**2020 ACCOUNTING Unit 3**

**Area of Study 2: Preparing and interpreting accounting reports**

**SAC**

**SOLUTION**

**Question 1** (20 marks)

|  |  |
| --- | --- |
|  | 6 marks |

**Lucia’s Coffee Cups**

**General Ledger**

**Bank**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date****2020** | **Cross Reference** | **Amount $** | **Date****2020** | **Cross Reference**  | **Amount $** |
| **1/5** | **Capital** | **20 000** | **15/5** | **Wages** | **3 000** |
| **1/5** | **Loan – YLE Bank** | **30 000** | **29/5** | **Drawings** | **3 400** |
| **28/5** | **Accounts receivable – Green Tapas** | **440** | **31/5** | **Loan – YLE Bank** | **500** |
|  |  |  | **31/5** | **Balance** | **43 540** |
|  |  | **50 440** |  |  | **50 440** |
| **1/6**  | **Balance** | **43 540** |  |  |  |

***1 mark for the Capital***

***1 mark for each Loan – YLE Bank entries***

***1 mark for Accounts receivable – Green Tapas***

***1 mark for Wages***

***I mark for Drawings***

***1 mark for completing the balancing process correctly. Students are required to know that as Bank is an asset, it is balanced, not closed***

***Deduct 1 mark for incorrect titles***

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| **b.** | 3 marks |

**Lucia’s Coffee Cups**

**Cash Flow Statement (extract) for 31 May 2020**

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
| **Cash Flow from Financing Activities** |  |  |
| **Capital** | **20 000** |  |
| **Loan – YLE Bank** | **30 000** |  |
| **Drawings** | **(3 400)** |  |
| **Loan repayment – YLE Bank** | **(500)** |  |
| **Net Cash Flow from Financing Activities** |  | **46 100** |

***1 mark for the Capital and Loan – YLE Bank***

***1 mark for Drawings***

***1 mark for Loan repayment - YLE Bank***

***Deduct 1 mark if report not completed as per the solution shown***

|  |  |
| --- | --- |
| **c.** | 4 marks |
|  **Lucia’s Coffee Cups****Balance Sheet (extract) as at 31 May 2020** |  |

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
| **Current Assets** |  |  |
| **Bank** | **43 540** |  |
| **Inventory** | **1 200** |  |
| **Accounts receivable** | **220** |  |
| **GST Clearing** | **90** | **45 050** |
| **Non-current assets** |  |  |
| **Vehicle** |  | **14 000** |
| **TOTAL ASSETS** |  | **59 050** |

***1 mark for every two entries in the Current Assets, with a consequential mark from 1a. being allocated for Bank***

***1 mark for Vehicle***

***Deduct 1 mark if report not completed as per the solution shown***

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| **d.** | 3 marks |
| **Qualitative characteristic Timeliness (1)** |
| **Explanation By preparing financial reports on the last day of each month, information about Luca’s Coffee Cups will be available to decision makers in time to be capable of influencing their decisions. As decision makes will have information sooner, rather than later, the capacity to influence decisions will be enhanced. (1) As generally, the older the information, the less useful it is, it can be determined that the information provided by Luca’s Coffee Cups is more useful. This means that Luca’s Coffee Cups has upheld the qualitative characteristic of timeliness. (1)** |

|  |  |
| --- | --- |
| **e.** | 4 marks |
| **Under accrual accounting, cash and profit are different resources. Cash is the difference between cash inflows and cash outflows, whereas profit is revenue earned less expenses incurred. (1) Not all cash inflows are revenue and not all cash outflows are expenses. Not all revenue items are cash inflows and not all expenses are cash outflows. (1) Referring to the transaction on 12 May 2020, this resulted in revenue of $400 being earned by Luca’s Coffee Cups, but there was no cash inflow. When the customer, Green Tapas, repaid the amount owing of $440, this resulted in an increase in cash at bank, but no revenue was earned. Furthermore, the customer repaid the full amount owing, including the GST charged at the time of the credit sale, however, the GST charged is not revenue. (1) Therefore, in this example, the cash collected from the accounts receivable ($440) is more than the revenue earned ($400) on the credit sale, hence cash and profit are different. (1)** |

**Question 2** (14 marks)

|  |  |
| --- | --- |
|  | 5 marks |

**Sam’s Sports Shoes**

**General Journal**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date****2020** | **Details** | **Debit** | **Credit** |
| **31/5** | **Cash sales** | **40 000** |  |
|  | **Credit sales** | **30 000** |  |
|  | **Inventory gain** | **300** |  |
|  | **Discount revenue** | **2 000** |  |
|  | **Interest revenue** | **400** |  |
|  | **Sales returns** |  | **1 500** |
|  | **Profit and Loss Summary** |  | **71 200** |

***1 mark for cash sales and credit sales***

***1 mark for inventory gain***

***1 mark for discount revenue and interest revenue***

***1 mark for sales returns***

***1 mark for Profit and Loss Summary***

***Deduct 1 mark if report not completed as per the solution shown***

|  |  |
| --- | --- |
|  | 3 marks |
|

|  |
| --- |
| **Accounting assumption The period assumption (1)** |
| **Explanation One reason for closing the revenue and expense accounts is to bring these to zero in preparation for the next reporting period OR on reason for closing the revenue and expense accounts is to calculate accurate net profit for the current reporting period. (1)** |
| **Closing revenue and expense accounts upholds the period assumption, which states that reports are prepared for a particular period of time, such as a month or a year, in order to obtain comparability of results. Profit determination involves a process of recognising the revenue for a period and deducting the expenses incurred for that same period. A distinction can be made between assets, which will provide benefit to future reporting periods, and expenses that are totally consumed within one reporting period. (1)** |

|  |  |
| --- | --- |
|  | 4 marks |

|  |
| --- |
| **Discussion When taking into account ethical issues, Sam needs to consider the Triple Bottom Line: Social, Environmental and Financial. (1) Sam’s Sports Shoes needs to consider the impact on the people involved in the supply chain of the basketball shoes, as the business is supporting a supplier that is known for exploiting its workers. (1) Additionally, Sam’s Sports Shoes needs to consider the impact on the environment of changing suppliers, as there is no evidence that the new supplier uses recycled materials, so this will have a detrimental effect on the environment. (1) Finally, the business needs to consider the financial issues associated with this change. As the cost price of basketball shoes is less, because there is no suggestion that Sam’s Sports Shoes will lower the selling price, the mark-up will effectively be increased. This will improve Gross Profit and therefore Net Profit, in the short term. Nonetheless, if customers discover what has happened, they may stop purchasing all sports shoes in the future. Furthermore, the business may receive negative publicity, which may then result in further loss of sales revenue. (1)** |

|  |  |
| --- | --- |
|  | 2 marks |
| **Explanation One reason for the Sales Returns of $1 500 is that customers are unhappy about the change in supplier. Customers may have found out about the new supplier, and have returned the basketball shoes due to ethical reasons and/or poor quality of the new basketball shoes. (1)** **Irrespective of the reason for the Sales Returns, Sam should be concerned, as not only does this lower his profit (as Sales Returns are a negative revenue), when customers are dissatisfied, this can also lead to loss of future income for the business. (1)**  |

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**Question 3** (6 marks)

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| **Overall, the profitability of Wood Craft Tables has improved from 2019 to 2020. The Return on Owner’s Investment, which measures how effectively a business has used the owner’s capital to earn a profit, has experienced a favourable trend, increasing by 2.2% from 2019 to 2020. Nonetheless, the Debt Ratio has seen a deterioration as it has increased by 20%. Although this financial indicator measures stability, not profitability, this shows that the business is more reliant on external funds. Having a significant debt will put pressure on the profitability in the future, due to the interest expense lowering net profit. The Debt Ratio may also somewhat explain the improved Return on Owner’s Investment.**  |
| **The Net Profit Margin and Return on Assets have also improved from 2019 to 2020, with increases of 2% and 2.5% respectively. The favourable result in the Net Profit Margin may be explained by Wood Craft Tables improving its expense control, because more sales revenue has been retained by Net Profit. This is supported by the increase in the Return on Assets, which shows the business has earned more profit from the investment in assets, which may also be due in to improved expense control. An improvement in expense control can also be a reason for the favourable trend in the Return on Owner’s Investment.** |
| **Nevertheless, there has been a deterioration in the Gross Profit Margin by 3%. The change in the Gross Profit Margin is due to a decrease in the average mark-up, as less sales revenue is retained by Gross Profit. This may be due to an increase in cost price with the selling price either remaining the same, or increasing but as not as much as the change in the cost price. Alternatively, Wood Craft Tables may have lowered its selling price, but not changed its cost price, or not as much as the reduction in the selling price. Additionally, the Asset Turnover is slower by 0.5 times per period in 2020 when compared to 2019. This shows that assets are being used less productively to generate sales revenue, and this is an unfavourable trend. Although the Return on Assets improved, this may have been because of an improvement in expense control, not a better use of assets.**  |
| **Therefore, whilst there is evidence of favourable trends in some financial indicators, suggesting an improvement in the profitability of Wood Craft Tables, there are other results which indicate otherwise.** |

***This question is to be marked globally***

***Marks are not to be awarded when students restate the data provided, as this does not demonstrate knowledge of financial indicators.***

**END OF SOLUTION**