

# BOOK 1: TABLE OF CONTENTS

## Section 1: Topic Tests

Unit 3, Test 1: Accounting Principles, Characteristics & Elements	6
Unit 3, Test 2: Double Entry Recording in Accounting	12
Unit 3, Test 3: Recording & Reporting of Stock	19
Unit 3, Test 4: Balance Day Adjustments & Depreciation of Non-Current Assets	25
Unit 3, Test 5: Profit & Loss	31
Unit 3, Test 6: Cash Flow Statement	38
Unit 4, Test 1: Stock Returns & Valuation	44
Unit 4, Test 2: Non-Current Assets	50
Unit 4, Test 3: Balance Day Adjustments: Revenue	55
Unit 4, Test 4: Budgeting	60
Unit 4, Test 5: Profitability & Liquidity	69

## Section 2: Trial Examinations

Trial Examination 1	74
Trial Examination 2	92
Trial Examination 3	111
Trial Examination 4	129

# BOOK 2: TABLE OF CONTENTS

## Section 1: Model Solutions & Marking Schemes

Unit 3, Test 1: Accounting Principles, Characteristics & Elements	6
Unit 3, Test 2: Double Entry Recording in Accounting	11
Unit 3, Test 3: Recording & Reporting of Stock	17
Unit 3, Test 4: Balance Day Adjustments & Depreciation of Non-Current Assets	23
Unit 3, Test 5: Profit & Loss	28
Unit 3, Test 6: Cash Flow Statement	35
Unit 4, Test 1: Stock Returns & Valuation	40
Unit 4, Test 2: Non-Current Assets	45
Unit 4, Test 3: Balance Day Adjustments: Revenue	50
Unit 4, Test 4: Budgeting	55
Unit 4, Test 5: Profitability & Liquidity	62
Trial Examination 1	68
Trial Examination 2	84
Trial Examination 3	101
Trial Examination 4	118

## Section 2: Detailed Solutions

Unit 3, Test 1: Accounting Principles, Characteristics & Elements	137
Unit 3, Test 2: Double Entry Recording in Accounting	144
Unit 3, Test 3: Recording & Reporting of Stock	150
Unit 3, Test 4: Balance Day Adjustments & Depreciation of Non-Current Assets	156
Unit 3, Test 5: Profit & Loss	164
Unit 3, Test 6: Cash Flow Statement	169
Unit 4, Test 1: Stock Returns & Valuation	174
Unit 4, Test 2: Non-Current Assets	178
Unit 4, Test 3: Balance Day Adjustments: Revenue	183
Unit 4, Test 4: Budgeting	188
Unit 4, Test 5: Profitability & Liquidity	194
Trial Examination 1	199
Trial Examination 2	212
Trial Examination 3	223
Trial Examination 4	236

# UNIT 3, TEST 1

## ACCOUNTING PRINCIPLES, CHARACTERISTICS & ELEMENTS

Writing time: 23 minutes (exam standard), 15 minutes (challenge)

### Structure of Test

<i>Number of questions</i>	<i>Number of questions to be answered</i>	<i>Number of marks</i>
3	3	23

### Question 1

John Smith owns Smith's Sporting Goods, a business selling sporting goods and apparel. He has provided the following information regarding accounts on 31 December 2013.

- Cash at Bank: \$3 000
- Stock: \$20 000
- Vehicle: \$30 000 (historical cost), carrying value: \$25 000
- Creditors Control: \$4 000
- Debtors Control: \$2 000
- Loan – DD Bank: \$10 000 (repayable at \$2 000 per year on June 30)

a. Calculate the amount of Capital invested in the business as at 31 December 2013.

<b>Calculation</b>
<b>Capital as at 31 December 2013</b> \$

1 mark

b. Prepare a classified Balance Sheet as at 31 December 2013.

**Smith's Sporting Goods**  
**Classified Balance Sheet as at 31 December 2013**

<b>Current Assets</b>	<b>\$</b>	<b>\$</b>	<b>Current Liabilities</b>	<b>\$</b>	<b>\$</b>

3 marks

c. Referring to your answer above, **explain** your treatment of the loan in the Balance Sheet.

<b>Explanation</b>

2 marks

**d. Explain** why the Balance Sheet classifies assets and liabilities as current or non-current. **State** the Qualitative Characteristic that supports this classification.

<b>Explanation</b>
<b>Qualitative Characteristic</b>

2 + 1 = 3 marks

Total 9 marks

## Question 2

Paul owns Paulsterios, a business which sells Hi-Fi equipment. On 30 June 2013, he provided you with the following document.

	Tax Invoice Receipt: 19 Paulsterios 1 Girt Street, Carlton VIC 3053
Date: 28 June 2013	
Received from: Jake Rix	
For: Cash Sale of 2 Siny Sterios	
Amount: \$1 100 (including \$100 GST)	

a. Referring to **one** Accounting Principle and **one** Qualitative Characteristic, **explain** the use of the above document.

<b>Accounting Principle</b>
<b>Qualitative Characteristic</b>
<b>Explanation</b>

1 + 1 + 2 = 4 marks

Paul believes that he can take the \$1 100 he has received and spend it on personal items without recording it because he is the owner of the business.

b. With reference to an Accounting Principle, **explain** why he is incorrect.

<b>Accounting Principle</b>
<b>Explanation</b>

1 + 1 = 2 marks

c. Referring to the definition of an expense, **explain** why there is an expense involved with the sale of stock.

<b>Explanation</b>

2 marks

Total 8 marks



# MODEL SOLUTIONS & MARKING SCHEME

## UNIT 3, TEST 1

### ACCOUNTING PRINCIPLES, CHARACTERISTICS & ELEMENTS

#### Question 1

a. Calculate the amount of Capital invested in the business as at 31 December 2013.

<b>Calculation</b>	
20 000 + 25 000 + 2 000 + 3 000 = 50 000	
4 000 + 10 000 = 14 000	
50 000 – 14 000 = 36 000	
<b>Capital as at 31 December 2013</b>	<b>\$ 36 000</b>

1 mark

One mark for correct answer

Zero marks for incorrect answer

b. Prepare a classified Balance Sheet as at 31 December 2013.

**Smith's Sporting Goods**  
**Classified Balance Sheet as at 31 December 2013**

Current Assets	\$	\$	Current Liabilities	\$	\$
Bank	3 000		Creditors Control	4 000	
Stock Control	20 000		Loan – DD Bank	2 000	6 000
Debtors Control	2 000	25 000	<b>Non-Current Liabilities</b>		
<b>Non-Current Assets</b>			Loan – DD Bank		8 000
Vehicle	30 000		<b>Owner's Equity</b>		
less Accumulated Depreciation – Vehicle	5 000	25 000	Capital		36 000
<b>Total Assets</b>		50 000	<b>Total Equities</b>		50 000

3 marks

c. Referring to your answer above, **explain** your treatment of the loan in the Balance Sheet.

Reference must be made to these points (one mark per point):

- Loan is both a current liability and a non-current liability
- Will result in a future outflow of economic benefit within the next 12 months for the part paid next year and also an outflow when the rest is paid after 12 months

*Sample Answer:*

The loan from DD Bank is treated as both a current and non-current liability. This is because the loan will result in a future outflow of economic benefit within the next 12 months when part of the loan is repaid next year. A further outflow is expected after 12 months, and hence, this portion is treated as a non-current liability.

**d. Explain** why the Balance Sheet classifies assets and liabilities as current or non-current. **State** the Qualitative Characteristic that supports this classification.

Reference must be made to these points (one mark per point):

- Makes reports easier to understand
- Aids the owner in decision-making
- Qualitative Characteristic: Understandability

*Sample Answer:*

Because the owner of the business may not have a vast knowledge of accounting, the Balance Sheet should be classified into current and non-current assets and liabilities, which makes the report easier to understand and can aid in the owner's decision-making regarding the business.

## Question 2

a. Referring to **one** Accounting Principle and **one** Qualitative Characteristic, **explain** the use of the above document.

One mark awarded for each of the following:

- Accounting Principle: Reporting Period
- Qualitative Characteristic: Reliability
- Cash receipts detail that a sale has occurred in the current reporting period
- Records and reports will therefore be accurate and free from bias

*Sample Answer:*

The above cash receipt details a cash sale made in the current reporting period. It may be needed to verify sales made during this period, which will ensure that records and reports are kept accurate and free from personal bias.

b. With reference to an Accounting Principle, **explain** why he is incorrect.

One mark awarded for each of the following:

- Accounting Principle: Entity Principle
- Paul is separate from his business

*Sample Answer:*

Paul and his business are separate entities and must therefore be treated as such. He must record any money he withdraws or injects into the business. If Paul decides to spend the \$1100 he has received on personal items, this must be recorded as drawings.

Students must answer this question in relation to Paul's scenario. Generic responses such as 'Because the business is separate from its owner' will not be accepted.

c. Referring to the definition of an expense, **explain** why there is an expense involved with the sale of stock.

One mark awarded for each of the following:

- The selling of stock involves an outflow of economic benefit in the form of a decrease in Assets (Stock Control).
- The decrease in stock also decreases Owner's Equity (Net Profit) when the stock leaves the business.

Students must link their answer to the movement of stock.

*Sample Answer:*

Because stock has left the business after a sale, it creates an outflow of economic benefit in the form of a decrease in Assets (Stock Control) and Owner's Equity (Net Profit). Therefore, this movement of stock is considered an expense (Cost of Sales).

### **Question 3**

**Discuss** how Accounting Principles are involved in the accounting process.

One mark awarded for the following point:

- The accounting process involves four steps: Source Documents, Records, Reports, Advice

One mark awarded for each of the following points (any five points to receive five marks):

- **Entity Principle** ensures records and reports separate the owner from the business
- **Reporting Period Principle** ensures that the life of the business is separated into time periods so that profit can be calculated and reports can be prepared
- **Going Concern Principle** assumes that the business will have an infinite life so that advice can be given for the future
- **Historical Cost Principle** ensures that all items are recorded at their historical cost, which is verifiable by source documents to ensure that records and reports are accurate and free from bias
- **Conservatism Principle** takes the worst-case scenario approach to accounting so that Assets and Net Profit are not overstated, and so records and reports lead to more prudent decision-making and advice
- **Consistency Principle** ensures that records and reports are prepared the same way over time so that they can be useful for making comparisons and giving advice

- **Monetary Unit Principle** ensures that records and reports are reported in the correct currency to avoid inaccuracy

*Sample Answer:*

The accounting process involves four steps: Source Documents, Records, Reports, and Advice. Accounting Principles are used in relation to this process and assist in ensuring that the business continues to operate smoothly. The Entity Principle requires that records and reports separate the owner from the business; this ensures that the owner maintains strict boundaries regarding transactions with the business. The Reporting Period Principle states that the life of the business should be separated into time periods so that profit can be calculated and reports can be prepared. The Going Concern Principle assumes that the business will have an infinite life, allowing advice to be given for the future. The Historical Cost Principle ensures that all items are recorded at their historical cost, which is verifiable by source documents to ensure that records and reports are accurate and free from bias. The Conservatism Principle takes the worst-case scenario approach to accounting by ensuring that Assets and Net Profit are not overstated, resulting in records and reports which allow the owner to make more confident decisions. The Consistency Principle ensures that records and reports are prepared the same way over time so that they can be useful for comparison purposes. The Monetary Unit Principle ensures that records and reports are reported in the correct currency to avoid inaccuracy.

**DETAILED SOLUTIONS**  
**UNIT 3, TEST 1**  
**ACCOUNTING PRINCIPLES, CHARACTERISTICS**  
**& ELEMENTS**

**Question 1**

a. **Calculate** the amount of Capital invested in the business as at 31 December 2013.

This question asks students to determine which accounts are assets and which accounts are liabilities in order to calculate Capital. Using the accounting equation (Assets = Liabilities + Owner's Equity), \$36 000 is calculated as Capital after Liabilities are subtracted from Assets.

*Sample Answer:*

**Calculation**

$$20\ 000 + 25\ 000 + 2\ 000 + 3\ 000 = 50\ 000$$

$$4\ 000 + 10\ 000 = 14\ 000$$

$$50\ 000 - 14\ 000 = 36\ 000$$

<b>Capital as at 31 December 2013</b>	<b>\$ 36 000</b>
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**b. Prepare** a classified Balance Sheet as at 31 December 2013.

Students should know the general format of a classified Balance Sheet and how each account is classified. Below is a detailed description of each account in the Balance Sheet:

<b>Bank</b>	<b>Current Asset</b> Cash in the bank is expected to provide future economic benefit within the next 12 months.
<b>Stock Control</b>	<b>Current Asset</b> Stock is expected to provide future economic benefit when it is sold at a profit. This is expected to occur within the next 12 months.
<b>Debtors Control</b>	<b>Current Asset</b> Debtors are expected to repay the business within the next 12 months, which will provide an inflow of economic benefit.
<b>Vehicle</b>	<b>Non-Current Asset</b> The vehicle is expected to provide economic benefit to the business for more than 12 months.
<b>Accumulated Depreciation</b>	<b>Negative Asset</b> As the vehicle is used by the business, it is also consumed, which causes a negative effect on the asset.
<b>Creditors Control</b>	<b>Current Liability</b> When the business repays its creditors, it causes an outflow of economic benefit. This is expected to occur within the next 12 months.
<b>Loan</b>	<b>Current/Non-Current Liability</b> When the loan is repaid, there is an outflow of economic benefit. Because part of the loan is repaid within 12 months and the rest is repaid afterwards, it is both a current and non-current liability.
<b>Capital</b>	<b>Owner's Equity</b> Capital is the amount that the owner has contributed to the business. It can also be considered the amount that the business 'owes to the owner'.

c. Referring to your answer above, **explain** your treatment of the loan in the Balance Sheet.

The question asks students to refer to the answer above (in the Balance Sheet). Therefore, students must mention where they have placed the loan. Because part of the loan is paid within 12 months and the rest is paid after that, it is both a current and non-current liability.

*Sample Answer:*

The loan from DD Bank is treated as both a current and non-current liability. This is because the loan will result in a future outflow of economic benefit within the next 12 months when part of the loan is repaid next year. A further outflow is expected after 12 months, and hence, this portion is treated as a non-current liability.

**d. Explain** why the Balance Sheet classifies assets and liabilities as current or non-current. **State** the Qualitative Characteristic that supports this classification.

Students should remember that not all business owners are experts at accounting. Therefore, reports should be prepared in a manner that is easily understandable to both the accountant and the business owner/investors.

The Qualitative Characteristic being followed when the Balance Sheet is classified is Understandability. By separating assets and liabilities into those that are current and those that are non-current, the owner will have a better understanding of the current position of their business, which can allow them to make better decisions regarding the business' future.

*Sample Answer:*

Because the owner of the business may not have a vast knowledge of accounting, the Balance Sheet should be classified into current and non-current assets and liabilities, which makes the report easier to understand and can aid in the owner's decision-making regarding the business.

## Question 2

a. Referring to **one** Accounting Principle and **one** Qualitative Characteristic, **explain** the use of the above document.

The document given is a cash receipt, which gives the business information regarding the cash sale that was made. As the cash receipt is a source document, it aids the business in maintaining accurate records, which allows them to follow the Qualitative Characteristic of Reliability. The cash receipt also details that the sale has been made in the current reporting period and will be essential in determining profit.

It is important that students remember to provide a link to the Principle or Characteristic they have mentioned. When using Reliability, key words that should always be mentioned are 'accurate and free from bias'. Because examiners don't have a lot of time to mark exams, it is important that you mention these key words to tell the examiner that you understand the reason behind using Reliability. For the Reporting Period Principle, key words include 'accurate profit' and 'current reporting period'.

*Sample Answer:*

The above cash receipt details a cash sale made in the current reporting period. It may be needed to verify sales made during this period, which will ensure that records and reports are kept accurate and free from personal bias.

b. With reference to an Accounting Principle, **explain** why he is incorrect.

Paul is a separate entity from his business, as per the Entity Principle, and therefore any transactions he makes with his business must be appropriately recorded. This also ensures that reports are accurate.

This question refers to the scenario given in the question. Because the question asks students why Paul is incorrect, they must refer to Paul in the question. It is common for students to answer these questions with answers such as 'Because the owner is separate from the business according to the Entity Principle', and while this refers to the correct concept, it will not receive marks because the student has not linked it to the question. Examiners have written in Assessment Reports that they do not like 'rote-learned responses', and by linking back to the question, students will be less likely to fall into this trap.

*Sample Answer:*

Paul and his business are separate entities and must therefore be treated as such. He must record any money he withdraws or injects into the business. If Paul decides to spend the \$1100 he has received on personal items, this must be recorded as drawings.

c. Referring to the definition of an expense, **explain** why there is an expense involved with the sale of stock.

When selling stock, the expense incurred is 'Cost of Sales'. An expense is an outflow of economic benefit which decreases Assets and Owner's Equity. Cost of Sales is an expense because there is an outflow of economic benefit in the form of a decrease in Assets (Stock Control) which also decreases Net Profit and Owner's Equity.

This is a very common exam-type question which examines whether students understand how expenses are classified. Because the question asks students to refer to the definition of an expense, their answer must include 'outflow of economic benefit', 'decrease in Assets' and 'decrease in Owner's Equity'.

It is important that students remember to refer to stock in this question. Answers such as 'Because there is an outflow of economic benefit which decreases Assets and Owner's Equity' will not be accepted because they do not show the examiner why the stock movement is an expense. The above is a classic example of a rote-learned response, which is highly discouraged.

*Sample Answer:*

Because stock has left the business after a sale, it creates an outflow of economic benefit in the form of a decrease in Assets (Stock Control) and Owner's Equity (Net Profit). Therefore, this movement of stock is considered an expense (Cost of Sales).

### **Question 3**

**Discuss** how Accounting Principles are involved in the accounting process.

Although not often asked, the accounting process should be known by all students. The four steps involved are actually the entire Accounting course. The business starts off with source documents (receipts, cheque butts, invoices, memos, etc.), which are recorded into records (journals, ledgers). From the records, the business will generate reports (Income Statement, Cash Flow Statement, Balance Sheet). Finally, advice is given after an analysis of the performance revealed by the reports. This question is asking whether students understand how Accounting Principles work in relation to the business' operations.

- **Entity Principle** separates the business from the owner, and records and reports are kept on this basis. The owner must also provide source documents for any transactions they have with the business.
- **Reporting Period Principle** ensures that records and reports are separated into periods of time so that profit can be calculated. If the business did not separate the life of the business into periods, reports would be unable to be prepared and profit would not be calculated.

- **Going Concern Principle** assumes that the business will have an infinite life, allowing advice to be given for the future. It also allows the business to have prepaid and accrued accounts in its records and reports, as these will affect the business in the future.
- **Historical Cost Principle** ensures that all assets are recorded at their historical cost, which is verifiable by source documents to ensure records and reports are accurate and free from bias.
- **Conservatism Principle** takes the worst-case scenario approach to accounting so that Assets and Net Profit are not overstated, and so records and reports lead to more prudent decision-making and advice.
- **Consistency Principle** ensures that records and reports are prepared the same way over time so that they can be used for making comparisons and giving advice.
- **Monetary Unit Principle** ensures that records and reports are reported in the correct currency to avoid inaccuracy.

This is a discussion question, which students must answer in paragraph form. Dot points are not accepted as answers, as stated in the 2012 VCAA Exam 1 Assessment Report.

*Sample Answer:*

The accounting process involves four steps: Source Documents, Records, Reports, and Advice. Accounting Principles are used in relation to this process and assist in ensuring that the business continues to operate smoothly. The Entity Principle requires that records and reports separate the owner from the business; this ensures that the owner maintains strict boundaries regarding transactions with the business. The Reporting Period Principle states that the life of the business should be separated into time periods so that profit can be calculated and reports can be prepared. The Going Concern Principle assumes that the business will have an infinite life, allowing advice to be given for the future. The Historical Cost Principle ensures that all items are recorded at their historical cost, which is verifiable by source documents to ensure that records and reports are accurate and free from bias. The Conservatism Principle takes the worst-case scenario approach to accounting by ensuring that Assets and Net Profit are not overstated, resulting in records and reports which allow the owner to make more confident decisions. The Consistency Principle ensures that records and reports are prepared the same way over time so that they can be useful for comparison purposes. The Monetary Unit Principle ensures that records and reports are reported in the correct currency to avoid inaccuracy.