.8

Explanation: Current assets would be overstated by $960 as the bad debt would not be written off. Owner’s Equity would also be overstated by $960 as the net profit would be overstated by $960. There would no effect on liabilities as bad debts decrease debtors and increase the expense known as bad debts.

Many responses were awarded full marks for this question. Generally, students appeared to be well prepared for a question assessing the two-fold effect on the accounting equation.

Question 5c.

Marks	0	1	Average
%	46	54	0.6

Working space	
40% of $16 200 = $6 480 $6 480/12 = $540	
Depreciation of Van for September 2018	$ 540

Many students were not able to complete a basic calculation of depreciation under the reducing balance method.

Question 5d.

Marks	0	1	2	3	4	5	6	Average
%	33	9	7	7	8	14	22	2.8

DC Computing

General Journal

Date 2018	Details	General Ledger		Subsidiary Ledger	
		Debit	Credit	Debit	Credit
30 Sep	Disposal of Van	45 000			
	Van		45 000		
	Accumulated Dep'n of Van	29 340			
	Disposal of Van		29 340		
	Sundry Creditor – Nifty Vans	10 000			
	Disposal of Van		10 000		
	Loss on Disposal of Van	5 660			
	Disposal of Van		5 600		
	Van	55 000			
	GST Clearing	5 500			
	Sundry Creditor – Nifty Vans		60 500		

The six marks available on this question were allocated as follows:

- one mark for each of the four entries required to record the disposal of van
- two marks for recording the purchase of the new van

Although there were some very accurate responses provided, some responses did not score any marks. Common errors included:

- recording an incorrect cost for the van
- incorrect calculation of the accumulated depreciation amount
- recording the disposal as a cash receipt, rather than as a trade-in
- incorrect titles of the ledger accounts involved
- omitting the loss on disposal entry, or recording it as a profit.
- the purchase of the new van being recorded as Creditors Control, rather than a Sundry Creditor.

Question 6

Marks	0	1	2	3	4	Average
%	46	18	15	11	9	1.2

Explanation: The graphs reveal that there has been an increase in the overall borrowing of the business. Alternatively, the increase in the debt ratio may have been caused by a decrease in Owner's Equity. When the Debt Ratio increases, it may bring about a positive change on the profitability of the business. The borrowed funds may be used to purchase new, more efficient assets that hopefully can increase the revenue of the business. This may lead to an increase in Net Profit, as long as the cost of borrowing the money is less than the additional revenue being generated. When profit is compared to the owner's investment, the ROI can increase when borrowed funds are used to purchase new assets.

In regards to liquidity, borrowing money can have an immediate, positive effect on the liquidity of the business as a large sum of cash may be received. However, the negative impact is two-fold: interest is usually payable on borrowed funds, which will have a negative impact on the cash flows of the business, and regular loan repayments can have a significant impact on cash flows and liquidity over many years. Instalment loans necessitate careful planning by a business owner as cash must be on-hand when repayments are due, and if a business is struggling to generate cash, loan repayments may become a significant cash flow issue.

It is important to note that when responding to a question such as this, both parts of the question must be addressed. Some responses focused on profitability, without ever mentioning liquidity. This question required a response to both areas of business performance and students are strongly advised to read questions carefully and then respond fully.

Question 7a.

Marks	0	1	2	3	4	5	Average
%	29	11	11	14	18	17	2.3

Katy's Cakes

General Ledger

Prepaid Advertising

Date 2018	Cross-reference	Amount	Date 2018	Cross-reference	Amount
1 Sep.	Balance	3 800	30 Sep.	Advertising	4 300
30 Sep.	Bank	2 400		Balance	1 900
		6 200			6 200
1 Oct.	Balance	1 900			

Advertising Expense

Date 2018	Cross-reference	Amount	Date 2018	Cross-reference	Amount
30 Sep	Prepaid advertising	4 300	30 Sep	P&L Summary	4 300

Three marks were allocated to the Prepaid Advertising account, with two marks being allocated to the Advertising Expense account. The question stated that accounts were to be closed or balanced (as required). Students were required to use their knowledge in relation to balance day. Prepaid Advertising is an asset account and therefore should be balanced. The Advertising Expense account is required to be closed off to the P&L Summary account. These two processes were an integral part of this question but were not completed in some responses.

Question 7b.

Marks	0	1	2	3	Average
%	20	23	26	32	1.7

Accounting principle: Reporting period

Explanation: The Advertising Expense account requires closing as it represents the expense incurred for the current reporting period. It is closed off to the P&L Summary account in order to help determine an accurate net profit for the period. The second reason for the closing entry is to return the expense account back to a zero balance in preparation for the next reporting period. This prevents counting the expense over two consecutive periods.

Question 8a.

Marks	0	1	2	3	4	5	6	7	8	Average
%	21	6	9	10	12	13	14	10	4	3.6

Peter's Pots

Budgeted Income Statement for the month ending 31 October 2018

	$	$
Revenue		
Cash Sales	103 500	
Credit Sales	34 500	138 000
Less Sales Returns		1 800
Net sales		136 200
Less Cost of goods sold		
Cost of Sales	68 100	
Customs Duty	1 250	69 350
Gross Profit		66 850
Less Stock Write-down		500
Adjusted Gross Profit		66 350
Plus Other Revenue		
Discount Revenue		1 200
		67 550
Less Expenses		
Wages	9 300	
Depreciation of Fittings	2 800	
Bad Debts	1 450	
Interest	100	
Rent	2 600	16 250
Net Profit		51 300

One mark each was allocated for:

- the correct Sales figure, along with the Sales Returns figure
- Cost of Sales

- Customs Duty
- Stock Write-down and the adjusted gross profit figure
- Discount Revenue and the subsequent subtotal
- Rent expense
- any two other expense items
- any other two expenses.

The Cost of Sales figure had to be 50% of the net sales figure. Cost of Sales increases when goods are sold and decreases when returns are accepted from debtors. Some responses based the Cost of Sales figure on 50% of the gross sales, which was technically incorrect. Other common errors included incorrect classification of various items, formatting errors within the report and the omission of rent expense.

Question 8b.

Marks	0	1	2	3	4	Average
%	27	25	27	13	8	1.5

Explanation: Planning allows management to set targets for sales and profit and they can then identify issues that may have an impact on these results. Management may decide to change mark-ups or devise alternative strategies to improve business performance.

In terms of control, when reviewing predicted performance, management may see the need to cut back on expenses and put measures in place to ensure that expenses are kept within reasonable limits of spending.

This question required students to focus on the use of a Budgeted Income Statement in relation to planning and control. Some students focused on the use of a variance report, which was not required by the question.

Question 8c.

Marks	0	1	2	3	4	5	6	Average
%	20	8	14	20	10	12	17	3

Description: Cash sales had a favourable variance as more cash was generated than that predicted by the budget. This could have been the result of the $3 500 spent on advertising in the month of September.

Receipts from debtors was also a favourable variance as more cash was collected than that predicted in the budget. This could have been achieved through the tightening of collection procedures, including actions such as more prompt invoicing and reminders being sent to slow payers.

Payments to creditors were less than predicted. This also represents a favourable variance, which may have been achieved by management using the full extent of credit terms and keeping cash within the business for longer periods of time.

This question was answered well by many students. Many correctly identified all three variances as favourable and provided a variety of logical reasons. However, some responses were not specific in relation to identifying the favourable variances and some did not provide valid reasons for the variances. Some responses simply stated that it was above or below budget. Students are strongly advised to always use the terms ‘favourable’ and ‘unfavourable’ whenever referring to budget variances.