Revised Edition

Accounting and Finance

A resource for Year 11 ATAR/ Year 12 General

Marking Guide

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Marking Guide for Chapter Review Questions and selected Activities

These are suggested responses only, and should form the basis for further classroom discussion. This Marking Guide aims to provide a scaffold around which answers might be structured using relevant examples and supported with teacher guidance.

UNIT ONE ATAR/ UNIT THREE GENERAL

CHAPTER 1: SMALL BUSINESS OWNERSHIP

Review Questions 1.1

1. *List five local examples each of:*

   a. *service-providing business*
   For example: car wash, hairdresser, veterinarian, gardener, dentist.

   b. *manufacturing business*
   For example: computer parts manufacturer, car manufacturer, lights, hovercams.

   c. *retail/trading business.*
   For example: clothes, shoes, bookshop, cafe, newsagent.

2. *What is the difference between a service-providing business and a retailing business?*

A service business provides a service and a retailer purchases product then resells to the customer.

3. *What is the difference between a trading business and a manufacturing business? Use examples.*

A trading business is that same as a retailer in that the owner purchases product then resells them to the customer. A manufacturing business is a business which purchases raw material and converts this into a product for sale.

4. *Complete the following chart, listing an example of each type of business and their main characteristics.*

Type of business	Example	Characteristics
Manufacturing	Bicycle maker	Purchases raw material such as metal and rubber and converts this into bicycles.
Service providing	Accountant	Provides services such as completed financial reports to individuals and businesses.
Trading/retailing	Bookshop	Purchases products such as books and sells these direct to customers.

5. *What is a sole trader? List five sole traders in your local area.*

A business owned by one person.

6. *List three advantages of operating as a sole trader. Select what you believe to be the best advantage and justify why you believe this.*

Sole trader advantages:

- Owner is responsible for making all the decisions.
- The owner keeps all the profit.
- The owner has the ability to manage the business the way they want to.
- There is a high degree of flexibility for the owner.
- Easiest and least expensive form of business ownership to commence.
- Winding up the business is relatively simple and cost free.

7. *List two disadvantages of operating as a sole trader.*

Disadvantages:

- Limited options for expansion, because financial resources are limited.
- The owner is responsible for any losses which are incurred and has unlimited liability.
- Should the owner become ill or need to be absent from the business there may be no one available to replace him/her.

8. *How is a business name registered? List three local sole traders who would not have needed to register their business name, and explain. List three local sole traders who would have had to register their business name, and explain why.*

To start a business as a sole trader an individual may trade under their own name. They may commence business without official permission or any legal formalities. The business is regarded as being a separate Accounting Entity, meaning the business has an existence separate from that of its owner. However the business is not a separate legal entity. Any other business name needs to be registered with the Australian Securities and Investments Commission (ASIC). Businesses need to register or renew a business name nationally and pay a fee.

9. *What steps are needed to commence business as a sole trader?*

Registration of the business name.

Review Questions 1.2

1. *How does the Partnership Act 1895 define a partnership?*

The relationship which exists between persons carrying on a business in common with a view to profit.

2. *How many people are allowed in a partnership in Australia? Why might some partnerships be allowed to have more than 20 partners?*

In Australia the number of partners allowed in a Partnership is restricted by the Corporations Law to between two to twenty people. The number of partners can be higher only if the type of business being conducted is not handled by companies. For example: accountants, medical practitioners, stockbrokers, architects, pharmacists, veterinary surgeons and lawyers.

3. *Do all partnership names need to be registered? Explain.*

A partnership will need to register a business name with the Australian Securities and Investments Commission (ASIC) unless it uses the surnames of all the partners involved.

4. *What is a Partnership Agreement?*

A document setting out the rights, liabilities and duties of all the partners. This can include the splitting of profits and losses, payments of interest on drawings and on capital.

5. *List two reasons why it is important to have a Partnership Agreement.*

To resolve potential disputes and to ensure fairness in any dissolution of the partnership.

6. *List three things that may be included in a Partnership Agreement. What do you think is the most important right to include in an agreement? Justify your answer.*

Contents:

- Duties and responsibilities of each partner.
- Each partner's investment.
- Profit distribution.
- Withdrawal of partners.
- Transfer of ownership.
- Conflict resolution.

7. *What are three advantages of operating as a partnership?*

Advantages:

- More capital than a sole trader.
- Less expensive than a company to form.
- Easy to dissolve.
- A range of specialist skills or knowledge.
- Able to share workloads.

8. *What are two disadvantages of operating as a partnership?*

Disadvantages:

- Unlimited liability.
- Limited life if Partnership Agreement does not state what should transpire when a partner leaves.
- Profits are shared.
- Decisions may take time to reach to due to disagreements.
- All actions and decisions are legally binding on all partners.
- Changing ownership can be difficult.

9. *Explain why an individual might enter into a limited partnership.*

If they do not want to be involved in any way in the management of the business.

Review Questions 1.3

1. *What is a small proprietary company?*

A business structure limited by shares or an unlimited company with a share capital which has a minimum of one member (shareholder) with no more than 50 non-employee members.

2. *List three advantages of operating as a small proprietary company.*

Advantages:

- Separate legal existence from owners.
- Limited liability.
- Do not need financial statements audited unless ordered to do so by ASIC or members holding 5% of the voting shares.
- Transfer of ownership relatively simple.
- Continuity of existence not dependent on any of the owners.
- Easier to raise capital.
- More experience and expertise possible.

3. *List two disadvantages of operating as a small proprietary company. Discuss what you believe is the biggest disadvantage of a small proprietary company.*

Disadvantages:

- Set up and administration costs can be high.
- Losses are retained by the company.
- Increased statutory requirements.
- More complicated to form compared to a partnership.
- Demanding record-keeping and reporting requirements.
- Can be difficult to dissolve.

4. *What are the steps involved in setting up a small proprietary company?*

Apply to ASIC to be registered, Have a registered office, Decide how the company is to be internally governed, Keep a register of shareholders, Obtain written consent, Register the company.

5. *Outline how a company name is registered.*

It is not a requirement to have a company a name. The Australian Company Number (ACN) is acceptable as the company name instead. To register an intended company name, an application is lodged with ASIC. If approved, this is reserved for two months or until the company is formally registered.

6. *Explain the consequences of insolvency.*

This occurs when a company is in financial difficulties and no longer able to pay its debts when they are due. A liquidator is appointed.

7. *Describe the role of a liquidator.*

Investigate assets owned by the company, find out who is owed money, pay creditors, distribute remaining assets to shareholders, have the company deregistered.

8. *Outline the steps to take to close a small proprietary limited company.*

The company must: not be carrying on business, pay all fees and penalties under the Corporations Act, not be subject to any legal proceeding, have no outstanding liabilities and members must have agreed to deregistration.

9. *Complete a summary table comparing the characteristics of a sole trader, partnership and small proprietary company, including:*

   a. *number of owners*
   b. *liability of owners*
   c. *ability to raise capital or borrow funds*
   d. *distribution of profits*
   e. *transfer of ownership*
   f. *separate accounting or legal entity*
   g. *continuity of existence.*

   No answer supplied for this question.

Chapter 1 Activities

(Please note that the Activity question is not repeated here. Refer to the text.)

1. BUSINESS STRUCTURES

A. As the owner Henry is responsible for making all the decisions and can manage the business as he wishes. He keeps all profit. A sole trader is the easiest and least expensive form of business ownership to commence. If he chooses to, winding up the business is relatively simple and cost free.

B. Henry should further research how to set up a home based business and set up as a sole trader. In the future, if the business expands he might consider bringing Tim in as a partner.

2. SOLE TRADER

A. Emily has limited financial resources as well as having to be the main employee in the business, so if she needs time off this might be difficult. Emily is responsible for any losses which are incurred and has unlimited liability.

B. For example: Being able to have complete autonomy and make all decisions (answer dependent on justification given).

C. The business is not subject to tax, so Emily will be liable to pay tax on any profit the business makes. There is no division between business assets and personal assets.

D. The business has a financial existence separate from that of Emily. This means that the business's transactions are recorded separately from Emily's private transactions.

3. NAMING A BUSINESS

A. Yes she needs to register a business name with the Australian Securities and Investments Commission (ASIC).

B. Discussion question. For example: Hammer and Shamin Partners.

4. PARTNERSHIPS

A. Between 2 and 20.

B. Any name that is not the names of the partners.

C. So that disagreements or dissolution can be clearly negotiated.

D. Wilfred will need to trust his partners because they all have unlimited liability for business debts and the actions and decisions of any partner are legally binding on all partners. He will need to negotiate decisions and share profits.

E. Wilfred will have the shared expertise from his two partners, and the support of additional finance and people to work in the business.

5. EXPANSION

A. Sally and her partners can form a small proprietary company, limited by shares with no more than 50 non-employee members. As she will not know all of the shareholders, the liability of the company's members can be limited to the amount unpaid on their shares.

B. To register the small proprietary company, Sally needs to apply to ASIC to be registered, have a registered office, decide how the company is to be internally governed, keep a register of shareholders, obtain written consent from the nominated director, secretary and member, then she can register the company.

C. The set up and administration costs will be high and the business will need to meet stringent statutory and reporting requirements under the Corporations Law. They will be able to more easily raise extra capital id required.

D. To deregister, the company must not be carrying on business which will be challenging to coordinate across the state and nationally. All the members will need to agree.

6. SMALL PROPRIETARY COMPANIES

A. Limited liability.

B. To set up he needs to:

- Apply to ASIC to be registered
- Have a registered office
- Decide how the company is to be internally governed
- Keep a register of shareholders
- Obtain written consent
- Register the company.

C. Advantages:

- Separate legal existence from owners.
- Limited liability.
- Do not need financial statements audited unless ordered to do so by ASIC or members holding 5% of the voting shares.
- Transfer of ownership relatively simple.
- Continuity of existence not dependent on any of the owners.
- Easier to raise capital.
- More experience and expertise possible.

D. Disadvantages:

- Set up and administration costs can be high.
- Losses are retained by the company.
- Increased statutory requirements.
- More complicated to form compared to a partnership.
- Demanding record-keeping and reporting requirements.
- Can be difficult to dissolve.

E. Discussion question. Responses dependent on justification given. Discuss the costs involved, likely sales, the friendship and the reporting requirements.

7. SETTING UP A BUSINESS

A. Comparison:

	Partnership	Pty Ltd Co
Owners	2- 50	2 or more
Liability	Unlimited	Limited
Capital raising	Other partners	Invited shareholders
Profit distribution	As agreed	Share dividends
Transfer of ownership	Limited	Can be restricted
Accounting and legal entity	Separate accounting, not legal	Separate

B. Recommend small proprietary limited company because of capital raising and liability issues mainly. Both types of business would allow close involvement and control, and they can make their own decision about the sharing of profits under either version. (Any well supported explanation).

8. WINDING UP

A Spencer can keep speaking to creditors about changing repayment deadlines, approach a financial institution for a loan, invest more of his own money, or wind up the business.

B. They will investigate assets owned by the company, find out who is owed money, pay creditors, distribute remaining assets to shareholders, and have the company deregistered.

C. If Spencer has continued to trade while insolvent, he can be personally sued by the creditors for his own assets.

D. Steps to deregister:

- Not carrying on business
- Pay all fees and penalties under the Corporations Act
- Not subject to any legal proceeding
- No outstanding liabilities
- Members have agreed to deregistration.

CHAPTER 2: SOURCES OF FINANCE

Review Questions 2.1

1. *Outline the difference between capital expenditure and working capital.*

Capital expenditure is spending on non-current assets which usually cost large sums of money. For example, new machinery or a new office building. Working capital is the day-to-day money required for running the business. For example, paying expenses such as wages, telephone, electricity and rent.

2. *Compare the main characteristics of short-term, medium-term and long-term finance.*

Short-term finance is typically needed for working capital to cover day-to-day expenses when the business has fallen short of its ability to pay. This may be because customers are taking too long to pay their debts. It is only needed for a short period of time such as 3 months. Medium-term finance is needed for a mixture of working capital and capital expenditure. It involves borrowing money for a period greater than 12 months and usually less than five years. Long-term finance is usually required for capital expenditure. The period of borrowing usually exceeds five years.

3. *Define the following terms:*
   a. **debt financing** – money is borrowed. The money has to be paid back, even if no profit is made. Often interest is charged.
   b. **equity financing** – selling part ownership of the business to an investor in exchange for some of the start up costs needed.
   c. **capital expenditure** – money is used to buy long term fixed assets.
   d. **working capital** –day-to-day money required for running the business.

4. *What is the difference between debt financing and equity financing?*

Debt is a liability owed to creditors external to the business, equity is owed to the owners of the business.

5. *What is the difference between internal and external finance?*

Internal finance comes from sources within the business, such as further investment of capital by the owner of a sole trader business. External finance comes from sources outside of the business, such as loans and mortgages.

6. *List and explain two sources of internal finance.*

Investment of money or non-current assets (For example: machinery, equipment, furniture) by the owner.

7. *What are retained profits?*

Profits that remain in the business and are not distributed to the owners.

8 *What is working capital?*

Funds required to run the day to day operations of the business.

9. *Identify and explain two sources of external finance.*

For example: Loan for vehicle, mortgage on premises.

10. *How can working capital be controlled?*

By reducing everyday business expenses, delaying outflows by negotiating a longer time period before having to pay creditors, speeding up inflows by getting debtors to pay their bills more quickly.

11. What is the difference between a line of credit and an overdraft?

A line of credit from creditors is trade credit given when a business purchases items for their business, such as raw materials from a supplier. The supplier allows the business payment terms varying between 30 and 90 days. An overdraft is an agreement with a bank (or other financial institution) to be allowed to overdraw a cash account to a specified amount.

12. What is the difference between a mortgage and a lease?

Leasing is used for the purchase of large non-current assets such as plant and equipment. Mortgages are used to purchase property.

13. Identify and explain a source of finance that is available for a small proprietary company but not for a sole trader.

For example: shares, debentures.

14. Templeton Harris operates a business that manufactures hair wigs. He has heard of a fantastic fake hair that has come onto the market. The hair is very expensive. Templeton needs $10 000 to purchase a batch of it. His business has no retained profit or any assets to sell off. His only options are to go to the bank and borrow the money at an interest rate of 5% or to use his personal savings. Currently, he has $14 000 in his personal bank account. Advise Templeton as to which option he should choose. Justify your answer.

Either option is feasible depending on the justification given. Discuss the differences between internal and external sources of finance.

Review Questions 2.2

1. What is a guarantor?

If the borrower cannot pay the loan the guarantor will have to make the payments or provide the security for the loan.

2. Explain how financial institutions attempt to balance risk and return when lending funds.

Risk will consider the history of the borrower, their capacity to repay and the collateral being offered. Return will include the interest rate and future business.

3. What is collateral? Provide examples.

The assets that will be used if the borrower cannot repay the funds.

4. Describe the most common return earned by a bank.

Interest.

5. Explain how each of the following is used to determine risk:

A. Collateral is the security for the loan, if this is an asset that can be easily converted to cash then it is a less risky investment.
B. If they have a high disposable income and low expenses they are more likely to be able to meet payments.
C. A history of repaying previous loans on time as well as a good employment history
D. A well respected and trustworthy guarantor.

6. Why would a bank be interested in the amount of future business of a potential client?

To increase their business dealing in the future.

Chapter 2 Activities

1. SOURCES OF FINANCE FOR A SOLE TRADER

Financing option	Advantage	Disadvantage
Save the required capital	Jim won't have to pay any interest	May take a long time Ties up personal funds
Credit card	Available immediately	High rate of interest Pressure on Jim to make repayments
Personal loan	Available immediately Lower interest than the credit card	Will have to pay interest Pressure to meet regular repayments

2. TYPES OF FINANCE

- **Short-term finance:** this type of finance is typically needed for working capital to cover the day-to-day expenses when the business has fallen short of its ability to pay. This may be because customers are taking too long to pay their debts. Whatever the reason, it is finance that is hopefully only needed for a short period of time such as 3 months. Matilda's short term finance would relate to her overdraft facility and her credit card.
- **Medium-term finance:** this type of finance is needed for a mixture of working capital and capital expenditure. It involves borrowing money for a period greater than 12 months and usually less than five years. Matilda's medium-term finance would be her car loan.
- **Long-term finance:** this type of finance is usually required for capital expenditure. As most capital items purchased are costly, the period of borrowing usually exceeds five years. Matilda's long-term finance would be her mortgage.

3 EXPANDING A BUSINESS

A. **Sale of assets:** Petunia can consider if there are any fixed assets which are in surplus; for example, a new delivery van may have been purchased and nobody is using the old delivery van. In this case, the delivery van can be sold. If the business did not want to sell surplus fixed assets they could look at leasing them to another business for a fee. If a business is desperate for some extra finance, they could consider not offering certain services if that put them in a position where they were then able to sell extra fixed assets which would now no longer be used.

B. **Personal funding:** savings that Petunia has in her personal bank account. The biggest advantage of using personal savings is that presumably the business will not have to pay interest on the amount injected into the business.

C. **Crowdfunding:** Petunia can consider the impact of using social media to gain a following of people who will finance her business, and then later support it through sales. She will need to give a benefit either in terms of some of the hot dogs, or some form of equity interest.

D. **Loan:** A loan from a financial institution will have a set amount of interest to be repaid at regular intervals.

4. WORKING CAPITAL

A. Working capital is finance needed to meet everyday business expenses. It helps to keep the business afloat. It is the current assets of the business minus the current liabilities.

B. Methods of controlling working capital include:

1. Reducing everyday running costs. This can be done by budgeting and reducing daily expenses.
2. Delaying outflows by negotiating a longer time period before having to pay large bills.
3. Speeding up inflows by getting debtors to pay their bills more quickly. This can be done by shortening the terms of credit extended to customers. For example, Billy Bob can make customers pay within one month of receiving the service rather than three months. The quicker debtors pay their bill the better off the business will be in terms of liquidity.

5. SALE OF ASSETS

A. Two of the vehicles.

B. Provide the funds required to purchase stock for the business, with minimal impact on the day to day operations.

6. EXTERNAL FINANCE

A. A mortgage is used to purchase property whereas a loan will be used to finance the outdoors display areas.

B. Debentures are a type of loan. Lewis can offer investors the chance to invest in the company through the purchase of debentures. The debenture holders are really lending the company money for a set period of time at a set interest rate. A disadvantage is the debenture holders are creditors waiting to be paid back in full by an agreed date and must receive interest payments from Lewis's company. An advantage is that debentures are fairly secure.

C. The answer should select a medium to long term source of finance. If an external source such as a loan or mortgage is selected, a discussion of interest rates is appropriate. Must outline the advantages and disadvantages of the selected source for Lewis's business.

If an internal source is selected this will be more difficult to justify as it is unlikely that Lewis would have these funds or that the business would have other assets to this value that could be sold.

7. FINANCE APPROVAL

A. A person who acts as a guarantor for the loan agrees to repay Pollyanna's loan should she not be able to make the repayments.

B. Pollyanna will probably not get the loan. The bank will view her as being a high risk due to her age and lack of banking history. In addition to this she has no capacity to pay back the loan as she has no savings. She would only be able to make the loan repayments if the business was successful straight away and most new businesses take a while before they start generating positive cash flow.

8. RISK AND RETURN

A. The bank may give Dermot the loan as his past history has shown that he can run a business successfully. Dermot would have shown the bank their projected sales figures for the new chip, the bank would give him the loan if projected future sales figures were realistic.

B. The bank may not give Dermot the loan if they feel that the chip is too high a risk, that is they may look at how easy it is for competitors to offer a similar product.

C. If Dermot has a patent for the chip so that other competitors are not able to sell the same product, then the bank may give him the funding. His character (history) is strong, his capacity to repay is good and he can potentially offer collateral for the loan.

CHAPTER 3: FINANCIAL ACCOUNTING PRINCIPLES

Review Questions 3.1

1. *What are accounting conventions and principles?*

The basic rules of accounting which have become accepted procedures over time. If they are followed it is expected that accounting records and reports should be able to be prepared in a similar manner. If this is done, the user of the accounting information should be able to compare different businesses and different financial years.

2. *Tick which of the following transactions would not be entered into the financial statements of G Hopper's business Jumping for Joy:*

- purchase of a computer for G Hopper's husband ✓
- G. Hopper's family car ✓
- photocopier
- business mini van
- family home mortgage ✓
- business mortgage
- business loan
- G. Hopper's personal credit card ✓

3. *Define and explain the accounting entity assumption.*

Requires the owner of the business to keep his/her personal transactions separate from those of the business. For accounting purposes the business is viewed as a separate entity to the owner of the business.

4. *Give an example of a situation where the accounting entity assumption would not apply.*

The purchase of personal items for the owner should not be entered into the businesses accounting records.

5. *What is the monetary assumption?*

Requires that only items that can be expressed in dollar terms (money) are included in the accounting records. Concepts such as customer satisfaction, which may be important and valuable to the business, cannot be expressed in terms of a dollar amount.

6. *Define the historical cost assumption.*

Requires that all Balance Sheet assets be valued at their original cost.

7. *Give an example of how the principle of materiality can be breached.*

An item that would be material is the separate reporting of a large unexpected costs, such as loss due to a fire. This should be itemised separately so that it materiality is known.

8. *Can a business produce its financial reports every six months? Explain.*

If the business owner wishes. As long as the reporting period is regular and less than a year.

9. *Can a business produce its financial reports every three months for the first year of business and every six months for the second year of business? Why or why not?*

No because this is an irregular reporting pattern. A business cannot suddenly change the length of time for the reporting period.

10. *Explain why a business is not permitted to produce its financial reports once every two years.*

To meet financial year and ASIC reporting requirements.

11. *Could a business choose to produce their financial reports on the first of September each year?*

Yes

12. *What does 'going concern' assume?*

That the business will continue to operate indefinitely.

13. *How would assets need to be recorded in the Balance Sheet if the going concern assumption did not apply?*

If the going concern assumption were not used then the business could potentially wind up at any point in time, and therefore would report non-current assets at their liquidation value.

14. *Explain, using an example, how an item may be material to one business, yet immaterial to another.*

A small petty cash account may contain a material amount for a small newsagency run on a cash accounting basis, however this may be immaterial for separate reporting in the Balance Sheet of a business with a $20000 bank account.

15. *Identify the relevant accounting assumption that applies to each example below:*

Example	Assumption
• *It is assumed that the business will continue indefinitely.*	Going concern
• *The accounting records of the business are separate to the owner's personal transactions.*	Accounting entity
• *Income is recorded for a service not yet performed.*	Accounting period
• *Details of an expense are recorded four weeks after the expense was incurred, when a payment was made.*	Accounting period/Cash accounting/ (Matching)
• *A vehicle purchased for $15 000 five years ago is shown in the Balance Sheet at a cost of $15 000.*	Historical cost

Review Questions 3.2

1. *Explain the difference between the cash basis of accounting and the accrual basis.*

Under the cash basis of accounting, income is not recognised in the financial records until it is actually received in cash. The income that has actually been received is matched with the expenses that have been paid. Under the accrual basis of accounting, transactions are recognised on the day they occur and not when the cash is paid or received.

2. *Why is the accrual basis of accounting seen as being more relevant?*

Transactions are recorded in the accounting records and reported in the financial statements of the time period to which they relate.

3. *Give an example of a situation where cash accounting could be used.*

Small deli or newsagent.

4. *Explain how income is matched with expenses under the accrual basis of accounting.*

Income that has been earned is matched against expenses as they are incurred.

5. *Sandy Desert owns a sandpit retailing business, Soil and Sandpits. In her first year of business, Sandy tried to use the accrual method of accounting. As she did not really understand what she was doing, in her second year of business she reverted to using the cash basis of accounting. She is now more experienced and, about to enter her third year of business, is considering trying the accrual basis of accounting again. Explain to Sandy how to correct this.*

Sandy needs to be consistent in her accounting records. She has to pick which method she will use and stick to it – she cannot switch over every year.

Chapter 3 Activities

1. ASSUMPTIONS

A. Breach of the Accounting Period Assumption – reports should be produced at least once a year.

B. Breach of Historical Cost – assets should be shown at their original cost in the Balance Sheet (and then the accumulated depreciation can be subtracted from it.)

C. Business is using a mixture of cash accounting and accrual accounting – it should only be using one method.

D. Accounting Entity being breached.

E. Accrual accounting means the transactions should be recorded when it occurs.

F. Breach of Accounting Period – the accounting period needs to be determined, eg. 12 months, and then the reports always produced according to this time frame.

G. Breach of Accounting Entity – owner should record this as drawings thereby reducing equity.

2. MATERIALITY

Materiality requires that all significant items be reported in the financial reports. An item is significant if its omission or misstatement could influence the economic decisions of a user of the information.

All expenses should be recorded and reported in the financial statements, however if a very small amount is not reported separately then this is often because it is immaterial. It depends on the dollar amount and also depends on the significance of the item to the business. If morning tea expenses are a small amount that does not change significantly each time, they could be aggregated in with the Office Expenses or Administrative Expenses for the period. A small dollar amount that might be quite significant and therefore material is more likely to be a one off problem such as cleaning up a chemical spill or an unusual unexpected expense.

3. BREACHING THE ASSUMPTIONS

A. It could be a breach of the Accounting Entity Assumption as these sentimental things belong, strictly speaking, to the owner as personal possessions.

B. Timmy could be assuming that, because he places a high value on them, this means the general public would also place a high monetary value on them and be willing to buy them therefore, he has recorded them as assets.

4. ASSETS OF A BUSINESS

A. The owner has breached the accounting entity assumption which states that the business records should be kept separate to those of the owner.

B. She should withdraw the car as an asset of the business or she should buy it from her daughter so that it becomes a business asset.

C. Anyone interested in buying the business or buying into the business as a partner. The bank may also look at the reports and the ATO or her tax accountant.

D. They would be under the assumption that the business has more assets than it does actually have. The figure would be overstated.

5. OWNER SEPARATE FROM THE BUSINESS

A. The records should be kept separately, as the business is a separate accounting entity, even though it is not a separate legal entity as Rory is a sole trader. Rory should have separate records for the business and a business bank account rather than using his personal account. If he really does not want two bank accounts then his personal account could become the business account, and any money he takes out for himself could be recorded as Drawings.

B. The Accounting Entity (Business Entity) Assumption – this assumption requires Rory as the owner of the business to keep his personal transactions separate from those of the business. For accounting purposes the business is viewed as a separate entity to the owner of the business.

6. INCORRECT ASSUMPTIONS

A. The accounting entity assumption to keep personal and business transactions separate.

B. This requires Sadb to keep personal transactions separate as the business is a different entity to him as an individual. The accounting equation A = L + Eq is derived from this assumption. Sadb should have recorded the bill payments as drawings by the owner from the Equity of the business.

C. The historical cost assumption – that assets should be recorded and reported at the actual amount they were purchased at with evidence of that cost being available as a source document of Sadb's business. The going concern assumption – the business is assumed to continue indefinitely, therefore Sadb should not be constantly revaluing assets as if they are to be sold off and the business closed at any minute.

7. EXTERNAL USER OF INFORMATION

A. Accounting assumptions (also known as principles) are the basic rules of accounting. They need to be followed so that all accounting records and reports are prepared in a similar way. If this is done, the user of the accounting information should be able to compare different businesses and different financial years.

B. **Accounting Period Assumption** – this assumption requires that the life of a business be divided into equal periods of time for reporting purposes. These periods of time are known as reporting periods. The length of the reporting period cannot be longer than a year, and once the accounting period is chosen, it must remain; for example, if a business chooses its accounting period as 12 months, then every other reporting period also needs to be 12 months in length.

Going Concern Assumption – this assumption assumes that the business will continue to operate indefinitely. If the going concern assumption was not in existence, then the owner would have to assume that the business may wind up at any point in time, and therefore would have to state all the non-current assets at their liquidation value instead of at their cost price. The cost of the assets would be written off in the year they were purchased instead of over several years.

The link between the two assumptions is that they exist to provide consistency and continuity. If it is assumed that Dotty's business will exist for a long period of time, then she needs to be able to break that time period up into regular interval to review and analyse the financial results and plan for the next accounting period.

C. The **Accounting Entity (Business Entity) Assumption** – this assumption requires that Dotty to keep her personal transactions separate from those of the business. For accounting purposes, the business is viewed as a separate entity to the owner of the business. With regards to Dotty, her three bedroom house should be recorded separately to the pub or the newspaper subscriptions.

D. The $100 she has received for each of the 150 subscriptions should be treated as both income and a liability. $50 of each subscription will be recorded as income for the previous financial year. And $50 of each subscription will be treated as fees in advance, which is a liability for the current financial year.

8. CASH OR ACCRUAL?

A. Accrual accounting.

B. Under the cash basis of accounting, income is not recognised in the financial records until it is actually received in cash. For example: If Dr Smith sees a patient on 10 June and the patient does not pay immediately for the visit, then Dr Smith would not record the visit as income earned. However, once the patient has paid the bill, it will be recorded. If the patient pays the bill on 20 July, then this will be the date that the service fee is recorded in Dr Smith's accounting records, even though this might be a different accounting period to when the service was performed.

CHAPTER 4: THE BALANCE SHEET

Review Questions 4.1

1. *Define an 'asset', using examples.*

An asset is a resource controlled by the entity (business) as a result of past events and from which future economic benefits are expected to flow to the entity. For example: Vehicle, furniture, property, plant, equipment, machinery, fittings.

2. *Make a list of assets a 10-year-old running a lemonade stand may have.*

Cups, jugs, mixer, chair, table.

3. *Make a list of assets a lawn-mowing business might have.*

For example: Mowers, leaf blower, vehicle, trailer, computer, phone.

4. *Define a 'liability', using examples.*

A liability is a present obligation of the entity resulting from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. For example: creditors, overdraft, loan, mortgage.

5. *Make a list of some liabilities a lawn-mowing business may have.*

Accounts payable, loan for mowers, vehicle loan.

6. *Classify each of the following as an* Asset, Liability *or* Equity*:*

a.	cash in the till	A
b.	cash in the bank account	A
c.	business premises	A
d.	mortgage	L
e.	car loan	L
f.	stock/Inventory	A
g.	furniture	A
h.	motor vehicle	A
i.	accounts receivable	A
j.	accounts payable	L
k.	owner's interest in the business	EQ
l.	creditors	L
m.	debtors	A
n.	drawings	EQ
o.	amount the business owes the owner.	EQ

7. *Explain the accounting equation.*

The simplified accounting equation can be expressed as the relationship between the total assets and total liabilities and equity of a business at a specific point in time.

It is often written as A = L + Eq

8. *Using the accounting equation, fill in the missing amounts below:*

Assets	–	Liabilities	=	Equity
2 000		300		1 700
1 500		200		1 300
4 100		600		3 500
600		0		600
980		780		200
1 200		800		400
800		750		50
300		100		200

9. *What is a Balance Sheet?*

The Balance Sheet is a representation of the accounting equation (A – L = Eq) in a detailed form. It shows the financial position, which is the total assets and total liabilities and equity of a business at a specific point in time.

10. *List the various elements that make up a Balance Sheet.*

Assets, Liabilities and Equity.

Review Questions 4.2

1. *What is the difference between a current asset and a non-current asset? Use examples.*

Current assets are resources which the business expects to turn into cash (such as accounts receivable) or consume (such as cash at bank) within a 12 month period. Non-current assets are resources which the business intends to have the use of for a period longer than 12 months to help generate income.

2. *What is the difference between a current liability and a non-current liability? Use examples.*

Current liabilities are amounts that the business owes other entities. This includes all future economic sacrifices which fall due within a 12 month period. Non-current liabilities are obligations which the business will be committed to for a period longer than 12 months.

3. *Classify the following as either assets, liabilities or equity: cash at bank, petty cash, motor vehicle, bank loan, drawings, equipment, furniture, accounts payable, accounts receivable.*

- Cash at bank A
- Petty cash A
- Motor vehicle A
- Bank loan L
- Drawings Eq
- Equipment A
- Furniture A
- Accounts payable L
- Accounts receivable A

4. *Classify the following as either current or non-current assets, current or non-current liabilities, or equity: cash at bank, petty cash, start-up capital, motor vehicle, bank loan, drawings, equipment, furniture, accounts payable, accounts receivable, mortgage.*

- Cash at bank CA
- Petty cash CA
- Start up capital Eq
- Motor vehicle NCA
- Bank loan NCL
- Drawings Eq
- Equipment NCA
- Furniture NCA
- Accounts payable CL
- Accounts receivable CA
- Mortgage NCL

5. *Complete this worksheet to test your understanding of the double entry (all debits equal all credits) effect of transactions.*

Accounting equation: Assets – Liabilities = Equity							
Transaction	**Assets**				**Liabilities**		**Equity**
	Cash at Bank	Motor Vehicle	Office Equipment	Supplies	Accounts Payable	Loan	Capital
Owner contributed a computer to the business worth $3 000			+ $3 000				+ $3 000
Purchased a vehicle worth $25 000 on credit		+ $25 000			+$25 000		
Took out a short-term loan for $2 000	+ $2 000					+ $2 000	
Owner contributed $5 000 cash to the business	+ $5 000						+$5 000
Owner withdrew the computer worth $3 000 for personal use at home			- $3 000				- $3 000
Bought office supplies for $250 and put it on account				+$250	+$250		
Paid $500 cash on the short-term loan	- $500					- $500	
Paid $750 off the Motor Vehicle account	- $750				- $750		

6. *Prepare a classified Balance Sheet for The Giggles as at 30 June 2021.*

Van	$ 15 000
Cash at bank	5 000
Costumes	25 000
Stage props	15 000
Office supplies	5 000
Accounts receivable	23 000
Accounts payable	12 000
Mortgage on premises	100 000
Stock	40 000
Office equipment	20 000
Furniture	10 000
Sound equipment	50 000
Short-term loan to be paid by August 2021	5 000

The Giggles
Balance Sheet
as at 30 June 2021

	$
CURRENT ASSETS	
Cash at Bank	5 000
Offie supplies	5 000
Accounts receivable	23 000
Stock	40 000
NON CURRENT ASSETS	
Van	15 000
Costumes	25 000
Stage props	15 000
Office equipment	20 000
Furniture	10 000
Sound equipment	50 000
TOTAL ASSETS	208 000
CURRENT LIABILITIES	
Accounts payable	12 000
Loan due August 2029	5 000
NON CURRENT LIABILITIES	
Mortgage	100 000
TOTAL LIABILITIES	117 000
NET ASSETS	**$ 91 000**
CAPITAL	**$ 91 000**

Chapter 4 Activities

1. CLASSIFICATION OF ACCOUNTS

Account	Classification	Explanation
Sewing machine	Non-current asset	Will last longer than 12 months
Scissors	Non-current asset	Will last longer than 12 months (would be industrial strength, not a domestic pair)
Stock	Current asset	Consumed within 1-16 months
Business vehicle	Non-current asset	Retained by the business for longer than 12 months
Computer	Non-current asset	Will last longer than 12 months
Business mortgage	Non-current liability	Will take longer than 12 months to pay
Owner's personal bicycle	Irrelevant	Belongs to owner and not the business. The business is a separate legal entity to the owner.
Stationery	Current asset	Will be used in the next 12 months or earlier
Amount owed to Spotlight Sewing	Current liability	Will be paid within 12 months
Henrietta's personal television	Irrelevant	Belongs to owner not the business. The business is a separate legal entity.
Amount owed from Fabric Warehouse	Current asset	Should be paid to the business within 30 days
Amount owed to neighbour's child for walking the dog	Irrelevant	Owner's personal affairs and not those of the business

2. ELEMENTS OF THE BALANCE SHEET

A. For example:
A = L + Eq or as
L = A – Eq
Eq = A – L

B. An asset in simple terms is anything of value either owned or controlled by the business. For example: cash, stock/inventory, motor vehicles and a debt owed to a business by a customer. The accounting definition is that assets are resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

A liability is a present obligation of the entity resulting from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. In other words, liabilities are amounts which a business owes to others. For example: a mortgage on a building, a loan repayable in the future and money owed to another business for services or goods provided on credit.

C. Drawings reduce equity.

D. Profit is added to the capital figure in the equity section of the Balance Sheet. A loss reduces the capital figure.

E. Assets are resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. Assets can be classified as either current assets or non-current assets. A current asset is a resource which the business expects to turn into cash within a 12 month period. For example: stock or inventory, debtors, cleaning supplies, cash. Non-current assets are resources the business intends to have the use of for a period longer than 12 months to help generate income. For example: property, equipment, vehicle, machinery.

F. Equity is the residual interest in the assets of the entity after deduction of its liabilities. In other words, equity is what the owner is worth once he/she has deducted the liabilities of the business from the assets of the business. Equity appears as a section in the Balance Sheet, along with anything that affects the overall equity figure such as capital, drawings, profit or loss.

G. A service business provides a service, not goods for sale. Trading/retail businesses include inventory in their Balance Sheets.

3. ORGANISATION OF THE BALANCE SHEET

A. Stock or inventory.

B. Accounts receivable are a current asset and accounts payable are a current liability.

C. Accounts payable are a current liability whereas drawings come under the equity section and reduce the capital figure.

D. The Balance Sheet is a representation of the accounting equation (A – L = Eq) in a detailed form. It lists the business entity's assets, liabilities and equity.

E. Cash at bank is a current asset. It is money the business currently has available in its bank account. A bank overdraft is a current liability and is how much cash the business owes to the bank or financial institution where the account is held.

4. INCORRECT CLASSIFICATION

A. Max Factor's Incorrect Balance Sheet:

ASSETS	
Cash at bank	4 000
Accounts payable	**35 000**
Equipment	8 000
Motor vehicle	10 000
Total Assets	$ 57 000
LIABILITIES	
Accounts receivable	**5 000**
NET ASSETS	$52 000

B. Correct Balance Sheet:

ASSETS	
Cash at bank	4 000
Accounts receivable	5 000
Equipment	8 000
Motor vehicle	10 000
Total Assets	$ 27 000
LIABILITIES	
Accounts payable	35 000
NET ASSETS	($ 8 000)

C. Max owes creditors more funds than he has in the business. He has no equity. He will need to invest more funds in order to repay these accounts.

5. THE DOUBLE ENTRY SYSTEM

Transaction	First effect	Second effect
Owner contributed a computer worth $2 000 to the business	Computer (A) increases by $2 000	Capital (Eq) increases by $2 000
Bought office equipment on credit from Freedom for $10 000	Office Equipment (A) increases	Accounts Payable (L) increases
Took out a premises mortgage for $200 000	Mortgage Loan (L) Account increases	Premises (A) increases
Business bought $15 000 shares for cash	Cash at Bank (A) decreases	Share Investment (A) account increases
Owner sold personal shares for $17 000	No effect	
Owner withdrew the computer for partner to use at home	Computer (A) decreases	Equity (Eq) decreases
Took out $5 000 loan from Westpac bank	Bank Loan (L) increases	Cash at Bank (A) increases
Purchased a vehicle for $20 000 on credit from Toyota	Vehicle (A) increases	Loan or Accounts Payable (L) increases
Owner withdrew $1 000 cash from the business	Cash at Bank (A) decreases	Equity (Eq) decreases
Bought inventory for $3 000 cash	Cash at Bank (A) decreases	Stock (Inventory) (A) increases

6. BALANCE SHEET PRESENTATION

A. T. Cat:

T. Cat
Balance Sheet
As at 1 July 2025 (T-format)

Assets		**Liabilities**	
Cash at bank	500	Loan	2 000
Equipment	5 000	Equity	
Mouse food	4 000	Capital	11 250
Furniture	750		
Vehicle	3 000		
	$13 250		**$13 250**

T. Cat
Balance Sheet
As at 1 July 2025 (Vertical format)

Assets	
Cash at bank	500
Equipment	5 000
Mouse food	4 000
Furniture	750
Vehicle	3 000
Total Assets	$13 250
Liabilities	
Loan	2 000
Net Assets	$11 250
Equity	
Capital	$11 250

B. T. Ball:

T. Ball
Balance Sheet
As at 1 July 2022 (T-format)

Assets		**Liabilities**	
Tennis balls	100	Bank overdraft	200
Racquets	250	Loan	10 000
Ball machine	1 000	Equity	
Vehicle	15 000	Capital	6 150
	$16 350		**$16 350**

T. Ball
Balance Sheet
As at 1 July 2022 (Vertical format)

Assets	
Tennis balls	100
Racquets	250
Ball machine	1 000
Vehicle	15 000
Total Assets	$16 350
Liabilities	
Bank overdraft	200
Loan	10 000
Total Liabilities	12 000
Net Assets	$6 150
Equity	
Capital	$6 150

C. Snip Hairdressing

Equity = Assets – Liabilities

Assets = Accounts receivable $3 600 + cash in till $150 + cash at bank $990 + materials $2 000 + furniture $15 000 + computer $4 000 = $25 740

Liabilities = Accounts payable $2 500 + Bank loan $10 000 = $12 500

Equity = Assets - Liabilities
= $25 740 - $12 500
= $13 240

D. Scream Savers Computer Services

The value of the motor vehicle is $45 000, not $25 000. (Error in book first print run)

Equity = Assets – Liabilities
= (200 + 20 000 + 15 000 + 1 500 + 45 000) - (300 + 2 000 + 75 000)
= $81 700 - $77 300
= $4 400.

E. Smelly Pooch Dog Supplies

Equity = Assets – Liabilities
= $19 650 - $1 075
= $18 575

F. Bob the Builder

Bob the Builder
Balance Sheet
As at 30 June 2020

	$		$
Current Assets			
Cash at bank	15 000		
Supplies	5 000		
Accounts receivable	17 000		37 000
Non-current Assets			
Furniture	10 000		
Machinery	30 000		
Van	20 000		
Tools	25 000		
Office equipment	20 000		105 000
Total Assets			**$142 000**
Current Liabilities			
Accounts payable	14 000		
Loan	6 000	20 000	
Non-current Liabilities			
Mortgage	100 000		100 000
Total Liabilities			**$120 000**
Net Assets			**$22 000**
Equity			
Capital			22 000
Total Equity			**$22 000**

G. Kirsten and Kimberly

Kirsten and Kimberly Izzett
Balance Sheet
As at 30 June 2020

	$	$
Current Assets		
Petty cash	100	
Cash at bank	50 000	
Inventory	25 000	
Accounts receivable	27 000	102 100
Non-current Assets		
Vehicle	30 000	
Equipment	50 000	
Office equipment	23 000	
Furniture	15 000	
Investment	75 000	193 000
Total Assets		**$295 100**
Current Liabilities		
Accounts payable	6 000	6 000
Non-current Liabilities		
Mortgage	80 000	80 000
Total Liabilities		**$86 000**
Net Assets		**$209 100**
Equity		
Capital		209 100
Total equity		**$209 100**

H. Cricket Academy

Corder Cricket Academy
Balances as at 30 June 2021

Current assets	= $72 050
Non-current assets	= $214 000
Current liabilities	= $2 000
Non-current liabilities	= $200 000
Equity	= $84 050

I. Super Fins Swimming Academy

Super Fins Swimming Academy
Balances as at 30 June 2020

Current assets	= $22 000
Non-current assets	= $22 000
Current liabilities	= $3 400
Non-current liabilities	= $0
Equity	= $40 600

J. Sunshine and Smiles

Sunshine and Smiles
Balance Sheet totals as at 30 June 2021

Current assets	= $33 000
Non-current assets	= $135 000
Current liabilities	= $12 000
Non-current liabilities	= $145 000
Equity	= $11 000

K. Jaslyn Allnut

Allnut Art Gallery
Balance Sheet totals as at 30 June 2021

Current assets	= $195 000
Non-current assets	= $965 000
Current liabilities	= $40 000
Non-current liabilities	= $75 000
Equity	= $1 045 000

L. Jaiden O'Connell

O'Connell Detective Agency
Balance Sheet totals as at 30 June 2022

Current assets	= $16 000
Non-current assets	= $160 000
Current liabilities	= $4 000
Non-current liabilities	= $15 000
Equity	= $157 000

7. CLASSIFICATION OF ACCOUNTS AND TRANSACTIONS

A. Ghostbusters Inc.

Office equipment	Non-current asset
Mortgage	Non-current liability
Motor vehicle loan	Non-current liability
Motor vehicle	Non-current asset
Office furniture	Non-current asset
Accounts payable	Current liability
Accounts receivable	Current asset
Stock	Current asset
Cash at bank	Current asset
Capital	Equity
Drawings	Equity
Profit	Equity
Long term investment shares	Non-current asset
Office premises	Non-current asset
Office supplies	Current asset

B.

TRANSACTION	ASSETS			LIABILITIES		EQUITY
	Bank	Office	Accounts receivable	Accounts payable	Loan	Capital
Took out a $50 000 loan	+ 50 000				+ 50 000	
Owner deposited $2 000	+ 2 000					+ 2 000
Purchase stock on credit from MGM Studios for $500		+ 500		+ 500		
Owner withdrew $200	- 200					- 200
Customer paid $3 000 account	+ 3 000		- 3 000			
Paid $1 000 off loan	-1 000				- 1 000	
Paid $250 to MGM	- 250			- 250		

8. INTERPRETING BALANCE SHEET INFORMATION

A. S. Martie is the owner.

B. Cash at bank $8 000

C. Non-current assets = Computer $7 000 + Motor vehicle $15 000
= $22 000

D. The business owes for the purchase of a car.

E. $20 000

F. The motor vehicle is controlled by the business because it is owned and garaged at their premises, it was obtained through past event of a purchase taking place, and its future economic benefits, the income that will arise from driving it around to meet customers, deliver goods and general business use, will come into the businesses accounts. It is therefore an asset of the business.

9. CHANGES TO THE BALANCE SHEET

A.

i.

Captain Tugboat Cruises
Balance Sheet as at 31 July 2022

Current Assets	$	$
Cash at Bank	52 600	
Accounts Receivable	800	53 400
Non-current Assets		
Motor vehicle	25 000	
Boats (at cost)	140 200	
Office Equipment	6 400	
Computers	12 000	183 600
Total Assets		**237 000**
Current Liabilities		
Accounts Payable	45 000	
Loan	8 000	53 000
Non-current Liabilities		
Motor vehicle loan	25 000	
Loan on Boats	79 000	104 000
Total Liabilities		**157 000**
Net Assets		**80 000**
Equity		
Capital		85 000
Add: Profit		10 000
Less: Drawings		(15 000)
Total Equity		**$ 80 000**

ii. Equity would be $15 000 less. ie:

Balance Sheet extract as at 31 July 2022 (revised)

Equity	
Capital	75 000
Less Drawings	(5 000)
Less Loss	(5 000)
Total Equity	65 000

B.

Corn Flake
Balance Sheet as at 30 June 2020

Current Assets	$	$
Accounts Receivable		
U. Toby's	20 000	
W. Eeties	6 000	26 000
Non-current Assets		
Office Equipment	5 000	
Office Furniture	8 000	
Land	200 000	
Building	62 000	275 000
Total Assets		**301 000**
Current Liabilities		
Bank overdraft		45 000
Accounts Payable		
Harvey Norman	5 000	
N. Grain	50 000	
P. Wheat	5 000	105 000
Non-current Liabilities		
Mortgage	134 000	239 000
Net Assets		**$ 62 000**
Equity		
Capital	62 000	
Total Equity		$ 62 000

C. City Tours

i.

City Tours
Balance Sheet
As at 31 July 2020

	$	$
Assets		
Accounts Receivable	300	
Office Furniture	17 400	
Office Equipment	12 400	30 100
Liabilities		
Bank Overdraft	3 350	
Accounts Payable	1 500	
Loan with Westpac	7 750	12 600
NET ASSETS		**17 500**
Equity		
Capital		17 500

ii. Accounts payable are a present obligation because they are due to be paid within the next month or so, arising from a past event which would have been a credit purchase of some form, and the settlement of the account payable will require a outflow from the entity of resources embodying economic benefits in the form of the cash that will be paid.

iii. The office furniture is controlled by the business because it is owned by them and used in their office, it was obtained through past event of a purchase taking place, and it will generate future economic benefits, as it is being used in the ordinary course of business to support the functioning of the office. It is therefore an asset of the business.

10. THE ACCOUNTING EQUATION

A. The simplified accounting equation expresses the relationship between the total assets and total liabilities and equity of a business at a specific point in time.

It is often written as A = L + Eq or as
L = A – Eq or as
Eq = A – L

B. Equity exists due to the need to keep the personal transactions of the owner separate from the transactions of the business. It is because of the accounting entity principle that equity exists. The accounting entity principle regards the business entity as being separate from the owner. For accounting purposes the personal transactions of the owner are always kept separate from those of the business.

C. Profit adds to the equity of the owner.

The extended accounting equation can be written as:

A = L + Eq + (Profit - Drawings)
and because Profit = Ex - I
A = L + Eq + (I - Ex)
A + Ex = L + Eq + I

11. BALANCE SHEET INFORMATION AND CORRECTIONS

A. Jerry Mouse's business would make a better investment as it has net assets of $182 000, comprising a higher proportion of assets to liabilities. In particular, current liabilities are quite low and current asset high.

In contrast, Tom Cat's business only has net assets of $42 000. Liabilities are very high and the business would not be able to pay all the current liabilities with its current assets. This is quite concerning.

B. M. Monster

i. M. Monster - Corrected Balance Sheet

	$	$
Current Assets		
Cash at Bank	2 000	
Debtors	20 000	
Office supplies	500	22 500
Non-current Assets		
Office computer	3 000	
Motor vehicle	25 000	
Office furniture	15 000	
Office equipment	20 000	
Photocopier	2 000	65 000
TOTAL ASSETS		**87 500**
Current Liabilities		
Business credit card	1 000	
Creditors	10 000	11 000
Non-current Liabilities		
5 year motor vehicle loan	15 000	
Mortgage on business	50 000	65 000
TOTAL LIABILITIES		**76 000**
Net Assets		**$ 11 500**
Equity		
Capital	18 500	
Less Drawings	(7 000)	
Total Equity		**$ 11 500**

ii. The office computer is controlled by the business because it is owned by them and is part of the office furniture, it was obtained through past event of a purchase taking place, and it will generate future economic benefits, as it is being used in the ordinary course of business to support the recording of information and preparation of accounts (etc). It is therefore an asset of the business.

iii. Equity is the residual interest in the assets of M. Monster's business after deducting all the liabilities. The equity of the business is therefore equal to $11 500.

CHAPTER 5: DOUBLE ENTRY RECORDING FOR ASSET, LIABILITY AND EQUITY ACCOUNTS

Review Questions 5.1

1. *Define source documents and list three.*

A source document is an original record of a transaction that can be reported in the accounts. Source documents are evidence that a transaction has occurred. For example: Receipt, cheque, invoice.

2. *What is meant by the term 'double entry accounting'?*

Every transaction affects two accounts, or two sides of the ledger, by the same total dollar amount.

3. *Do asset accounts have a debit or a credit nature?*

Debit nature.

4. *Do liability and equity accounts have a debit or credit nature?*

Credit nature.

5. *State which of the following accounts have a debit nature: machinery, computer, loan, motor vehicle, mortgage, capital, office equipment, office furniture, drawings, accounts receivable, accounts payable, bank overdraft, petty cash, cash at bank.*

Machinery, computer, motor vehicle, office equipment, office furniture, accounts receivable, patty cash, cash at bank.

6. *State which of the following accounts have a credit nature: machinery, computer, loan, motor vehicle, mortgage, capital, office equipment, office furniture, drawings, accounts receivable, accounts payable, bank overdraft, petty cash, cash at bank.*

Loan, mortgage, capital, drawings, accounts payable, bank overdraft.

7. *Fill in the chart below, stating which side of the ledger account would be affected.*

	Debit side	Credit side
Liability account decreasing	✓	
Asset account increasing	✓	
Equity account decreasing	✓	
Equity account increasing		✓
Asset account decreasing		✓
Liability account increasing		✓

Review Questions 5.2

1. *Bryce Lanigan has started a skateboarding coaching academy, Skate Masters, with the following assets and liabilities:*

Skateboard spare parts	$ 2 500
Skateboards	5 000
Filming equipment	20 000
Sound equipment	15 000
Motorbike	3 000
Cash at bank	10 000
Van	20 000
Skate ramps	50 000

Bryce would like you to establish a double entry accounting system for the business.

Ledger accounts with opening debit balances: Spare parts, skateboards, filming equipment, sound equipment, motorbike, cash at bank, van, skate ramps.

Ledger accounts with opening debit balances: Capital

2. *Ashlea Allnut is the owner of an insect identification business, Bug Busters. The following transactions occurred in the first week of March 2020:*

2020		
Mar	1	Owner contributed $150 000 to the business.
	2	Purchased new van on credit from *Wheels* for $10 000.
	3	Purchased computer for $3 000 cash.
	4	Paid Wheels $5 000.
	5	Took out a bank loan from *Sunny Days Bank* for $250 000.
	6	Mortgage of new office premises of $260 000.
	7	Owner withdrew $500 cash for personal use.

a. *Enter the transactions for 1 March to 7 March 2020 into the ledger.*

b. *Balance the accounts as at 8 March 2020.*

Bug Busters

Capital

			1 March	*Cash at bank*	150 000

Cash at Bank

1 March	*Capital*	150 000	3 March	*Computer*	3 000
5	*Loan - Sunny Days Bank*	250 000	4	*Accounts Payable - Wheels*	5 000
			7	*Drawings*	500
			8	*Balance c/d*	391 500
		400 000			400 000
8 March	*Balance b/d*	391 500			

Van

2 March	*Accounts payable - Wheels*	10 000			

Accounts Payable – Wheels

4 March	*Cash at Bank*	5 000	2 March	*Van*	10 000
8	*Balance c/d*	5 000			
		10 000			10 000
			8 March	*Balance b/d*	5 000

Computer

3 March	*Cash at Bank*	5 000			

Loan – Sunny Days Bank

			5 March	*Cash at Bank*	250 000

Mortgage

			6 March	*Premises*	260 000

Premises

6 March	*Mortgage*	260 000			

Drawings

7 March	*Cash at Bank*	500			

3. *Post the following transactions into the ledger accounts listed. Remember that for the purposes of this exercise you are to ignore the effects of GST.*

Transactions:

May 1 Business paid $500 cash for a second-hand photocopier.
2 Business bought a computer on credit for $2 000.
3 Business took out a $10 000 loan from Happy Days Bank.
4 Owner contributed a printer worth $300 to the business.
5 Business paid $1 000 cash owing for the computer.

On the May 2, the computer was purchased for $2 000. This could be entered into either the loan or the creditor account. (The computer amount omitted from the first print run of the book.)

Cash at Bank

3 May	*Bank Loan*	10 000	1 May	*Office Equipment*	500
			5 May	*Creditors*	1 000
				Balance c/d	8 500
		10 000			10 000
	Balance b/d	8 500			

Loan

Office equipment

1 May	*Cash at Bank*	500			
2 May	*Creditors*	2 000			
4 May	*Capital*	300		*Balance c/d*	2 800
		2 800			2 800
	Balance b/d	2 800			

Creditors

5 May	*Cash at Bank*	1 000	2 May	*Office Equipment*	2 000

Capital

			4 May	*Office Equipment*	300

Bank Loan

			3 May	*Cash at Bank*	10 000

4. *Mars Bart commenced his business, Smart Bart, on 1 May 2020 with the following assets and liabilities:*

Assets		Liabilities	
Bank	15 000	Loan	15 000
Motor Vehicle	20 000		
Office Equipment	25 000		
	$60 000		$15 000

a. *Fill in the ledger accounts to establish the double entry system for Smart Bart.*

b. *Balance and close the accounts.*

Cash at Bank (Asset)

Dr			Cr		
2020					
1 May	*Balance*	15 000			

Loan (Liability)

Dr			Cr		
			2020		
			1 May	*Balance*	15 000

Office Equipment (Asset)

Dr			Cr		
2020					
1 May	*Balance*	25 000			

Motor Vehicle (Asset)

Dr			Cr		
2020					
1 May	*Balance*	20 000			

Capital (Equity)

Dr			Cr		
			2020		
			1 May	*Balance*	45 000

Chapter 5 Activities

1. CLASSIFICATION OF ACCOUNTS

Account	Classification	Nature	Explanation
Machinery	Asset	Debit	Assets have a debit nature when they are increasing
Stock	Asset	Debit	Assets have a debit nature when they are increasing
Loan	Liability	Credit	Liabilities have a credit nature when increasing
Business Vehicle	Asset	Debit	Assets have a debit nature when they are increasing
Computer	Asset	Debit	Assets have a debit nature when they are increasing
Business Mortgage	Liability	Credit	Liabilities have a credit nature when increasing
Capital	Equity	Credit	Equity is credited when it is increasing
Office Equipment	Asset	Debit	Assets have a debit nature when they are increasing
Accounts Receivable/ Creditors	Asset	Debit	Assets have a debit nature when they are increasing
Bank Overdraft	Liability	Credit	Liabilities have a credit nature when increasing
Accounts Payable/Debtors	Liability	Credit	Liabilities have a credit nature when increasing

2. SOURCE DOCUMENTS

A. Definitions.

- **source documents:** evidence that a transaction has occurred; for example, when purchasing a magazine from a newsagent, a receipt is given as proof of purchase.
- **cheque**: written in order to pay an amount to a supplier, or to repay a customer. Through doing this, the business has a permanent record of the transaction taking place. The cheque is given to the payee and the cheque butt is kept by the business with the details recorded on it. Cheques are also received from customers.
- **cash receipt:** if a business receives cash for a product sold or a service provided, then a cash receipt is issued. The cash receipt can be hand written or produced by a cash register or computer. Regardless of how it is produced it needs to include:
  - the name of the business supplying the service
  - the name of the customer
  - the amount paid
  - what the service provided was
  - a receipt number.

  The customer is issued a cash receipt and the business also keeps a copy of the receipt for their own records.

- **invoice:** if a business buys on credit or provides a good/service on credit, then an invoice is issued. A purchase invoice is issued to the supplier when goods are purchased on credit, as a record of the order. A invoice is issued when goods/services are provided on credit. An invoice is used to show the customer how much they have been charged for the goods or services and as a reminder to pay.

- **double entry accounting:** source documents record transactions which have taken place. If a business is using a double entry accounting system this means that every transaction affects two accounts (or two sides of the ledger accounts - sometimes more than two accounts are affected) by the same dollar amount. For example: if the business buys a second hand motor vehicle for $5 000 cash, the two accounts affected are the bank account and the motor vehicle account. The bank account decreases by $5 000 and the motor vehicle account increases by the same amount of $5 000. It is more correct to say that in double entry accounting, equal debit and credit entries are made for every transaction.
- **general ledger:** the general ledger is an accounting record. This record contains all the individual business accounts showing the details of all the transactions which have taken place in the accounting period

B. Order form ➠ Invoice ➠ Cheque or EFTPOS payment ➠ Receipt

C. A source document is an original record of a transaction that can be reported in the accounts. Source documents are evidence that a transaction has occurred so it is important that Penny provides these, in case of later issues with the sale. Source documents are important as they show a transaction has taken place, and they give the details, amount and date of the transaction.

3. NATURE OF ASSET, LIABILITY AND EQUITY ACCOUNTS

A. Asset accounts have a debit nature – this means that they are recorded on the debit side unless they are decreasing. Liability and Equity accounts are recorded on the credit side unless they are decreasing.

B. Each transaction that is entered into the accounts must have the same total debited and credited. There may be more than two entries, but as long as the sum of the debit entries equals the sum of the credit entries, the double entry accounting rule has been followed.

4. THE DOUBLE ENTRY SYSTEM

A.

Transaction	First effect	Second effect
Owner contributed $10 000 to the business	*Cash at Bank Account (asset) increases by $10 000*	*Capital Account (equity) increases by $10 000*
Owner contributed a computer and printer worth $3 500 to the business	Office equipment (A) increases	Capital (Eq) increases
Bought office equipment on credit from *Office Supplies* for $1 000	Office equipment (A) increases	Creditor - Office Supplies (L) increases
Took out a premises mortgage for $200 000	Mortgage (L) increases	Premises (A) increases
Owner withdrew the computer worth $2 000 for use at home	Computer (A) decreases	Drawings (-Eq) increases (Overall, Capital decreases)
Took out a $5 000 loan from *Happy Days Bank*	Loan (L) increases	Cash at bank (A) increases
Purchased a vehicle for $20 000 on credit from *Toot Motors*	Vehicle (A) increases	Creditor - Toot Motor (L) increases
Owner withdrew $500 cash from the business	Cash at bank (A) decreases	Drawings (-Eq) increases (Overall, Capital decreases)

B.

Transaction	First effect	Second effect
Purchased a vehicle for $25 000 on credit from *Wacky Wrecks*	Vehicle (A) increases	Creditors (L) increases
The owner contributed $50 000 and an office chair worth $5 500 to the business	Cash at bank (A) increases $50 000 AND Office equipment (A) increases $5 500	Capital (Eq) increases by $55 500
Purchased an office building for $250 000	Premises or Property (A) increases	Mortgage (L) increases
Bought office furniture on credit from *Furniture Bazaar* for $8 000	Office furniture (A) increases	Creditors (L) increases
Took out a $15 000 long-term loan from *Sunny Days Bank*	Loan (L) increases	Creditors (L) increases
Owner withdrew $700 cash from the business	Cash at bank (A) decreases	Drawings (-Eq) increases (Overall, Capital decreases)
Owner withdrew the furniture for use at home and bought $4 000 worth of furniture for cash from *Funky Furniture*	Office furniture (A) decreases by $8 000 then increases by $4 000 AND Cash at bank decreases $4 000	Drawings (-Eq) increases $8 000 (Overall, Capital decreases)

C.

Transaction	First effect	Second effect
Owner contributed $70 000 to the business	Cash at bank (A) increases	Capital (Eq) increases
Owner contributed a photocopier, computer and printer worth $8 500 to the business	Office equipment increases	Capital (Eq) increases
Bought office furniture on credit from *Inca Designs* for $10 000	Office equipment (A) increases	Creditor - Inca Designs (L) increases
Took out a premises mortgage for $300 000	Property (A) increases	Mortgage (L) increases
Owner withdrew $2 000 of furniture for use at home	Furniture (A) decreases	Drawings (-Eq) increases (Overall, Capital decreases)
Opened a $15 000 cash management account with funds invested by the owner	Investments (A) increases	Capital (Eq) increases
Purchased a vehicle for $30 000 on credit from *Vroom Motors*	Vehicle (A) increases	Creditor - Vroom Motors (L) increases
Owner withdrew $750 cash from the business	Cash at bank (A) decreases	Drawings (-Eq) increases (Overall, Capital decreases)

5. RECORDING TRANSACTIONS

A. Smarty Pants General Ledger

Motor Vehicle (A)

2019					
3 May	*Balance*	20 000			

Equipment (A)

2019					
3 May	*Balance*	50 000			

Cash at Bank (A)

2019					
3 May	*Balance*	20 000			

Bank Loan (L)

			2019		
			1 May	*Balance*	40 000

Costumes (A)

2019					
1 May	*Balance*	50 000			

Capital (Eq)

			2019		
			1 May	*Balance*	10 000

B. Smash Hit General Ledger

Tennis Balls (A)

	Opening balance	250			

Ball Machines (A)

	Opening balance	5 000			

Tennis Racquets (A)

	Opening balance	2 000			

Motorbike (A)

	Opening balance	3 000			

Cash at Bank (A)

	Opening balance	1 000			

Capital (Eq)

				Opening balance	11 250

C. Cakes and All General Ledger

Computer

1 July	*Opening balance*	2 500			

Inventory

1 July	*Opening balance*	50 000			

Fixtures

1 July	*Opening balance*	20 000			

Ovens

1 July	*Opening balance*	30 000			

Cash at Bank

1 July	*Opening balance*	10 000			

Capital

			1 July	*Opening balance*	112 000

D. Dashing Dramatics General Ledger

Music Equipment

1 July	*Opening balance*	75 250			

Costumes

1 July	*Opening balance*	35 000			

Props

1 July	*Opening balance*	20 000			

Motor Vehicle

1 July	*Opening balance*	30 000			

Cash at Bank

1 July	*Opening balance*	20 000			

Capital

			1 July	*Opening balance*	180 250

E. Sure Shot General Ledger

Cameras

Balance	40 250		

Darkroom Equipment

Balance	5 000		

Office Furniture

Balance	20 000		

Van

Balance	30 000		

Cash at Bank

Balance	10 000		

Capital

		Balance	105 250

6. RECORDING TRANSACTIONS

A. Sunny Lowell

i. and ii.

Note: Sandy's contribution on the 1 March was $250 000.

Dustbusters
General Ledger
8 March 2021

Cash at Bank

2021			2021		
1 Mar	*Capital*	250 000	3 Mar	*Computer*	3 000
5	*Loan*	250 000	4	*Creditor - Wacky Wrecks*	5 000
			6	*Premises*	260 000
			7	*Capital*	500
			8	*Balance c/d*	231 500
		$500 000			**$500 000**
	Balance b/d	**231 500**			

Capital

2021			2021		
7 Mar	*Bank*	500	1 Mar	*Bank*	250 000
8	*Balance c/d*	239 500			
		$250 000			**$250 000**
			9	*Balance b/d*	239 500

Van

2021					
2 Mar	*Creditor - Wacky Wrecks*	10 000			

Creditor – Wacky Wrecks

2021			2021		
4 Mar	*Cash at Bank*	5 000	2 Mar	*Van*	10 000
	Balance c/d	5 000			
		$10 000			**$10 000**
				Balance b/d	5 000

Computer

2021					
3 Mar	*Bank*	3 000			

Loan

			2021		
			5 Mar	*Bank*	250 000

Premises

2021					
6 Mar	*Bank*	260 000			

iii.

Dustbusters
Balance Sheet
8 March 2021

	$
ASSETS	
Cash at bank	231 500
Computer	3 000
Premises	260 000
TOTAL ASSETS	494 500
LIABILITIES	
Creditor - Wacky Wrecks	5 000
Loan	250 000
TOTAL LIABILITIES	255 000
NET ASSETS	**239 500**
EQUITY	**239 500**

B. Tristan Markham

i. and ii.

Painted to Perfection
General Ledger
8 February 2024

iii.

Cash at Bank

2024			2024		
1 Feb	*Capital (Equity)*	75 000	3 Feb	*Office eqipment*	12 000
5	*Loan - Crazy Credit Bank*	100 000	4	*Funky Furniture*	15 000
			6	*Office lease*	100 000
			7	*Drawings(Equity)*	750
			8	*Balance c/d*	47 250
		175 000			**175 000**
9	*Balance b/d*	47 250			

Equity

2024			2024		
7 Feb	*Bank*	750*	1 Feb	*Bank*	75 000
8	*Balance c/d*	74 250			
		75 000			**75 000**
			9	*Balance b/d*	74 250

*Could have been entered into a drawings account instead.

Office Furniture

2024					
2 Feb	*Funky Furniture*	30 000			

Creditor – Funky Furniture

2024			2024		
4 Feb	*Bank*	15 000	2 Feb	*Office furniture*	30 000
	Balance c/d	15 000			
		30 000			**30 000**
			9	*Balance b/d*	15 000

Office Equipment

2024					
3 Feb	*Bank*	12 000			

Loan – Crazy Credit Bank

			2024		
			5 Feb	*Bank*	100 000

Office Lease

2024					
6 Feb	*Bank*	100 000			

Painted to Perfection
Balance Sheet
As at 8 February 2024

	$
ASSETS	
Cash at Bank	47 250
Office Furniture	30 000
Office Equipment	12 000
Lease	100 000
TOTAL ASSETS	189 250
LIABILITIES	
Creditor	15 000
Loan	100 000
TOTAL LIABILITIES	115 000
NET ASSETS	**74 250**
EQUITY	**74 250**

C. Vivien Taylor

Muscles Manipulations
General Ledger
8 April 2022

Cash at Bank

2022			2022		
1 Apr	*Capital*	10 000	3 Apr	*Massage supplies*	300
5	*Friendly Bank*	10 000	4	*Massage equipment*	500
			6	*Office equipment*	3 500
			7	*Drawings*	250
			8	*Balance c/d*	15 450
		20 000			**20 000**
9	*Balance b/d*	15 450			

Equity

			2022		
			1 Apr	Cash at *bank*	10 000

Drawings

2022					
7 Apr	*Cash at bank*	250			

Creditor – Massage Equipment

2022			2022		
4 Apr	*Cash at bank*	500	2 Apr	*Tables*	1 000
8	*Balance c/d*	500			
		1 000			**1 000**
			9	*Balance b/d*	500

Massage Tables

2022					
2 Apr	*Massage equipment*	1 000			

Massage Supplies

2022					
3 Apr	*Cash at bank*	300			

Loan – The Friendly Bank

			2022		
			5 Apr	*Cash at bank*	10 000

Office Equipment

2022					
7 Apr	*Cash at bank*	3 500			

iii.

Muscles Manipulations
Balance Sheet
As at 8 April 2022

	$
ASSETS	
Cash at Bank	15 450
Massage Tables	1 000
Massage Supplies	300
Office Equipment	3 500
TOTAL ASSETS	20 250
LIABILITIES	
Creditor	500
Loan	10 000
TOTAL LIABILITIES	10 500
NET ASSETS	**9 750**
EQUITY	
Capital	10 000
Less: Drawings	(250)
TOTAL EQUITY	**9 750**

D. Maddy Maverick

Learners Let Loose
General Ledger
8 January 2019

Cash at Bank

2019			2019		
1 Jan	*Capital*	15 000	3 Jan	*Car equipment*	3 000
			4	*Cars, cars, cars*	5 000
			6	*Supplies*	200
			7	*Office supplies*	4 000
			7	*Drawings*	100
			8	*Balance c/d*	2 700
		15 000			**15 000**
	Balance b/d	2 700			

Drawings

2019					
7 Jan	*Cash at bank*	100			

Equity

			2019		
			1 Jan	Cash at *bank*	15 000

Vehicle

2019					
2 Jan	*Cars, cars, cars*	25 000			

Cars, cars, cars – Creditor

2019			2019		
4 Jan	*Cash at bank*	5 000	2 Jan	*Vehicle*	25 000
	Balance c/d	20 000			
		25 000			**25 000**
			8	*Balance b/d*	20 000

Car Equipment

2019					
3 Jan	*Cash at bank*	3 000			

Supplies

2019					
5 Jan	*Cash at bank*	200			

Office Equipment

2019					
6 Jan	*Office Supplies*	4 000			

Office Supplies – Accounts Payable

2019			2019		
7 Jan	*Cash at bank*	4 000	6 Jan	*Office equipment*	4 000

iii.

Muscles Manipulations
Balance Sheet
As at 8 January 2019

	$
ASSETS	
Cash at Bank	2 700
Vehicle	25 000
Car Equipment	3 000
Supplies	200
Office Equipment	4 000
TOTAL ASSETS	34 900
LIABILITIES	
Creditor - Cars cars cars	20 000
TOTAL LIABILITIES	20 000
NET ASSETS	**14 900**
EQUITY	
Capital	15 000
Less: Drawings	(100)
TOTAL EQUITY	**14 900**

E. Tippy Tweed

i. and ii.

Cooking Up a Storm
General Ledger
8 June 2025

Cash at Bank

2025			2025		
1 Jun	*Capital*	20 000	3 Jun	*Utensils*	3 000
			4	*Kitchen supplies*	5 000
			6	*Fridge*	7 000
			7	*Drawings*	400
			8	*Kitchen supplies*	1 000
			8	*Balance c/d*	3 600
		20 000			**20 000**
9	*Balance b/d*	3 600			

Vehicle

2025					
1 Jun	*Capital*	10 000			

Inventory

2025					
1 Jun	*Capital*	5 000			

Cookery Books

2025					
5 Jun	*Capital*	500			

Capital

2025			2025		
			1 Jun	*Motor veh/Cash at bank/ Inventory*	35 000
8 Jun	*Balance c/d*	35 500	5	*Cookery books*	500
		35 500			**35 000**
			9	*Balance b/d*	35 500

Drawings

2025					
7 Jun	*Cash at bank*	400			

Creditor – Kitchen Supplies

2025			2025		
4 Jun	*Cash at bank*	5 000	2 Jun	*Kitchen Equipment*	10 000
7	*Cash at bank*	1 000			
8	*Balance c/d*	4 000			
		10 000			**10 000**
			9	*Balance b/d*	4 000

Kitchen Equipment

2025					
2 Jun	*Creditor - Kitchen Supplies*	10 000			
3	*Cash at bank*	3 000			
6	*Cash at bank*	7 000			
		20 000			

iii.

Cooking Up a Storm
Balance Sheet
As at 8 June 2025

	$
ASSETS	
Cash at Bank	3 600
Vehicle	10 000
Inventory	5 000
Cookery Books	500
Kitchen Equipment	20 000
TOTAL ASSETS	39 100
LIABILITIES	
Creditor	4 000
TOTAL LIABILITIES	4 000
NET ASSETS	**35 100**
EQUITY	
Capital	35 500
Less: Drawings	(400)
TOTAL EQUITY	**35 100**

7. RECORDING TRANSACTIONS WITH OPENING BALANCES

A. Rough and Tumble General Ledger

Cash at Bank

2020			2020		
1 Jul	*Balance b/d*	3 500	1 Jul	*Jim Kidd*	50
3	*Abe Lite*	80	4	*Capital*	100
			5	*Jim Kidd*	50
			7	*Balance c/d*	3 380
		$3 580			**$3 580**
9	*Balance b/d*	3 380			

Capital

2020			2020		
4 Jul	*Bank*	100	1 Jul	*Balance b/d*	3 750
7 Jul	*Balance c/d*	4 150	5	*Equipment*	500
		$4 250			**$4 250**
			9	*Balance b/d*	4 150

Accounts Payable – Jim Kidd

2020			2020		
1 Jul	*Bank*	50	1 Jul	*Balance b/d*	150
5	*Bank*	50	2	*Equipment*	100
7	*Balance c/d*	150			
		$250			**$350**
			8	*Balance b/d*	150

Accounts Receivable – Abe Lite

2020			2020		
1 Jul	*Balance b/d*	200	3 Jul	*Bank*	80
			7	*Balance b/d*	120
		$200			**$200**
8	*Balance b/d*	120			

Equipment

2020					
1 Jul	*Balance b/d*	200			
3	*Jim Kidd*	100			
6	*Capital*	500			
		$800			

B. Spick n Span

Opening balance in the Capital account = $37 550

Cash at Bank

2020			2020		
1 Jul	*Opening Balance b/d*	500	5 Jul	*Creditor - Elegant Equipment*	150
3	*Capital*	75	7	*Cleaning equipment*	500
8	*Balance c/d*	*75*			
		650			**650**
				Balance c/d	75

Cleaning Equipment

2020			2020		
1 Jul	*Opening Balance b/d*	22 000	4 Jul	*Capital*	1 000
	Capital	50			
2	*Creditor - Elegant Equipment*	250			
6	*Capital*	500			
7	*Cash at Bank*	500	8	*Balance c/d*	22 300
		23 300			**22 300**
8	*Balance b/d*	22 300			

Cleaning Supplies

2020					
1 Jul	*Opening balance b/d*	50			

Motor Vehicle

2020					
1 Jul	*Opening balance b/d*	15 000			

Creditor – Elegant Equipment

2020			2020		
5 Jul	*Cash at bank*	150	2 Jul	*Cleaning equipment*	250
8	*Balance c/d*	100			
		250			**250**
			8	*Balance b/d*	0

Capital

2020			2020		
4 Jul	*Cleaning equipment*	1 000	1 Jul	*Opening balance b/d*	37 550
				Cleaning equipment	50
			3	*Cash at bank*	75
8	*Balance b/d*	37 175	6	*Cleaning equipment*	500
		38 175			**38 175**
			8	*Balance b/d*	37 175

The final balance in *Spick n Span's* Cash at Bank is a credit balance of $75. This credit balance is a liability, as the owner has withdrawn more money from their bank account than the business actually has. The business needs to have arranged for an overdraft facility in order to be able to do this. The $75 will be reported in the current liabilities section of the Balance Sheet as an overdraft.

C. Aced First Time

Opening balance for Capital = $17 200

Cash at Bank

2019			2019		
1 Sep	*Opening balance*	10 000	1 Sep	*Accounts payable*	5 000
9	*Accounts receivable*	1 750	7	*Ball machines*	1 000
			7	*Drawings/Captial*	100
			7	*Accounts payable*	5 000
				Balance c/d	650
		11 750			**11 750**
17	*Balance b/d*	650			

Tennis Equipment

2019			2019		
1 Sep	*Opening Balance b/d*	1 200			
12	*Capital*	1 000	17 Sep	*Balance c/d*	2 200
		2 200			**2 200**
17	*Balance b/d*	2 200			

Ball Machines

2019			2019		
1 Sep	*Opening Balance*	4 000			
12	*Cash*	1 000	17 Sep	*Balance c/d*	5 000
		5 000			**5 000**
17	*Balance b/d*	5 000			

Lawn Mowers

2019					
1 Sep	*Opening balance*	15 000			

Accounts Receivable

2019			2019		
1 Sep	*Opening balance*	2 000	2 Sep	*Cash*	1 750
			17	*Balance cd*	250
		2 000			**2 000**
17	*Balance b/d*	250			

Accounts Payable

2019			2019		
1 Sep	*Cash*	5 000	1 Sep	*Opening balance*	15 000
11	*Cash*	5 000			
17	*Balance c/d*	5 000			
		15 000			**15 000**
			17	*Balance b/d*	5 000

Capital

2019			2019		
10 Sep	*Cash*	100	1 Sep	*Opening balance b/d*	17 200
17	*Balance b/d*	18 100	12	*Tennis equipment*	1 000
		18 200			**18 200**
			17	*Balance b/d*	18 100

D. Changing Image

Please note: The accounts receivable (S. Dwight) in the text first print run is an **Account Payable** (S Dwight)
Opening balance for Capital = $50 300

Cash at Bank

2021			2021		
1 Aug	*Opening balance*	30 000	1 Aug	*T Main*	50
			14	*T Main*	80
			15	*Drawings*	50
			16	*S Dwight*	100
			30	*Balance c/d*	29 720
		30 000			**30 000**
30	*Balance b/d*	29 720			

Office Furniture

2021			2021		
1 Aug	*Opening Balance b/d*	20 000			
13	*S Dwight*	100	30 Aug	*Balance c/d*	20 100
		20 100			**20 100**
30	*Balance b/d*	20 100			

Style Books

2021			2021		
1 Aug	*Opening Balance*	1 000			
21	*Capital*	200	30 Aug	*Balance c/d*	5 000
		1 200			**5 000**
30	*Balance b/d*	1 200			

T Main

2021			2021		
1 Aug	*Cash*	50	1 Aug	*Opening balance*	300
14	*Cash*	80			
30	*Balance b/d*	170			
		300			**300**
			30	*Balance b/d*	170

S Dwight

2021			2021		
16 Aug	*Cash*	100	1 Aug	*Opening balance*	400
			13	*Office furniture*	100
30	*Balance c/d*	400			
		500			**500**
			30	*Balance b/d*	400

Capital

2021			2021		
			1 Aug	*Opening balance b/d*	50 300
30 Aug	*Balance c/d*	50 500	21	*Style books*	200
		50 500			**50 500**
			30	*Balance b/d*	50 500

Drawings

2021			2021		
15 Aug	*Cash*	50			
			30 Aug	*Balance c/d*	50
		50			**50**
30	*Balance b/d*	50			

E. Sassy Sounds

Opening balance for Capital = $75 500

Cash at Bank

2020			2020		
1 Jul	*Opening balance*	500	5 Jul	*Instrument World*	2 000
4	*Capital*	10 000	5	*Musical Sounds*	2 000
10	*Loan*	20 000	6	*Drawings*	1 000
			7	*Instrument World*	1 000
			9	*Sound equipment*	1 000
			12	*Balance c/d*	23 500
		30 500			**30 500**
12	*Balance b/d*	23 500			

Sound Equipment

2020			2020		
1 Jul	*Opening Balance*	20 000	11 Jul	*Drawinings*	2 000
1	*Capital*	1 000			
3	*Musical Sounds*	2 000			
8	*Capital*	500			
9	*Cash at bank*	1 000	12	*Balance c/d*	22 500
		24 500			**24 500**
12	*Balance b/d*	22 500			

Instruments

2020			2020		
1 Jul	*Opening Balance*	40 000			
2	*Instrument World*	5 000	12 Jul	*Balance c/d*	45 000
		45 000			**45 000**
12	*Balance b/d*	45 000			

Van

2020			2020		
1 Jul	*Opening Balance*	15 000			
			12 Jul	*Balance c/d*	15 000
		15 000			**15 000**
12	*Balance b/d*	15 000			

'Instrument World' – Creditor

2020			2020		
1 Jul	*Cash at bank*	2 000	2 Jul	*Instruments*	5 000
7	*Cash at bank*	1 000			
12	*Balance c/d*	2 000			
		5 000			**5 000**
			30	*Balance b/d*	2 000

'Musical Sounds' – Creditor

2020			2020		
5 Jul	*Cash at bank*	2 000	1 Jul	*Sound equipment*	2 000
12	*Balance c/d*	0			
		0			**0**
			12	*Balance b/d*	0

Capital

2020			2020		
			1 Jul	*Opening balance b/d*	75 500
			1	*Sound equipment*	1 000
			4	*Cash at bank*	10 000
12 Jul	*Balance c/d*	87 000	8	*Sound equipment*	500
		87 000			**87 000**
			12	*Balance b/d*	87 000

Drawings

2020			2031		
6 Jul	*Cash at bank*	1 000			
11	*Sound equipment*	2 000	30 Jul	*Balance c/d*	3 000
		3 000			**3 000**
30	*Balance b/d*	3 000			

Loan

2020			2031		
			10 Jul	*Cash at bank*	20 000
15 Jul	*Balance c/d*	20 000			
		20 000			**20 000**
			12	*Balance b/d*	20 000

8. INTERPRETING TRANSACTIONS

A. *Billy Bathgate's Shoe Shine – Analysis Chart*

DEBIT ENTRY	$	CREDIT ENTRY	$
Cash at Bank	600	Capital	600
Equipment	200	Cash at Bank	200
Cash at Bank	5 000	Loan	5 000
Loan	1 000	Cash at Bank	1 000
Capital	400	Cash at Bank	400
Equipment	2 000	Creditor - Klean We Can	2 000

B. *Aussie Ocker's Car Cleaning – Analysis Chart*

DEBIT ENTRY	$	CREDIT ENTRY	$
Cash at Bank	500	Capital	500
Cleaning Supplies	100	Cash at Bank	100
Cash at Bank	3 000	Loan - Olive Ocker	3 000
Loan - Olive Ocker	200	Cash at Bank	200
Capital	50	Cleaning Materials	50
Vacuum Cleaner	12 000	Creditor - Sucks R Us	12 000
Creditor - Sucks R Us	70	Cash at Bank	70

C. *Bunty Brown's Aerobics – Analysis Chart*

DEBIT ENTRY	$	CREDIT ENTRY	$
Music Equipment	$200	Capital	$200
Music Equipment	$400	Cash at Bank	$400
Cash at Bank	$10 000	Capital	$10 000
Stereo	$5 000	Meldrum Music World	$5 000
Meldrum Music World	$1 000	Cash at Bank	$1 000
Capital	$30	Music Equipment	$30

9. INTERPRETING LEDGER ACCOUNTS

A. Little Miss Moffat

i.

May 1	Owner contributed $20 000 cash to the business.
May 2	Bought $4 000 office equipment on credit from *Office Bits*.
May 3	Took out a $30 000 loan.
May 4	Paid $2 000 off the loan.

ii.

Little Miss Moffat
Balance Sheet
As at May 5

Assets		
Cash at Bank	48 000	
Office Equipment	4 000	52 000
Liabilities		
Accounts Payable	4 000	
Loan	28 000	32 000
NET ASSETS		**$ 20 000**
Equity		
Capital		**$ 20 000**

iii. Drawings of $300 would reduce the Cash at Bank account by $300 to a total of $47 700 and would reduce the total equity by $300 to $19 700.

B. Balls R Us

i.

May 1:	Owner contributed $50 000 cash to the business
May 2:	Bought a motor vehicle on credit for $15 000 from Marvellous Motors
	Bought sports equipment on credit for $10 000 from Sporting World
May 3:	No transactions
May 4:	Paid Marvellous Motors $5 000

ii.

Cash at Bank

1 May	*Capital*	50 000	4 May	*Marvellous Motors*	5 000
				Balance c/d	45 000
		50 000			**50 000**
	Balance b/d	45 000			

Marvellous Motors

4 May	*Bank*	5 000	2 May	*Motor vehicle*	15 000
	Balance b/d	10 000			
		15 000			**15 000**
				Balance c/d	10 000

iii.

Cash at Bank

1 May	*Capital*	50 000	4 May	*Marvellous Motors*	5 000
				Balance c/d	45 000
		50 000			**50 000**
	Balance b/d	45 000	5	*Sporting World*	5 000

Sporting World

5 May	*Bank*	5 000	2 May	*Sporting equipment*	10 000

CHAPTER 6: THE INCOME STATEMENT AND TRIAL BALANCE

Review Questions 6.1

1. *Calculate whether a profit or loss has been made in each situation.*

INCOME	minus	EXPENSES	equals	State whether a PROFIT or LOSS has been made
30 000	-	20 000	=	10 000 profit
50 000	-	40 000	=	10 000 profit
10 000	-	20 000	=	10 000 loss
17 000	-	19 000	=	2 000 loss
9 000	-	9 000	=	no profit or loss
12 000	-	10 000	=	2 000 profit
100 000	-	120 000	=	20 000 loss
90 000	-	60 000	=	30 000 loss
48 000	-	43 000	=	5 000 profit
13 000	-	10 000	=	3 000 profit
97 000	-	97 000	=	no profit or loss
18 000	-	10 000	=	8 000 profit
1 000	-	500	=	500 profit

2. *Define 'income'.*

Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

a. *What is another word for an 'inflow'?*

Enhancement of asset or decrease of liability

b. *Explain in your own words what 'enhancements of assets' means.*

Good because it is a gain.

c. *Is an enhancement of assets a good occurrence or a bad occurrence for a business? Explain why.*

Less is owed to others.

d. *Why is a decrease in a liability good for a business?*

This is their investment in the business.

e. *Why might the owner of a business be happy with an increase in equity?*

Their investment in the business has increased. This could be positive or negative depending on their return.

3. Which of these transactions are income in the form of revenue (not gains)?

EVENT	REVENUE Yes/No
Dr Spock saw a patient and was paid $80.	Yes
Jim Deal sold a house for his client. His fee is 5% commission on the selling price. He has billed the client but has not yet received payment.	Yes
Sally Goodwin bought a vehicle valued at $30 000.	No
Rapid Couriers delivered a parcel to an address where the previous tenants had vacated the house. They have posted the parcel back to the firm. Their delivery fee is usually $25.	Yes
Apple Blueberry mowed some lawns and was paid $90.	Yes
Vivian Boland bought a computer for $2 500.	No
Ace Tutoring tutored Jimmy Little for six weeks, two years ago. Jimmy's mother has still not paid the bill.	Yes
Dr Do Little saw 10 patients and bulk billed their invoices to Medicare so that the patients did not have to pay cash for their visit.	Yes
Jessy Harper took out a $15 000 loan.	No
Bobby Brown has just started Year One; the school has posted his parents the bill for Term One.	Yes
Tom Moy withdrew $200 from the business to buy his mother a present.	No
Victor Nutt sold $4 000 worth of merchandise.	Yes

4. Define 'expense'. List examples of the expenses the following businesses would have:

Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

a. **doctor:** Wages, cleaning, office supplies, phone/Internet
b. **hairdresser:** Supplies, rent, cleaning, utilities
c. **courier:** Petrol station, vehicle maintenance, spare parts
d. **petrol station:** Wages, inventory, electricity
e. **gift shop:** Rent, wages, cleaning, gift wrapping supplies.

5. Which of these transactions are an expense for the business?

EVENT	EXPENSE Yes/No
Big House Real Estate has just paid their $400 phone bill.	Yes
Bobbie Black bought work desk valued at $300.	No – asset
Roomy House Real Estate owes the bank $70 interest on their loan.	Yes
Brett Harris the owner of a deli borrowed $20 from his best friend to go to a movie.	No – personal
Maurice Grader paid off a $2 000 loan.	No – liability
Harpo Electrical Services just received a $200 electricity bill.	Yes
Southern Comfort Guest House just took out a $55 000 loan.	No – liability

Review Questions 6.2

1. *Indicate which side of the ledger account (debit side or credit side) would be affected by each of the following:*

	Debit side	Credit side
• Income account decreasing	✓	
• Expense account increasing	✓	
• Income account increasing		✓
• Expense account decreasing		✓

2. *Classify the following ledger accounts as income or expense, and state which side of the ledger is affected by the account increasing or decreasing.*

LEDGER ACCOUNT	ACCOUNT CLASSIFICATION (Expense or income account)	ACTION	RECORDED (debit side or credit side)
Electricity	Expense	Increased	Debit
		Decreased	Credit
Wages	Expense	Increased	Debit
		Decreased	Credit
Bad Debt	Expense	Increased	Debit
		Decreased	Credit
Fees Received	Income	Increased	Credit
		Decreased	Debit
Interest Paid	Expense	Increased	Debit
		Decreased	Credit
Insurance	Expense	Increased	Debit
		Decreased	Credit
Fees Paid	Expense	Increased	Debit
		Decreased	Credit
Sales	Income	Increased	Credit
		Decreased	Debit
Discount Received	Income	Increased	Credit
		Decreased	Debit
Rates	Expense	Increased	Debit
		Decreased	Credit
Interest Received	Income	Increased	Credit
		Decreased	Debit
Internet Bill	Expense	Increased	Debit
		Decreased	Credit
Discount Given	Expense	Increased	Debit
		Decreased	Credit

3. *Why are all income and expense accounts closed to the Profit and Loss account at the end of the accounting period?*

To close the accounts in preparation for the next reporting period and to calculate the profit or loss for the period.

4. *Summarise the steps to follow when closing income and expense accounts.*

Steps:

1. Close all expense accounts by crediting with their total for the period and debiting to the Profit and Loss account.
2. Close all income accounts by debiting with their total for the period and crediting to the Profit and Loss account.
3. Calculate the profit or loss by adding both sides of the Profit and Loss account. If the credit side (income) is greater than the debit side (expenses), there is a profit. If the debit side is greater, then the business has made a loss instead of a profit.
4. Transfer the profit or loss to the owner's Capital account.

Review Questions 6.3

1. *Define 'inventory'. What are some alternative names for inventory?*

Inventory is the goods that the business has in stock for sale. For a merchandising business this can include the raw materials and work in progress being prepared for sale. Other names include: stock, goods and property for sale.

2. *Explain how a service business earns income.*

Mainly from fees.

3. *Explain how a trading/retail business earns income.*

Primarily from the sale of inventory.

4. *Compare and contrast the perpetual and periodic inventory methods.*

Perpetual	Periodic
Continuous record of inventory maintained after every purchase or sale.	Stock levels only determined once a stock take has been taken.
Purchases recorded in the Inventory account.	Purchases recorded in a Purchases Account.
Cost of sales calculated continuously.	Cost of sales only determined at the end of the accounting period
Inventory on hand is always known.	There can be a lack of information as to the exact level of inventory on hand.
Management knows when to reorder stock.	Stock takes need to be carried out.
No entry to record the ending inventory, because a continuous record of inventory is kept. The closing entries transfer the balance in the Cost of Sales account to the Profit and Loss account.	The ending inventory needs to be recorded and all accounts related to inventory are transferred to a Profit and Loss account.

5. *Create a summary chart showing the following transactions for a retail business: sales (cash and credit), purchases (cash and credit), cash receipt, cash payment, sales return, purchases return, discount allowed, discount received.*

Transaction	Accounts involved
Cash purchase	Inventory debited – asset account increasing. Cash credited – asset account decreasing.
Credit purchase	Inventory debited – asset account increasing. Accounts Payable credited – liability account increasing.
Purchase return	Accounts Payable debited – liability account decreasing. Inventory credited – asset account decreasing.
Discount received	Accounts Payable debited – liability account decreasing Cash at Bank credited – asset account decreasing. Discount Received credited – income account increasing.
Cash sale	Cash debited – asset account increasing. Sales credited – income account increasing. Cost of Sales debited – expense account increasing. Inventory credited – asset account decreasing.
Credit sale	Accounts Receivable debited v asset account increasing. Sales credited – income account increasing. Cost of Sales debited – expense account increasing. Inventory credited – asset account decreasing.
Sales return	Sales Returns debited – decreasing the Sales (Income) account. Accounts Receivable credited – asset account decreasing. Inventory debited – inventory on hand has increased. Cost of Sales credited – decrease in expenses.
Discount allowed	Cash at Bank debited – asset account increasing Discount Allowed debited – expense account increasing Accounts Receivable credited – asset decreasing.
Payment for credit purchase	Accounts Payable debited – liability account decreasing. Cash credited – asset account decreasing.

Review Questions 6.4

1. *What is the purpose of the Trial Balance?*

A list of all the ledger account names with their respective debit or credit balances. The debit or credit balances in each ledger account are calculated by footing each account. The business owner can check the balances in the ledger accounts by completing a Trial Balance.

2. *Outline three errors that might not be revealed by the Trial Balance.*

If the incorrect amount was entered into both accounts, if a transaction was recorded more than once, or a transaction was left out. Also if a transaction was recorded in the wrong account.

3. *Which errors in the accounts are likely to show up when a Trial Balance is created for a business?*

If an entry was omitted, a transposition error, the incorrect recoding of one amount, and incorrect addition.

4. *Why is the Income Statement prepared?*

To report on the profit or loss of the business for a specific accounting period.

5. *List the direct expenses the following businesses may have.*

For example:

a. **clothes retailer** – clothing repairs, ironing of clothes, display costs

b. **advertising agency** – telephone/Internet, writing/printing materials

c. **tour business** – petrol, vehicle maintenance, tour supplies, wages of driver

d. **movie cinema** – snack bar supplies, projector maintenance, wages of projector operator

e. **small deli** – shop supplies, inventory, cleaning of shelves

6. *Explain the differences between the Income Statements of a service busines and a retail business.*

The Income Statement of a service business has income from fees whereas the trading business had incomes from sales and calculates cost of sales.

Review Questions 6.5

1. *How does the Income Statement inform the business owner about the financial performance of the business?*

It shows the financial performance of the business and provides the figures required to calculate profitability.

2. *Define ‘liquidity’, and explain its importance to a small business.*

Liquidity is the ability of the business to meet its debts as they fall due in the short term, generally a twelve-month period. The Balance Sheet figures can be used to work out both the short term and long term stability of the business through measuring liquidity.

3. *Outline how the Balance Sheet can be used to measure the financial position of a business.*

It shows the financial position of the business and provides the figures needed to calculate the liquidity of the business.

Chapter 6 Activities

1. CLASSIFICATION OF ACCOUNTS

A.

Detail	Income or expense
Insurance paid	Expense
Interest received	Income
Fees received	Income
Electricity	Expense
Repairs	Expense
Rent received	Income
Interest paid	Expense
Discount received	Income
Discount allowed	Expense
Postage	Expense
Bad debt	Expense
Office cleaning	Expense
Bank fees	Expense
Purchases of stock	Expense
Stationery used	Expense
Petrol	Expense
Motor vehicle repairs	Expense
Council rates	Expense
Wages	Expense
Salaries	Expense
Sales	Income

B. The Framework defines income as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Yes, interest received from a cash management account is considered to be income as it is an economic benefit which will increase equity and it has not been contributed by the owner rather the bank.

2. CLASSIFICATION OF EXPENSES

B.

Expense	Classification
Postage	General and Administrative
Wages of tennis coaches	Direct
Bank fees and charges	Financial
Stationery	General and Administrative
Rent	General and Administrative
Interest charged	Financial
Repairs to tennis equipment	Direct
Bad debts	Direct
Insurance	General and Administrative
Office staff wages	General and Administrative
Advertising	General and Administrative
Electricity	General and Administrative
Discount given	Financial
Office cleaner salary	General and Administrative
Stationery	General and Administrative
Depreciation of tennis equipment	Direct
Any repairs to office equipment	General and Administrative
Water	General and Administrative
Telephone charges	General and Administrative

C. Interest paid is an expense because there has been a decrease in economic benefits in the form of an outflow of the asset cash at bank. This has resulted in a decrease in equity, because this amount will be subtracted in the Income Statement, thus reducing profit, which is an amount included in the final equity figure in the Balance Sheet.

3. ELEMENTS OF THE INCOME STATEMENT

A. Assets + Expenses = Liabilities + Income + Equity

B. Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets whereas expenses are decreases. Examples of income: sales, fees received, discount received, interest received. Examples of expenses: wages, cost of sales, depreciation, bad debts, rent, Internet bill, interest paid.

C. Drawings have an effect on the Balance Sheet not the Income Statement. They reduce the capital of the owner and thus the overall equity.

D. Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets. For example: sales income.

E. Expenses are decreases in economic benefits in the form of outflows or depletions of assets that result in decreases in equity. For example: office cleaning expenses, giving customers a discount.

F. Most businesses classify their income statement into sub-groups. By dividing the income and expenses into different groups, someone studying the Income Statement can see how each type of income or expense has contributed to the results of the business. This can be useful if the business is looking at ways to reduce expenses. Classified expenses allow the owner to identify areas that are costing the business the most, in order to try and reduce them.

4. LINK BETWEEN BALANCE SHEET AND INCOME STATEMENT

A. The main reason for preparing an Income Statement is to report on the profit performance of a business over a given time period. The statement results in the final profit or loss figure for the accounting period.

B. Any profit that a business earns belongs to the owner of the business. If the Income Statement results in a profit figure then this amount is transferred to the Equity section of the Balance Sheet. It results in an increase in equity. If however, a loss is made, this amount is still transferred to the equity section of the Balance Sheet but results in a decrease in equity.

5. INCORRECT CLASSIFICATION

A. i. It is dishonest and fraudulent, because it means the incorrect information is being shown to an investor. Technically the investor is knowingly being lied to.

ii. The potential investor and bank.

B. i. The final profit figure in the Income Statement will have the $1 500 deducted from it as a cleaning expense. Profit will be lower.

ii. The non-current assets section will be $1 500 less than what it should be. If the furniture was bought on credit the Accounts Payable under current liabilities should be $1 500 higher. If cash was paid, the Cash at Bank in the current assets section should be $1 500 less.

C. i. It will not have any impact on the final profit figure.

ii. The Income Statement does not need to be changed. A note can be made explaining what the final totals for the G&A expenses and the DC expenses should be. The reason being that it does not affect the overall profit figure.

(Alternate answers are fine as long as they are justified.)

6. THE DOUBLE ENTRY SYSTEM

A.

Transaction	First effect	Second effect
Paid $5 000 advertising	*Advertising account (expense) increases by $5 000*	*Cash at bank account (asset) decreases by $5 000*
Paid $200 interest on business loan.	Cash at Bank (A) decreases	Interest (Ex) increases
Received $1 000 in fees.	Fees (I) increases	Cash at Bank (A) increases

Transaction	First effect	Second effect
Received a $1 000 discount from *Furniture World* after purchasing $5 000 furniture on credit. ***Note the double entry system working with three entries required for the one transaction***	Discount Received (I) increases $1 000 AND Creditors (L) increases $4 000	Furniture and Fittings (A) increases
Received $50 interest.	Interest (I) increases	Cash at Bank (A) increases
Gave *Harper World* a $300 discount. Harper World currently owes the business $5 000 in fees.	Discount Allowed (Ex) increases	Debtor (A) decreases
Sold $10 000 of inventory.	Cash at Bank (A) increases AND Sales (I) increases	Cost of Sales (Ex) increases AND Inventory (A) decreases
Paid $100 electricity account.	Cash at Bank (A) decreases	Electricity (Ex) increases
Paid $250 telephone account.	Telephone (Ex) increases	Cash at Bank (A) decreases
Purchased $5 000 worth of stock. Paid cash.	Inventory (A) increases	Cash at Bank (A) decreases
Incurred $50 in bank fees and charges.	Bank Fees (Ex) increases	Cash at Bank (A) decreases

B. NOTE: Not all transactions involve just income and expenses. The full double entry result has been shown here.

Transaction	First effect	Second effect
Paid $2 000 interest on mortgage.	Interest (Ex) debited	Cash at Bank (A) credited
Paid $450 advertising to local paper.	Advertising (Ex) debited	Cash at Bank (A) credited
Received $1 000 discount off a $10 000 purchase made on credit.	Accounts Payable $10 000 (L) debited	Discount Received $1 000 (I) AND Cash at Bank $9 000 (A) credited
Received $70 000 in consulting fees.	Cash at Bank (A) debited	Fees (I) credited
Received $75 interest.	Cash at Bank (A) debited	Interest (I) credited
Gave *ABC Learning* a $10 discount on a consultation.	Cash at Bank (A) debited AND Discount Allowed $10 (Ex) debited	Accounts Receivable (A) credited OR Fees (I)
Received $250 in fees.	Cash at Bank (A) debited	Fees (I) credited
Paid $200 petrol.	Petrol (Ex) debited	Cash at Bank (A) credited
Paid $25 postage.	Postage (Ex) debited	Cash at Bank (A) credited
Sold $7 000 of inventory. Original cost of the inventory was $3 500.	Cash at Bank $7 000 (A) AND Cost of Sales $3 500 (Ex) debited	Inventory $3 500 (A) AND Sales $7 000 (I) credited
Purchased $2 000 of stock on credit from *Wholesale Foods Inc.*	Inventory (A) debited	Accounts Payable (L) credited

7. POSTING TRANSACTIONS AND INCOME STATEMENT PREPARATION

A.

i. Ask Sal

	DEBIT	CREDIT
Paid advertising:	Advertising	Cash at Bank
Bought office computer:	Office Equipment	Creditors/CAB
Paid electricity bill:	Electricity	Cash at Bank
Bought office desk on credit from *The Office Place*:	Office Equipment	Creditors
Received consulting fees:	Cash at Bank	Fees
Performed a consultation on credit terms:	Debtors	Fees
Paid *The Office Place*:	Creditors	Cash at Bank
Received interest:	Cash at Bank	Interest Received
Paid interest:	Interest Expense	Cash at Bank

ii.

Ask Sal
General Ledger
May 2020

Cash at Bank

2020			2020		
1 May	*Capital*	75 000	2 May	*Rent*	5 000
4 May	*Loan - Happy Days Bank*	6 250	3 May	*Advertising*	750
6 May	*Capital*	3 000	5 May	*Furniture*	15 000
				Loan - Happy Days Bank	2 500

Capital

			2020		
			1 May	*Bank*	75 000

Rent

2020					
1 May	*Bank*	5 000			

Advertising

2020					
3 May	*Bank*	750			

Loan – Happy Days Bank

2020			2020		
5 May	*Bank*	2 500	4 May	*Bank*	6 250

Fees

			2020		
			6 May	*Bank*	3 000

Furniture

2020					
5 May	*Bank*	15 000			

Ask Sal
Trial Balance
6 May 2020

	DEBIT	CREDIT
Cash at Bank	61 000	
Capital		75 000
Rent	5 000	
Advertising	750	
Loan		3 750
Fees		3 000
Furniture	15 000	
TOTALS	**$81 750**	**$81 750**

iii. Smash Hitz

Smash Hitz
General Ledger
June 2020

Cash at Bank

2020			2020		
1 Jun	*Fees*	3 000	2 Jun	*Electricity*	75
3	*Fees*	4 000		*Phone*	80
7	*Fees*	5 000		*Rent*	300
			5	*Insurance*	400
			6	*Wages*	2 000

Fees

			2020		
			1 Jun	*Bank*	3 000
			3	*Bank*	4 000
			7	*Bank*	5 000

Electricity

2020					
2 Jun	*Bank*	75			

Rent

2020					
2 Jun	*Bank*	80			

Phone

2020					
2 Jun	*Bank*	300			

Office Equipment

2020					
4 Jun	*Creditor – Harvey Norman*	5 000			

Creditor – Harvey Norman

			2020		
			4 June	*Office equipment*	5 000

Insurance

2020					
5 Jun	*Bank*	400			

Wages

2020					
6 Jun	*Bank*	2 000			

Smash Hitz
Trial Balance
8 June 2020

	DEBIT	**CREDIT**
Cash at Bank	9 145	
Fees		12 000
Electricity	75	
Rent	80	
Phone	300	
Office Equipment	5 000	
Creditor		5 000
Insurance	400	
Wages	2 000	
TOTALS	**$17 000**	**$17 000**

iv. Snip 'n Time

Snip 'n Time
General Ledger
August 2020

Cash at Bank

2020			2020		
1 Aug	*Fees*	5 000	2 Aug	*Internet*	40
4	*Fees*	1 000		*Water*	60
7	*Fees*	1 000		*Wages*	400
			3	*Bank fees*	50
			5	*Insurance*	100
			6	*Electricity*	50

Fees

			2020		
			1 Aug	*Bank*	4 000
			4	*Bank*	1 000
			7	*Bank*	1 000

Internet

2020					
2 Aug	*Bank*	40			

Water

2020					
2 Aug	*Bank*	60			

Wages

2020					
2 Aug	*Bank*	400			

Bank Fees

2020					
3 Aug	*Bank*	50			

Insurance

2020					
5 Aug	*Bank*	100			

Electricity

2020					
6 Aug	*Bank*	50			

Snip 'n Time
Trial Balance
7 August 2020

	DEBIT	CREDIT
Cash at Bank	6 300	
Fees		7 000
Internet	40	
Water	60	
Wages	400	
Bank Fees	50	
Insurance	100	
Electricity	50	
TOTALS	**$7 000**	**$7 000**

v. Regal Tours

Regal Tours
General Ledger
June 2020

Cash at Bank

2020			2020		
1 Jun	*Fees*	20 000	2 Jun	*Petrol*	2 500
3	*Fees*	5 000		*Bus repairs*	340
				Advertising	300
4	*Interest*	250	5	*Insurance*	400
7	*Fees*	5 000	6	*Wages*	4 000

Fees

			2020		
			1 Jun	*Bank*	20 000
			3	*Bank*	5 000
			7	*Bank/Discount Allowed*	5 500

Discount Allowed

2020					
7 Jun	*Fees*	500			

Bus Repairs

2020					
2 Jun	*Bank*	340			

Advertising

2020					
2 Jun	*Bank*	300			

Petrol

2020					
2 Jun	*Bank*	2 500			

Interest Received

			2020		
			4 Jun	*Bank*	250

Insurance

2020					
5 Jun	*Bank*	400			

Wages

2020					
6 Jun	*Bank*	4 000			

Regal Tours
Trial Balance
8 June 2020

	DEBIT	CREDIT
Cash at Bank	22 710	
Fees		30 500
Discount Allowed	500	
Bus Repairs	340	
Advertising	300	
Petrol	2 500	
Interest Received		250
Insurance	400	
Wages	4 000	
TOTALS	**$30 750**	**$30 750**

vi. Scream Savers

***Scream Savers* General Ledger**

Cash at Bank

2010			2010		
1 May	*Fees*	10 000	2 May	*Electricity*	70
3	*Fees*	9000		*Phone*	90
7	*Interest*	350		*Rent*	1 800
			4	*Internet*	120
			5	*Insurance*	400
			6	*Wages*	8 000
			7	*Advertising*	800

Fees

			2010		
			1 May	*Bank*	10 000
			3	*Bank/Discount*	9 400

Electricity

2010					
2 May	*Bank*	70			

Telephone

2010					
2 May	*Bank*	90			

Rent

2010					
2 May	*Bank*	1 800			

Discount Allowed

2010					
3 May	*Fees*	400			

Internet

2010					
4 May	*Bank*	120			

Insurance

2010					
5 May	*Bank*	400			

Wages

2010					
5 May	*Bank*	8 000			

Interest

			2010		
			7 May	*Bank*	350

Advertising

2010					
7 May	*Bank*	800			

Scream Savers
Trial Balance
8 May 2010

	DEBIT	**CREDIT**
Cash at Bank	8 070	
Fees		19 400
Electricity	70	
Telephone	90	
Rent	1 800	
Discount Allowed	400	
Internet	120	
Insurance	400	
Wages	8 000	
Interest		350
Advertising	800	
TOTAL	**$19 750**	**$19 750**

B.

i. Pete's Plumbing

Pete's Plumbing
Income Statement

	$	$
Income		
Fees		100 000
Less: Expenses		
Wages of apprentice	14 000	
Vehicle expenses	6 000	
Telephone	2 000	
Postage	1 000	
Plumbing material used	3 000	
Rent	20 000	46 000
PROFIT		**$54 000**

ii. Inside Interior Designers

Inside Interior Designs
Income Statement

	$	$
INCOME		
Fees		300 000
LESS: EXPENSES		
Direct Selling Expenses		
Travelling expenses	4 500	
Designers commission	30 000	
General and Administration Expenses		
Rent	6 000	
Advertising	33 000	
Office salaries	45 000	
Motor vehicle repairs	1 000	
Telephone	4 500	
Office expenses	5 000	
Financial Expenses		
Interest on mortgage	4 500	
Bank charges	1 500	
Debt collection fee	7 000	142 000
PROFIT		**$158 000**

iii. Indi Tours

Indi Tours Designs
Income Statement for the period ended……(today's date)

	$	$
INCOME		
Fees	200 000	
Interest received	100	200 100
LESS: EXPENSES		
Direct Bus Expenses		
Bus expenses	5 000	
Petrol	19 000	
Bus servicing	2 000	
Wages for Tour operators	10 000	
Bus insurance	2 000	
Bad debts	3 500	41 500
General and Administrative Expenses		
Electricity	500	
Telephone	700	
Advertising	4 000	
Wages for secretary	5 000	
Office insurance	500	10 700
Financial Expenses		
Bank fees	75	75
TOTAL EXPENSES		52 275
PROFIT		**$147 825**

iv. Dodgy Traders

Dodgy Traders
Income Statement
for the period ended (today's date)

INCOME		
Fees		175 000
LESS: EXPENSES		
Direct Sales Expenses		
Sales commission	100 000	
Bad debts	20 000	
General and Administrative Expenses		
Advertising	10 000	
Rent	12 000	
Office insurance	1 000	
Office stationery	200	
Printing	5 000	
Internet expense	400	
Electricity	800	
Telephone	4 000	
Postage	700	
Water	400	
Financial Expenses		
Interest on loan	3 000	3 000
PROFIT		**$17 500**

v. Image Conscious

Image Conscious
Income Statement
for the period ended 31 December 2019

Income		
Fees	350 000	
Interest received	2 500	352 500
Less: Expenses		
Wages	100 000	
Rent	20 000	
Bad debt	320	
Advertising	5 000	
Electricity	1 000	
Office night security	2 000	
Parking space lease	5 000	133 320
PROFIT		**$219 180**

8. THE DOUBLE ENTRY SYSTEM FOR TRADING/RETAIL

A.

Transaction	First effect	Second effect
Paid $200 freight.	Freight (Ex) OR Inventory (A) **using the perpetual system** debited $200	Cash at Bank (A) credited
Received $1 000 in sales. Cost of sales $400.	Cash at Bank (A) debited $1 000 Cost of Sales (Ex) debited $400	Sales (I) credited $1 000 Inventory (A) credited $400
Offered a $20 discount on credit sale of $800.	Cash at Bank (A) debited $780 Discount Allowed (Ex) debited $20	Accounts Receivable (A) credited $800
Received $50 discount on $2000 stock purchase.	Accounts Payable (L) debited $2 000	Cash at Bank (A) credited $1 950 Discount Received (I) credited $50
Gave an accounts receivable a $300 discount. The creditor currently owes the business $5 000 in fees. ***Assume payment made in full***	Cash at Bank (A) debited $4 700 Discount Allowed (Ex) debited $300	Accounts Receivable (A) credited $5 000
Sold $10 000 of inventory on credit. Cost of sales $550.	Debtor (A) debited $10 000 Cost of Sales (Ex) debited $550	Sales (I) credited $10 000 Inventory (A) credited $550
Paid $200 electricity account.	Electricity (Ex) debited	Cash at Bank (A) credited
Paid $250 telephone account.	Telephone (Ex) debited	Cash at Bank (A) credited
Purchased $5 000 of stock. Paid cash.	Inventory (A) debited $5 000	Cash at Bank (A) credited $5 000
Incurred $50 in bank fees and charges.	Bank Fees (Ex) debited	Cash at Bank (A) credited
Goods sold for $300 on credit were returned. The inventory had a cost price of $100.	Sales Returns (-I) debited $300 Inventory (A) debited $100	Debtors (A) credited $300 Cost of Sales (Ex) credited $100
Purchased $2 000 worth of inventory on credit. Cost of sales 50%.	Inventory (A) debited $2 000	Creditors (L) credited $2 000
Returned $300 of inventory.	Creditors (L) debited $300	Inventory (A) credited $300

B. Inventory and Cost of Sales.

9. SIMPLE INCOME STATEMENTS

A.

Black Print Newsagency
Income Statement (simplified)
For the quarter ended 28 February 2027

	$	$
Net Sales		5 647
Less: Cost of Sales	2000	
Less: Discount received	50	1 950
Gross Profit/(Loss)		**3 697**
Add: Other income		
Interest	540	540
		4 237
Less: Other expenses		
Interest	290	
Wages	1 200	1 490
PROFIT		**$2 747**

B.

Madeline Racquett
Income Statement

	$	$
Sales		58 910
Less: Discount allowed	450	58 460
Less: Cost of sales		32 890
Gross Profit		**25 570**
Add: Other income		
Rent	890	26 460
Less: Other expenses		
Electricity	670	
Petrol	3 290	
Salaries	25 000	28 960
LOSS		**$ (2 500)**

C. Vicki Loaf

Vicki Loaf
Income Statement
for the period ended 1 December 2020

	$	$	
Sales	4 980		
Less: Cost of Sales	1 950	3 030	
Less: Discount received	50		
Gross Profit			
Add: Other income			
Interest	540	540	
Less: Other expenses			
Electricity	333		
Oil	7		
Interest	290		
Wages	1 200		
Petrol	100		
Servicing	300	2 230	
PROFIT			**$1 340**

D. Marissa's Masterpieces: Loss of $220.

E. Sacha's Saucepans: Profit of $24 270

F. Delightful Do-nutz: Profit of $1 520 (assume that Cleaning Supplies are an asset)

10. LEDGER ENTRIES FOR SALE AND PURCHASE OF INVENTORY

B.

Lachlan Fone
General Ledger
NOTE: The date column in each ledger indicates the transaction number

Inventory

June			June		
1	*Creditors*	2 200	2	*Cost of Sales*	1 320
5	*Cost of Sales*	440	3	*Creditors*	400
				Balance c/d	920
		2 640			**2 640**
	Balance b/d	920			

Creditors

June			June		
3	*Inventory*	400	1	*Inventory*	2 200
4	*Cash at Bank*	1 800			

Debtors

June			June		
2	*Sales*	2 640	5	*Sales Returns*	880
				Balance c/d	1 760
		2 640			**2 640**
	Balance b/d	1760			

Sales

			June		
			2	*Debtors*	2 640

Cost of Sales

June			June		
2	*Inventory*	1 320	5	*Inventory*	440
				Balance c/d	880
		1 320			**1 320**
	Balance b/d	880			

Cash at Bank

			June		
			4	*Creditors*	1 800

Sales Returns

June					
5	*Debtors*	880			

Lachlan Fone
Income Statement
for the period ended June 20XX

Sales	2 640
Less: Sales returns	880
Less: Cost of Sales	880
GROSS PROFIT	**$880**

C.

ABC Retailers

General Ledger

NOTE: The date column in each ledger indicates the transaction number

Inventory

May			May		
1	*Acc'ts payable/Discount rec*	5 000	2	*Accounts payable*	100
	Cash at bank	80	3	*Cost of sales*	500
6	*Accounts payable*	600	4	*Cost of sales*	200
	Cash at bank	30	7	*Cost of sales*	400
8	*Cost of sales*	40		*Balance c/d*	
	Balance b/d				

Accounts Payable

May			May		
2	*Inventory*	100	1	*Inventory*	4 900
5	*Cash at Bank*	4 800	6	*Inventory*	600
	Balance c/d	600			
		5 500			**5 500**
				Balance b/d	

Discount Received

			May		
			1	*Inventory*	100

Cash at Bank

			May		
			1	*Inventory*	80
			5	*Accounts payable*	4 800
			6	*Inventory*	30
			9	*Electricity*	300
			10	*Telephone*	200
	Balance c/d	11 410	11	*Wages*	6 000
		11 410			**11 410**
				Balance b/d	11 410

Accounts Receivable

May			May		
3	*Sales*	1 000	8	*Sales returns*	100
4	*Sales*	400			
7	*Sales*	800			2 100
		2 200			**2 200**
	Balance b/d	2 100		*Balance b/d*	

Sales

May			May		
			3	*Accounts receivable*	1 000
			4	*Accounts receivable*	400
	Balance c/d	2 200	7	*Accounts receivable*	800
		2 200			**2 200**
				Balance b/d	2 200

Cost of Sales

May			May		
3	*Inventory*	500	8	*Inventory*	40
4	*Inventory*	200			
7	*Inventory*	400		*Balance c/d*	1 060
		1 100			**1 100**
	Balance b/d	1 060			

Sales Returns

May			
8	*Accounts receivable*	100	

Electricity

May			
9	*Cash at bank*	300	

Telephone

May			
10	*Cash at bank*	200	

Wages

May			
11	*Cash at bank*	6 000	

ABC Retailers is in a precarious liquidity position at the end of the first week of May. While sales are being made, these are all on credit. Cash payments are too high and the business has overdrawn its bank account.

ABC Retailers
Income Statement
for the first week of May 20XX

		$
Net sales		2 100
Less: Cost of Sales		1 060
Less Discount received	100	
Total Cost of Sales		960
Gross profit		**1 140**
Less: Other expenses		
Electricity		300
Telephone		200
Wages		6 000
LOSS		**(5 360)**

D. Andy Blyth General Ledger

Inventory

Sept			Sept		
1	*Acc's payable/Discount*	15 000	2	*Accounts payable*	300
	Cash at bank	100	3	*Cost of sales*	3 000
6	*Accounts payable*	6 000	4	*Cost of sales*	500
	Cash at bank	90	7	*Cost of sales*	4 000
8	*Cost of sales*	200	13	*Cost of sales*	80
12	*Cash at bank/Discount*	1 000			

Accounts Payable

Sept			Sept		
2	*Inventory*	300	1	*Inventory*	14 000
5	*Cash at bank*	13 900	6	*Inventory*	6 000
14	*Cash at bank*	5 000			

Discount Received

			Sept		
			1	*Inventory*	1 000
			12	*Inventory*	100

Cash at Bank

Sept			Sept		
13	*Sales*	200	1	*Inventory*	100
			5	*Accounts payable*	13 900
			6	*Inventory*	90
			9	*Electricity*	200
			10	*Telephone*	200
			11	*Wages*	3 000
			12	*Inventory*	900
			14	*Accounts payable*	5 000

Accounts Receivable

Sept			Sept		
3	*Sales*	10 000	8	*Sales returns*	400
4	*Sales*	1 200			
7	*Sales*	7 500			

Sales

			Sept		
			3	*Accounts receivable*	10 000
			4	*Accounts receivable*	1 200
			7	*Accounts receivable*	7 500
			13	*Cash at bank*	200

Cost of Sales

Sept			Sept		
3	*Inventory*	3 000	8	*Inventory*	200
4	*Inventory*	500			
7	*Inventory*	4 000			
13	*Inventory*	80			

Sales Returns

Sept					
8	*Accounts receivable*	400			

Electricity

Sept					
9	*Cash at bank*	200			

Telephone

Sept					
10	*Cash at bank*	100			

Wages

Sept					
11	*Cash at bank*	3 000			

E. Computers Inc. General Ledger

Inventory

Feb			Feb		
1	*Creditors*	160 000	2	*Creditors*	1 000
5	*Cost of sales*	80	3	*Cost of sales*	6 000
7	*Creditors*	5 000	4	*Cost of sales*	2 000
	Cash at bank	80	8	*Cash at bank*	57 500
12	*Cash at bank/Discount rec*	9 000	13	*Cost of sales*	38 000
				Balance c/d	69 660
		174 160			**174 160**
	Balance b/d	69 660			

Creditors

Feb			Feb		
2	*Inventory*	1 000	1	*Inventory*	160 000
6	*Cash at bank*	80 000	7	*Inventory*	5 000
14	*Cash at bank*	50 000			
	Balance c/d	34 000			
		165 000			**165 000**
				Balance b/d	34 000

Debtors

Feb			Feb		
3	*Sales*	10 000	1	*Sales returns*	300
4	*Sales*	4 800			
13	*Sales*	80 000		*Balance c/d*	94 500
		94 800			**94 800**
	Balance b/d	94 500			

Cost of Sales

Feb			Feb		
3	*Inventory*	6 000	5	*Inventory*	80
4	*Inventory*	2 000			
13	*Inventory*	38 000		*Balance c/d*	45 920
		46 000			**46 000**
	Balance b/d	45 920			

Sales

Feb			Feb		
			3	*Debtors*	10 000
			4	*Debtors*	4 800
	Balance c/d	94 800	13	*Debtors*	80 000
		94 800			**94 800**
				Balance b/d	94 800

Sales Returns

Feb					
5	*Debtors*	300			

Cash at Bank

Feb			Feb		
8	*Inventory*	57 500	6	*Creditors*	80 000
			7	*Inventory*	80
			9	*Electricity*	400
			10	*Telephone*	300
			11	*Wages*	10 000
			12	*Inventory*	8 000
	Balance c/d	91 280	14	*Creditors*	50 000
		148 780			**148 780**
				Balance b/d	91 280

Electricity

Feb					
9	*Cash at bank*	400			

Telephone

Feb					
10	*Cash at bank*	300			

Wages

Feb					
11	*Cash at bank*	10 000			

Discount Received

			Feb		
			12	*Inventory*	1 000

11. FULLY CLASSIFIED INCOME STATEMENTS

A.

A. Dwelling
Income Statement
for the period ended 30 June 2021

	$	$	$
Income			
Fees		74 000	
Gain on disposal		100	
Interest		1 000	75 100
LESS: EXPENSES			
Office Expenses			
Office wages	3 500		
Office expenses	750		
Rent	1 000		
Telephone	250		
Stationery	100	5 600	
Selling Expenses			
Sales salaries	12 500		
Repairs to motor vehicle	500		
Advertising	2 500	15 500	
Financial Expenses			
Bank charges	50		
Interest	250	300	21 400
PROFIT			**$53 700**

B.

Aces Tennis Club
Income Statement
for the period ended 30 June 2022

	$	$	$
Income			
Fees		250 000	
Interest		8 000	
Rent		70 000	328 000
LESS: EXPENSES			
Tennis Expenses			
Tennis coaches' wages	46 000		
Repairs to ball machines	50		
Club insurance	2 700		
Ground keeper's wages	20 000	68 750	
General and Administrative Expenses			
Office wages	10 000		
Office expenses	750		
Telephone	700		
Advertising	4 000		
Stationery	70	15 520	
Financial Expenses			
Bank charges	75		
Bad debts	200		
Interest	90		
Discount on fees	3 000	3 365	87 635
PROFIT			**$240 365**

C.

Sleepy Hollow
Income Statement
for the period ended 30 June 2024

	$	$	$
Income			
Fees		320 000	
Interest received		50	320 050
LESS: EXPENSES			
B and B expenses			
Cleaning of rooms	12 000		
Host wages	24 000		
Window cleaning	500		
Gardener	18 000		
Equipment repairs	1 000	55 500	
General and Administration Expenses			
Office wages	32 500		
Office expenses	1 750		
Advertising	10 000		
Telephone	2 050	46 300	
Financial Expenses			
Interest expenses	1 000		
Bad debts	1 100		
Bank charges	24	2 124	103 924
PROFIT			**$216 126**

D.

Hole in One
Income Statement
for the period ended 30 June 2020

	$	$	$
Income			
Fees		2 300 000	
Rent		50 000	
Interest		4 000	2 354 000
LESS: EXPENSES			
Golf Expenses			
Golf pro's wages	200 500		
Green keeper's salaries	450 000	650 500	
General and Administration Expenses			
Telephone	2 000		
Advertising	25 500		
Office wages	200 000		
Office expenses	5 000	237 500	
Financial Expenses			
Bank charges	1 000		
Bad debts	3 000	4 000	892 000
PROFIT			**1 462 000**

12. PREPARING THE INCOME STATEMENT AND BALANCE SHEET

A.

A Plane Gliding
Income Statement
for the period ended 30 June 2021

	$	$
Income		
Fees		266 100
Less: Expenses		
Service costs	169 800	
Advertising	3 800	
Oil and fuel	8 000	
Repairs	20 000	
Interest	2 000	
Rent	20 000	
Telephone	900	
Electricity	1 100	225 600
PROFIT		**$40 500**

A = L + Eq
A = L + (Capital + Profit)
Capital = A - L - Profit
= 277 200 - 45 000 - 40 500
=191 700

A Plane Gliding
Balance Sheet
as at 30 June 2021

Assets	
Cash at bank	37 200
Debtors	45 600
Gliders	194 400
Total Assets	**277 200**
Liabilities	
Loan	45 000
Net Assets	**$232 200**
Equity	
Capital	191 700
Add: Profit	40 500
Total Equity	**$232 200**

B.

Bob's Bus Tour Business
Income Statement
for the period ended 30 June 2022

	$	$
Income		
Fees		399 150
Less: Expenses		
Advertising	5 700	
Oil and fuel	12 000	
Repairs	30 000	
Discount allowed	3 000	
Rent	30 000	
Telephone	1 350	
Electricity	1 650	83 700
PROFIT		**$315 450**

Capital = A - L - Profit
= 450 000 - 67 500 - 315 450
= 67 050

Bob's Bus Tour Business
Balance Sheet
as at 30 June 2022

	$
Assets	
Cash at bank	55 800
Debtors	102 600
Tour buses	291 600
Total Assets	**$450 000**
Liabilities	
Creditors	67 500
Net Assets	**$382 500**
Equity	
Capital	67 050
Add: profit	315 450
Total Equity	**$382 500**

C.

ABC Tutoring
Income Statement
for the period ended 30 June 2021

	$	$	$
Income			
Fees			133 050
Less: Expenses			
Direct Tutoring Expenses			
Tutors wages		84 900	
Office Expenses			
Advertising	5 900		
Receptionist wage	10 000		
Electricity	2 000		
Cleaners' wages	8 000		
Telephone	1 000	26 900	
Financial Expenses			
Interest		1 000	112 800
PROFIT			**$20 250**

ABC Tutoring
Balance Sheet
as at 30 June 2021

	$
Assets	
Cash at bank	18 600
Accounts receivable	22 800
Office building	97 200
Total Assets	**138 600**
Liabilities	
Accounts payable	12 500
Loan	10 000
Total Liabilities	22 500
Net Assets	**$116 100**
Equity	
Capital	95 850
Add: Profit	20 250
Total Equity	**$116 100**

i. The sale of an asset such as the building will not affect the Income Statement. It will affect the two assets accounts: Office Building and Cash at Bank.

13. CORRECTING ERRORS

A.

- The revenue total is incorrect
- The doubtful debt should not be recorded in the Income Statement
- Drawings should not be included in the Income Statement
- ‘Webpage manager’ is an advertising or personnel expense

B.

i. In the Trial Balance, insurance would be overstated and electricity understated. The Trial Balance would not reveal the error.

ii. The Trial Balance would still balance as the entry has just been incorrectly debited and credited to the correct accounts.

iii. The Trial Balance will reveal the error, as two different amounts have been debited and credited.

iv. The Trial Balance will not show the mistake as it has been completely omitted from the accounts.

CHAPTER 7: THE GENERAL JOURNAL FOR ASSET, LIABILITY, EQUITY, INCOME AND EXPENSE ACCOUNTS

Review Questions 7.1

1. *What are the functions of the General Journal?*

Functions of the General Journal

- Records the daily details of transactions.
- Collates and summarises information from source documents.
- Analyses transactions into debit and credit elements - preparation for General Ledger.
- Provides a record of transactions in date order.
- Enables easy reference.

2. *On 29 June 2021, Timothy Kania purchased a Jetta worth $45 000 for use in his business. Show how this transaction would be recorded in the General Journal.*

2021			
29 June	Vehicles	45 000	
	Accounts Payable		45 000

3. *List which account (or accounts) will be debited, and which will be credited, for each of the following transactions. This business is not registered for GST.*
   a. *A customer paid a $500 invoice and was given a 4% discount.*
   b. *Bad debt of $100 was written off.*
   c. *$340 of inventory with a cost price of $200 was returned to the business.*
   d. *$440 of inventory was purchased on credit.*
   e. *Purchased a vehicle on credit.*
   f. *Owner withdrew $200.*
   g. *Paid $98 electricity bill.*

	DEBIT ENTRY/IES	CREDIT ENTRY/IES
A.	Cash at Bank $480 and Discount Allowed $20	Debtors $500
B.	Bad Debts $100	Debtors $100
C.	Sales Returns $340	Debtor $340
	Inventory $200	Cost of Sales $200
D.	Inventory $440	Creditors $440
E.	Vehicle	Creditor or Loan
F.	Drawings $200	Cash at Bank $200
G.	Electricity $98	Cash at Bank $98

4. *Complete the following.*

a. *On 20 January 2021 Mac purchased a new motor vehicle on credit from We Go Motors for $30 000.*

i. *Show the General Journal entry to account for the purchase of the vehicle.*

DATE	DETAILS	DEBIT	CREDIT
2021 20 Jan	Vehicles We Go Motors *Purchased vehicle on credit*	$ 30 000	$ 30 000

ii. *If Mac had paid cash for the car would it still be necessary to complete the General Journal entry? Justify your answer.*

A journal entry should be completed for all business transactions. A cash payment could, however, be recorded in the Cash Payments Journal if the business is using this journal.

b. *On 29 January, Mac withdrew a printer worth $200 for his daughter to use at home.*

i. *Complete the necessary General Journal entry.*

DATE	DETAILS	DEBIT	CREDIT
2021 29 Jan	Drawings Office Equipment *Withdrawal of printer*	$ 200	$ 200

ii. *Post the journal entries into the appropriate ledger accounts.*

Drawings

2021					
29 Jan	*Office Equipment*	200			

Office Equipment

			2010		
			29 Jan	*Drawings*	200

iii. *If Mac had contributed $500 cash, would this need to be recorded in the General Journal? Justify your answer.*

A journal entry should be completed for all business transactions. A cash receipt could, however, be recorded in the Cash Receipts Journal if the business is using this journal.

Review Questions 7.2

1. *Complete the following General Journal entries for the business A Snap in Time Photography. Close the income and expense accounts at 31 August.*

Aug 10	The business received $4 000 in cash for services rendered.
12	Paid a $150 telephone account.
14	Paid wages of $4 000.
15	Completed servicing work for Harper Adams on credit for $6 000.
16	Sold $6 000 of inventory. Cost of sale was $2 000.
17	Purchased $2 600 worth of inventory on credit from *Happy Snappers Ltd*.
18	Owner withdrew $500 for personal use.
19	Withdrew $200 to pay water bill.
20	Wrote off a bad debt of $400. The debtor was Smiley Cyrus.

A Snap in Time Photography **- General Journal**

DATE	DETAILS	DEBIT	CREDIT
Aug			
10	Cash at Bank	4 000	
	Service Fees		4 000
	Fees received for service provided		
12	Telephone	150	
	Cash at Bank		150
	Payment of telephone bill		
14	Wages	4 000	
	Cash at Bank		4 000
	Payment of wages		
15	Debtor - Harper Adams	6 000	
	Service Fees		6 000
	Service provided on credit		
16	Cash at Bank	6 000	
	Sales		6 000
	Sale of inventory		
	Cost of Sales	2 000	
	Inventory		2 000
	Cost of sales		
17	Inventory	2 600	
	Creditor - Happy Snappers Ltd		2 600
	Credit purchase of inventory		
18	Drawings	500	
	Cash at Bank		500
	Drawings by owner		
19	Utilities Expenses	200	
	Cash at Bank		200
	Payment of water bill		

DATE	DETAILS	DEBIT	CREDIT
20	Bad Debts	400	
	Debtor - Smiley Cyrus		400
	Write off of bad debt		
31	Profit and Loss	6 750	
	Telephone		150
	Wages		4 000
	Cost of Sales		2 000
	Utilities		200
	Bad Debts		400
	Transfer of expense account balances		
31	Service Fees	10 000	
	Sales	6 000	
	Profit and Loss		16 000
	Transfer of income account balances		

2. *J'Lo runs a business Zippidy Bop, performing as a DJ at high school balls. He operates his business under a cash only policy. During the first week in May he had the following transactions:*

1 May	Received $2 500 in fees.
2	Paid $100 phone bill.
3	Paid $170 electricity bill.
4	Paid $50 for petrol.
5	Received $2 400 in fees.
6	Withdrew $100 for personal use

a. *Post the transactions to the General Journal.*
b. *Transfer the relevant information to the individual ledger accounts.*
c. *Foot the individual ledger accounts.*
d. *Prepare a Trial Balance.*

Zippidy Bop **- General Journal**

DATE	DETAILS	DEBIT	CREDIT
May			
1	Cash at Bank	2 500	
	Fees		2 500
	Fees received for service provided		
2	Telephone	100	
	Cash at Bank		100
	Payment of telephone bill		
3	Electricity	170	
	Cash at Bank		170
	Payment of electricity bill		
4	Petrol	50	
	Cash at Bank		50
	Payment for petrol		

DATE	DETAILS	DEBIT	CREDIT
5	Cash at Bank	2 400	
	Fees		2 400
	Fees received		
6	Drawings	100	
	Cash at Bank		100
	Drawings by owner		
6	Profit and Loss	320	
	Telephone		100
	Electricity		170
	Petrol		50
	Transfer of expense account balances		
6	Fees	4 900	
	Profit and Loss		4 900
	Transfer of income account balance		
6	Profit and Loss	4 580	
	Capital		4 580
	Transfer of profit to capital		
6	Capital	100	
	Drawings		100
	Transfer of drawings to capital		

3. *Complete the General Journal for the business Fine Furniture.*

May 1 Purchased $3 000 of inventory on credit for *Jarrah Furniture*.
2 Purchased $40 000 of inventory from *Albany Furniture* on credit.
7 Purchased $4 000 of inventory from *Jarrah Furnitur*e, paid cash.
8 Sold $4 000 of inventory. The cost of sales was $2 000.
9 Paid *Albany Furniture* $3000.
10 Sold $3 000 of inventory. The cost of sales was $2 000.
12 Owner withdrew $300 for personal use.

Fine Furniture **- General Journal**

DATE	DETAILS	DEBIT	CREDIT
May			
1	Inventory	3 000	
	Creditor - Jarrah Furniture		3 000
	Credit purchase of inventory		
2	Inventory	40 000	
	Creditor - Albany Furniture		40 000
	Credit purchase of inventory		
7	Inventory	4 000	
	Cash at Bank		4 000
	Cash purchase of inventory		

DATE	DETAILS	DEBIT	CREDIT
8	Cash at Bank	4 000	
	Sales		4 000
	Sale of inventory		
	Cost of Sales	2 000	
	Inventory		2 000
	Cost of sales		
9	Creditor - Albany Furniture	3 000	
	Cash at Bank		3 000
	Payment of account		
10	Cash at Bank	3 000	
	Sales		3 000
	Sale of inventory		
	Cost of Sales	2 000	
	Inventory		2 000
	Cost of sales		
18	Drawings	300	
	Cash at Bank		300
	Drawings by owner		
31	Profit and Loss	4 000	
	Cost of Sales		4 000
	Transfer of expense account balance		
31	Sales	7 000	
	Profit and Loss		7 000
	Transfer of income account balance		
31	Profit and Loss	3 000	
	Capital		3 000
	Transfer of profit to capital		
31	Capital	300	
	Drawings		300
	Transfer of drawings to capital		

4. *On 30 April 2020 Dexter Pavlou had the following income and expense accounts:*

You are required to:

a. Close the income and expense accounts to the Profit and Loss account.

b. Complete all relevant General Journal entries to close the income and expense accounts.

c. Complete the General Journal entry to transfer the profit or loss to the owner's Capital account

Dexter Pavlou – General Ledger

Rent

2020			2020		
1 March	*Cash at bank*	600	22 April	*Profit and Loss*	1 200
21 April	*Cash at bank*	600			1 200
		1 200			

Electricity

2020			2020		
2 March	*Cash at bank*	920	22 April	*Profit and Loss*	1 720
6 April	*Cash at bank*	800			1 720
		1 720			

Water

2020			2020		
12 March	*Cash at bank*	100	22 April	*Profit and Loss*	200
11 April	*Cash at bank*	100			200
		200			

Cost of Sales

2020			2020		
18 March	*Inventory*	4 000	22 April	*Profit and Loss*	5 700
16 April	*Inventory*	1 700			5 700
		5 700			

Sales

			2020		
			20 March	*Cash at bank*	8 000
22 April	*Profit and Loss*	11 400	18 April	*Cash at bank*	3 400
		11 400			1 400

Profit and Loss

2020			2020		
22 April	*Cost of sales*	5 700	22 April	*Sales*	11 400
	Rent	1 200		*Capital*	2 580
	Electricity	1 720			
	Water	200			
		11 400			11 400

Chapter 7 Activities

1. ENTRY TO COMMENCE BUSINESS

A. i. *Mac Little* – General Journal

DATE	DETAILS	DEBIT	CREDIT
2020			
12 January	Cash at Bank	15 000	
	Computer	3 000	
	Office Furniture	10 000	
	Motor Vehicle	15 000	
	Loan		10 000
	Capital		33 000
	Assets and liabilities contributed by the owner to commence the business		

ii.

Mac Little
General Ledger

Cash at Bank

2020					
12 Jan	*Opening Balance*	15 000			

Computer

2020					
12 Jan	*Opening Balance*	3 000			

Office Furniture

2020					
12 Jan	*Opening Balance*	10 000			

Motor Vehicle

2020					
12 Jan	*Opening Balance*	15 000			

Loan

			2020		
			12 Jan	*Opening Balance*	10 000

Capital

			2020 12 Jan	*Opening Balance*	33 000

B. i. *Sally Harper* – General Journal

DATE	DETAILS	DEBIT	CREDIT
2021			
1 January	Cash at Bank	2 000	
	Fixtures and Fittings	4 000	
	Inventory	8 000	
	Loan		3 300
	Capital		10 700
	Assets and liabilities contributed by the owner to commence the business		

ii.

Sally Harper
General Ledger

Cash at Bank

2021 1 Jan	*Opening Balance*	15 000			

Fixtures and Fittings

2021 1 Jan	*Opening Balance*	4 000			

Inventory

2021 1 Jan	*Opening Balance*	8 000			

Loan

			2021 1 Jan	*Opening Balance*	3 300

Capital

			2021 1 Jan	*Opening Balance*	10 700

C. i. *Dane Edwards* – General Journal

DATE	DETAILS	DEBIT	CREDIT
20XX			
1 January	Cash at Bank	40 000	
	Plant and Fittings	550 000	
	Raw Materials	12 000	
	Creditor		290
	Mortgage		370 000
	Capital		231 710
	Assets and liabilities contributed by the owner to commence the business		

ii.

Dane Edwards
General Ledger

Cash at Bank

20XX					
1 Jan	*Opening Balance*	40 000			

Plant and Fittings

20XX					
1 Jan	*Opening Balance*	550 000			

Raw Materials

20XX					
1 Jan	*Opening Balance*	8 000			

Creditor

			20XX		
			1 Jan	*Opening Balance*	290

Mortgage

			20XX		
			1 Jan	*Opening Balance*	300 000

Capital

			20XX		
			1 Jan	*Opening Balance*	231 710

D. i. *Lillie Bluewater* – General Journal

DATE	DETAILS	DEBIT	CREDIT
20XX			
1 January	Cash at Bank	100	
	Vehicle	7 000	
	Computer	3 000	
	Loan		1 200
	Capital		8 900
	Assets and liabilities contributed by the owner to commence the business		

ii.

Lillie Bluewater
General Ledger

Cash at Bank

20XX					
1 Jan	*Opening Balance*	100			

Vehicle

20XX					
1 Jan	*Opening Balance*	7 000			

Computer

20XX					
1 Jan	*Opening Balance*	3 000			

Loan

			20XX		
			1 Jan	*Opening Balance*	1 200

Capital

			20XX		
			1 Jan	*Opening Balance*	8 900

2. CORRECTING ERRORS

A. Jinty Rhodes – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
	Wages	800	
	Advertising		800
	Correction of error		

B. Tommy Moran – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
14 Jan.	Interest Received	200	
	Fees		200
	Correction of error		

C. General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
October			
8	Electricity	500	
	Cash at Bank		500
	Bill from 7 June		
	Drawings	100	
	Cash at Bank		100
	Correction of error - Additional Drawings		
	Cash at Bank	600	
	Electricity		600
	Correction of error - Overstatement of expense amount		
	Cash at Bank	4 000	
	Fees		4 000
	Amount of $2000 incorrectly recorded on wrong side of ledgers		
	Advertising	400	
	Rates		400
	Correction of error - incorrect account		

D. Edie's Eatery

i. Kitchen equipment overstated by $500. Delivery scooters and creditors understated by $5 000 and $4 500 respectively.

ii. General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
2019			
23 Dec.	Delivery Scooters	5 000	
	Creditors		4 500
	Kitchen Equipment		500
	Correction of error		

iii. Scooters are an asset because they are:

- A resource controlled by the entity, eg. the business has possession and use of the scooters
- As a result of a past event, eg. the purchase of the scooter
- and they provide future economic benefits, eg. cash from delivering burgers.

3. PURCHASE OF NON-CURRENT ASSETS WITH CASH

A. Wes Raven – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
17 May	Motor Vehicle	50 000	
	Cash at Bank		50 000
	Purchase of vehicle		

B. Jane Redmond – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
22 May	Computer	4 000	
	Cash at Bank		4 000
	Purchase of computer		

C. Harry Winston – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
26 May	Office Furniture	2 000	
	Cash at Bank		2 000
	Purchase of sofa		

D. Neil Champion – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
28 May	Office Equipment	6 000	
	Cash at Bank		6 000
	Purchase of photocopier		

4. PURCHASE OF NON-CURRENT ASSETS ON CREDIT

A. Bobby Johns – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
18 Nov.	Motor Vehicle	34 000	
	Creditor - Toyota		34 000
	Purchase of vehicle		

B. Sally Richards – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
19 Nov.	Office Equipment	2 500	
	Creditor - Officeworks		2 500
	Purchase of photocopier		

C. Bridey Hammond – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
21 Nov	Office Equipment	4 000	
	Creditor - Harvey Norman		4 000
	Purchase of computer		
	Office Furniture	2 000	
	Cash at Bank		2 000
	Purchase of sofa		

D. Shipley Templeton – General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
24 Nov.	Cash at Bank	900 000	
	Mortgage - Bank East		900 000
	Took out mortgage on factory		
24 Nov.	Factory	900 000	
	Cash at Bank		900 000
	Purchase of factory		

5. CASH TRANSACTIONS

DATE	DETAILS	DEBIT	CREDIT
20XX			
A	Inventory	2 000	
	Cash at Bank		2 000
	Purchase of inventory		
B	Internet Expense	100	
	Cash at Bank		100
	Paid Internet bill		
C	Wages	6 000	
	Cash at Bank		6 000
	Paid wages		
D	Insurance	230	
	Cash at Bank		230
	Paid insurance		
E	Inventory	1 000	
	Cash at Bank		1 000
	Purchase of inventory		
F	Telephone	120	
	Cash at Bank		120
	Paid phone bill		
G	Advertising	5 000	
	Cash at Bank		5 000
	Payment of advertising		
H	Utilities Expenses	175	
	Cash at Bank		175
	Paid electricity		

6. CREDIT TRANSACTIONS

A. General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
i.	Inventory	2 300	
	Creditor - Harper Adams		2 300
	Purchase of inventory on credit		
ii.	Inventory	1 000	
	Creditor - Laxton		1 000
	Purchase of inventory on credit		
iii.	Inventory	5 000	
	Creditor - Manchester Ltd		5 000
	Purchase of inventory on credit		
iv.	Inventory	300	
	Creditor - Mansfield		300
	Purchase of inventory on credit		
i.	Inventory	2 800	
	Creditor - Weatherby Materials		2 800
	Purchase of inventory on credit		

B. General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
i.	Debtor - Mimmi Petit	800	
	Sales		800
	Sale of inventory		
	Cost of Sales	358	
	Inventory		358
	Cost of sales		
ii.	Debtor - Wayne Winglight	900	
	Sales		900
	Sale of inventory		
	Cost of Sales	270	
	Inventory		270
	Cost of sales		
iii.	Debtor - Pappy Morgan	400	
	Sales		400
	Sale of inventory		
	Cost of Sales	300	
	Inventory		300
	Cost of sales		
iv.	Debtor - Meredith White	20 000	
	Sales		20 000
	Sale of inventory		
	Cost of Sales	8 000	
	Inventory		8000
	Cost of sales		
v.	Debtor - Peter Saint	6 000	
	Sales		6 000
	Sale of inventory		
	Cost of Sales	3 000	
	Inventory		3 000
	Cost of sales		

7. CREDIT TRANSACTIONS (SERVICES)

Ali's Architecture
General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
18 July	Debtor - Guy Matthews	15 000	
	Fees		15 000
	Services provided on credit terms		
19 July	Debtor - Freedo Mishod	40 000	
	Fees		40 000
	Services provided on credit terms		
23 July	Debtor - Molly Pilgrim	2 700	
	Fees		2 700
	Services provided on credit terms		
26 July	Debtor - Yentl Steep	4 000	
	Fees		4 000
	Services provided on credit terms		

8. WITHDRAWAL OF CASH AND ASSETS

General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
A	Drawings	40	
	Furniture		40
	Owner withdrew chair		
B	Drawings	10	
	Cash at Bank		10
	Owner withdrew cash for lunch purchase		
C	Drawings	400	
	Cash at Bank		400
	Owner withdrew cash		
D	Drawings	2 500	
	Office Equipment		2 500
	Owner withdrew computer		
E	Drawings	50	
	Cash at Bank		50
	Owner withdrew cash		

9. WRITING OFF OF BAD DEBTS

General Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
20XX			
2 February	Bad Debts	500	
	Debtor - B Hopkins		500
	Write off of bad debt		
15 March	Bad Debts	1 700	
	Debtor - G James		1 700
	Write off of bad debt		
30 March	Bad Debts	300	
	Debtor - C King		300
	Write off of bad debt		

10. CLOSING ENTRIES

A. Jim Baxter

i. General Ledger

Electricity

2019			2019		
1 March	*Cash at bank*	2 000			
1 April	*Cash at bank*	700	30 June	*Profit and Loss*	2 700
		2 700			**2 700**

Petrol

2019			2019		
12 March	*Cash at bank*	200			
1 April	*Cash at bank*	130	30 June	*Profit and Loss*	330
		330			**330**

Fees

2019			2019		
			23 March	*Cash at bank*	900
			4 April	*Cash at bank*	4 400
			13 May	*Debtor*	300
30 June	*Profit and Loss*	11 100	20 June	*Cash at bank*	5 500
		11 100			**11 100**

Profit and Loss

2019			2019		
30 June	*Electricity*	2 700			
	Petrol	330			
	Capital	8 070	30 June	*Fees*	11 100
		11 100			**11 100**

ii. General Journal

DATE	DETAILS	DEBIT	CREDIT
2019			
30 June	Profit and Loss	3 010	
	Electricity		2 700
	Petrol		330
	Transfer of expense balances		
	Fees	11 100	
	Profit and Loss		11 100
	Transfer of income balance		
	Profit and Loss	8 070	
	Capital		8 070
	Transfer of profit for period to capital account		

B. Sally Smurf

i. General Ledger

Rent

2021			2021		
1 March	*Cash at bank*	1 000			
1 April	*Cash at bank*	1 000	30 June	*Profit and Loss*	2 000
		2 000			**2 000**

Electricity

2021			2021		
1 March	*Cash at bank*	500			
1 April	*Cash at bank*	300	30 June	*Profit and Loss*	800
		800			**800**

Advertising

2021			2021		
5 March	*Cash at bank*	500			
14 April	*Cash at bank*	100	30 June	*Profit and Loss*	600
		600			**600**

Cost of Sales

2021			2021		
5 March	*Inventory*	8 000			
27 March	*Inventory*	6 000			
5 April	*Inventory*	7 500			
19 April	*Inventory*	8 000	30 June	*Profit and Loss*	29 500
		29 500			**29 500**

Sales

2021			2021		
			14 March	*Cash at bank*	15 000
			29 March	*Cash at bank*	12 000
			7 April	*Cash at bank*	14 000
30 June	*Profit and Loss*	54 000	21 April	*Cash at bank*	13 000
		54 000			**54 000**

Profit and Loss

2021			2021		
30 June	*Electricity*	800	30 June	*Sales*	54 000
	Rent	2 000			
	Advertising	600			
	Cost of sales	29 500			
	Capital	21 100			
		54 000			**54 000**

ii. General Journal

DATE	DETAILS	DEBIT	CREDIT
2021			
30 June	Profit and Loss	32 900	
	Rent		2 000
	Advertising		600
	Electricity		800
	Cost of Sales		29 500
	Transfer of expense balances		
	Sales	54 000	
	Profit and Loss		54 000
	Transfer of income balance		
	Profit and Loss	21 100	
	Capital		21 100
	Transfer of profit for period to capital account		

B. Henry Jones

i. General Ledger

Car Maintenance

2021			2021		
2 May	*Cash at bank*	4 000			
13 June	*Cash at bank*	600	30 June	*Profit and Loss*	4 600
		4 600			**4 600**

Supplies

2021			2021		
5 May	*Cash at bank*	1 900			
21 June	*Cash at bank*	1 300	30 June	*Profit and Loss*	3 200
		3 200			**3 200**

Advertising

2021			2021		
1 May	*Cash at bank*	4 500			
14 June	*Cash at bank*	100	30 June	*Profit and Loss*	4 600
		4 600			**4 600**

Cost of Sales

2021			2021		
5 May	*Inventory*	7 500			
19 June	*Inventory*	8 000	30 June	*Profit and Loss*	15 500
		15 500			**15 500**

Sales

2021			2021		
			7 May	*Cash at bank*	14 000
30 June	*Profit and Loss*	27 000	21 June	*Cash at bank*	13 000
		27 000			**27 000**

Profit and Loss

2021			2021		
30 June	*Car maintenance*	4 600	30 June	*Sales*	27 000
	Supplies	3 200		*Capital*	900
	Advertising	4 600			
	Cost of sales	15 500			
		27 000			**27 000**

ii. General Journal

DATE	DETAILS	DEBIT	CREDIT
2021			
30 June	Profit and Loss	27 900	
	Car maintenance		4 600
	Advertising		4 600
	Supplies		3 200
	Cost of Sales		15 500
	Transfer of expense balances		
	Sales	27 000	
	Profit and Loss		27 000
	Transfer of income balance		
	Capital	900	
	Profit and Loss		900
	Transfer of loss for period to capital account		

CHAPTER 8: THE GST AND BUSINESS TRANSACTIONS

Review Questions 8.1

1. *Define the GST.*

Goods and Services Tax, which is a broad based tax of 10% charged on most goods and services.

2. *Does a business have to register for the GST, or can it choose not to?*

A business only has to register for GST if it has an annual turnover over $75,000 or more ($150,000 or more for non-profit organisations).

3. *What happens if a business decides not to register for the GST?*

The business will still pay GST for any goods or services purchased for the business. The owner will just not charge GST to their customers, so will not lodge Business Activity Statements or collect GST on behalf of the government.

4. *What does 'GST exempt' mean?*

Most basic foods, some education courses and some medical, health and care products and services are exempt from GST. Items that are GST-free include (for example):

- most basic food
- some education courses, course materials and related excursions or field trips
- some medical, health and care services
- some medical aids and appliances
- some medicines
- some childcare services
- some religious services and charitable activities
- supplies of accommodation and meals to residents of retirement villages by certain operators
- cars for disabled people to use, as long as certain requirements are met
- water, sewerage and drainage
- international transport and related matters
- precious metals
- sales through duty-free shops
- grants of land by government
- farmland
- international mail
- exports
- sales of businesses as going concerns
- some telecommunications supplies
- eligible emissions units.

5. *What is an ABN?*

A number that the business must use so that the Australian Tax Office can identify the business in all their dealings.

6. *What is a BAS?*

Business Activity Statement, a form submitted to the Australian Taxation Office by all businesses to report their taxation obligations. These include pay as you go withholding (PAYGW), pay as you go installments (PAYGI), fringe benefits tax (FBT), wine equalisation tax (WET) and luxury car tax (LCT).

7. *How often does a BAS have to be lodged?*

A business can choose to lodge their BAS either monthly or quarterly or in some cases per annum.

Review Questions 8.2

1. *Complete the table below:*

GST inclusive

TRANSACTION	GST PAID AMOUNT	INVENTORY COST AMOUNT
Purchased $330 of inventory GST inclusive	$330 ÷ 11 = $30	$330 – $30 = $300
Purchased $200 of inventory GST inclusive	$18	$182
Purchased $165 of inventory GST inclusive	$15	$150
Purchased $792 of inventory GST inclusive	$72	$720
Purchased $77 worth of inventory GST inclusive	$7	$70
Purchased $495 worth of inventory GST inclusive	$45	$450

2. *Complete the table below:*

GST exclusive

TRANSACTION	GST TO PAY	TOTAL $ PAID
Purchased $8 000 of inventory GST exclusive	$8 000 ÷ 10 = $800	$8 000 + $800 = $8 800
Purchased $20 000 motor vehicle GST exclusive	$2 000	$22 000
Purchased $1 700 of inventory GST exclusive	$170	$1 870
Purchased $3 400 of inventory GST exclusive	$340	$3 740
Purchased $7 000 worth of non-current assets GST exclusive	$700	$7 700
Purchased a $4 000 computer GST exclusive	$400	$4 400

3. *Complete the following table:*

SELLING PRICE GST INCLUSIVE	GST COLLECTED	SALES INCOME
$891	$891 ÷ 11 = $81	$891 – $81 = $810
$1 375	$125	$1 250
$15 125	$1 375	$13 750
$99	$9	$90
$165	$15	$150
$8 800	$800	$8 000
$792	$72	$720
$275	$25	$250

4. *Complete the following table:*

SELLING PRICE GST EXCLUSIVE	GST COLLECTED	SALES INCOME
$990	$990 ÷ 10 = $99	$990 + $99 = $1 089
$1 000	$100	$1 100
$18 000	$1 800	$19 800
$1 500	$150	$1 650
$1 900	$190	$2 090
$8 800	$880	$9 680
$790	$79	$869
$275	$27.50	$302.50

Review Questions 8.3

1. *What is the difference between 'GST inclusive' and 'GST exclusive'?*

GST inclusive means that the GST has been included in the price. GST exclusive means that the GST needs to be added to the price.

2. *If the GST-inclusive price of a product is $165, what is the GST component?*

$15

3. *If the GST-exclusive price of a product is $185, then how much will the GST be?*

$18.50

4. *What is a taxable supply?*

Most goods and services are taxable supplies. If a business is registered for the GST, they must charge GST on taxable supplies and are entitled to input tax credits on the GST they have paid on purchases to make those supplies.

5. *What are GST-free supplies?*

GST free supplies are goods and services which are exempt from the GST.

6. *List three categories of GST-free supplies.*

For example:

- Cars for use by disabled people
- Child care
- Charities
- Education
- Exports of goods and services
- Food (although not prepared foods, confectionary, snacks, ice-cream, biscuits, alcohol, soft-drinks and certain other drinks.)
- Health services
- International travel
- International mail
- Religious services
- Water

7. *What are input-taxed supplies?*

If a business provides input taxed supplies then GST is not charged to the purchaser and the seller is unable to claim any input tax credit for GST paid on purchases made for input taxed supply.

8. *What is the difference between how GST is treated under the cash basis of accounting in comparison to the non-cash basis of accounting?*

If a business accounts for GST on a cash basis then it accounts for GST payable on a taxable supply in the tax period in which it receives payment for that supply. It can only account for the GST payable in that tax period if the actual payment has been received.

If a business accounts for GST on a non-cash (accrual) basis then it accounts for all GST payable on a taxable supply that is made in the tax period in which an invoice is issued for the supply, or the tax period in which any of the consideration is received, whichever occurs first.

9. *Outline the purpose of the GST Clearing account and explain how this is reported in the Balance Sheet.*

The GST Clearing account is a holding account which has the total GST Collected and GST Credits Received transferred into it. The business determines the amount either payable to the ATO or the amount the ATO owes the business. The clearing account will appear on the Balance Sheet as either a current asset or current liability.

10. *For the following question, complete the General Journal entry then post the transaction to the General Ledger. Balance and close all relevant ledger accounts and complete the current assets and current liabilities section of the Balance Sheet.*

May 1: Commenced business with the following assets and liabilities: cash at bank $8 000, motor vehicle $20 000, accounts payable – *Designer Clothin*g $5 000.

May 3: Purchased supplies for $1 100 GST-inclusive from *Designer Clothing*.

May 7: Paid internet advertising expense of $1 540.

May 15: Charged fees for dress design provided to H. Marion for $4 400 GST-inclusive.

May 18: Paid wages $2 720.

May 25: Charged fees of $440 GST-inclusive, client paid cash.

May 28: H Marion paid his account in full and was given a $400 discount.

May 30: Paid *Designer Clothing* in full and was given a 1% discount.

General Journal

DATE	DETAILS	DEBIT	CREDIT
20XX			
1 May	Cash at Bank	8 000	
	Vehicle	20 000	
	Accounts Payable - Designer Clothing		5 000
	Capital		23 000
	Entry to commence business		
3 May	Inventory	1 000	
	GST Credits Received	100	
	Accounts Payable - Designer Clothing		1 100
	Purchase of inventory		
7 May	Internet Expenses	1 400	
	GST Credits Received	140	
	Cash at Bank		1 540
	Payment of Internet bill		
15 May	Accounts Receivable - H Marion	4 400	
	GST Collected		400
	Fees		4 000
	Sale of GST inclusive services		
18 May	Wages	2 720	
	Cash at Bank		2 720
	Payment of wages		
25 May	Cash at Bank	440	
	GST Collected		40
	Fees		400
	Sale of GST inclusive services		

DATE	DETAILS	DEBIT	CREDIT
28 May	Cash at Bank	4 000	
	Discount Allowed	364	
	GST Collected	36	
	Accounts Receivable - H Marion		4 400
	Received payment and gave a discount		
30 May	Accounts Payable - Designer Clothing	6 100	
	GST Credits Received		55
	Discount Received		6
	Cash at Bank		6 039

General Ledger (Extract)

GST Collected (L)

28 May	*Accounts Receivable*	36	15 May	*Accounts Receivable*	400
30 May	*GST Clearing*	404	25 May	*Cash at bank*	40
		440			**440**

GST Credits Received (A)

5 May	*Accouonts Payable*	100	30 May	*Accounts Payable*	55
21 June	*Cash at bank*	140	30 May	*GST Clearing*	185
		240			**240**

GST Clearing

30 May	*GST Credits Received*	185	30 May	*GST Collected*	404
	Balance c/d	219			
		404			**404**
				Balance b/d	219

The GST Clearing account has a credit balance of $219. This balance is a liability owed to the ATO. This will be shown in the Balance Sheet as a current liability.

Chapter 8 Activities

1. DEFINITIONS

A.

- **GST** = Goods and Services Tax. It is a broad based tax of 10% which is charged on most goods and services.
- **ABN** = The Australian Business Number which is a unique number that the business must use so that the Australian Tax Office can identify them in all their dealings.
- **BAS** = Business Activity Statement.

B. In the GST Credits Received account.

C.

- **GST-Clearing** = a holding account which has the total GST Collected and GST Credits Received transferred into it. The business determines the amount either payable to the ATO or the amount the ATO owes the business.
- **GST Credits Received** is an asset account used to record any GST paid by the business.
- **GST Collected** is a liability account used to record any GST collected from other businesses.

2. FIGURES

i. 10%
ii. $75 000 per annum
iii. 11

3. GST-INCLUSIVE PRICING

i. 15
ii. 110
iii. 18
iv. 27
v. 33
vi. 44
vii. 53
viii. 34
ix. 62
x. 13

4. GST-EXCLUSIVE PRICING

GST EXCLUSIVE PRICE	GST TO BE ADDED	GST INCLUSIVE
$	$	$
700	70	770
2 000	200	2 200
5 400	540	5 940
6 100	610	6 710
8 400	840	9 240
3 100	310	3 410
850	85	935
440	44	484
720	72	792
65	6.50	71.50

5. GST INCLUDED?

PRICE	GST COMPONENT
$	$
1 400 exclusive	140
363 inclusive	33
880 exclusive	88
176 inclusive	16
1 440 exclusive	14.40
264 inclusive	24
130 exclusive	13
396 inclusive	36
330 exclusive	33
891 inclusive	81
165 inclusive	15
2 000 exclusive	200

6. THE GST

A. A supply.

B. When goods are made available or a service is performed.

C. Taxable Supplies, GST-free supplies, Input taxed supplies.

D. No.

E. Goods and services which can have the GST applied to them.

F. GST is not charged on GST-free supplies or payable to the ATO. Some of the main categories of GST-free supplies are:
- Cars for use by disabled people
- Child care
- Charities
- Education

G. If a business provides input taxed supplies then GST is not charged to the purchaser and the seller is unable to claim any input tax credit for GST paid on purchases made for input taxed supply.

H. The main categories of input taxed supplies are:
- Certain residential premises
- Residential rents
- Financial services such as interest, loans, life insurance, shares bought and sold for superannuation.

I.

TYPE OF SUPPLY	CAN THE BUSINESS COLLECT GST?	CAN THE BUSINESS CLAIM GST CREDITS?
TAXABLE	Yes	Yes
GST-FREE	No	Yes
INPUT TAXED	No	No

7. ACCOUNTING FOR THE GST

A. If a business accounts for GST on a cash basis then it accounts for GST payable on a taxable supply in the tax period in which it receives payment for that supply. The business can only account for the GST payable in that tax period if the actual payment has been received. In addition the business may claim a GST credit for GST paid on creditable items that it has purchased in the tax period in which payment for those items is made.

If a business accounts for GST on a non-cash (accrual) basis then it accounts for all GST payable on a taxable supply that is made in the tax period in which an invoice is issued for the supply, or the tax period in which any of the consideration is received, whichever occurs first. GST credits can be claimed for GST paid on creditable purchases that the business makes in the tax period in which an invoice is issued or when the business pay any amount for the purchases, whichever occurs first.

B. *Suzette's Crepes and Shakes*

i. Milk is a GST-free supply as it is an exempt item of food.

ii. Ice cream is a taxable supply.

Quoted amounts are GST exclusive so the GST = $\frac{550}{11}$ = \$50

iii. The BAS is used by a business that is registered for the GST so it is relevant to *Suzette's Crepes and Shakes*. Its purpose is to enable a business to lodge their GST reporting with the Australian Taxation Office. This is done on a monthly or quarterly basis is earning over \$75 000, and an annual basis if under \$75 000 and registered.

8. GST AND PURCHASE AND SALE TRANSACTIONS

A. i.

General Journal

DATE	DETAILS	DEBIT	CREDIT
20XX			
June			
1	Inventory	1 500	
	GST Credits Received	150	
	Accounts Payable - ABC Supplies		1 650
	Purchase of inventory		
4	Accounts Payable - ABC	110	
	GST Credits Received		10
	Inventory		100
	Inventory returned		
7	Inventory	1 740	
	GST Credits Received	174	
	Accounts Payable - ABC Supplies		1 914
	Purchase of inventory		
9	Accounts Payable - ABC	88	
	GST Credits Received		8
	Inventory		80
	Inventory returned		

ii.

General Journal

DATE	DETAILS	DEBIT	CREDIT
20XX			
July			
1	Inventory	750	
	GST Credits Received	75	
	Accounts Payable - Jett Wholesalers		825
	Purchase of inventory		
4	Accounts Payable - Jett	55	
	GST Credits Received		5
	Inventory		50
	Inventory returned		
7	Inventory	870	
	GST Credits Received	87	
	Accounts Payable - Jett Wholesalers		957
	Purchase of inventory		
9	Accounts Payable - Jett	44	
	GST Credits Received		4
	Inventory		40
	Inventory returned		

iii.

General Journal

DATE	DETAILS	DEBIT	CREDIT
20XX			
July			
1	Inventory	3 000	
	GST Credits Received	300	
	Accounts Payable - Timber Suppliers		3 300
	Purchase of inventory		
4	Accounts Payable - Timber Suppliers	165	
	GST Credits Received		15
	Inventory		150
	Inventory returned		
7	Inventory	2 610	
	GST Credits Received	261	
	Accounts Payable - Timber Suppliers		2 871
	Purchase of inventory		
9	Accounts Payable - Timber Suppliers	132	
	GST Credits Received		12
	Inventory		120
	Inventory returned		

iv.

General Journal

DATE	DETAILS	DEBIT	CREDIT
20XX			
July			
1	Accounts Receivable - Barnaby Ltd	1 980	
	GST collected		180
	Sales		1 800
	Sale of inventory		
	Cost of Sales	1 000	
	Inventory		1 000
	Cost of inventory sold		
2	Sales Returns and Allowances	160	
	GST Collected	16	
	Accounts Receivable - Barnaby Ltd		176
	Inventory returned by debtor		
	Inventory	100	
	Cost of sales		100
	Inventory returned		
7	Cash at Bank	550	
	GST collected		50
	Sales		500
	Sale of inventory		
	Cost of Sales	300	
	Inventory		300
	Cost of inventory sold		
9	Sales Returns and Allowances	100	
	GST Collected	10	
	Cash at bank		110
	Inventory returned for cash refund		
	Inventory	30	
	Cost of sales		30
	Inventory returned		

v.

General Journal

DATE	DETAILS	DEBIT	CREDIT
20XX			
June			
1	Accounts Receivable - Bryce Wholesalers	3 960	
	GST collected		360
	Sales		3 600
	Sale of inventory		
	Cost of Sales	2 000	
	Inventory		2 000
	Cost of inventory sold		
2	Sales Returns and Allowances	320	
	GST Collected	32	
	Accounts Receivable - Bryce Wholesalers		352
	Inventory returned by debtor		
	Inventory	200	
	Cost of sales		200
	Inventory returned		
7	Cash at Bank	1 100	
	GST collected		100
	Sales		1 000
	Sale of inventory		
	Cost of Sales	600	
	Inventory		600
	Cost of inventory sold		
9	Sales Returns and Allowances	200	
	GST Collected	20	
	Cash at bank		220
	Inventory returned for cash refund		
	Inventory	60	
	Cost of sales		60
	Inventory returned		

B.

Toy Wholesalers
General Journal

DATE	DETAILS	DEBIT	CREDIT
2029			
1 June	Inventory	5 100	
	GST Credits Received	510	
	Accounts Payable - Toys Inc		5 610
	Purchase of inventory		
2 June	Accounts Payable - Toys Inc	660	
	GST Credits Received		60
	Inventory		600
	Return of inventory bought on credit		
6 June	Cash at Bank	2 310	
	GST Collected		210
	Sales		2 100
	Sale of GST inclusive inventories		
	Cost of Sales	1 200	
	Inventory		1 200
	Cost of inventories sold		
8 June	Inventory	1 650	
	GST Credits Received		0
	Cash at Bank		1 650
	Purchase of inventory		
9 June	Accounts Receivable - G Daniels	4 950	
	GST Collected		450
	Sales		4 500
	Sale of GST inclusive inventories		
	Cost of Sales	4 368	
	Inventory		4 368
	Cost of inventories sold		
17 June	Sales Returns and Allowances	450	
	GST Collected	45	
	Accounts Receivable - G Daniels		495
	I*nventory returned by debtor*		
	Inventory	390	
	Cost of sales		390
	Cost of inventory returned		

Toy Wholesalers
Trial Balance
as at 30 June 2029

	DEBIT	CREDIT
Inventory	972	
GST Credits	450	
GST Collected		615
Accounts Payable		4 950
Accounts Receivable	4 455	
Cash at Bank	660	
Sales		6 600
Cost of Sales	5 178	
Sales Returns and Allowances	450	
TOTAL	**12 165**	**12 165**

9. GST MIXED

A.

Kylee Monogue
General Journal

DATE	DETAILS	DEBIT	CREDIT
May 1	Cash at bank	4 000	
	Motor vehicle	40 000	
	Accounts payable - Party Supplies		1 000
	Capital		43 000
	Commencement of business		
3	Supplies	500	
	GST credits received	50	
	Accounts payable - Party Supplies		550
	Purchase of inventory		
7	Advertising	1 400	
	GST credits received	140	
	Cash at bank		1 540
	Payment of advertising		
15	Accounts receivable - J Donovan	2 200	
	GST collected		200
	Fees		2 000
	Sale of GST inclusive services		
18	Inventory	2 473	
	GST credits received	247	
	Cash at bank		2 720
	Purchase of inventory		
25	Cash at bank	440	
	GST collected		40
	Fees		400
	Sale of GST inclusive services		
28	Cash at bank	1 982	
	Discount expense	200	

DATE	DETAILS	DEBIT	CREDIT
	GST collected	18	
	Accounts receivable - J Donovan		2 200
	Received account payment and gave $200 discount		
30	Accounts payable - Party Supplies	1 550	
	Cash at bank		1 516
	Discount received		31
	GST credits received		3
	Payment of account		
June 30	Profit and Loss	2 100	
	Advertising		1 400
	Supplies		500
	Discount expense		200
	Transfer of expense balances		
	Fees	2 400	
	Discount received	31	
	Profit and Loss		2 431
	Transfer of income balances		
	Profit and Loss	331	
	Capital		331
	Transfer of profit for period to capital account		

Total GST collected = 222
Total GST received = 434
Balance of GST Clearing = 434 - 222
= $212 Asset

Kylee Monogue
Balance Sheet
as at 30 June

	$
ASSETS	
Cash at Bank	646
GST Clearing	212
Inventory	2 473
Accounts Receivable	0
Vehicle	40 000
LIABILITIES	
Accounts Payable	0
Net Assets	**$43 331**
EQUITY	
Capital	43 000
ADD: Profit	331
Total Equity	**$43 331**

B.

Orville Enterprises
General Journal

DATE	DETAILS	DEBIT	CREDIT
June 1	Cash at bank	27 000	
	Inventory	17 000	
	Motor vehicle	1 200	
	Capital		45 200
	Commencement of business		
5	Inventory	5 454	
	GST credits received	546	
	Wright Enterprises		6 000
	Purchase of inventory		
7	Wright Enterprises	550	
	Inventory		500
	GST credits received		50
	Purchase returns		
8	Wright Enterprises	5 450	
	Cash at bank		5 178
	Discount received		245
	GST credits received		27
	Payment of account		
10	Telephone	150	
	GST credits received	15	
	Cash at bank		165
	Payment of telephone bill		
14	Cash at bank	2 640	
	Sales		2 400
	GST collected		240
	Sale of inventory		
	Cost of sales	1 500	
	Inventory		1 500
	Cost of inventory sold		
16	Sales returns allowance	150	
	GST collected	15	
	Cash at bank		165
	Faulty inventory returned		
	Inventory	100	
	Cost of sales		100
	Cost of inventory returned		
18	Electricity	170	
	GST credits received	17	
	Cash at bank		187

DATE	DETAILS	DEBIT	CREDIT
	Payment of electricity bill		
25	Inventory	1 000	
	GST credits received	100	
	Cash at bank		1 089
	Discount received		11
	Purchase of inventory with receipt of 1% discount		
27	Williams and Co	880	
	Sales		880
	Sale of GST free inventory		
	Cost of sales	500	
	Inventory		500
	Cost of inventory sold		
28	Sales returns allowance	225	
	GST collected	25	
	Williams and Co		250
	Faulty inventory returned		
	Inventory	125	
	Cost of sales		125
	Cost of inventory returned		
29	Cash at bank	608	
	Discount expense	20	
	GST collected	2	
	Williams and Co		630
	Received account payment		
30	Profit and Loss	2 115	
	Telephone		150
	Electricity		170
	Discount expense		20
	Cost of sales		1 775
	Transfer of expense balances		
	Sales	3 280	
	Discount received	256	
	Profit and Loss		3 536
	Transfer of income balances		
	Profit and Loss	375	
	Sales returns allowance		375
	Transfer of sales returns allowances		
	Profit and Loss	1 046	
	Capital		1 046
	Transfer of profit for period to capital account		

10. JOURNAL ENTRIES FOR A GST REGISTERED TRADING BUSINESS

3% discount on half of Sunny Landscapes' 1 March bill:
$2 750/2 = $1 375
$1 375 x 3% = $41.25

The GST component of the discount = $41.25/11= $3.75
Net discount: $41.25 – $3.75 = $37.50

Greener Garden Suppliers
General Journal

DATE	DETAILS	DEBIT	CREDIT
March			
1	Inventory	$2 500	
	GST credits/outlay	250	
	Green Landscapes/ Creditor		$2 750
	Purchase of inventory		
4	Cash at bank	265	
	GST Collected		24.09
	Sales		240.91
	Sale of stock		
	Cost of sales	50	
	Inventory		50
	Cost of goods sold		
6	Telephone expense	120	
	GST credits/outlay	12	
	Cash at bank		132
	Payment of telephone bill		
9	Sales returns and allowances	50	
	GST collected	5	
	Cash at bank		55
	Return of faulty inventory		
10	Green Landscapes/ Creditor	1 375	
	GST credits/outlay		3.75
	Discount revenue/received		37.50
	Cash at bank		1 333.75
	Partial payment of 1 March bill and receipt of discount		

11. INCOME STATEMENT FOR A GST REGISTERED TRADING BUSINESS

A.

Bruno's Bakery
Income Statement
For the period ended 30 June 2018

	$
Net sales	87 480
Less: Cost of sales	61 800
GROSS PROFIT	**25 680**
Add: Other Income	
Interest	560
Discount	70
	630
Less: Expenses	
Shop expenses	
Rent	12 000
Cleaning supplies used	400
	12 400
Administrative expenses	
Advertising	450
Internet	800
Electricity	5 000
Telephone	6 700
	12 950
Financial expenses	
Interest	340
	340
Total expenses	25 690
PROFIT	**620**

B. The GST Clearing account has a debit balance because the amount of GST paid to suppliers is greater than the amounts received by customers. It is therefore an asset, to be recorded in the Balance Sheet under current assets.

C.

Bruno's Bakery
Balance Sheet Extract
As at 30 June 2018

CURRENT ASSETS	**$**
Inventory	$800
GST Clearing	450
	1 250
NON-CURRENT ASSETS	
Fixtures	3 400
Display cabinet	600
Cash register and computer	8 900
Oven	69 000
Delivery van	55 000
	136 900

CHAPTER 9: INTERNAL CONTROL

Review Questions 9.1

1. *What is a bad debt?*

A debt which the business does not expect to be repaid. The business owner writes it off, knowing that the debt is unlikely to be paid by the customer.

2. *List two advantages of internal control.*

For example:
- Lessen accidental errors
- Keep accurate records
- Ensure transactions are properly authorised
- Minimise wastage
- Safeguard assets against theft and fraud

3. *Define internal control.*

The overall methods and procedures which a business adopts in order to ensure that assets are safeguarded, correct procedures, policies, regulations and laws are adhered to, financial information is valid and that the effectiveness and efficiency of the business is improved.

4. *What is the difference between administrative controls and accounting controls?*

Administrative controls are designed to promote overall operational efficiency, effectiveness, and adherence to the policies and procedures that management have put into place for the business. Accounting controls are designed to safeguard business assets and ensure the accuracy of financial records. An accounting control is anything (methods or procedures) that aims to limit the possibility of a transaction being manipulated.

5. *Suggest inventory control methods that a bookshop retailer could implement.*

For example:
- Protect from weather by not displaying outside the shop or in sunlight
- Use sticker tags to prevent theft
- Seal expensive books and have one only as a display item so that books are not damaged by customers looking through them
- Lock display cabinets

6. *List two internal control measures over non-current assets.*

For example:
- Use of an Asset Register
- Having a formal approval process for the purchase of new assets
- Locking assets away securely
- Determining correct depreciation methods and scrap values
- Insuring all assets adequately
- Distributing responsibilities for maintenance, storage and recording
- Tagging and numbering all assets
- Regular security checks.

7. Write an internal control policy over accounts receivable for a dentist.

The management of accounts receivable for a dentist may include some of the following:

- Invoices should be issued on a timely basis - as the customer is finishing each appointment.
- Invoices should be issued in numerical sequence, and large bills broken down into manageable amounts.
- Different people should be responsible for billing and maintaining accounts receivable records, receiving or handling incoming payments and reconciling receivable records to the general ledger.
- Late accounts should be followed up regularly to facilitate payment.

Review Questions 9.2

1. What should a business owner do if they are having trouble paying their accounts payable?

The business owner should get in touch with the creditor as soon as it becomes apparent that there might be difficulty in meeting a payment deadline. They must keep a positive relationship with creditors and open communication lines, this should enable them to negotiate a new payment schedule.

2. What are two things a business needs to consider before extending credit to a customer?

For example:

- Credit history
- Employment history
- Security
- Bad debts

3. List and explain three limitations of internal control.

For example:

- If the business does not have many staff the owner may not be able to segregate duties properly
- Human error
- Employee conspiracy
- May not pick up unusual, out of the ordinary transactions
- Controls can be overridden
- Needs constant review

4. Summarise the steps a small business owner should follow when deciding whether to extend credit to a customer.

Develop a credit policy that examines potential debtors credit history, ability to pay and any security they might offer for a large debt.

Chapter 9 Activities

1. INTERNAL CONTROL OVER CASH

A. Yes Sally must adopt internal control measures over cash. Cash is vital to her small business so it must be protected.

B. Sally could adopt the following controls over cash:

- Different employees should be responsible for receiving and recording cash collections, balancing daily cash receipts to related cash recordings and verifying that the deposit amounts reflected in the general ledger match the departmental records. As the business only has two employees these duties will be split between Sally and the receptionist. As the business is too small to allow for proper role segregation, Sally must be aware of this shortcoming and periodically do additional checks to ensure that the cash funds are being adequately protected.
- Separate, lockable containers should be available for Sally and the receptionist. The money should be locked and keys to the cash box be available only to them. The work experience student should not have access to this. The cash should be locked in a drawer or safe overnight.
- If cash is kept in a safe, the safe combination should be changed regularly.
- Cash should be counted in a secure area where the person is free from interruptions.
- Cash should be banked either at the end of each day or weekly depending on how large the amounts are.
- All cash receipts should be recorded on a cash receipt form, cash register or a properly controlled computer database at the time of receipt.
- If the work experience student does the banking, Sally must fill in the amount and check when the student arrives back at the office that it was all banked.

C. The advantages of using internal control for Sally's business include:

- Lessening accidental errors
- Keeping accurate records
- Ensuring transactions are properly authorised
- Minimising wastage
- Safeguarding assets against theft and fraud

2. INTERNAL CONTROL OVER INVENTORY

A. Jeremy may have some of the surfboards which are outside the shop stolen as they are not always being watched. Also, some of the surfboards outside may fade due to the exposure to the outside elements of wind, rain and sun. Because Jeremy gets different friends to deliver the surfboards to the shop, some of the boards may be damaged as not all the cars will be suitable for transporting surfboards.

B. Possible inventory control methods for Jeremy's surfboard inventory:

- protect surfboards from sun damage by not displaying them outside the shop
- use protective bags to transport surfboards
- use a reputable transport company for delivering the surfboards
- secure stock that is displayed outside
- install security cameras to prevent theft by customers.

3. DEFINITIONS

A. Internal control refers to the overall methods and procedures that a business adopts in order to ensure that:

- assets are safeguarded
- correct procedures, policies, regulations and laws are followed by employees
- financial reports and records are valid
- the effectiveness and efficiency of business operations are improved.

B. Administrative controls refer to any method or procedure that has been implemented to promote the overall operational efficiency, effectiveness, and adherence to the policies and procedures that management have put into place for the business.

C. An accounting control is any methods or procedures that aim to limit the possibility of a transaction being manipulated. They exist to make sure that:

- errors do not accidently occur
- errors do not deliberately occur through manipulation
- records are kept accurately
- transactions are authorised correctly

D.

- **Cash** = money that is legal tender such as coins and notes.
- **Inventory** = the stock or goods that a trading or retail business has for sale.
- **Accounts receivable** = individuals and businesses that owe the business entity money
- **Accounts payable** = individuals and businesses that the business entity owes money.
- **Non-current assets** = items of value to the business that will be kept in the business, being used to earn income, for a period of time usually longer than 5 years.

4. INTERNAL CONTROL OVER NON-CURRENT ASSETS

A. Darwin has no safety guidelines and operating instructions to ensure machinery is operated efficiently. He has no locks on his garage, or fence and locked gate, to prevent vandalism or theft. He provides no training in the correct use of carpentry equipment for his friends.

B. Darwin could introduce the following controls over non-current assets:

- safety guidelines and operating instructions to ensure machinery is operated efficiently
- locks on garage to prevent theft or vandalism
- installation of a fence and locked gate to prevent theft or vandalism
- staff training in the correct use of carpentry equipment
- the observance of legal noise level requirements when loud manufacturing equipment is being used - find this out from the local council
- the recording all relevant details of each non-current asset in an Asset Register
- keeping the Asset Register up to date to ensure all assets are accounted for, maintained when required, and disposed of when they are no longer of use.

5. INTERNAL CONTROL OVER ACCOUNTS PAYABLE

Tilly can manage her accounts payable by, for example:

- contacting creditors as soon as it becomes apparent that there might be difficulty in meeting a payment deadline, especially in the last week of every month, to organise new payment plans
- banking all cheques daily so that cashflow does not dry up
- keeping a positive relationship with creditors and open communication lines so they know what is happening. Most businesses prefer a late payment to no payment
- forecasting potential cash flow problems and comparing them with payment deadlines
- taking advantage of discounts for early payment
- using a computerised accounting system to keep track of deadlines.

6. ACCOUNTS RECEIVABLE AND SUPPLYING CREDIT

A. To manage accounts receivable Bobbi can, for example:

- keep contact details of customers so they can be contacted if they have forgotten to pick up their dry cleaning
- follow up late accounts regularly to facilitate payment – an SMS reminder could be used
- set up a specific set of procedures for determining bad debts and collection actions
- make customers pay for their dry cleaning when they bring it in rather than when they pick it up.

B. Winfred

i. Extending credit facilities to customers can increase business, as some people want to take advantage of buying a luxury car but are unable to pay up front. However, the downside of extending credit is that Winfred then has to make sure all his customers pay. There is a risk that some customers will not pay and will end up being a bad debt. Winfred should therefore not extend credit to all customers, but rather only to those who have a good credit history and the regular income that will allow them to meet their repayments.

ii. As part of internal control systems over accounts receivable, Winfred will have to create a policy for supplying credit to customers. Some of the areas he must consider are:

- **Credit history:** this is a record of the prospective customers past borrowing and repaying history. It will list all personal and business information, credit lines currently being utilised and the two biggest risk factors – whether the prospective customer makes late payments or has had a bankruptcy in the last 7 years. It is relatively simple to obtain a credit history in Australia.
- **Employment history:** if credit is to be extended to someone, it helps to know whether that person is employed and how long they have been employed. A person with a good employment history is less likely to default on paying their bill.
- **Security:** this is what a business promises if it is unable to pay its bill. The business should very rarely lend money without this. If a customer does not have enough of his or her own assets to offer as collateral/security, then the business may accept someone acting as a guarantor for the extended line of credit. This means that if the customer cannot pay, the person who has acted as the guarantor will have to make the payments.
- **Bad debts:** the business needs to consider the likelihood that the customer could become a bad debt and if so, to what extent this would affect the business.

7. LIMITATIONS OF INTERNAL CONTROL

A. Monty

i. No internal control system is perfect – some of the reasons why are:

- Staff size – if the business does not have enough staff, these limitations may prevent the owner from implementing a system of segregating duties properly.
- Humans can and do make errors – this inaccuracy may lead to a seemingly perfect internal control system being not as effective as it was designed to be.
- If two or more people conspire together to falsely report an activity to protect themselves, then the internal control system will probably not pick up on this.
- Most internal control systems are designed to monitor the usual everyday transactions of the business and will not pick up on the unusual, out of the ordinary transactions.
- People in management can override a control making the overall system vulnerable.
- The controls may need to be reviewed and changed if the business grows or changes the way it currently operates. Without such changes, the existing system could be ineffective and irrelevant. This is a limitation if the owner does not constantly review the system.
- Businesses design internal control systems to be cost effective – this objective means that some errors may never be detected.

ii. As cheques are pre-numbered each one should be recorded against the account payable immediately when it is issued. Another employee can double check that the correct procedure has been followed, such as the owner when they sign the cheques. The processed invoice and bills should be filed correctly both in physical copy (which could be scanned) and in the accounting records on the computer. Reconciliations should be regularly carried out.

B. Ingrid needs:

- The stock to have security, such as tags and a beeper to detect customers going out of the shop, a video surveillance camera or a security guard
- Stock in the back office to be secure and locked
- A lockable display cabinet in the main shop for the small items of equipment
- Stock to be protected from the elements, so the window needs to be fixed straight away. The broken window is ruining stock and could potentially help a burglar get into and out of the storage area
- The rotation of duties among the three staff with regard to checking the daily takings and
- banking them. Having the same administration person completing all these is poor internal control.

8. INVENTORY CONTROL

- **Accidents:** health and safety guidelines, staff training
- **Employee error:** segregation of duties so that there is a double check being done of inventory movement, check daily totals
- **Customer theft:** Security cameras, tags, staff training in monitoring of customers, lockable cabinets for small expensive items
- **Employee theft:** Security cameras, different employees responsible for different areas of inventory management, secure storage areas, physical security and surveillance of cash register area (also for employee safety), authorisation of voided or cancelled sales transactions by a different staff member
- **Spoilage:** Rotate raw materials, so that “use by” dates do not expire, secure and sturdy shelving and refrigeration to ensure stock does not spoil, correct training for staff in storage requirements for fresh goods (fruit and vegetables), refrigerated and frozen goods (meat, milk products).

CHAPTER 10: GOVERNMENT AND THE COMMUNITY

Review Questions 10.1

1. *List two restrictions that businesses may face.*

For example, restrictions such as:

- Zoning restrictions
- Discharge of waste restrictions
- Health regulations
- Workers' compensation issues
- Food handling and preparation regulations
- Packaging regulations
- Signs
- Telephones
- Consumer protection laws
- Occupational health and safety
- Hazardous chemicals
- Fire regulations
- Industrial awards for staff employed
- Environment regulations
- Measuring equipment to be inspected periodically.

2. *List and explain one regulation with which a small business may need to comply.*

Health and Safety regulations. Under workplace health and safety legislation business owners are obliged to provide a safe premises, safe machinery and materials, information, instruction, training and supervision as well as a suitable working environment.

3. *Which government department regulates most of the business premises' rules and regulations?*

Department of Commerce.

4. *Why does a small business need to comply with occupational health and safety guidelines?*

Creating a safe and healthy work environment is beneficial for employees and customers. It avoids unnecessary costs and ensures that problems do not escalate.

5. *Define GST.*

A broad based tax charged on most goods and services.

6. *What is an ABN?*

A single identifier used so the the ATO can identify the business.

Review Questions 10.2

1. *Define corporate social responsibility.*

CSR is about business engaging in socially, environmentally and ethically responsible behaviour. This is a practice where the business takes into consideration whether:

- they have ethical values in the way they are conducting their business
- they have respect for their employees and customers and
- they are respecting the environment through the manner in which they go about their daily business.

2. *List two examples of socially responsible behaviour.*

Community sponsorship, setting up an education program.

3. *List two examples of environmentally responsible behaviour.*

Recycling and reusing resources within the business.

4. *List two examples of ethically responsible behaviour.*

Anti-discrimination and anti bribery policies.

5. *List two benefits of a small business engaging in CSR.*

For example:

- Increased ability to attract and retain staff
- Increased customer loyalty
- Demonstration of care for the community
- New perspectives and ideas
- Staff participation and satisfaction
- New business opportunities
- Raising the businesses profile amongst customers and the community.

6. *List three items that may be included in a code of ethics.*

Code of ethics:

- Not to deliberately do anything illegal.
- To only do business with other ethical businesses.
- To treat customers and suppliers in the manner that the business owners would like to be treated.
- To not exploit customers, suppliers or employees.
- To be truthful at all times.
- To deliver a high level of customer service.
- To not let business practices adversely affect anyone.

7. *How may office waste be minimised?*

For example: Using less paper, not printing unless required (using emails and electronic documents more), recycling paper/electronics, use both sides of paper, storing manuals online and not printing these, shut down or unplug unused equipment, set the airconditioning temperature higher, use natural lighting, set computers to go to sleep when not being used.

8. *What do consumer concerns about the use of packaging usually relate to?*

Consumer concerns about the use of packaging usually relate to the overuse of 'once off' containers that are thrown away, such as fast food containers. A business can aim to reduce the amount of packaging used for a product, and can create containers that suit individual products, minimising the use of materials. Minimising packaging of items in supermarkets and clothing stores also assists – carry bags are a major source of packaging waste.

9. *How may manufacturing waste be minimised?*

Manufacturing waste can be minimised by keeping equipment and machinery maintained, recycling outdated assets, and using the most energy efficient appliances.

10. *Bearing in mind the power the consumer has either to support or to boycott a business, how can a small business operator with limited funds operate in an ethical manner?*

Discussion question. Responses could include:

- An understanding of how a business can gain widespread support from the community for its aim of doing good in the world using a portion of the business' profit.
- This encourages customers to support the business by buying its products, which in turn leads to success.
- If the public feels a business is being unethical or not environmentally friendly they can campaign to stop consumers buying their products, which in turn has an effect on the profits.

Chapter 10 Activities

1. REGULATIONS FOR SMALL BUSINESS

A. Students will have different answers due to their research. In addition, by this stage of the unit, students should be able to make up realistic examples. They should focus on looking at local council regulations as well as the requirements of the Worksafe and Department of Health websites.

B. If a business is to be operated from the business owner's home, then a home occupation permit and approval is required. The restrictions placed on the business will vary depending on the local council, which will need to be contacted. It is important that premises regulations exist, otherwise people would do whatever they wanted and this could begin to get out of hand; for example, making loud noise or using bright lighting throughout the night, or polluting excessively.

The Small Business Development Corporation website has further information: www.homebasedbusiness.sbdc.com.au.

2. BUSINESS RESTRICTIONS

Research and discussion question. Possible responses might include:

A. If Detroit Harper chooses to have a name for his business rather than using his own name, he must register a business name with the Australian Securities and Investments Commission (ASIC). Businesses only need to register or renew a business name nationally and pay a single fee. Registering his business name gives Detroit the right to use that name for a nominated period of time, however it does not give him ownership of the name.

In this case Detroit wants to name the business Harper Catering, so he would need to register the business name.

B. Areas which should be covered:

- Detroit will have to follow Occupational Health and Safety rules as set out by the Department of Commerce and the Department of Health.
- He will have to pay workers' compensation insurance and superannuation for his employees.
- He will have to pay tax to the ATO.
- He will have to follow food handling and preparation regulations as well as packaging regulations. His kitchen will need to be approved.
- He will need to be aware of consumer protection laws and make sure he does not infringe these.

C. Detroit will need to contact the local Council about (for example): zoning regulations, parking requirements, building permits, approved business use, signs, health regulations, and permits.

D. Detroit will only be able to run the business from his parents house if the building, and particularly the kitchen, passes all the regulations. For example, it may need to be extended or the zoning might affect what can be done in the building. He needs to obtain council approval.

E. If a small business owner employs staff, then it is compulsory to have workers' compensation insurance. Workers' compensation insurance covers employers if an employee has a work related injury or disease and makes a financial claim. The insurance company with which the business has their workers' compensation insurance policy will pay the claim. The statutory authority in charge of administering workers' compensation insurance in Western Australia is Workcover WA. Yes, Detroit will need to pay Workers' Compensation Insurance as he will be employing members of his family.

3. ABN, GST AND INSURANCE

A. An Australian Business Number (ABN) is a number that Harmonica must use so that the Australian Tax Office can identify her business in all dealings. If a business does not register for an ABN, then other entities may withhold tax from payments to the business at the highest marginal tax rate. The business will only be able to claim this money back when the owner lodges an annual income tax. This tax will not be withheld if an ABN is available.

Harmonica only needs to register the business for GST if it has an annual turnover of more than $75 000. If the business earns less than this amount the owner can choose whether to register for the GST. If a business does not register for GST they will still pay GST for any goods or services purchased for the business. However, in this situation Harmonica will not charge GST to her customers, so will not have to lodge any Business Activity Statements or collect GST on behalf of the government.

B. Harmonica would only need to pay State tax if:

- The business has a payroll greater than $750 000 per annum, she must pay payroll tax.
- She buys a business property. Land tax is paid to the state government. Stamp duty is a tax on the transfer of ownership of a piece of property.

C. Harmonica will need to take out workers' compensation insurance if she hires any employees. Other policies she may be interested in are (For example):

- professional indemnity
- public liability
- fire and theft
- life insurance
- vehicle/ property insurance
- business disruption.

4. SPONSORSHIP

A. Sponsorship occurs when a business provides either resources, funding or services to an individual or an organisation or event. Usually the business will receive some advantage; for example, they might want their business name to be advertised. There will not always be an obvious commercial advantage from the sponsorship; however, the community goodwill alone may benefit the business at a later stage.

B. The main advantage for Dilli is that she will be doing something good for her community. Her business will receive publicity which could have a flow on effect overseas if she has news stories written on what she is doing. She will be able to advertise her business as one that gets involved in CSR and this may be looked upon favorably by her clients.

C. Discussion question – there are a range of possibilities. For example:

- Supporting community projects in non-financial ways by allowing employees to volunteer time to help the cause, or advertising the cause in their business so that community awareness is increased.

- Introducing occupational health and safety measures in her business so the workplace is a safer, healthier, happier place for her employees.
- Adopting environmentally friendly practices wherever possible, such as using recycled photocopying paper and decreasing electricity usage.
- Drafting and implementing a code of ethics to be followed by all employees.
- Making sure the workplace is free of discrimination.
- Having a hiring policy which aims to hire people who require support in the workplace.
- Donating to charity.

5. A HAPPY WORKFORCE

A. There are several benefits for Hugh if he decides to engage his small businesses with CSR:

- Increased ability to attract and retain staff leading to lower employee turnover, which in turn means less money being spent on employing new staff. Having to recruit staff can be costly with the expenses associated with advertising, interviewing and training staff.
- Increased customer loyalty as customers see the business doing the 'right thing' and therefore they are willing to support the business. This can lead to increased business and income.
- Demonstration of care for the community.
- New perspectives and ideas.
- Staff participation and satisfaction.
- Happier staff.

B. CSR practices which Hugh could adopt for a happier workforce are (for example):

- a chance for employees to suggest changes to improve the workplace
- a weekly reward for employees
- a monthly dinner for employees
- bonuses on nights the restaurant does very well

C. Costs related to CSR which might impact on Hugh include (for example):

- lack of finance or an increased financial cost
- lack of knowledge and expertise
- lack of resources
- time burden
- sourcing environmentally friendly products can be difficult
- employee training.

D. For example: High could implement a recycling scheme. For example, office waste can be minimised by ensuring that paper is recycled and both sides of the page are used, photocopying and printing onto smaller pages, using electronic copies of documents not photocopies or printouts, and recycling paper, ink cartridges and other consumables.

6. CORPORATE SOCIAL RESPONSIBILITY

Research and discussion question. Possible responses might include:

Environmental friendliness

- To not let business practices adversely affect the environment.
- Adopting environmentally friendly practices wherever possible, such as using recycled photocopying paper.

Community awareness

- Not to deliberately do anything illegal.
- To treat customers and suppliers in the manner that the business owners would like to be treated.
- To not exploit customers, suppliers or employees.
- To deliver a high level of customer service.
- To not let business practices adversely affect anyone.
- Having a hiring policy which also looks at the benefits of hiring people with disabilities or mature age workers who possess life experience.
- Donating to charity.
- Conducting business without bribery or corruption.
- To only do business with other ethical businesses.
- To be truthful at all times.
- Supporting community projects in non-financial ways could include getting employees to volunteer time to help the cause or advertising the cause in their business so that community awareness is increased.

Employee support

- To treat employees in the manner that the business owners would like to be treated.
- Introducing occupational health and safety measures in their business so the workplace is a safer, healthier, happier place for their employees.
- To not exploit customers, suppliers or employees.
- To not let business practices adversely affect employees.
- Drafting and implementing a code of ethics to be followed by all employees.
- Listening to what employees would like.
- Making sure the workplace is free of discrimination.
- To be truthful at all times.

7. PRODUCTION PROCESSES AND SAFETY

Research and discussion question. Possible responses might include:

Safety procedures

- Tag electrical equipment
- Provide personal protective equipment and clothing
- Hazard reporting systems
- Barricades
- Correct stacking of containers and boxes
- Driving forklifts and other vehicles
- Moving parts of machines

Waste disposal

- Sorting of paper, plastic, glass, aluminum
- Reusing obsolete electronic parts
- Staff food waste eg. Composting
- Recycling computer parts and electronic waste
- Secure data destruction
- Repairing, not discarding, damaged items

Packaging

- Review use of excessive packaging/ individually wrapped items
- Use sustainable paper, recycled timber, secondhand boxes
- Payment for shopping bags
- Optimal design of packaging to reduce material use
- Disassembly and reuse of transport packaging

Why have improvements

- Increased ability to attract and retain staff
- Increased customer loyalty
- Demonstration of care for the community
- New perspectives and ideas
- Staff participation and satisfaction
- New business opportunities
- Raising the businesses profile amongst customers and the community.

8. CSR ESSAY

Research based essay – previous answers are available on the Internet.

9. ETHICALLY AND SOCIALLY RESPONSIBLE BEHAVIOUR

A. Piers' socially responsible business practices toward employees:

- consider the employees as an important part of the business
- are not just about the financial 'bottom line'
- allow for elements such as family life, fitness, stress-free commute, flexible working hours.

B. Challenges for Piers in getting other companies to meet minimum standards for work:

- Some suppliers are overseas – how can he ensure they are doing what they say?
- He needs an audit process for checking that the claims of fairness and equality are being carried out
- Does he have a planned response if a supplier is found to be unethical?
- Concern about consumer reaction if he cannot supply goods because his standards are potentially too stringent
- What alternative supply chain does he have?

UNIT TWO ATAR/ UNIT FOUR GENERAL

CHAPTER 11: PROVISIONS

Review Questions 11.1

1. *Define 'depreciation'.*

Depreciation is an expense which involves allocating the cost of an asset over time. This means that the financial reports of a business will show the gradual consumption of economic benefits from a non-current asset, or in other words, its decreasing potential to provide assistance to the business.

2. *Explain how depreciation is a cost allocation process.*

Depreciation is an allocation process. It spreads the cost of an asset over the period of time the asset is used to generate income. From the first day that an asset is purchased it begins to loose value. Assets are depreciated so that the business can account for the loss in value of the asset through time, wear and tear and obsolescence. By depreciating the asset, this loss in value is turned into a legitimate business expense. The expense is treated like any other expense by being charged against income for the calculation of the accounting period profit.

3. *Define each of the following classes of non-current assets:*

   - *property, plant and equipment*

Non-current assets specifically purchased for the purpose of earning income for the business. They are not purchased with the intention of selling them or converting them into cash. They are expected to remain in the business for a period longer than twelve months.

   - *intangible assets*

An identifiable non-monetary asset, with no physical substance.

   - *other non-current assets*

The other main class of non-current assets is financial assets or investments being held by the business for longer than twelve months. These assets do not have a value based on their physical existence.

4. *What are the three main reasons for depreciation?*

Reasons for depreciation:

- Wear and tear.
- Commercial obsolescence.
- Technical obsolescence.

5. *Compare and contrast the meaning of 'book value' and 'market value'.*

Since depreciation is an allocation of cost over accounting periods, it is not directly connected to market value – or the amount that the asset would be worth if it was sold. The book value of an asset, (or carrying amount) is the actual cost minus the accumulated depreciation. This is simply the unallocated cost of the item.

Review Questions 11.2

1. *For which assets is it more appropriate to use straight-line depreciation? Give four examples.*

The straight line method involves a constant charge of depreciation in every reporting period, and is used when the asset is expected to contribute evenly to the income earning activities of the business over its useful life. For example, furniture, fittings, desks and buildings.

2. *For which assets is it more appropriate to use reducing balance depreciation? Give three examples.*

The diminishing balance method involves a decreasing charge of depreciation being made to the asset in every reporting period. This depreciation method is used when more benefits are expected in the early years of an asset's life. For example, machinery, cars and computers.

3. *List and explain the four factors to consider when calculating depreciation.*

Factors:

- Cost or Depreciable Amount
- Estimated Useful Life
- Residual Value
- Method

4. *Compare the main advantage and main disadvantage of the straight-line method of depreciation.*

Advantages of the straight-line method	Disadvantages of the straight-line method
1. It is simple to use. 2. Suitable for assets such as furniture and buildings, where the benefits tend to be equal in each period. 3. It is suitable for service, retail and merchandising entities.	1. Does not consider the degree of usage of the asset. 2. Does not take into account the age of the asset. 3. Does not consider the efficiency of the asset. 4. It does not take into account assets requiring more repairs later in their useful life than the beginning of their useful life.

5. *Compare the main advantage and main disadvantage of the reducing balance method of depreciation.*

Advantages of the diminishing balance method	Disadvantage of the diminishing balance method
1. Useful for assets such as machinery and motor vehicles. This is because this method results in a greater amount of depreciation being written off during the early stages of the assets useful life. 2. The older and less useful the assets becomes, the lower the depreciation charge will be.	The main disadvantage of this method is that it does not suit all types of non-current assets. For example it would not be ideally suited towards non-current assets such as furniture, where the benefits of the asset are fairly even in each accounting period.

6. *Draw a graph comparing the straight line and reducing balance depreciation rates. Graph how an asset valued at $10 000 would be depreciated using either of:*
   - *Straight line of $2 000 per year.*
   - *Reducing balance at 20% per year.*

Construct graph based on these calculations:

Year	Straight line	Reducing value
1	2 000	2 000
2	4 000	1 600
3	6 000	880
4	8 000	704
5	10 000	563.20

7. *Draw a graph showing how the written down value (WDV) of a $20 000 asset will change over time, if the asset is depreciated at $1 000 per year for 20 years. (Place WDV on the vertical axis and time in years on the horizontal axis.)*
8. *On the same graph, show how the written down value changes if the asset is depreciated at:*
   - *$2 000 per year*
   - *$500 per year.*

7. and 8. Construct graph based on these calculations:

$1 000 per year	$2 000 per year	$500 per year
20 000	20 000	20 000
19 000	18 000	19 500
18 000	16 000	19 000
17 000	14 000	18 500
16 000	12 000	18 000
15 000	10 000	17 500
14 000	8 000	17 000
13 000	6 000	16 500
12 000	4 000	16 000
11 000	2 000	15 500
10 000	0	15 000
9 000		14 500
8 000		14 000
7 000		13 500
6 000		13 000
5 000		12 500
4 000		12 000
3 000		11 500
2 000		11 000
1 000		10 500

9. *Explain which depreciation method: straight-line or reducing balance (OR neither!) would be appropriate for the following assets, and justify your answer.*
   - *Office chair* Straight Line
   - *Lathe* Reducing Balance
   - *Factory* Straight Line
   - *Shop shelves* Straight Line
   - *Truck* Reducing Balance
   - *Land* Neither
   - *Hammer drill* Reducing Balance
   - *Mannequin* Straight Line
   - *Goodwill* Neither

Review Questions 11.3

1. *Define 'depreciation' and 'accumulated depreciation'.*

Accumulated depreciation is the total amount of depreciation that has been charged over the life of the asset.

2. *What is the nature of each of the accounts in (1), and how do they affect the financial statements?*

Depreciation is an expense. Accumulated depreciation is reducing the value of the asset. It is a type of contra asset (or negative asset) account.

3. *Explain the nature of a contra asset account, using an example.*

Accumulated depreciation which reduces the value of an asset.

4. *Show the General Journal entry to record depreciation expense.*

General Journal (Extract)

Date	Particulars	Dr	Cr
Jun 30	Depreciation of Motor Vehicle	5 000	
	Accumulated Depreciation of Motor Vehicle		5 000
	Depreciation of asset		

5. *Show the General Ledger double entry to record depreciation expense.*

General Ledger (extract, T account format)

Depreciation of Motor Vehicle (Expense)

30 June	*Accumulated Depreciation*	5 000	30 June	*Profit and Loss*	5 000

Accumulated Depreciation of Motor Vehicle (Asset)

			30 June	*Depreciation*	5 000

6. *Where are accumulated depreciation and depreciation expense shown in the Balance Sheet and Income Statement?*

Depreciation is an expense in the Income Statement. Accumulated Depreciation is subtracted from Assets in the Balance Sheet.

7. *Summarise the steps involved in recording depreciation.*

The depreciation process:

- Record asset purchase
- Select depreciation method
- Calculate depreciation expense
- Record in General Journal
- Post journal entry into the General Ledger
- Close depreciation expense account by transferring to Income Statement
- Balance accumulated depreciation account
- Adjust carrying amount of asset in the Balance Sheet

Review Questions 11.4

1. *Explain the difference between depreciation and accumulated depreciation.*

Accumulated depreciation is the total amount of depreciation that has been charged over the life of the asset and it is a contra-Asset account. Depreciation is an expense.

2. *Why are Accumulated Depreciation and Allowance for Doubtful Debts both a type of 'provision' account?*

Balance day adjustments are entries that are made in the accounting records which do not relate to a specific transaction, such as the purchase or sale of goods. Provisions are one type of balance day adjustment, and they allow for expenses such as depreciation and doubtful debts. Without these provisions, the business would not be able to present a more accurate 'true and fair' view of the state of the accounts on balance day.

3. *Why does depreciation ensure that the financial statements show a true and fair view of the state of the business?*

Depreciation allows for a gradual cost allocation over the life of a non-current asset. The calculation of depreciation involves estimating several pieces of information about the non-current asset to be depreciated. It is rare for an asset to be depreciated to equal exactly its estimated residual value.

4. *Define each of the three main types of non-current assets.*

Property, plant and equipment.

5. *What four items of information are required in order to calculate depreciation?*

Cost, useful life, depreciation method, residual value.

6. *Summarise the three main depreciation methods.*

Straight line and reducing balance. The third is prime cost.

7. *How can a business determine the more appropriate method of depreciation to use for a particular asset?*

Consider pattern of use.

8. What are initial costs of an asset? Give one example.

The initial cost is the total amount paid to purchase the asset. Some costs associated with property, plant and equipment may not directly increase the future economic benefits produced by a specific asset. These costs might be important however, because they allow the entity to gain benefits from other assets. eg. Purchase price of machinery.

9. What are subsequent costs? Give three examples.

After purchasing an asset, there are some costs of using the asset that will not be considered expenses, because they are not consumptions of future economic benefits. These costs are usually permanent changes or additions to the asset, and if their cost can be measured reliably, they are included as part of the asset and will be depreciated. eg. Replacement of major component such as vehicle air conditioning, permanent change of a part such as machinery, major inspection required for further operation of plant.

10. Outline the two methods used to measure the value of an asset after recognition.

- **Cost Model:** Assets are carried (in the accounts) at their cost less accumulated depreciation (and less any impairment losses).
- **Revaluation Model:** If the fair value can be measured reliably, the assets can be carried at their revalued amount less accumulated depreciation (and less any impairment losses).

11. Summarise the steps to follow when calculating the gain or loss on disposal of an asset.

Calculating gain or loss:
Carrying Amount = Cost of asset – Accumulated depreciation

When an asset is sold or 'disposed of', the business will receive cash and/or a trade-in discount in return. This is called the PROCEEDS FROM DISPOSAL. Ideally the total amount received would be equal to its residual value.

Proceeds from Disposal of Asset = Total consideration (cash/ debtors/ other benefits) received

If the Carrying Amount > Proceeds from Disposal = LOSS

If Proceeds from Disposal > Carrying Amount = GAIN

12. Explain the terms 'over-depreciation' and 'under-depreciation'.

Gain on disposal of asset = 'over' depreciation
Loss on disposal of asset = 'under' depreciation

13. Complete journal and ledger entries illustrating the sale of a non-current asset.

Steps involved in recording the sale of a non-current asset:

- Transfer the cost of the asset from the Asset (A) account into the Sale of Asset account.
- Transfer the accumulated depreciation of the asset from the Accumulated Depreciation (-A) account into the Sale of Asset account.
- Recognise the proceeds. Enter the cash received into the Cash at Bank (A) account, and the Sale of Asset account. Alternatively if the asset was sold on credit, enter the amount owing into the Debtor (A) account, and the Sale of Asset account. (Note that this Course does not require students to consider trade-ins).

- Calculate the balance of the Sale of Asset account. A balance on the DEBIT side is a PROFIT on disposal, and a balance on the CREDIT side is a LOSS on disposal. This result can be checked by subtracting the carrying amount from proceeds.
- Transfer the balance of the Sale of Asset account into the Loss on Disposal OR the Profit on Disposal account.

Review Questions 11.5

1. *List possible reasons for debtors not paying.*

Debtors can become bankrupt or insolvent.

2. *What steps should a business follow to ensure it has control over the collection of money from debtors?*

The management of debtors may include:

- Invoices should be issued on a timely basis.
- Invoices should be issued in numerical sequence.
- Different people should be responsible for billing and maintaining accounts receivable records, receiving or handling incoming payments and reconciling receivable records to the general ledger.
- Delinquent accounts should be followed up regularly to facilitate payment.
- The business must set up and follow a specific set of procedures for determining bad debts and collection actions.

3. *Define 'debtors'.*

Credit is usually offered to customers from the sale of goods (or services), and this is recorded in the asset account Debtors or Accounts Receivable.

4. *Compare and contrast 'doubtful debts' and 'bad debts'.*

Bad debts are written off when identified and are a known amount. They directly affect the Accounts Receivable/Debtors account. Doubtful debts are provided for (allowed for) each accounting period and are an estimation. They indirectly decrease the Accounts Receivable/Debtors account.

5. *Explain the difference between bad debts and the allowance for doubtful debts.*

Steps involved in recording bad debts and doubtful debts:

- Write off bad debts as they occur by debiting Bad Debts, debiting GST Collected, and crediting Accounts Receivable (assuming the business does not have individual creditor accounts).
- On balance day (the end of the accounting period) transfer the balance of Bad Debts into the Allowance for Doubtful Debts.
- Also on balance day, enter the estimation of likely bad and doubtful debts. Credit the Allowance for Doubtful Debts, and debit the Bad Debts, with the appropriate amount.
- NOTE: If the business was to use the Doubtful Debts (Ex) account, this would require additional steps.

6. *Summarise a method that can be used to record bad and doubtful debts.*

The direct method is useful when a debt is known to be bad and confirmed to not be expected to be paid. The allowance method allows for an estimation and it matches the likely debts with the relevant accounting period.

7. *How are doubtful debts estimated?*

Using the percentage of net credits sales method or the aging of accounts receivable method.

8. *Why are accounts receivable 'aged', and how is this done using an electronic accounting package?*

This method is based on an assumption that the older a debt is, the more likely it is to become a bad debt. The business will review past accounts receivable and determine how likely it is for older debts to not be repaid, categorising them into time periods. They will then list accounts receivable based on their 'age', or the amount of time they are overdue, and multiply each category by a percentage representing the estimated amount of bad debts from that time period.

Chapter 11 Activities

1. COMPARISON OF DEPRECIATION METHODS

A.

Method	Definition and example	Impact on annual depreciation
Straight line	Same amount of depreciation charged on the original cost of the asset each period. Used when the asset is expected to contribute evenly to the income earning activities of the business over its useful life. For example, furniture, fittings and buildings.	A constant charge of depreciation in every reporting period.
Diminishing balance	A fixed percentage of depreciation is charged on the diminishing balance, not the original cost of the asset, each period. Used when more economic benefits are expected in the early years of an asset's life. For example, machinery, cars and computers.	A decreasing charge of depreciation in every reporting period.
Units of production	The depreciation charge is based on the expected usage or output from the asset. The amount of depreciation for an accounting period is the depreciable value of the asset (actual cost minus any residual value), divided by the (unit) lifetime, and multiplied by the units produced in the period. For example, deliveries, goods manufactured.	Depreciation charge in a period depends on the amount of production in the period.

B.

Asset	Depreciation method
Motor vehicle	Diminishing balance
Machinery	Diminishing balance
Office furniture	Straight line
Computer	Diminishing balance
Scanner	Diminishing balance
Gym equipment	Straight line

C. Matching principle: match income for the period with expenses for the period. The asset declines in value over time due to wear and tear and obsolescence resulting in a need to record this expense.

D. Factors:

- Cost of asset
- Estimated useful life
- Scrap value
- Straight line or reducing balance.

E. Decline in value:

- **Wear and tear** – non-current assets that are mechanical, such as motor vehicles and machinery, and those which are electrical, such as computers, all decline in value due to wear and tear.
- **Commercial obsolescence** – this is when equipment has no further use (is obsolete) due to a decline in the market demand for the goods or services in the production of which the asset is used. This can affect both machinery and computer software.
- **Technical obsolescence** – when the asset becomes out of date and inefficient due to new technologies. This affects computer software.

2. DEPRECIATION CALCULATIONS

A. Assuming no scrap value:

Furniture would have been depreciated using the straight line method.

Depreciation of Office Furniture = $\frac{50\,000 - 30\,000}{5}$

= $4 000 per year.

B. Depreciation of Gym Equipment = $\frac{40\,000 - 3\,000}{7}$

= $5 286 per year.

C. Depreciation of Computer:

Year	Calculation	Depreciation	Diminished balance (written down value)
Year 1	30% of $6 000	$1 800	$4 200
Year 2	30% of $4 200	$1 260	$2 940
Year 3	30% of $2 940	$882	$2 058

D. Depreciation of Factory = $\frac{2\,000\,000}{30}$

= $66 667 per year.

E. Depreciation of Motor Vehicle = 50 000 x 20/100

= $10 000 per year.

3. STRAIGHT-LINE METHOD

A. Calculations:

Depreciation expense for hardware equipment = 10 000 x 10/100

= $1 000

Depreciation expense for office equipment = 15 000 x 10/100 x 11/12

= $1 375

Tim The Tool Man
General Ledger (extract)

Hardware Equipment

2018						
1 July	*Cash at Bank*	10 000				

Office Equipment

2018						
30 June	*Cash at Bank*	15 000				

Depreciation of Equipment

2019						
30 June	*Accumulated Depreciation of Equipment*	2 375				

Accumulated Depreciation of Equipment

				2019		
				30 June	*Depreciation of Equipment*	2 375

General Journal (extract)

Date	Details	Debit $	Credit $
2019 30 June	Depreciation of Equipment Accumulated Depreciation of Equipment *Depreciation expense for year*	2 375	 2 375

Tim the Tool Man
Balance Sheet (extract)
30 June 2019

NON-CURRENT ASSETS

Equipment	25 000	
Less: Accumulated depreciation of equipment	2 375	22 625

B. *Bananas in Bathers*

Depreciation expense = 30 000 x 0.25 x 9/12
= $5 625

General Ledger (extract)

Pool Equipment

2019					
1 Oct	*Accounts Payable*	30 000			

Depreciation of Pool Equipment

2019					
30 June	*Accumulated Depreciation of Pool Equipment*	5 625			

Accumulated Depreciation of Pool Equipment

			2020		
			30 June	*Depreciation of Equipment*	5 625

General Journal (extract)

Date	Details	Debit $	Credit $
2020 30 June	Depreciation of Pool Equipment Accumulated Depreciation of Pool Equipment *Depreciation expense for year*	5 625	5 625

Bananas in Bathers
Balance Sheet (extract)
30 June 2020

	$	$
NON-CURRENT ASSETS		
Pool equipment	30 000	
Less: Accumulated depreciation of pool equipment	5 625	24 375

C. *Nelson Supermarket Holdings*

Depreciation expense	=	$\frac{60\,000}{10}$
	=	$6 000
Owned for 11 months	=	6 000 x 11/12
	=	$5 500

General Ledger (extract)

Fittings

2019					
1 Aug	*Accounts Payable*	60 000			

Depreciation of Fittings

2020					
30 June	*Accumulated Depreciation of Fittings*	5 500			

Accumulated Depreciation of Fittings

			2016		
			30 June	*Depreciation of Fittings*	5 500

General Journal (extract)

Date	Details	Debit $	Credit $
2020 30 June	Depreciation of Fittings Accumulated Depreciation of Fittings *Depreciation expense for 11 months*	5 500	 5 500

Nelson Supermarket Holdings
Balance Sheet (extract)
30 June 2020

	$	$
NON-CURRENT ASSETS		
Fittings	60 000	
Less: Accumulated depreciation of fittings	5 500	54 500

D. *Bikes n' Boxing*

Purchase of asset in 2018

Depreciation expense = $\frac{30\,000}{10}$

= $3 000 per year.

In 2019, depreciation expense is for 6 months only:

Depreciation = 3 000 x 6/12

= $1 500

General Ledger (extract)

Gym Equipment

2018					
1 Dec	*Accounts Payable*	30 000			

Depreciation of Gym Equipment

2019			2019		
30 June	*Accumulated Depreciation of Gym Equipment*	1 500	30 June	*Profit and Loss*	1 500
2020					
30 June	*Accumulated Depreciation of Gym Equipment*	3 000			

Accumulated Depreciation of Equipment

2019			2019		
30 June	*Balance c/d*	1 500	30 June	*Depreciation of Gym Equip't*	1 500
		1 500			1 500
2020			2020		
	Balance c/d	4 500	1 July	*Balance b/d*	1 500
		4 500	30 June	*Depreciation of Gym Equip't*	3 000
					4 500
				Balance b/d	4 500

General Journal (extract)

Date	Details	Debit $	Credit $
2019 30 June	Depreciation of Gym Equipment Accumulated Depreciation of Gym Equipment *Depreciation expense for 6 months of year*	1 500	 1 500
2020 30 June	Depreciation of Gym Equipment Accumulated Depreciation of Gym Equipment *Depreciation expense for year*	3 000	 3 000

Bikes n' Boxing
Balance Sheet (extract)
30 June 2019

	$	$
NON-CURRENT ASSETS		
Gym equipment	30 000	
Less: Accumulated depreciation of gym equipment	1 500	28 500

Bikes n' Boxing
Balance Sheet (extract)
30 June 2020

	$	$
NON-CURRENT ASSETS		
Gym equipment	30 000	
Less: Accumulated depreciation of gym equipment	4 500	25 500

4. REDUCING/DIMINISHING BALANCE METHOD

A. *The Giggles*

Depreciation expense for music equipment = 20 000 x 0.20
= $4 000

Depreciation expense for van = 35 000 x 0.20 x 10/12
= $5 833

General Ledger (extract)

Music Equipment

2021					
1 July	*Cash at Bank*	20 000			

Delivery Van

2021					
31 Aug	*Cash at Bank*	35 000			

Depreciation of Equipment

2022					
30 June	*Accumulated Depreciation of Equipment*	4 000			

Accumulated Depreciation of Pool Equipment

			2022		
			30 June	*Depreciation of Equipment*	4 000

Depreciation of Delivery Van

2022					
30 June	*Accumulated Depreciation of Delivery Van*	5 833			

Accumulated Depreciation of Delivery Van

			2022		
			30 June	*Depreciation of Delivery Van*	5 833

General Journal (extract)

Date	Details	Debit	Credit
2022 30 June	Depreciation of Equipment Accumulated Depreciation of Equipment *Depreciation expense for year*	4 000	4 000
	Depreciation of Delivery Van Accumulated Depreciation of Delivery Van *Depreciation expense for 10 months of year*	5 833	5 833

The Giggles
Balance Sheet (extract)
30 June 2022

NON-CURRENT ASSETS		
Equipment	20 000	
Less: Accumulated depreciation of equipment	4 000	16 000
Delivery Van	35 000	
Less: Accumulated depreciation of delivery van	5 833	29 167

B. *Howling Hounds*

Calculations:

Depreciation expense for 2021 = 40 000 x 0.10 x 10/12
= \$3 333
Depreciation expense for 2022 = (40 000 – 3 333) x 0.10
= \$3 667

General Ledger (extract)

Depreciation of Kennels

2021			2021		
30 June	*Accumulated Depreciation of Kennels*	3 333	30 June	*Profit and Loss*	3 333
2022					
30 June	*Accumulated Depreciation of Kennels*	3 667			

Accumulated Depreciation of Pool Equipment

2021			2021		
30 June	*Balance c/d*	3 333	30 June	*Depreciation of Kennels*	3 333
		3 333			3 333
2022			2022		
June	*Balance c/d*	7 000	1 July	*Balance b/d*	3 333
		7 000	30 June	*Depreciation of Kennels*	3 667
					7 000
				Balance b/d	7 000

General Journal (extract)

Date	Details	Debit $	Credit $
2021 30 June	Depreciation of Kennels Accumulated Depreciation of Kennels *Depreciation expense for 10 months of year*	3 333	3 333
2022 30 June	Depreciation of Kennels Accumulated Depreciation of Kennels *Depreciation expense for year*	3 667	3 667

Howling Hounds
Balance Sheet (extract)
30 June 2021

	$	$
NON-CURRENT ASSETS		
Kennels	40 000	
Less: Accumulated depreciation of kennels	3 333	36 667

Howling Hounds
Balance Sheet (extract)
30 June 2022

	$	$
NON-CURRENT ASSETS		
Kennels	40 000	
Less: Accumulated depreciation of kennels	7 000	33 000

C. *Pascal's Foreign Language School*

2021	Depreciation expense	=	17 000 x 0.15
		=	$2 550
2022	Depreciation expense	=	(17 000 - 2 550) x 0.15
		=	$2 167

Pascal's Foreign Language School
Balance Sheet (extract)
30 June 2021

	$	$
NON-CURRENT ASSETS		
Sound equipment	17 000	
Less: Accumulated depreciation of sound equipment	2 550	14 450

Pascal's Foreign Language School
Balance Sheet (extract)
30 June 2022

	$	$
NON-CURRENT ASSETS		
Sound equipment	17 000	
Less: Accumulated depreciation of sound equipment	4 717	12 282

5. NATURE OF DEPRECIATION

What is depreciation?

- the allocation of the cost of an asset over its useful life – the period in which benefits are expected to be derived
- spread cost of an asset over the period of time it is used to generate income
- account for the loss in value of the asset through time, wear and tear and obsolescence.

Why should the motor vehicle and office equipment be depreciated?

- allow the business to show a gradual decline in the future economic benefits provided by the motor vehicle and office equipment
- these assets depreciate due to wear and tear from their constant use
- ongoing maintenance and repairs can help to extend their useful life however at some stage they will require replacement

The matching principle and how it relates to depreciation

- matching of all income in an accounting period against all the associated expenses
- the vehicle and equipment are to be used to earn income for the business, so their decline in value needs to be offset against the income earned

Is depreciation tax deductable?

- By depreciating the asset, this loss in value is turned into a legitimate business expense. The expense is treated like any other expense by being charged against income for the calculation of the accounting period profit.

Methods to calculate depreciation expense

- Straight line – the same amount of depreciation is charged on the original cost of the asset each period. Used when the asset is expected to contribute evenly to the income earning activities of the business over its useful life.
- Diminishing balance – a fixed percentage of depreciation is charged on the diminishing balance, not the original cost of the asset, each period. Used when more economic benefits are expected in the early years of an asset's life.

The depreciation that best suits these assets

- straight line for the equipment, as this provides a constant charge of depreciation in every reporting period
- equipment provides a consistent contribution to the income earning of the business
- diminishing balance for the vehicle, as there will be a decreasing charge of depreciation in every reporting period

How depreciation is recorded in the accounting records

- to record the depreciation of an asset, an entry is made in the general journal and then posted to the ledger
- general journal entry – depreciation is a debit entry as it is an expense, accumulated depreciation is a credit entry as it is reducing the value of the asset.
- general ledger entry – the depreciation account is debited as it is an expense. The accumulated depreciation account is credited as it is reducing the value of the asset.

Does the depreciation of non-current assets set aside cash so that the assets can be replaced?

- no, it is a book entry only
- book value (or carrying amount) is the actual cost minus the accumulated depreciation and is only the unallocated cost

6. EFFECT OF DEPRECIATION METHOD ON THE REPORTS

Discussion question. Possible responses include:

- While the choice of depreciation method does not change the total deprecation allocated over the useful life of the asset, it affects the timing of the expensing of the asset
- In comparison to the straight line method, the reducing balance method will have a higher depreciation charge in the earlier years of the life of Taylor's sewing machines. This results in a lower profit in earlier years and correspondingly a higher profit in the later years of the asset life
- Depreciation requires estimation that results in matching of all income in an accounting period against all associated expenses
- The depreciation method that is chosen should be applied consistently and selected as the most appropriate one for the pattern of use of the sewing machines
- The matching principle therefore requires the charging of cost that reflects this pattern of use and of the benefits derived from use
- In reality, there is a lot of subjectivity in the decisions made about the residual/scrap value, estimated useful life and pattern of use/ depreciation method for any asset. The only certainty is the initial value paid for the asset.

7. COMPARISON OF DEPRECIATION METHODS

	2020	**2021**	**2022**
Barking Dog Obedience School	84 000	88 400	90 000
The Perfect Pampered Pooch Academy	68 000	76 000	85 000

A. Annual and total depreciation:

Barking Dog Obedience School

Annual depreciation expense for building = $\frac{320\,000 - 20\,000}{40}$

= **\$7 500 per year.**

Total depreciation for 3 years = \$22 500

The straight line rate (building) = $\frac{100\%}{40}$

= 2.5%

Depreciation expense for equipment = $\frac{110\,000 - 10\,000}{10}$

= **\$10 000 per year.**

Total depreciation for 3 years = \$30 000

The straight line rate (equipment) = $\frac{100\%}{10}$

= 10%

The Perfect Pampered Pooch Academy

2020 depreciation expense for building = 320 000 x 5/100
= **\$16 000**

2021 depreciation expense for building = (320 000 – 16 000) x 5/100
= **\$15 200**

2022 depreciation expense for building = (320 000 – 31 200) x 5/100
= **\$14 440**

Total depreciation for 3 years = \$45 640

2020 depreciation expense for equipment = 110 000 x 20/100
= **\$22 000**

2021 depreciation expense for equipment = (110 000 – 22 000) x 20/100
= **\$17 600**

2022 depreciation expense for equipment = (110 000 – 39 600) x 20/100
= **\$14 080**

Total depreciation for 3 years = \$53 680

B. Comparative data:

Barking Dog Obedience School			
Profit	84 000	88 400	90 000
Add: Depreciation	17 500	17 500	17 500
	\$101 500	**\$105 900**	**\$107 500**

The Perfect Pampered Pooch Academy			
Profit	68 000	76 000	85 000
Add: Depreciation	38 000	32 800	28 520
	\$106 000	**\$108 000**	**\$113 520**

8. INTERPRETATION OF ASSET REGISTER

A. Annual depreciation 2019 to 2022 = $10 000

Total depreciation = $40 000

B. Written down value in 2020 = $40 000

C.

General Journal (extract)

Date	Details	Debit $	Credit $
2021 30 June	Depreciation of Vehicle Accumulated Depreciation of Vehicle *Depreciation expense for year*	10 000	 10 000

D. Accumulated depreciation on 30 June 2021 = $30 000

E. and F. and G.

General Ledger (extract)

Vehicle

1/07/18	*Creditor*	60 000			

Profit and Loss (extract)

30/06/19	*Depreciation of Vehicle*	10 000			
30/06/20	*Depreciation of Vehicle*	10 000			
30/06/21	*Depreciation of Vehicle*	10 000			
30/06/22	*Depreciation of Vehicle*	10 000			

Depreciation of Vehicle

30/06/19	*Acc Depreciation of Vehicle*	10 000	30/06/19	*Profit and Loss*	10 000
30/06/20	*Acc Depreciation of Vehicle*	10 000	30/06/20	*Profit and Loss*	10 000
30/06/21	*Acc Depreciation of Vehicle*	10 000	30/06/21	*Profit and Loss*	10 000
30/06/22	*Acc Depreciation of Vehicle*	10 000	30/06/22	*Profit and Loss*	10 000

Accumulated Depreciation of Vehicle

			30/06/19	Depreciation of Vehicle	10 000
			30/06/20	Depreciation of Vehicle	10 000
					20 000
				Balance b/d	20 000
			30/06/21	Depreciation of Vehicle	10 000
				Balance b/d	30 000
					30 000
			30/06/22	Depreciation of Vehicle	10 000
					40 000
				Balance b/d	40 000

Balance Sheet (extract)
30 June 2022

NON-CURRENT ASSETS		
Vehicle	60 000	
Less: Accumulated depreciation of vehicle	40 000	20 000

9. DEPRECIATION COSTS

A.

i.	Factory	Removal of trees on building location	**Yes, Subsequent Cost**
ii.	Office block	Local celebrity hired to open the building	**No**
iii.	New machinery	Concrete pad to hold machinery	**Yes, Subsequent Cost**
iv.	New machinery	Advertising for the new product that machinery can manufacture	**No**
v.	Equipment	Salary of the mechanic who installed the equipment	**Yes, Subsequent Cost**
vi.	Equipment	Salary of staff member in charge of cleaning the equipment	**No**
vii.	Land	Land ownership transfer fees	**Yes, Subsequent Cost**
viii.	Land	Surveyors' fees	**No**

B.

- **Cost Model:** Assets are carried (in the accounts) at their cost less accumulated depreciation (and less any impairment losses).
- **Revaluation Model:** If the fair value can be measured reliably, the assets can be carried at their revalued amount less accumulated depreciation (and less any impairment losses).

C. Discussion question. Tends to be used when a business is likely to be sold or requires the revaluing of assets for purposes such as lending.

10. BAD DEBTS

A. **Bad debts** are debts that are written off as not expected to be paid by debtors.

Debtors control (or the Debtors account or Accounts Receivable account) is the account where the credit sales/fees to customers are recorded.

Allowance for doubtful debts is an account used to estimate the likely proportion of bad debts for the period.

11. CORRECT THE ERRORS

Machinery

Balance	130 000	*Sale of asset*	130 000

Accumulated Depreciation of Machinery

Sale of asset	127 000	*Balance*	127 000

Debtor – Production Lines Ltd

Sale of asset	27 000		

Sale of Asset

Motor vehicle	130 000	*Acc. dep. of machinery*	127 000
Profit on disposal	24 000	*Production Lines Ltd*	27 000

Profit on Disposal

		Sale of asset	24 000

12. CASE STUDY

Discussion question. Responses could cover:

The impact of changing methods on the accounting reports that are produced. The method that is chosen should be applied consistently.

The purpose of depreciation is an allocation process. It spreads the cost of an asset over the period of time the asset is used to generate income. From the first day that an asset is purchased it begins to loose value. Assets are depreciated so that the business can account for the loss in value of the asset through time, wear and tear and obsolescence. By depreciating the asset, this loss in value is turned into a legitimate business expense. The expense is treated like any other expense by being charged against income for the calculation of the accounting period profit.

The reason for bad debt estimates is to ensure a more accurate matching of income and expenses to the relevant accounting period. It is an estimation made on balance day of the amount of the current Accounts Receivable/Debtors that will not pay in the next accounting period.

The aim is to meet the requirements of accounting principles to provide a true and fair view, and the accrual concept. By depreciating non-current assets, and providing for potential bad debts, the business can recognise expenses in the accounting period in which the economic benefits are consumed or expire.

13. INITIAL AND SUBSEQUENT COSTS

Note that answers may vary, and will depend upon the justification given for asset recognition. Responses should use the definitions of initial and subsequent costs:

- The initial cost is the total amount paid to purchase the asset. Some costs associated with property, plant and equipment may not directly increase the future economic benefits produced by a specific asset. These costs might be important however, because they allow the entity to gain economic benefits from other assets. For example, the cost of part of property, plant or equipment required for safety or environmental reasons is included as an asset.
- Subsequent costs occur after purchasing an asset, there are some costs of using the asset that will not be considered expenses, because they are not consumptions of future economic benefits. These costs are usually permanent changes or additions to the asset, and if their cost can be measured reliably, they are included as part of the asset and will be depreciated.

A. $1 012 000

B. $501 300

C. $2 006 000

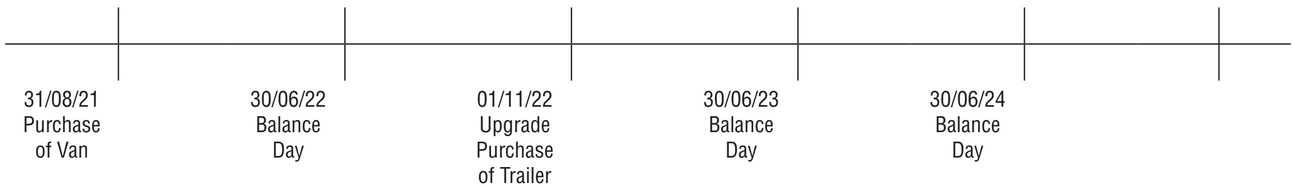
D. $54 500

E. $5 150

14. CALCULATING DEPRECIATION WITH SUBSEQUENT COSTS

A. The Giggles

i. Working out: Time line:



Deprectiation of Trailer:

Year	Calculation	Depreciation Expense	Accumulated Depreciation	Carrying Amount (W.D.V)
2022	6000 x 15% x 8/12	600	600	5400
2023	(6000 – 600) x 15%	810	1410	4590

Depreciation of Van:

Year	Calculation	Depreciation Expense	Accumulated Depreciation	Carrying Amount (W.D.V)
2021	35000 x 15% x 10/12	4375	4375	30635
2022	(35000 – 4375) x 15%	4594	8969	26031
2023	(35000 – 8969) x 15%	3905	12874	22126

Depreciation of Upgrade (to be added to van depreciation):

Year	Calculation	Depreciation Expense	Accumulated Depreciation	Carrying Amount (W.D.V)
2022	5000 x 15% x 8/12	500	500	4500
2023	(5000 – 500) x 15%	675	1175	3825

General Ledger (extract)

Van

31/08/20	*Creditor*	35 000			
01/11/21	*Creditor*	5 000			

Trailer

01/11/21	*Creditor*	6 000			

Accumulated Depreciation – Van

			30/06/21	*Depreciation – Van*	4 375
			30/06/22	*Depreciation – Van*	5 094
			30/06/23	*Depreciation – Van*	4 580

Accumulated Depreciation – Trailer

			30/06/21	*Depreciation – Trailer*	600
			30/06/22	*Depreciation – Trailer*	810

Depreciation – Van

30/06/21	*Acc. Depreciation*	4 375			
30/06/22	*Acc. Depreciation*	5 094			
30/06/23	*Acc. Depreciation*	4 580			

Depreciation – Trailer

30/06/22	*Acc. Depreciation*	600			
30/06/23	*Acc. Depreciation*	810			

ii.

The Giggles
Balance Sheet (extract)
As at 30 June:

	2022	2023
NON-CURRENT ASSETS		
Van	40 000	40 000
Less: Accumulated Depreciation – Van	9 469	14 049
	30 531	25 951
Trailer	6 000	6 000
Less: Accumulated Depreciation – Trailer	600	1 415
	5 400	4 590

B. Grer's Groceries

i. Depreciation of Machinery at 10%

Year	Calculation	Depreciation Expense	Accumulated Depreciation	Carrying Amount (W.D.V)
2015	300 000 x 0.10 x 6/12	15 000	15 000	285 000
2016	300 000 x 0.10	30 000	45 000	255 000
2017	300 000 x 0.10	30 000	75 000	225 000
2018	300 000 x 0.10	30 000	105 000	195 000
2019	300 000 x 0.10	30 000	135 000	165 000

Depreciation of Upgrade at 20% straight line

Year	Calculation	Depreciation Expense	Accumulated Depreciation	Carrying Amount (W.D.V)
2018	44 000 x 0.20	8 800	8 800	35 200
2019	44 000 x 0.20	8 800	17 600	26 400

General Ledger (Extract)

Machinery

Date	Details	Amount	Date	Details	Amount
01/01/15	*Creditor*	300 000			
01/07/17	*Creditor*	44 000		*Balance c/d*	344 000
		344 000			344 000
	Balance b/d	344 000			

Creditor – Mels Machines

Date	Details	Amount	Date	Details	Amount
			01/01/15	*Machinery*	300 000
	Balance c/d	344 000	01/07/17	*Machinery*	44 000
					344 000
				Balance b/d	344 000

Accumulated Depreciation – Machinery

			30/06/15	*Depreciation – Machinery*	15 000
	Balance c/d	45 000	30/06/16	*Depreciation – Machinery*	30 000
		45 000			45 000
				Balance b/d	45 000
	Balance c/d	75 000	30/06/17	*Depreciation – Machinery*	30 000
		75 000			75 000
				Balance b/d	75 000
	Balance c/d	113 800	30/06/18	*Depreciation – Machinery*	38 800
		113 800			113 800
				Balance b/d	113 800
	Balance c/d	152 600	30/06/19	*Depreciation – Machinery*	38 800
		152 600			152 600
				Balance b/d	152 600

Depreciation – Machinery

30/06/15	*Acc. Depreciation*	15 000			
30/06/16	*Acc. Depreciation*	30 000			
30/06/17	*Acc. Depreciation*	30 000			
30/06/18	*Acc. Depreciation*	38 800			
30/06/19	*Acc. Depreciation*	38 800			

ii.

Grer's Groceries
Balance Sheet (extract)
As at 30 June

	2018	**2019**
NON-CURRENT ASSETS		
Machinery	344 000	344 000
Less: Accumulated Depreciation – Machinery	113 800	152 600
	230 200	**191 400**

iii.

Depreciation of Upgrade at 15% reducing balance

Year	Calculation	Depreciation Expense	Accumulated Depreciation	Carrying Amount (W.D.V)
2018	44 000 x 0.15	6 600	6 600	37 400
2019	37 400 x 0.15	5 610	12 210	31 790

Grer's Groceries
Balance Sheet - Comparison
As at 30 June

	2018	**2019**
NON-CURRENT ASSETS		
Machinery	344 000	344 000
Less: Accumulated Depreciation – Machinery	111 600	147 210
	232 400	**196 790**

C. Eclectic Electrics

Shop fixtures and fittings

The most appropriate method of depreciation is straight line, with a residual value of 0 and a estimated life of 10 years.

Calculations:

Depreciable amount on 4 January 2016	=	$2 000
Additional depreciable amount on 6 August 2016	=	4 400 + 500 + 400 + 3000
	=	$8 300

Depreciation of Fixtures and Fittings at 10%:

Year	Calculation	Depreciation Expense	Accumulated Depreciation	W.D.V.
2019	2 000 x 0.10 x 177/365	97	97	1 903
2020	2 000 x 0.10	200	297	1 703

Depreciation of upgrade at 10%:

Year	Calculation	Depreciation Expense	Accumulated Depreciation	W.D.V.
2020	8 300 x 0.1 x 328/365	746	746	7 554

General Ledger (Extract)

Accumulated Depreciation – Fixtures and Fittings

	Balance c/d	97	30/06/16	*Depreciation – F&F*	97
		97			97
				Balance b/d	97
	Balance c/d	1 043	30/06/17	*Depreciation – F&F*	946
		1 043			1 043
				Balance b/d	1 043

Depreciation – Fixtures and Fittings

30/06/19	*Acc. Depr. Fixtures & Fittings*	97			
30/06/20	*Acc. Depr. Fixtures & Fittings*	946			

Eclectic Electrics
Balance Sheet (extract)
As at 30 June

	2019	2020
NON-CURRENT ASSETS		
Fixtures and Fittings	2 000	10 300
Less: Accumulated Depreciation – Fixtures and Fittings	97	1 043
	1 903	**9 257**

D. Ned's Netball Paraphernalia

The changeroom modifications $600 and replacement shelves $400 would be depreciated. A usual depreciation rate for furniture and fittings is 10% per annum straight line. May also choose to depreciate the barcode scanner – discuss your assumptions with your teacher.

Assuming a 10% depreciation rate, the Balance Sheet would appear as follows:

Ned's Netball Paraphernalia
Balance Sheet (extract)
As at 31 December

	2021	**2022**	**2023**
NON-CURRENT ASSETS			
Furniture and Fittings	1 000	1 000	1 000
Less: Accumulated Depreciation – Furn. and Fit.	92	192	292
	908	**808**	**708**

15. JOURNAL AND LEDGER ENTRIES FOR SALE OF ASSET

A. Shilling n' Dimes

i. Gain or loss on disposal = Proceeds – Carrying amount
= 4 000 – (20 000 – 15 000)
= 4 000 – 5 000
= $1 000 Loss

ii.

Shilling n' Dimes
General Journal

DATE	DETAILS	DEBIT $	CREDIT $
1 May	Sale of Asset	20 000	
	Furniture and Fittings		20 000
	Transfer of cost of furniture and fittings sold.		
1 May	Accumulated Depreciation of Furniture and Fittings	15 000	
	Sale of Asset		15 000
	Transfer of accumulated depreciation of furniture and fittings sold.		
1 May	Cash at Bank	4 400	
	Sale of Asset		4 000
	GST Collected		400
	Proceeds received from sale of furniture and fittings.		
1 May	Loss on Disposal	1 000	
	Sale of Asset		1 000
	Loss on disposal of furniture and fittings.		

iii. ***Shilling n' Dimes***

General Ledger

Furniture and Fittings (A)

1 May	*Balance*	20 000	1 May	*Sale of Asset*	20 000

Accumulated Depreciation of Furniture and Fittings (A)

1 May	*Sale of Asset*	15 000	1 May	*Balance*	15 000

Cash at Bank (A)

1 May	*Sale of Asset/GST*	4 400			

Sale of Asset

1 May	*Motor Vehicle*	20 000	1 May	*Accum. Depr. of Motor Vehicle*	15 000
				Cash at Bank	4 000
				Loss on disposal	1 000

Loss on Disposal

1 May	*Sale of Asset*	1 000			

iv. Gain or loss on disposal = Proceeds – Carrying amount
= 6 000 – (20 000 – 15 000)
= 6 000 – 5 000
= $1 000 Profit.

B. Marvelous Mobile Moggies

i. Gain or loss on disposal = Proceeds – Carrying amount
= 2 000 – (10 000 – 4 375)
= 2 000 – 5 625
= $3 625 Loss

ii. Marvelous Mobile Moggies

General Journal (extract)

DATE	DETAILS	DEBIT $	CREDIT $
1 Mar	Sale of Asset	10 000	
	Trailer		10 000
	Transfer of cost of trailer sold.		
1 Mar	Accumulated Depreciation of Trailer	4 375	
	Sale of Asset		4 375
	Transfer of accumulated depreciation of trailer sold.		
1 Mar	Cash at Bank	2 200	
	Sale of Asset		2 000
	GST Collected		200
	Proceeds received from sale of trailer.		
1 Mar	Loss on Disposal	3 625	
	Sale of Asset		3 625
	Loss on disposal of trailer.		

iii.

Marvelous Mobile Moggies
General Ledger

Trailer(A)

1 Mar	*Balance*	10 000	1 Mar	*Sale of Asset*	10 000

Accumulated Depreciation of Trailer (A)

1 Mar	*Sale of Asset*	4 375	1 Mar	*Balance*	4 375

Cash at Bank (A)

1 Mar	*Sale of Asset*	2 000			

Sale of Asset

1 Mar	*Motor Vehicle*	10 000	1 Mar	*Accum. Depr. of Trailer*	4 375
				Cash at Bank	2 000
				Loss on disposal	3 625

Loss on Disposal

1 Mar	*Sale of Asset*	3 625			

C. Narnia Magic Shoppee

i. Gain or loss on disposal = Proceeds – Carrying amount
= 1 000 – (2 300 – 770.50)
= 1 000 – 1529.50
= $529.50 Loss

ii.

General Journal (extract)

DATE	DETAILS	DEBIT $	CREDIT $
1 Mar	Sale of Asset Equipment Transfer of cost of computer equipment sold.	2 300	 2 300
1 Mar	Accumulated Depreciation of Equipment Sale of Asset Transfer of accumulated depreciation.	770.50	 770.50
1 Mar	Cash at Bank Sale of Asset GST Collected Proceeds received from sale of equipment.	1 100	 1 000 100
1 Mar	Loss on Disposal Sale of Asset Loss on disposal of eqipment.	529.50	 529.50

iii. **General Ledger**

Computer Equipment (A)

1 May	*Balance*	2 300	*1 May*	*Sale of Asset*	2 300

Accumulated Depreciation of Equipment (-A)

1 May	*Sale of Asset*	770.50	*1 May*	*Balance*	770.50

Cash at Bank (A)

1 May	*Sale of Asset*	1 100			

Sale of Asset

			1 May	*Accum. Depr. of Equipment*	770.50
				Cash at Bank	1 100.00
1 May	*Computer equipment*	2 300		*Loss on Disposal*	529.50

Loss on Disposal

1 May	*Sale of Asset*	529.50			

iv. Ask for another sale price

D. Tom's Tutoring

i. Gain or loss on disposal = Proceeds – Carrying amount
= 500 – 100
= $400 Profit

ii.

Tom's Tutoring
General Journal (extract)

DETAILS	DEBIT $	CREDIT $
Sale of Asset	6 000	
Motor Vehicle		6 000
Transfer of cost of vehicle sold.		
Accumulated Depreciation of Motor Vehicle	5 900	
Sale of Asset		5 900
Transfer of accumulated depreciation of vehicle sold.		
Cash at Bank	550	
Sale of Asset		500
GST Collected		50
Proceeds received from sale of motor vehicle.		
Sale of Asset	400	
Profit on Disposal		400
Profit on disposal of motor vehicle.		

Tom's Tutoring
General Ledger (extract)

Motor Vehicle

Opening Balance	6 000	*Sale of Asset*	6 000

Accumulated Depreciation of Motor Vehicle

Sale of Asset	5 900		

Cash at Bank (A)

Sale of Asset	500		

Sale of Asset

Motor Vehicle	6 000	*Accum. Depr. of Motor Vehicle*	5 900
Profit on Disposal	400	*Cash at Bank*	500

Profit on Disposal

		Sale of Asset	400

16. CALCULATING GAIN OR LOSS AND GENERAL JOURNAL

A. Depreciation calculation:

Year ending 30 June	Accumulated depreciation	Written Down Value
2017	5/12 x 61000 x 15% = $3812.50	$57 187.50
2018	57187.50 x 15% = $8578.12	$48 609.38
2019	WDV x 15% = $7291	$41 317
2020	WDV x 15% = $6198	$35 119

Carrying amount = $35 119
Gain or loss on disposal = 35 119 – 30 000
= $ 5119 LOSS

B. A loss on disposal indicates that the delivery van was under depreciated. This is a book entry only, not and actual cash outflow. It shows that Sammi's estimate of the value of the van is greater than the amount that someone else is willing to trade it in for.

C. General Journal (extract)

DATE	DETAILS	DEBIT $	CREDIT $
2020	Sale of Asset	61 000	
30 June	Motor Vehicle		61 000
	Transfer of cost of delivery van sold.		
	Accumulated Depreciation of Motor Vehicle	25 881	
	Sale of Asset		25 881
	Transfer of accumulated depreciation of van sold.		
	Cash at Bank	33 000	
	Sale of Asset		30 000
	GST Collected		3 000
	Proceeds received from sale of van.		
	Loss on Disposal	5 119	
	Sale of Asset		5 119
	Loss on disposal of van.		

17. CALCULATING GAIN OR LOSS ON DISPOSAL AND THE INCOME STATEMENT

A. Miles – PR Consultant

i. Gain/Loss on Disposal = Proceeds – Carrying Amount
= 3 000 – 4 000
= $1 000 Loss

ii. The loss is an expense in the Income Statement.

B. Dominic – White water rafting

i. Gain/Loss on Disposal = Proceeds – Carrying Amount
= 5 500 – 4 000
= $1 500 Profit

ii. The gain (or profit) on disposal indicates that the rafts were over depreciated.

C. Fancy Plants

Workings:

Year ending	Calculation	Accumulated Depreciation	Carrying Amount (W.D.V)
1 Jan 2023	50 000 x 15%	7 500	42 500
1 Jan 2024	(50 000 – 7 500) x 15%	13 875	36 125
1 Jan 2025	(50 000 – 13875) x 15%	19 294	30 706
1 Jan 2026	(50 000 – 19294) x 15%	23 900	26 100

i. Gain/Loss on Harry's Offer = Proceeds – Carrying Amount
= 25 000 – 26 100
= $1 100 Loss

Gain/Loss on Henrietta's Offer = 30 000 – 26 100
= $39 000 Profit

ii.

Income Statement (extract):	**Harry**	**Henrietta**
Income		
Proceeds from sale of motor vehicle	25 000	30 000
Expenses		
Carrying amount of motor vehicle	26 100	26 100

18. ESTIMATING BAD DEBTS AND SHOWING BALANCE SHEET ENTRIES

A.

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
2017	Bad Debts	600	
1 July	Allowance for Doubtful Debts		600
	Increase balance of allowance for doubtful debts.		
2018	Bad Debts	200	
1 May	GST Collected	20	
	Accounts Receivable		220
	Account written off as a bad debt.		
1 May	Allowance for Doubtful Debts	800	
	Bad Debts		800
	Transfer balance of bad debts.		

Balance Sheet (extract)

ASSETS	Before Write-off	After Write-off
Accounts Receivable	5 000	4 780
LESS: Allowance for Doubtful Debts	500	300
Total	4 500	4 480

General Ledger

Bad Debts

31/12/17	*Allowance for Doubtful Debts*	600			

Allowance for Doubtful Debts

1/5/18	*Creditors*	200	31/12/17	*Bad debts*	600

Creditors

	Balance	5 000	1/05/18	*Allowance for Doubtful Debts*	220

GST Collected

1/05/18	*Creditors*	20			

19. COMPARISON OF DEPRECIATION AND VALUATION METHODS

Discussion question. Responses could cover:

Purpose of depreciation as the allocation of the cost of an asset over its useful life - the period in which benefits are expected to be derived. Important to spread cost of an asset over the period of time it is used to generate income

Need to account for the loss in value of the asset through time, wear and tear and obsolescence, and to do this by matching of all income in an accounting period against all the associated expenses

The decline in value of the equipment and machinery needs to be offset against the income earned. Reducing balance depreciation best suits the machinery, vehicle and computing equipment, as this provides a decreasing charge of depreciation in every reporting period and these assets provides a great contribution to the income earning of the business at the start of their useful life

Initial costs and subsequent costs.

The purpose of depreciation is an allocation process. It spreads the cost of an asset over the period of time the asset is used to generate income. From the first day that an asset is purchased it begins to loose value. Assets are depreciated so that the business can account for the loss in value of the asset through time, wear and tear and obsolescence. By depreciating the asset, this loss in value is turned into a legitimate business expense. The expense is treated like any other expense by being charged against income for the calculation of the accounting period profit.

The aim is to meet the requirements of accounting principles to provide a true and fair view, and the accrual concept. By depreciating non-current assets, the business can recognise expenses in the accounting period in which the economic benefits are consumed or expire.

20. BAD DEBTS AND REVIEW OF CLOSING ENTRIES

A.

Profit and Loss

Date	Particulars	Debit	Date	Particulars	Credit
2020	Cost of sales	76000	2020	Sales	172700
30 June	Internet	1200	30 June	Interest	1900
	Depreciation	5400			
	Bad debts/ Doubtful debts	7955*			
	Supplies	5300			
	Rent expense	6000			
	Interest expense	4200			
	Delivery costs	1900			
	Advertising	8100			
	Electricity	1490			
	Salaries	92300			
	Telephone	1200			
	Loss	36445			

*Note: Account is dependent on method chosen for Part B.

GST Clearing

Date	Details	Debit	Date	Details	Credit
2020 30 June	GST Credits	1000	2020 30 June	GST Collected	3000

B. 5% of sales = $8635

There are two valid solutions, depending on if student has learnt the Doubtful debts (expense) account or not.

Method 1:

Allowance for Doubtful Debts

Bad debts	320	Balance	1000
		Bad debts	7955

Method 2:

Allowance for Doubtful Debts

Bad debts	320	Balance	1000
		Doubtful debts	7955

CHAPTER 12: RECOGNITION AND CLASSIFICATION

Review Questions 12.1

1. *Define each of the elements of financial statements: asset, liability, equity, income and expense.*

An **asset** is a resource controlled by the entity (business) as a result of past events and from which future economic benefits are expected to flow to the entity.

A **liability** is a present obligation of the entity resulting from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Equity is the residual (remaining) interest in the assets of the entity (business) after deduction of its liabilities.

Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

2. *Outline the criteria for the following: asset recognition, liability recognition, income recognition and expense recognition.*

An asset is recognised in the Balance Sheet when:

1. It is probable that the future economic benefits will flow
2. It has a cost or value that can be measured reliably.

A liability is recognised in the Balance Sheet when:

1. It is probable that an outflow of resources (representing economic benefits) will result
2. The amount can be measured reliably.

Expenses are recognised in the Income Statement when:

1. A decrease in future economic benefits has arisen
2. The decrease can be measured reliably.

Income is recognised in the Income Statement when:

1. An increase in future economic benefits has arisen
2. The increase can be measured reliably.

3. *Give one example of an asset that can be recognised in the Balance Sheet.*

For example: vehicles

4. *Give one example of a liability that can be recognised in the Balance Sheet.*

For example: accounts payable

5. *Give one example of an expense that can be recognised in the Income Statement.*

For example: wages

6. *Give one example of income that can be recognised in the Income Statement.*

For example: sales

7. *Summarise how income is recognised for the sale of goods and the rendering of services.*

Income (or revenue) arising from the sale of goods must be recognised when the entity has transferred to the buyer the significant risks and rewards of ownership, does not retain ownership or control over the goods, revenue can be measured reliably, it is probable that future economic benefits will flow and costs incurred in respect to the sale can be measured reliably. Income (or revenue) arising from the rendering of services, is recognised by reference to the stage of completion of the contract.

Review Questions 12.2

1. *Explain how the Income Statement (or Statement of Financial Performance) of a retail/ merchandising business differs from the statement for a service business.*

It has sales and cost of sales.

2. *How might a financial institution present its Income Statement?*

A financial institution could show interest income and interest expenses, with NET INTEREST REVENUE as a subtotal.

3. *List the most common elements found in cost of sales.*

For a manufacturing business, 'Cost of manufacturing goods' might include: Direct materials, Manufacturing overheads and Direct labour

For a trading/retail business, the cost of sales may be calculated as follows using the perpetual system: Cost of Sales = Inventory sold (at cost price)

4. *What is gross profit?*

Net sales less cost of sales.

5. *In a table, summarise the main methods of calculating cost of sales.*

Manufacturing business:	Cost of Sales = Inventory sold (at cost price) + Cost of manufacturing goods
Trading/retail business:	Cost of Sales = Inventory sold (at cost price)

6. *Summarise the main difference between the classification of an Income Statement by nature and by function.*

The functions of a business are the main activities required to support the manufacturing and retailing of the business. Expenses can alternatively be grouped by nature, in relation to the type of cost.

7. *What are two accounts that would be included in the Income Statement of a retail/trading/ merchandising business but not a service business?*

Sales and Cost of Sales

8. *Compare and contrast the two alternative methods of classifying expenses in an Income Statement.*

By nature and by function.

9. Prepare an example of an Income Statement using functional classification.

For example:

LESS EXPENSES

***Selling Expenses**			
Advertising	(1 500)		
Delivery costs	(800)		
Depreciation of delivery vehicles	(6 300)		
Commissions paid to salespeople	(1 600)		
Wages of delivery staff	(23 000)		
Doubtful debts	(562)	(33 762)	
***Administration Expenses**			
Depreciation of fixtures and fittings	(2 300)		
Loss on disposal of computer	(120)		
Rent of office	(6 600)		
Salaries of office staff	(52 300)		
Office supplies	(7 802)	(69 122)	
***Financial Expenses**			
Interest	(9 632)	(9 632)	(112 516)

10. Prepare an example of an Income Statement with classification by nature.

For example:

LESS EXPENSES

Vehicles			
Delivery costs		(800)	
Employee expenses			
Commissions paid to salespeople	(1 600)		
Salaries of office staff	(52 300)		
Wages of delivery staff	(23 000)	(76 900)	
Depreciation			
Depreciation of delivery vehicles	(6 300)		
Depreciation of fixtures and fittings	(2 300)	(8 600)	
Finance costs			
Loss on disposal of computer	(120)		
Interest	(9 632)		
Doubtful debts	(562)	(10 314)	
Office costs			
Advertising	(1 500)		
Rent of office	(6 600)		
Office supplies	(7 802)	(15 902)	(112 516)

11. *Revise your main understandings of the simplified Balance Sheet (or Statement of Financial Position), by showing one format for a classified Balance Sheet. Indicate where inventory would be shown.*

For example:

Current Assets	+	Non-current Assets	-	Current Liabilities	-	Non-current Liabilities	=	Net Assets	=	Equity

12. *What are the main headings used in each of the three alternative Balance Sheet formats?*

Show the:

Current/non-current presentation
Accounting equation
Liquidity presentation

13. *Prepare an example of a Balance Sheet with current/non-current classification.*

Current/Non-current presentation:

CURRENT ASSETS
NON-CURRENT ASSETS
Total Assets
EQUITIES
CURRENT LIABILITIES
NON-CURRENT LIABILITIES
Total Liabilities
Net Assets
EQUITY

14. *Prepare an example of a Balance Sheet with accounting equation presentation.*

Accounting equation presentation:

ASSETS
Total Assets
EQUITIES
Liabilities
Total Liabilities
Equity
Capital
Total Equity
Total Equities

15. *Prepare an example of a Balance Sheet with the liquidity presentation format.*

Liquidity presentation, with equity being shown first:

Capital
Total Equity
ASSETS
Total Assets
LIABILITIES
Total Liabilities
Net Assets

16. *Which Balance Sheet format would be most commonly used for a small business, and why?*

The accounting equation presentation because it is simple, and most small businesses do not have very complex accounts.

Chapter 12 Activities

1. MATERIALITY AND CLASSIFICATION OF ACCOUNTS

A.

Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial report. This means that even though an item might be of low dollar value, it could still be meaningful, and should be included in the detailed information in reports.

B.

BUSINESS TYPE	Grocery retailer	Surfboard manufacturer
ANNUAL SALES	**$1 000 000**	**$150 000**
Loss on write down of inventory $5 000	Small in comparison to overall sales.	Large compared to total sales.
Cost of restructuring checkout area $1 000	Not a material item requiring separate disclosure, a small amount and not an unusual item.	Not requiring separate disclosure, a small amount and not an unusual item.
Sale of investment $3 000	Material because its nature is of significance to the user of reports.	Material because nature of significance to the user of reports.
Dividends received $300	Immaterial because of small size. Could be included with other like items.	Immaterial. Could be included with other like items.
Cost of new shelving – in-store (retailer) and storage (manufacturer) $12 000	A material amount.	A material amount.
Income from legal settlement $4789	Material because it is large and its nature is of significance to the user of reports.	Material because it is large and its nature is of significance to the user of reports.

C.

BUSINESS TYPE	Grocery retailer	Surfboard manufacturer
TOTAL ASSETS	**$500 000**	**$2 000 000**
Copyright licence $500 000	Material because it doubles total assets.	Material because it is 25% of the total assets.
Machinery $202 020	A material amount – half of total assets.	A material amount but its nature is common to this type of business, include in Machinery items.
Trade receivables $10 100	Immaterial and not of an unusual nature. Could be included with other like items.	Immaterial and not of an unusual nature. Could be included with other like items.
Cash management account $5 000	Immaterial. Could be included with other like items.	Immaterial. Could be included with other like items.
Trade payables $9 800	Immaterial. Could be included with other like items.	Immaterial. Could be included with other like items.
Investment property $1 000 000	A material amount because of large size compared with total assets.	A material amount because of size compared to total assets.
Debtors $300	Immaterial. Include with other like items.	Immaterial. Include with other like items.

D. Weighted average: different quantities of product purchased by business for different prices. The cost of the inventory is calculated by averaging the cost of the items over the number of items of inventory.

$$\text{Weighted average cost} = \frac{\text{Cost of items for sale}}{\text{Number of items for sale}}$$

First-in First-out: the first stock to come into the business assumed to be the first sold by the business. The cost of the inventory is calculated by adding up the cost of the number of items sold that were purchased by the business earliest.

E. A deli would sell a lot of fresh food items, such as sandwiches, drinks and other perishable items. The oldest items must be sold first or they will go out of date and expire before the freshest items.

F. A music shop would sell many items that are similar (ie: a lot of CDs). Due to the high volumes of similar stock, they should use the weighted average method.

2. NATURE OR FUNCTION AND EXTRAORDINARY ITEMS

A., B., C.

Discussion and extention questions – dependent on justificaton given. Students should show an understanding of the differeneces between the terms 'relevance', 'reliability' and 'materiality'.

3. GROSS PROFIT/GROSS MARGIN

A.

Broome Bank
Income Statement

Interest Income	$ 45 000
Less: Interest Expense	43 800
Net Interest	$ 1 200

B.

Forestdale Furniture Manufacturers
Income Statement (extract)

Net Sales		$ 260 000
Less: Cost of Sales		
Opening Inventory	0	
Add: Direct materials	50 900	
Manufacturing Overheads	67 600	
Direct labour	90 900	
	209 400	
Less: Closing inventory	2 000	207 400
Gross Margin		$ 52 600

C.

Carnarvon Cookies
Income Statement (extract)

Sales	$ 69 000	
Less: Sales Returns and Allowances	900	68 100
Less: Cost of Sales		
Raw materials	15 300	
Manufacturing Overheads	23 000	
Direct labour	34 000	72 300
Gross Loss		$ (4 200)

D.

Wickham Wig Retailers
Income Statement (extract)

Sales	$ 230 000	
Less: Sales Returns and Allowances	5 000	225 000
Less: Cost of Goods Sold		
Cost of sales	115 000	
Other Inventory Expenses	33 000	148 000
Gross Profit		$ 77 000

4. THE ELEMENTS OF FINANCIAL STATEMENTS

A.

ELEMENT	DEFINITION A, L, I, Ex?	PROBABLE?	RELIABLE?
Electricity	Expense	Yes – electricity has been used.	Yes – a detailed bill will have been received.
Vehicle	Asset	If the business has possession and use of the vehicle.	Yes – a purchase price would have been paid, or market valuation can be used.
Royalties	Income	Yes – money would have been received.	Yes – a measurable dollar amount.
An access road for a mine site	Asset	If the business has sole access the benefits should flow to it. Benefits may not occur in the present accounting period though – uncertainty.	Benefits from mine site.
Research and development costs	Asset or expense	An asset only if it is considered probable that the economic benefits will result with a large degree of certainty – unlikely.	May not be able to apply to specific assets.
Office supplies	Asset	Yes - Benefits have resulted from the office.	Yes – a purchase price.
Warranties	Liability	Only if it is probable that an outflow of resources will be required.	Based on past results, an amount may be possible to measure.
Bad debts	Expense	Yes – based on past history of the customer not going to be paid.	Yes – amount of debt is known.
Donations	Income	Yes – a form of asset has been received.	Yes – will have a written record.
Depreciation	Expense	Yes – a decrease in future economic benefits that is related to an asset.	Yes – the allocation of the asset cost.
Cost of sales	Expense	Yes – benefits from the sale of the stock.	Yes – sale amounts.
Inventory	Asset	Yes – cash or debtors.	Yes – sales.
Livestock	Asset	If the livestock is able to be sold.	Dependent on market.
Computer upgrade	Asset	Economic benefits will flow as long as the business has use of this asset.	Yes – purchase price.

B.

i. Are athletes assets to the business?

- Resource controlled by the entity: If the athletes have signed exclusive contracts to play for the team, they are effectively controlled by the business.
- As a result of past events: The signing of a contract is a past event.

- From which future economic benefits are expected to flow to the entity: the business would receive economic benefits in the form of cash from ticket sales to basketball events, sponsorship deals involving the players and other income.

ii. Should the athletes be recognised? Under what circumstances?

While it is probable that the economic benefits from the athletes ticket sales and sponsorships will flow to the business, it is difficult to argue that the amount can be valued with reliability. The athletes could become injured, disqualified, or decide to not participate in some deals. It is very difficult to gauge the exact amount of economic benefit earned by an individual, especially when they form part of a much larger team of payers and support workers.

C.
i. Is the road is an asset?

- Resource controlled by the entity: If this is owed only by Ness Vines, it is controlled by the business.
- As a result of past events: The agreement with the builders of the road is a past event.
- From which future economic benefits are expected to flow to the entity: the business would receive economic benefits in the form of wine sales to customers.

ii. Should the road be recognised in the Balance Sheet? Under what specific circumstances?

It is probable that the economic benefits associated with an exclusive access road will flow to the business, and it is likely that the amount can be measured with reliability. It is possible to gauge the exact amount of cost of the access road if the business has to pay for it themselves. It would be more difficult if the local council was paying for part of the road.

5. COST CENTRE ALLOCATION

Discussion question. Responses could cover:

Expenses are frequently allocated to cost centre categories in order to assist a business with budgeting. This is a valid argument for this type of presentation.

The calculation of profit can be broken down into a number of different elements, and it is not just the final profit or loss that the business is interested in obtaining. The decision needs to be based around the usefulness of the information to the users of the financial statements.

As well as budgeting, the owners might want to set forecasts based on the results reported in the cost centres or the cost classifications. It might be decided that both forms of presentation have validity for different users of the information.

6. COMPARATIVE INCOME STATEMENT AND BALANCE SHEET

A. Solution check for *Salty Sea Souvenirs*:

Gross profit = $12200; Profit = $3660
Assets = $19800; Liabilities = $8620.

B. Solution check for *Alika's Glass Splashback Supplies*:

Profit = $7160; Total assets = $52000; Liabilities =$26800.

C. i. Classification by nature.

Citrusy Treez Nursery
Income Statement
For the year ended 31 December 2028

Sales		$ 40 000
<u>Less: Cost of Sales</u>		
Cost of sales	$ 25 600	
Freight inwards	800	26 400
Gross profit		13 600
<u>Add: Other income</u>		
Gain on sale of vehicle	680	
Interest	1 200	1 880
		15 480
<u>Less: Other expenses</u>		
Employee		
Salary – administrative assistant	1 000	
Wages – part time desk staff	2 000	
Salary – gardener	500	3 500
Depreciation		
Depreciation – tractor	300	
Depreciation – gardening equipment	100	400
Interest		
Loan interest	500	
Interest expense	300	800
Office		
Occupancy	800	
Supplies	300	
Computer ink and paper	200	1 300
Advertising		
News advertising	200	
Billboard	500	
Brochures	500	1 200
Gardening		
Rent of greenhouse	1 000	
Petrol	200	
Lawnmower costs	100	
Gardening supplies	900	2 200
		9 400
Profit		$ 6 080

ii. Classification by function.

Citrusy Treez Nursery
Income Statement
For the year ended 31 December 2028

Sales		$ 40 000
Less: Cost of Sales		
Cost of sales	$ 25 600	
Freight inwards	800	26 400
Gross profit		13 600
Add: Other income		
Gain on sale of vehicle	680	
Interest	1 200	1 880
		15 480
Less: Other expenses		
Selling and Distribution		
Rent of greenhouse	1 000	
Petrol	200	
Depreciation – tractor	300	
Depreciation – gardening equipment	100	
Salary – gardener	500	
Lawnmower costs	100	
Gardening supplies	900	3 100
General and Administration		
Occupancy	800	
Supplies	300	
Salary – administrative assistant	1 000	
Wages – part time desk staff	2 000	
News advertising	200	
Billboard	500	
Brochures	500	
Computer ink and paper	200	5 500
Financial		
Loan interest	500	
Interest expense	300	800
		9 400
Profit		$ 6 080

iii. Current/non-current classification.

Citrusy Treez Nursery
Balance Sheet
As at 31 December 2028

CURRENT ASSETS			
Inventory		4 000	
Cash		300	
Trade debtors		3 500	
Prepaid rent		50	
Prepaid advertising		150	8 000
NON-CURRENT ASSETS			
Trademark		800	
Tractor	3000		
Less: Accumulated depreciation of tractor	300	2 700	
Equipment	1 000		
Less: Accumulated depreciation of equipment	100	900	
Shares		600	
Sheds		6 000	
Land		2 000	
Lawn mowers		6 000	14 000
TOTAL ASSETS			22 000
CURRENT LIABILITIES			
Accrued interest		60	
GST Clearing (Payable)		300	
Trade creditors		3 340	
Accrued wages		300	
Overdraft		400	4 400
NON-CURRENT LIABILITIES			
Loan		1 000	
Mortgage		3 000	4 000
TOTAL LIABILITIES			8 400
NET ASSETS			13 600
EQUITY			
Capital		7 520	
Add: Profit		6 080	13 600

iv. Liquidity presentation.

Citrusy Treez Nursery
Balance Sheet
As at 31 December 2028

ASSETS		
Cash in hand		50
Cash management account		250
Prepaid rent		50
Prepaid advertising		150
Inventory		4 000
Trade debtors		3 500
Shares		600
Lawn mowers		6 000
Tractor	3000	
Less: Accumulated depreciation of tractor	300	2 700
Equipment	1 000	
Less: Accumulated depreciation of equipment	100	900
Sheds		6 000
Trademark		800
Land		2 000
TOTAL ASSETS		22 000
LIABILITIES		
Overdraft		400
GST Clearing (Payable)		300
Accrued interest		60
Accrued wages		300
Trade creditors		3 340
Loan		1 000
Mortgage		3 000
TOTAL LIABILITIES		8 400
		13 600
EQUITY		
Capital		7 520
Add: Profit		6 080
		13 600

v. The most useful presentation method is dependent on the requirements of the users of the financial statements. For example, if the business is going to be sold then the liquidity presentation is advantageous.

7. RETAIL BUSINESS: INVENTORY SYSTEMS

PERPETUAL: / **PERIODIC:**

A. *Samantha's CD store*

PERPETUAL:

Net Sales	$ 5 900
Less: Cost of Goods Sold	
Cost of sales	2 400
Freight	870
	3 270
Gross profit	$ 2 630

PERIODIC:

Net Sales	$ 5 900
Less: Cost of Goods Sold	
Opening inventory	4 500
Net purchases	1 100
Freight	870
Less: Closing inventory	3 000
	3 470
Gross profit	$ 2 430

B. *Mikey's Motors*

PERPETUAL:

Net Sales	$ 266 000
Less: Cost of Goods Sold	
Cost of sales	210 000
Inventory expenses	8 800
	218 800
Gross profit	$ 47 200

PERIODIC:

Net Sales	$ 266 000
Less: Cost of Goods Sold	
Opening inventory	45 000
Net purchases	525 000
Freight	8 800
Less: Closing inventory	360 000
	218 800
Gross profit	$ 47 200

C. *Charlie's Chocolat Shoppe*

PERPETUAL:

Net Sales	$ 39 700
Less: Cost of Goods Sold	
Cost of sales	20 000
Inventory expenses	1 080
Customs	400
	21 480
Gross profit	$ 18 220

PERIODIC:

Net Sales	$ 39 700
Less: Cost of Goods Sold	
Opening inventory	3 000
Net purchases	26 050
Freight	1 080
Customs	400
Less: Closing inventory	5 580
	24 950
Gross profit	$ 14 750

8. INCOME STATEMENT CLASSIFICATION

A. Income Statement classified by nature

Darlene's Formal Fashions
Income Statement
for the period ended 30 June 2020

Margin on wedding attire		
Sales	94 700	
Less: Sales returns and allowances	1 190	93 510
Less: Cost of sales		43 210
		50 300
Hire income		44 980
Gross margin on wedding attire		95 280
Margin on formal wear		
Sales	62 900	
Less: Sales returns and allowances	1 190	61 710
Less: Cost of sales		28 120
		33 590
Hire income		18 400
Gross margin on formal wear		51 990
TOTAL GROSS MARGIN		147 270
Other income		
Gain on sale of office desk		300
		147 570
Warehouse and sewing expenses		
Rent of warehouse	24 500	
Depreciation of sewing machines	120	
Sewing machine repairs	4 500	
Wages - Warehouse	18 000	
Wages – Sewing staff	55 000	
Warehouse supplies	10 490	112 610
Office expenses		
Rent of office	4 400	
Office supplies	4 500	
Wages – Office	35 000	
Depreciation – Furniture	400	
Depreciation – Computer	200	44 500
Advertising expenses		
Magazines	4 850	
Billboard	3 300	8 150
Financial		
Loss on sale	230	
Interest	2 800	3 030
		168 290
LOSS		$ (20 720)

B. Income Statement classified by function.

Darlene's Formal Fashions
Income Statement
for the period ended 30 June 2020

Sales		
Wedding attire	94 700	
Formal wear	62 900	
Less: Sales returns and allowances	2 380	155 220
Less: Cost of sales		71330
GROSS PROFIT		83 890
Other income		
Gain on sale of office desk		300
Hire of wedding attire		44 980
Hire of formal wear		18 400
		147 570
Other expenses		
Administrative and general		
Rent of warehouse	24 500	
Rent of office	4 400	
Wages - Warehouse	18 000	
Wages – Office	35 000	
Warehouse supplies	10 490	
Wages – Sewing staff	55 000	
Office supplies	4 500	
Sewing machine repairs	4 500	
Depreciation of sewing machines	120	
Depreciation – Furniture	400	
Depreciation – Computer	200	157 110
Selling and distribution		
Magazines	4 850	
Billboard	3 300	8 150
Financial		
Loss on sale	230	
Interest	2 800	3 030
		168 290
LOSS		$ (20 720)

9. EVALUATION OF AN INCOME STATEMENT

A. *Conway's Coffees.* Errors = Interest income is 'Other income', Baking costs should be added to Purchases not subtracted, Office supplies is an expense, Depreciation of fixtures and fitting is not a 'Transport expense', Gain on sale of vehicle is 'Other income'. Note that there are errors in classification which do not affect the overall total profit. Discount received should be subtracted from Cost of Sales, not added as Other Income. Bad debts (and doubtful debts) are a Selling Expense.

B. Correct profit = $157 372

C. Under the perpetual method, Gross profit =$662 025 and Profit = $138 817

10. RETAIL BUSINESS INCOME STATEMENT

Eloise's Mags
Income Statement
For the period ended 31 December 2018

Sales	$ 172 600
LESS: Discount allowed	5 430
Sales returns and allowances	320
Net Sales	166 850
Sales returns and allowances	320
Cost of sales	65 000
LESS: Discount received	1 520
Total Cost of sales	63 480
GROSS PROFIT	103 370
Add: Other income	
Interest	540
	103 910
Administration / Office Expenses	
Internet	1 200
Council rates	3 100
Electricity	4 300
Wages - Office Staff	34 200
Cleaning of Office	960
Paper and office supplies	4 290
Repairs to computer	550
	48 600
Delivery expenses	
Cleaning of van	700
Petrol for delivery van	4 980
Servicing delivery van	3 270
Wages - Delivery Staff	42 000
	50 950
Financial expenses	
Bad debts	60*
Interest	1 200
	1 260
Total expenses	100 810
PROFIT	$ 3 100

* note that Bad debts would now be classified as a Selling and Distribution expense, if such a category existed in this statement. Borrowing costs are the only items permitted under Financial expenses.

CHAPTER 13: BASIC BALANCE DAY ADJUSTMENTS

Review Questions 13.1

1. *Summarise the accounting period assumption.*

The life of the business can be broken into accounting period for reporting purposes.

2. *Distinguish between the cash and accrual basis of accounting.*

Cash accounting: transactions are recognised on the date that cash is received or paid.
Accrual accounting: transactions are recorded when they have economic effect on the business.

3. *Define 'income recognition principle' and the 'accounting period assumption'.*

Income is recognised as in the Income Statement when:

- An increase in future economic benefits has arisen
- The increase can be measured reliably.

4. *Illustrate the concept of balance day adjustments, using two examples.*

For example:

- **Prepayments:** The business has either paid an expense in advance ('prepaid expense') or received income early ('unearned income' or 'income in advance').
- **Accruals:** The business owes money and has not paid it yet ('accrued expense') or is owed money by another business ('accrued income'). Think about the word accrued as meaning 'owing' in this context.

5. *Describe two situations where balance day adjustments might not be required.*

Situations where businesses would not use balance day adjustments include where the businesses has mainly cash transactions, and, under the accrual system, when the dollar amount of the adjustment is very small.

6. *Define 'accrued expense' and 'prepaid expense'. Give examples.*

A prepaid expense is an asset, because money has been paid for a good or service, and the future economic benefits from this payment have not been received or consumed yet. On balance day, the business will record the amount of this asset that has been used up. For example: insurance, supplies, rent expense, advertising

An accrued expense is a liability because it is a payment that has not yet been made by the business, even though the time period for the payment has occurred. On balance day, the amount owed by the business is recorded. For example: wages, interest expense, electricity, telephone.

7. *Summarise the entry that must be made to adjust for each of: accrued expense, stock of supplies and prepaid expense.*

Adjusting entries:

Accrued expense:	Debit Expense	Credit Accrued Expense (L)
Stock of supplies:	Debit Expense	Credit Supplies Asset
Prepaid expense:	Debit Expense	Credit Prepaid Expense (A)

Review Questions 13.2

1. Define 'accrued income' and 'unearned income/income in advance'. Give examples.

Unearned income (or income in advance) is a liability, because money has been received for a good or service, and the future economic benefits from this receipt have not been provided to the customer yet. On balance day, the amount earned by the business is recorded. For example: sales, fees, magazine subscriptions, rent received

Accrued income is an asset because it is an amount that has not yet been received by the business, even though the time period for the receipt has occurred. On balance day, the amount earned by the business is recognised. For example: interest income, commissions, dividends received, royalties.

2. Summarise the entry that must be made to adjust for each of: accrued income and unearned income.

Adjusting entries:

Accrued income	Debit Accrued income (Asset)	Credit Income
Unearned income	Debit Unearned income (L)	Credit Income

3. How is a balance day adjustment worksheet useful?

A worksheet will assist with calculating the effect of each adjustment on accounts making it easier to complete the Income Statement and Balance Sheet.

4. Check the answer to the Sandy Starjump balance day adjustment worksheet scenario, by completing two simple, unclassified financial reports: a Balance Sheet and an Income Statement.

Sandy Starjump
Income Statement

Net Sales	35 850
Less: Cost of sales	21 487
Add: Other income	
Rent	1 800
Interest	3 000
Less: Other expenses	
Salary	26 000
Office expenses	2 300
Bad debts	600
Advertising	900
Insurance	800
Depreciation	6 060
LOSS	**$17 497**

Sandy Starjump
Balance Sheet

ASSETS	
Stock	3 245
Prepaid insurance	1 600
Accrued income	3 300
Debtors3 560	
Less: Allowance for Doubtful debts	(200)
Vehicle 60 600	
Less: Accumulated depreciation	(6 060)
Total Assets	**66 045**
LIABILITIES	
Unearned rent	450
GST Clearing account	610
Accrued expenses	1 650
Total Liabilities	**2 710**
Net Assets	**$63 335**
Capital	80 832
Less: Loss	(17 497)
Total Equity	**$63 335**

5. What is the main reason for calculating balance day adjustments?

To meet the matching principle and accounting period requirements.

Chapter 13 Activities

1. REPORTING AND RECORDING – CASH OR ACCRUAL?

A. Accounting period: The life of the business is divided into time periods for the purpose of regular reporting to stakeholders. Financial reports should be presented at least annually. When applying accrual accounting, all income and expenses re recognized when the product is sold or the service is performed, regardless of whether payment for the good or service has been received or paid.

B. i. Cash basis
ii. Accrual basis

C. In order to report on a regular basis (accounting period assumption), income and expenses must be recorded on a date in the time period to which they relate (income recognition principle) and resulting in - under accrual accounting - transactions being recorded when they have an economic effect on the business.

D. Because inflows and outflows are recorded at the time they have an effect on the business.

E. Materiality involves the consideration of how significant the transaction or account is to the business. For some businesses, balance day adjustments are not required generally because the amount of the adjustment is so small (or immaterial) that it would not have a significant effect on the reporting result of the business. Situations where businesses would not use balance day adjustments include where the businesses has mainly cash transactions, and, under the accrual system, when the dollar amount of the adjustment is very small.

2. CLASSIFICATION OF PREPAID EXPENSES AND UNEARNED INCOME

Prepaid Expense: A prepaid expense amount is a resource controlled by the entity, as the business owns the asset related to the payment. It resulted from past events and future economic benefits are expected to flow to the business. It is classified as current as long as it is intended for sale within the next accounting period of the business (or within twelve months after the reporting date).

Unearned Income: This is a present obligation of the business arising from past events, and is expected to result in an outflow from the business of resources (such as cash) embodying economic benefits. It is classified as current as long as it is expected to be paid within the businesses normal operating cycle (or is due to be settled within twelve months after the reporting date).

3. MODIFYING ADJUSTMENTS

A., B., C. Discusion questions , answers dependent on justification given.

4. CASH VERSUS ACCRUAL ACCOUNTING

Carson's Computing
Comparative Income Statements

	Cash	Accrual
Sales income	40 000	35 000
Less: Cost of sales	29 900	29 900
Gross profit/loss	10 100	5 100
Less: Expenses		
Supplies	2 390	1 370
Interest	0	560
Rent	3 000	2 400
Telephone	2 000	2 000
Depreciation	0	1 440
	7 390	7 770
Profit/(Loss)	**$ 2 710**	**$ (2 670)**

Accrual accounting matches incomes that has been earned in a time period with the expenses that were incurred earning that income. If income is earned in June it is important that Carson show all related expenses, even if some of these expenses are not actually paid until the next financial year in July.

5. BALANCE DAY ADJUSTMENT ENTRIES

Information	Type of adjustment	Debit entry	Amount	Credit entry	Amount
A car retailer depreciates their $1100 of office furniture at 11% straight line	*Depreciation*	*Depreciation of Furniture*	*$121*	*Accumulated Depreciation of Furniture*	*$121*
A text book writer is owed $100 royalties	*Accrued income*	*Accrued Royalties*	*$100*	*Royalty Income GST Collected*	*$100*
Doubtful debts are estimated to be 5% of the current balance of debtors, which is $6000	*Bad debt*	*Bad Debts*	*$300*	*Allowance for Doubtful Debts*	*$300*
Annual car insurance of $240 was paid eight months ago	*Prepaid expenses*	*Insurance Expense* *GST Credits Received*	*$160* *$16*	*Prepaid Insurance*	*$176*
A real estate agent has $11523 in Unearned Rent and calculated that 80% of this will have been earned on balance day	*Unearned income*	*Unearned Rent*	*$9 218*	*Rent Income*	*$9 218*
A bungy jumping operator owes their employees $560 wages	*Accrued expense*	*Wages*	*$560*	*Accrued Wages*	*$560*
A clothing retailer has paid $6600 for six months advertising and four months have been provided	*Prepaid expense*	*Advertising Expense* *GST Credits Received*	*$4 400* *$440*	*Prepaid Advertising*	*$4 840*

6. ADJUSTING ENTRIES FOR EXPENSES

A. Insurance expense = $17 250; Supplies expense = $7 480; Wages expense = $38 200; Accrued interest expense = $24 750.

B.

Balance Sheet (extract)

CURRENT ASSETS	
Prepaid Insurance	$ 5 750
Stock of Supplies	220
CURRENT LIABILITIES	
Accrued Wages	$ 38 200
Accrued Interest	24 750

7. ADJUSTING ENTRIES FOR INCOME

A. Sales income = $27 500; Rent income $2 000; Unearned rent $2 000; Accrued interest income $600.

B.

Balance Sheet (extract)

CURRENT ASSETS	
Accrued Interest	$600
CURRENT LIABILITIES	
Unearned Sales	$ 27 500
Unearned Rent	4 000

8. BALANCE DAY ADJUSTMENT LEDGERS, WORKSHEET AND STATEMENTS

A. *Squeaky Shoes* – Solution Check:

ii. Trial Balance totals before balance day adjustments and not including GST = $22560
After balance day adjustments = $22990

Trial Balance totals before balance day adjustments and including GST = $23100

After balance day adjustments including GST = $23133

iii. Loss = $1960

B. *Sharon's Sport Supplies* – Solution Check:

i. Closing balances: Cash at bank = $268 (credit), Motor vehicle = $7000, Capital = $12000, Creditors = $1900, Freight = $38, Prepaid rent = $3000, Sales = $2080, Debtors = $1480, Electricity = $900, Discount = $30, Supplies asset = $80, Sales returns = $100, Accrued interest = $30, Interest income = $30, Supplies = $720, Rent = $1000, Inventory = $320, Cost of sales = $1580. (Note: Not registered for GST).

ii. ***Sharon's Sport Supplies***
Trial Balance for the month of May

	$	$
Cash at bank		268
Motor vehicle	7000	
Capital		12 000
Creditor		1 900
Freight	38	
Prepaid rent	3000	
Sales		2 080
Debtors	1 480	
Electricity	900	
Discount allowed	30	
Supplies asset	80	
Sales returns	100	
Accrued interest	20	
Interest		30
Supplies	720	
Rent	1 000	
Inventory	320	
Cost of sales	1580	
	$16 278	**$16 278**

iii. ***Sharon's Sport Supplies***

Income Statement for the month of May

Net sales		1 950
Less: Cost of Goods Sold		
Cost of Sales	1 900	
Freight	38	1 938
GROSS PROFIT		12
Add: Interest		30
Less: Expenses		
Electricity	900	
Supplies	720	
Rent	1 000	2 620
LOSS		$ 2 578

9. BALANCE DAY ADJUSTMENT WORKSHEET AND BALANCE SHEET EXTRACT

A. *Carrie's Copy*

Account name	Trial Balance		Balance day adjustments		Adjusted Trial Balance totals	
	Dr	Cr	Dr	Cr	Dr	Cr
Stationery	1 100			*569*	*531*	
Loan		3 000				*3 000*
Unearned newsletter sales/ Sales in advance		5 431	*4 345*			*1 086*
Motor vehicle	15 000				*15 000*	
Computers	5 400				*5 400*	
Printer	550				*550*	
Prepaid insurance	1 841			*530*	*1 311*	
Cost of sales	501				*501*	
Debtors	126				*126*	
Creditors		60				*60*
Equity		10 927				*10 927*
Accumulated depreciation – motor vehicle		5 000		*1 200*		*6 200*
Accumulated depreciation – office equipment		900		*476*		*1 376*
Inventory	1000			*50*	*950*	
GST collected		400				*400*
GST credits received	200				*200*	
Additional accounts:						
Stationery expense			*569*		*569*	
Interest				*150*		*150*
Accrued interest			*150*		*150*	
Sales				*4 345*		*4 345*
Depreciation – motor vehicle			*1 200*		*1 200*	
Depreciation – office equipment			*476*		*476*	
Insurance expense			*530*		*530*	
Inventory adjustment expense			*50*		*50*	
TOTALS					***27 544***	***27 544***

B. *MV Gogh Studios*

i.

Account name	Trial Balance		Balance day adjustments		Adjusted Trial Balance totals	
	Dr	Cr	Dr	Cr	Dr	Cr
Cost of sales	9 632				*9 632*	
Equity		4 644				*4 644*
Unearned sales		12 360	*10 729*			*1 631*
Prepaid rent	2 400			*1 800*	*600*	
Wages	4 400		*100*		*4 500*	
Art equipment	2 000				*2 000*	
Accumulated depreciation – art equipment		300		*600*		*900*
Loan		2900				*2 900*
Stock	1 222				*1 222*	
Web manager fee	550				*550*	
Transport and petrol costs	400				*400*	
GST collected		1000				*1 000*
GST credits received	600				*600*	
Additional accounts:						
Sales				*10 729*		*10 729*
Rent expense			*1 800*		*1 800*	
Royalty income				*700*		*700*
Accrued income			*700*		*700*	
Depreciation – art equipment			*600*		*600*	
Accrued wages				*100*		*100*
Total					***$ 22 604***	***$ 22 604***

ii. **MV Gogh Studios**

Balance Sheet (extract)
As at 30 June 2008

CURRENT ASSETS	
Prepaid Rent	$ 600
Accrued Income	700
CURRENT LIABILITIES	
GST Clearing (Payable)	400
Unearned Sales	$ 1 632
Accrued Wages	100

C. *Jebro*

Note: Accrued interest and Supplies on hand are for the current financial year, 2020

Trial Balance	**AS AT 31 DEC 2020**		**ADJUSTMENTS**		**NEW BALANCES**	
Investments (due May 2036)	15 000				15 000	
Cash at Bank	22 000				22 000	
Accounts Receivable	16 000				16 000	
Allowance for Doubtful Debts		950				950
Supplies Asset	3 000			1 000	2 000	
Prepaid Insurance	1 000				1 000	
Equipment	135 000				135 000	
Accumulated Depreciation Equipment		30 200				30 200
Accounts Payable		8 000				8 000
Capital (Jebro)		202 050				202 050
Drawings	67 000				67 000	
Unearned Service Revenue		178 000	175 000			3 000
Salaries Expense	48 000				48 000	
Advertising Expense	8 200				8 200	
Discount Expense	1 000				1 000	
Insurance Expense	5 000				5 000	
Accrued Salaries		900				900
Supplies Expense	7 000				7 000	
Land and Buildings	250 000				250 000	
Mortgage on Land and Buildings (due 2046)		180 000				180 000
Bad Debts	700				700	
Interest on Mortgage	10 000		900		10 900	
Depreciation of Equipment	11 200				11 200	
TOTALS	**$600 100**	**$600 100**				
Additional accounts:						
Interest Income				480		480
Accrued income			480		480	
Service Revenue				175 000		175 000
Accrued Interest on Mortgage				900		900
Supplies Expense			1 000		1 000	
Accumulated Depreciation - Buildings				10 000		10 000
Depreciation - Buildings			10 000		10 000	
TOTALS					**$611 480**	**$611 480**

CHAPTER 14: BALANCE DAY ADJUSTMENT ENTRIES

Review Questions 14.1

1. *What part of the manual system of recording accounting information includes balance day adjustments?*

Under the manual system, source documents are used to enter each transaction into the journals. It is not a requirement of this course that students learn about specialised journal entries. As the General Journal is a requirement, however, it is possible to enter all transactions into the general journal and ignore the specialist Cash Receipts, Cash Payments, Credit Purchases and Credit Sales journals. In this way the double entry system can be emphasised.

2. *What is the 'asset method' of recording balance day adjustments?*

The business will frequently need to pay for particular requirements, such as office supplies and insurance, before they are actually used. When the business pays for these requirements it records them as an ASSET, as it is expected that they will be providing benefit to the business for longer than the current accounting period and so they will only be expensed as they are consumed. This initial entry into the accounts is a debit to the prepaid asset account.

3. *What is meant by the 'liability method' of recording balance day adjustments?*

A business will usually record expenses as they are paid during the accounting period. This payment is recorded by debiting the expense account on the date of the transaction. On balance day, some expenses can have been used up but not paid for yet, therefore they are a LIABILITY. In order to ensure the accounting records are accurate, these expenses need to be recorded as if they have actually been paid, otherwise they will not have been allocated to the correct time period.

4. *Show the General Journal entry for a prepaid expense.*

Journal Entry

DATE	DETAILS	DEBIT $	CREDIT $
Date	Expense *(increases)*	*Amount*	
	Prepaid expense *(decreases)*		*Amount*
	Narration		

5. *Summarise the General Ledger entry for a prepaid expense.*

Ledger Entry

Dr — Expense (Ex) — Cr

Date	Details	Amount	Date	Details	Amount
Date	Prepaid expense	Amount			

Dr — Prepaid Expense (A) — Cr

Date	Details	Amount	Date	Details	Amount
			Date	Expense	Amount

6. *Show the General Journal entry for an accrued expense.*

Note that this shows an expense that is GST free.

Journal Entry

DATE	DETAILS	DEBIT $	CREDIT $
Date	Expense *(increases)*	*Amount*	
	Accrued expense *(increases)*		*Amount*
	Narration		

7. *Summarise the General Ledger entry for an accrued expense.*

Ledger Entry

Dr **Expense (Ex)** **Cr**

Date	Accrued expense	*Amount*			

Dr **Accrued Expense (A)** **Cr**

			Date	Expense	*Amount*

8. *When are GST Credits Received part of the adjusting entry for accrued expenses?*

When GST is owed on the expense that has been used up but not paid for yet.

9. *Why are reversing entries not required for accrued expenses?*

Reversing entries are not required. Expenses are included in the expenses for the accounting period as accruals. In the next accounting period, when the expenses are actually paid, the accrued expense account will be closed off. The business will record a debit to Accrued Expenses and a credit to Cash at Bank.

10. *Show the General Journal entry for income in advance.*

Journal Entry

DATE	DETAILS	DEBIT $	CREDIT $
Date	Income in advance *(decreases)*	*Amount*	
	Income *(increases)*		*Amount*
	Narration		

11. *Summarise the General Ledger entry for income in advance.*

Ledger Entry

Dr		Income in Advance (L)			Cr
Date	Income	*Amount*			

Dr		Income (I)			Cr
			Date	Income in advance	*Amount*

12. *Show the General Journal entry for an accrued income adjustment.*

Note that this shows income that is GST free/ input taxed/ using the cash basis of accounting.

Journal Entry

DATE	DETAILS	DEBIT $	CREDIT $
Date	Accrued income *(increases)*	*Amount*	
	Income *(increases)*		*Amount*
	Narration		

13. *Summarise the General Ledger entry for an accrued income adjustment.*

Ledger Entry

Dr		Accrued Income (A)			Cr
Date	Income	*Amount*			

Dr		Income (I)			Cr
			Date	Accrued income	*Amount*

14. *Why may GST Collected be part of the entry for an accrued income adjustment?*

On the rare occasion that the income account could be taxable, the GST component is recognised as follows.

Journal Entry

DATE	DETAILS	DEBIT $	CREDIT $
Date	Accrued income *(increases)*	*Amount*	
	Income *(increases)*		*Amount*
	GST collected *(increases)*		*Amount*
	Narration		

15. *Summarise the General Ledger entry for the loss of inventory under the perpetual inventory system.*

16. *Show the General Journal entry for the loss of inventory.*

Journal Entry

DATE	DETAILS	DEBIT $	CREDIT $
Date	Inventory adjustment *(increases)*	*Amount*	
	Inventory asset *(decreases)*		*Amount*
	Narration		

These double entries will now be recorded in ledger accounts as follows:

Ledger Entry

Dr — Inventory Adjustment (Ex) — Cr

Date	Inventory asset	*Amount*			

Dr — Inventory Asset (A) — Cr

			Date	Inventory adjustment	*Amount*

Chapter 14 Activities

1. SUMMARY OF BALANCE DAY ADJUSTMENTS

Balance Day Adjustment	Definition	Debit Entry		Credit Entry	
		Account	Nature	Account	Nature
Prepaid Expense	A prepaid expense is an asset, because money has been paid for a good or service, and the future economic benefits from this payment have not been received or consumed yet. On balance day, the business will record the amount of this asset that has been used up	Expense	E ↑	Prepaid account	A ↓
Accrued Expense	An accrued expense is a liability because it is a payment that has not yet been made by the business, even though the time period for the payment has occurred. On balance day, the amount owed by the business is recorded.	Expense	E ↑	Accrued account	L ↑
Unearned income/Income in advance	Unearned income (or income in advance) is a liability, because money has been received for a good or service, and the future economic benefits from this receipt have not been provided to the customer yet. On balance day, the amount earned by the business is recorded.	Unearned account	L ↓	Income	I ↑
Accrued income	Accrued income is an asset because it is an amount that has not yet been received by the business, even though the time period for the receipt has occurred. On balance day, the amount earned by the business is recognised.	Accrued account	A ↑	Income	I ↑
Inventory adjustment	A business using the PERPETUAL inventory system uses the inventory balance from the unadjusted Trial Balance as the ending inventory, to be entered in the Balance Sheet. Cost of sales and other inventory expenses are entered in the Income Statement. Stocktakes are used to identify inventory shortages and any inventory losses are entered into the accounts by debiting an Inventory Adjustment (Expense) account and crediting the Inventories (Asset) account.	Inventory adjustment expense	E ↑	Inventory Asset	A ↓

2. FILL THE BLANKS

A. A business using cash accounting recognises transactions on the date that money is received or paid.

B. To meet the income recognition principle, a business must use the accrual system of accounting. This means that income and expenses are recorded in the time period in which the business sells goods or performs a service.

C. Transactions are recorded when they have an economic effect on the business under the accrual accounting method.

D. A prepaid expense is an asset, because money has been paid for a good or service, and the future economic benefits from this payment have not been received or consumed yet.

E. A payment that has not yet been made by the business, even though the time period for the payment has occurred is a type of accrued expense. On balance day, the amount owed by the business is recorded.

F. income in advance is a liability, because money has been received by the business for a good or service, and the future economic benefits from this have not been provided to the customer yet.

G. An amount that has not yet been received by the business is the asset accrued income, even though the time period for the receipt has occurred.

3. WHICH METHOD?

Account	Debit or credit?	Account	Debit or credit?
Interest Expense	DEBIT	Interest Income	CREDIT
Rent Expense	DEBIT	Rent Income	CREDIT

4. JOURNAL ENTRIES FOR BALANCE DAY ADJUSTMENTS

Date	Details	Debit	Credit
A	Insurance expense	17 250	
	Prepaid insurance		17 250
	Insurance expense for year		
B	Supplies expense	7 480	
	Stock of supplies		7 480
	Supplies expense for year		
C	Wages	2 200	
	Accrued wages		2 200
	Wages owed on balance day		
D	Interest	24 750	
	Accrued interest expense		24 750
	Interest owed on balance day		
E	Subscriptions in advance	27 500	
	Subscriptions income		27 500
	Subscriptions income for year		
F	Rent in advance	2 000	
	Rent income		2 000
	Rent income for last six months		
G	Accrued income	600	
	Interest income		600
	Interest earned on balance day		
H	Inventory adjustment	340	
	Inventory asset		340
	Inventory loss on balance day		

5. LEDGER ENTRIES FOR BALANCE DAY ADJUSTMENTS

Insurance

2020					
30 June	Prepaid insurance	17 250			

Prepaid Insurance

2029			2030		
30 Sept	Balance	23 000	30 June	Insurance	17 250

Supplies Expense

2030					
30 June	Stock of Supplies	7 480			

Stock of Supplies

2029			2030		
30 July	Cash at bank	7 700	30 June	Supplies expense	7 480

Wages

2030					
	Balance	36 000			
30 Jun	Accrued wages	2 200			

Accrued Wages

			2030		
			30 Jun	Wages	2 200

Interest Expense

2030					
30 June	Accrued interest expense	24 750			

Accrued Interest Expense

			2030		
			30 June	Interest expense	24 750

Subscriptions in Advance

2021			2020		
30 June	Subscriptions income	27 500	1 Jan	Cash at bank	55 000

Subscriptions Income

			2021		
			30 June	Subscriptions in advance	27 500

Rent Income

			2021		
			30 June	Rent in advance	2 000

Rent in Advance

2021			2019		
30 June	Rent income	2 000	1 May	Cash at bank	6 000

Accrued Interest Income

2020					
30 Jun	Interest income	600			

Interest Income

			2020		
			30 Jun	Accrued interest income	600

Inventory Adjustment

2020					
30 June	Inventory asset	340			

Inventory Asset

			2020		
			30 June	Inventory adjustment	340

6. JOURNALS AND LEDGERS FOR INCOME AND EXPENSE ADJUSTMENTS

A. Carrie's Copy

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
2026	Stationery expense	569	
30 June	Stationery		569
	Stationery consumed.		
	Sales in advance	4 345	
	Sales		4 345
	Newsletter sales.		
	Insurance expense	530	
	Prepaid insurance		530
	Insurance expenses March-June.		
	Depreciation expense of motor vehicle	1 200	
	Accumulated depreciation of motor vehicle		1 200
	Depreciation of motor vehicle.		
	Accrued interest	150	
	Interest income		150
	Interest owing from the bank.		
	Depreciation of office equipment	476	
	Accumulated depreciation of office equipment		476
	Depreciation of office equipment.		
	Inventory adjustment	50	
	Inventory asset		50
	Adjustment for stock losses.		

General Ledger (extract)

Stationery Asset

2026			2026		
30 June	*Balance b/d*	1 100	30 June	*Stationery expense*	569
				Balance c/d	531
		1 100			1 100
	Balance b/d	531			

Stationery Expense

2026					
30 June	*Stationery*	569	30 June	*Profit and loss*	569

Sales in Advance

			2026		
30 June	*Sales*	4 345	30 June	*Balance b/d*	5 431
	Balance c/d	1 086			
		5 431			5 431
				Balance b/d	1 086

Sales

			2026		
30 June	*Profit and loss*	4 345	30 June	*Sales in advance*	4 345

Prepaid Insurance

2026					
30 June	*Balance b/d*	1 841	30 June	*Insurance expense*	530
				Balance c/d	1 311
		1 841			1 841
	Balance b/d	1 311			

Insurance Expense

2026					
30 June	*Prepaid insurance*	530	30 June	*Profit and loss*	530

Accumulated Depreciation - Motor Vehicle

			2026		
			30 June	*Balance b/d*	5 000
30 June	*Balance c/d*	6 200		*Depreciation of motor vehicle*	1 200
		6 200			6 200
				Balance b/d	6 200

Depreciation - Motor Vehicle

2026					
30 June	*Accumulated depreciation of motor vehicle*	1 200	30 June	*Profit and loss*	1 200

Accumulated Depreciation - Office Equipment

			2026		
			30 June	*Balance b/d*	900
30 June	*Balance c/d*	1 376		*Depreciation of office equipment*	476
		1 376			1 376
				Balance b/d	1 376

Depreciation - Office Equipment

2026					
30 June	*Accumulated depreciation of office equipment*	476	30 June	*Profit and loss*	476

Inventory

2026					
30 June	*Balance b/d*	1 000	30 June	*Inventory adjustment*	50
				Balance c/d	950
		1 000			1 000
	Balance b/d	950			

Inventory Adjustment

2026					
30 June	*Inventory*	50	30 June	*Profit and loss*	50

B. MV Gogh Studios

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
2018	Sales in advance	10 729	
30 June	Sales		10 729
	Orders completed.		
	Rent expense	1 800	
	Prepaid rent		1 800
	Rent consumed.		
	Depreciation expense of art equipment	600	
	Accumulated depreciation of art equipment		600
	Depreciation of art equipment.		
	Accrued income	700	
	Royalty income		700
	Royalties due.		
	Wages expense	100	
	Accrued wages		100
	Wages owing.		

General Ledger (extract)

Unearned Sales

			2018		
30 June	*Sales*	10 729	30 June	*Balance b/d*	12 360
	Balance c/d	1 631			
		12 360			12 360
				Balance b/d	1 631

Sales

			2018		
30 June	*Profit and loss*	10 729	30 June	*Unearned sales*	10 729

Prepaid Rent

2018					
30 June	*Balance b/d*	2 400	30 June	*Rent expense*	1 800
				Balance c/d	600
		2 400			2 400
	Balance b/d	600			

Rent Expense

2018					
30 June	*Prepaid rent*	1 800	30 June	*Profit and loss*	1 800

Wages

2018					
30 June	*Balance b/d*	4 400			
	Accrued wages	100	30 June	*Balance c/d*	4 500
		4 500			4 500
	Balance b/d	4 500			

Accrued Wages

			2018		
30 June	*Profit and loss*	100	30 June	*Wages*	100

Accumulated Depreciation - Art Equipment

			2018		
			30 June	*Balance b/d*	300
30 June	*Balance c/d*	900		*Depreciation of art equipment*	600
		900			900
				Balance b/d	900

Depreciation - Art Equipment

2018					
30 June	*Accumulated depreciation art equipment*	600	30 June	*Profit and loss*	600

C. Jebro

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
2020	Supplies expense	1 000	
31 Dec.	Supplies asset		1 000
	Supplies consumed.		
	Unearned service revenue	175 000	
	Service revenue		175 000
	Fees earned.		
	Accrued income	480	
	Interest income		480
	Interest due.		
	Interest on mortgage	900	
	Accrued interest on mortgage		900
	Mortgage interest owing.		
	Depreciation of buildings	10 000	
	Accumulated depreciation of buildings		10 000
	Depreciation of buildings.		

7. INTERPRET BALANCE DAY ADJUSTMENT LEDGER ACCOUNTS

Mikey's Mobiles
General Ledger (extract)

Dr — Rent Expense — Cr

30 June	Prepaid rent	2 000			

Dr — Prepaid Rent — Cr

	Balance	6 000	30 June	Rent	2 000

Advertising

Dr					Cr
30 June	Prepaid Advertising	5 000			

Prepaid Advertising

Dr					Cr
1 Feb	Cash at bank	5 900	30 June	Advertising	5 000

Electricity

Dr					Cr
	Balance	5 300			
30 June	Accrued expenses	600			

GST Collected

Dr					Cr
			30 June	Accrued income	940

Accrued Expenses

Dr					Cr
			30 June	Electricity/GST Credits	660

Rent in Advance

Dr					Cr
30 June	Rent income	500		Balance	5 000

Rent Income

Dr					Cr
			30 June	Rent in advance	500

Accrued Income

Dr					Cr
30 June	Commissions/ GST Collected	10 340			

GST Credits Received

Dr					Cr
30 June	Accrued expenses	60			

Commissions

Dr					Cr
				Balance	34 000
			30 June	Accrued income	9 400

8. FIND THE ERRORS

Sales in advance (L)

Dr					Cr
30 June	Sales	90 000	30 June	Balance	100 000

Insurance (Ex)

Dr					Cr
30 June	Prepaid rent	5 000			

Prepaid insurance (A)

Dr					Cr
30 June	During year	2 000	30 June	Insurance	5 000

Inventory adjustment (Ex)

Dr					Cr
30 June	Inventory asset	2 000			

Inventory asset (A)

Dr					Cr
			30 June	Inventory adjustment	2 000

Sales (I)

Dr					Cr
			30 June	Sales in advance	90 000

9. INTERPRET BDA INFORMATION

A.

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
2022	Unearned sales	64 000	
30 June	Sales		64 000
	Sales for six months.		
	Advertising expense	4 400	
	Prepaid advertising		4 400
	Advertising consumed.		
	Accrued interest	100	
	Interest income		100
	Interest owing from the bank.		

DATE	DETAILS	DEBIT $	CREDIT $
	Depreciation expense	300	
	Accumulated depreciation of fittings		300
	Depreciation of shop fittings.		
	Wages expense	500	
	Accrued wages		500
	Wages owing.		
	Depreciation of computer	500	
	Accumulated depreciation of computer		500
	Depreciation of computer.		
	Inventory adjustment	222	
	Inventory asset		222
	Adjustment for stock losses.		

B and C.

General Ledger

Unearned sales

2022			2		
30 June	Sales	64 000	30 June	Balance	65 000

Sales

			2022		
			30 June	Unearned sales	64 000

Prepaid advertising

			2022		
	Balance	6 000	30 June	Advertising	4 400

Advertising

30 June	Prepaid advertising	4 400			

GST collected

			2022		
				Balance	900

Interest income

			2022		
			30 Jun	Interest income	100

Accrued Income

2022					
30 June	Interest income	100		Balance	900

Depreciation – Shop Fittings

2022					
30 June	Accumulated depreciation	300			

D.

Zing Spices
Adjusted Trial Balance
As at 30 June 2022

	Debit	Credit
Cost of sales	37000	
Equity		11000
Prepaid advertising	1600	
Wages	15500	
Unearned sales		1000
Shop fittings	6000	
Accumulated depreciation – shop fittings		3900
Cash at bank	4000	
Loan		3172
Inventory	4000	
Computer	7000	
Internet and telephone fee	1050	
Transport and petrol costs	3000	
GST collected		900
GST credits received	400	
Sales		64000
Advertising	4400	
Accrued interest	100	
Interest income		100
Depreciation of fittings	300	
Accrued wages		500
Depreciation of computer	500	
Accumulated depreciation - computer		500
Inventory adjustment	222	
	$ 85072	**$ 85072**

CHAPTER 15: FINAL FINANCIAL REPORTS

Review Questions 15.1

1. *Why are closing General Journal entries prepared?*

Closing entries occur after the adjusting entries, followed by the preparation of a final Trial Balance in readiness for the presentation of Financial Statements. At the end of the accounting period, each individual income and expense ledger account is 'closed'. This means these accounts will have a zero balance for the commencement of the next accounting period. If the accounts were not closed, then the income and expense for the year would not be transferred to another account in order to calculate the profit or loss for the period.

2. *What is the closing general journal entry for depreciation?*

DATE	DETAILS	DEBIT $	CREDIT $
	Profit and Loss Summary account		
	Depreciation		
	Closing off depreciation expense to income statement account		

3. *Show the closing General Journal entries for a profit on disposal and a loss on disposal.*

General Journal entry for Loss on Disposal

DATE	DETAILS	DEBIT $	CREDIT $
	Income Statement account		
	Depreciation		
	Loss on disposal of motor vehicle		
	Closing off depreciation expense and loss on disposal to income statement account		

General Journal entry for Profit on Disposal

DATE	DETAILS	DEBIT $	CREDIT $
	Profit and Loss Summary account		
	Depreciation		
	Closing off depreciation expense to income statement account		
	Profit on disposal of motor vehicle		
	Profit and Loss Summary		
	Closing off profit on disposal to income statement account		

4. *List the closing General Journal entries that are made to recognise bad and doubtful debts.*

DATE	DETAILS	DEBIT $	CREDIT $
	Allowance for doubtful debts		
	Bad debts		
	Transfer of balance of Bad Debts.		
	Bad debts		
	Allowance for doubtful debts		
	Increase Allowance for Doubtful Debts to $5 000		
	Profit and Loss Summary		
	Bad debts		
	Closing of Bad Debts expense account.		

5. *What would be the effect on the final financial reports of not completing balance day adjustment entries?*

Income and expenses would not be matched with the correct accounting period, and the final profit or loss would be incorrect.

6. *Clearly explain the difference between adjustment entries and closing entries, using an example.*

A closing entry closes the income or expense account so that profit/loss can be calculated. An adjusting entry recognises an income or expense amount in the correct accounting period.

7. *What are the closing General Journal entries for income and expense accounts?*

Debit income accounts, credit expense accounts, and close to the Profit and Loss account.

8. *How are the balances of asset, liability and equity accounts finalised?*

They are balanced.

9. *What is the main purpose of the Trial Balance?*

To identify errors in the record keeping.

Review Questions 15.2

1. *Compare and contrast the manual and electronic methods of recording accounting information.*

Electronic accounting involves using a computer and a suitable software package to take care of the accounts.

2. *What are three advantages of electronic accounting?*

Advantages of electronic accounting:

- Processing speed
- Reduction in errors
- Minimal paper
- Automatic reports

3. *What is the main disadvantage to a business of using electronic accounting?*

For example:

- Accuracy of Inputs
- Fraud
- Back ups
- Training

4. *Describe the main purpose of the following sections of an accounting software package:*

MODULE NAME	WHY THE BUSINESS USES THE MODULE	MAIN OUTPUT
General Ledger	To keep the main business records in order to calculate and produce the major financial statements.	• Chart of accounts • Ledger accounts • Trial balance • Bank reconciliation • Income Statement • Statement of Financial Position
Accounts receivable	To record amounts owing from customers and control overdue accounts.	• Account Statements • Accounts receivable list • Aged analysis of accounts receivable
Accounts payable	To record amounts owed and ensure they are paid.	• Writing of cheques • Remittance advices • Accounts payable list • Aged analysis of accounts payable
Non-current assets	To record and control non-current assets	• Schedule of non-current assets showing purchase dates, original cost and depreciation

5. *What would the owner of a small business use each of the following reports for:*

Answers are dependent on the software package selected by the students for analysis. Responses should reflect an understanding of the user of the information.

Chapter 15 Activities

1. CLOSING ENTRIES IN THE GENERAL JOURNAL

A.

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
2021			
Jan 1	Depreciation of plant and equipment	5 000	
	Accumulated depreciation of plant and equipment		5 000
	Depreciation expense to date of sale.		
June 30	Sale of asset	150 000	
	Plant and equipment		150 000
	Transfer of historical cost of asset sold.		
	Accumulated depreciation of plant and equipment	90 000	
	Sale of asset		90 000
	Transfer of accumulated depreciation of asset sold.		
	Debtor	40 000	
	Sale of asset		40 000
	Consideration received on sale of asset		
	Loss on disposal of plant and equipment	20 000	
	Sale of asset		20 000
	Loss on sale		

B.

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
2021			
Feb 1	Bad debts	4 000	
	GST collected	400	
	Debtors		4 400
	Bad debt written off.		
June 30	Allowance for doubtful debts	4 000	
	Bad debts		4 000
	Transfer of bad debts balance.		
	Bad debts	2 000	
	Allowance for doubtful debts		2 000
	Estimation of likely bad and doubtful debts.		

C.

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
	Sales	143 000	
	Discount	2 300	
	Interest	4 560	
	Profit and loss		149 860
	Transfer of income accounts.		
	Profit and loss	154 130	
	Cost of sales		53 000
	Office supplies		12 900
	Depreciation – office equipment		2 000
	Depreciation – fixtures		3 400
	Power and water		21 900
	Advertising		4 500
	Wages		54 980
	Bad debts		1 110
	Inventory adjustment		340
	Transfer of expense accounts.		
	Capital	4270	
	Profit and loss		4 270
	Transfer of loss.		

2. TRIAL BALANCE PREPARATION

A. Trial Balance for *Trendy Threads* for the month of April 2020.

	DEBIT	CREDIT
Sales		65 000
Interest income		650
Cost of sales	18 000	
Internet	400	
Depreciation	4 000	
Bad debts	450	
Interest expense	3 200	
Delivery costs	600	
Advertising	3 000	
Electricity	650	
Salaries	20 550	
Telephone	450	
Supplies expense	3 950	
Rent expense	5 100	
Profit	5 300	
Cash management	1 000	
Prepaid rent	1 100	
Stock	17 400	
Accounts receivable	13 100	
Fittings	4 000	
Cash register	2 200	
Motor vehicle	10 300	
Shop fittings	50 000	
Buildings	400 000	
GST Clearing (Payable)		6 000
Accumulated depreciation		97 000
Overdraft		600
Accrued salaries		1 500
Accounts payable		14 000
Loan		58 000
Mortgage		194 500
Equity		127 500
	$ 564 750	**$ 564 750**

B. Trial Balance for *Gas 'n' Bubbles* for the nine months ending 30 September 2023

	DEBIT	CREDIT
Cost of sales	440 000	
Customs duty	20 000	
Depreciation expense	80 000	
Accumulated depreciation		920 000
Bad debts	4 000	
Inventory	402 000	
Accounts receivable	210 000	
Fittings	80 000	
Interest expense	40 000	
Delivery costs	8 000	
Paper supplies	60 000	
Electricity expense	8 000	
Accrued wages		16 000
Wages	320 000	
Postage	16 000	
Office furniture	42 000	
Office supplies	64 000	
Profit and Loss	176 000	
Cash at bank	244 000	
Sales		1320 000
Dividend income		12 000
Rent	96 000	
Prepaid rent	8 000	
Motor vehicle	200 000	
Machinery	800 000	
Buildings	4000 000	
Accounts payable		240 000
GST Clearing (Payable)		80 000
Loan		800 000
Mortgage		2000 000
Equity		1930 000
	$ 7318 000	**$ 7318 000**

3. FIND THE ERRORS IN A TRIAL BALANCE

Unadjusted (Corrected) Trial Balance
For the 3 months ending 30 June 2020

	Debit	Credit
Cost of sales	$ 74 000	
Wages	30 000	
Capital		$ 22 000
Prepaid advertising	12 000	
Sales		130 000
Equipment	12 000	
Computer	14 000	
Utilities	2 100	
Accumulated depreciation – Equipment		7 200
Cash at Bank	8 000	
Loan		6 344
Inventory	8 444	
GST Clearing (Payable)		1 000
Rent	2 000	
Transport and petrol costs	4 000	
	$16 544	$16 544

4. PREPARING FINANCIAL STATEMENTS FROM A TRIAL BALANCE

A. *Great Rates on China Plates*

Adjusted Trial Balance

Cost of sales	41 000	
Prepaid advertising	1 000	
Advertising expense	2 000	
Wages	24 120	
Selling costs	2 380	
Distribution expenses	2 800	
Insurance	2 000	
Sales		130 000
Sales returns	1 200	
Commission		1 300
Discount		200
Equity (including profit/loss)		2 920
Drawings	30 000	
Loss on disposal of computer	130	
GST collected		1 000
GST credits	650	
Computer	3 700	
Accumulated depreciation of computer		670
Stock	5 040	
Debtors	3 400	
Vehicle	18 700	
Accumulated depreciation of vehicle		5 425
Creditors		1 400
Interest expense	200	
Accrued interest		200
Depreciation of computer	370	
Depreciation of vehicle	4 425	
	$143 115	**$143 115**

Great Rates on China Plates
Income Statement
As at 30 June 20XX

Sales	130 000	
Less: Sales returns	1 200	
Net Sales	128 800	
Less: Cost of sales	41 000	88 000
Less: Discount	200	
Total Cost of Sales	40 800	
Add: Other income		
Commission	1 300	1 300
Less: Other expenses		
Selling		
Advertising	2 000	
Depreciation of vehicle	4 425	
Selling costs	2 380	
Distribution expenses	2 800	11 605
Office		
Wages	24 120	
Depreciation of computer	370	
Loss on disposal of computer	130	24 620
Financial		
Insurance	2 000	
Interest	200	2 200
PROFIT		**$50 875**

Great Rates on China Plates
Balance Sheet
For the year ended 30 June 20XX

Current assets	***$***	***$***	***$***
Prepaid advertising		1 000	
Stock		5 040	
Debtors		3 400	9 440
Non-current assets			
Vehicle	18 700		
Less: Accumulated depreciation of vehicle	5 425	13 275	
Computer	3 700		
Less: Accumulated depreciation of computer	670	3 030	16 305
TOTAL ASSETS			**25 745**
Current liabilities			
GST Payable		350	
Accrued interest		200	
Creditors		1 400	1 950
TOTAL LIABILITIES			**1 950**
NET ASSETS			**$23 795**
Equity			
Capital	2 920		
Add: Profit	50 875	53 795	
Less: Drawings		30 000	**$23 795**

B. *Jaymies Jade Jewellery*

Adjusted Trial Balance for the last six months of trading

Subscriptions in advance		2 690
Subscriptions income		10 760
Gain on disposal of van		1 205
Cost of sales	32 980	
Prepaid insurance	3 500	
Insurance expense	3 500	
Stock of supplies	2 880	
Supplies expense	10 100	
Salaries	34 560	
Sales		73 546
Sales returns	320	
Petty cash	36	
Cash at bank	2 379	
Trade mark	11 000	
Fixtures/fittings	45 000	
Accumulated depreciation of fixtures/fittings		12 000
Depreciation of fixtures/fittings	2 000	
Stock	32 560	
Debtors	3 200	
Creditors		14 260
Loan		2 404
Utilities expense	7 400	
Delivery expenses	4 500	
Loss from robbery	450	
Capital		109 000
Drawings	32 000	
GST Clearing		1 100
Accrued electricity		1 400
TOTAL	**$228 365**	**$228 365**

Jaymie's Jade Jewellery
Income Statement
For the previous six months

Sales		73546
Less: Sales returns		320
		73226
Cost of sales		32980
Gross Profit		**40246**
Add: Other income		
Subscriptions income	10760	
Gain on disposal of van	1205	11965
Less: Expenses		
Selling and distribution		
Delivery expenses		4500
General and administration		
Supplies expense	10100	
Salaries	34560	
Depreciation of fixtures/fittings	2000	
Utilities expense	7400	
Loss from robbery	450	
Insurance expense	3500	58 010
Loss		**$(10299)**

Jaymie's Jade Jewellery
Balance Sheet
As at 30 June 20XX

Current Assets	$	$
Prepaid insurance	3 500	
Stock of supplies	2 880	
Petty cash	36	
Cash at bank	2 379	
Stock	32 560	
Debtors	3 200	44 555
Non-current Assets		
Trade mark	11 000	
Fixtures/fittings	45 000	
Less: Accumulated depreciation of fixtures/fittings	12 000	44 000
Total Assets		**88 555**
Current Liabilities		
GST Clearing	1 100	
Creditors	14 260	
Accrued electricity	1 400	
Subscriptions in advance	2 690	19 450
Non-current Liabilities		
Loan		2404
Total Liabilities		**21 854**
NET ASSETS		**$66 701**
Equity		
Capital	109 000	
Less: Drawings	(32 000)	
Less: Loss	(10 299)	$66 701

C. *Happy Hour*

General Journal

DATE	DETAILS	DEBIT $	CREDIT $
30 June	Stock adjustment	300	
	Stock		300
	Stock losses for the period.		
	Sales	105 094	
	Sales in advance		105 094
	Sales for the period.		
	Commission	3 000	
	GST credits received	300	
	Accrued commission		3 300
	Commission earned by staff on balance day.		
	Supplies expense	4 000	
	Stock of supplies		4 000
	Supplies consumed		
	Wages	500	
	Accrued wages		500
	Wages owing on balance day		
	Allowance for doubtful debts	130	
	Bad debts		130
	Write off of bad debts to the allowance.		
	Bad debts	108	
	Allowance for doubtful debts		108
	To set allowance at 2% of accounts receivable.		
	Depreciation Motor vehicle	7 600	
	Accumulated depreciation – Motor vehicle		7 600
	Depreciation for year.		
	Depreciation – Office equipment	1 560	
	Accumulated depreciation – Office equipment		1 560
	Depreciation for year.		
	GST collected	5 600	
	GST clearing		5 600
	To close account		
	GST clearing	660	
	GST credits received		660
	TO close account		

Adjusted Trial Balance for the previous financial year

Cost of sales	43561	
Insurance expense	12450	
Stock of office supplies	200	
Supplies expense	4000	
Rent expense - Office	24000	
Wages - Staff	13950	
Accrued wages		500
Interest expense	890	
Electricity expense - Office	5790	
Bad debts	26	
Allowance for doubtful debts		76
Commission paid to staff	4398	
Sales		105094
Dividends received		4390
Discount received		320
Accrued commission	4400	
Commission income		1000
Gain on sale of motor vehicle		568
Cash at bank	560	
Land and buildings	32000	
Motor vehicles	43000	
Accumulated depreciation of Motor vehicles		12600
Depreciation of Motor vehicles	7600	
Office equipment	15600	
Accumulated depreciation of Office equipment		9360
Depreciation of Office equipment	1560	
Stock	34680	
Stock adjustment	300	
Accounts receivable	3800	
Accounts payable		7890
Loan		35677
Capital		70000
GST Clearing		5290
TOTAL	**$252765**	**$252765**

Happy Hour
Income Statement

Sales			105094
Less: Cost of sales			43561
Less: Discount received	320		
Total Cost of Sales	43 241		
Gross Profit			**61853**
Add: Other income			
Dividends received		4390	
Discount received		320	
Gain on sale of motor vehicle		568	
Commission income		1000	5 958
Less: Other expenses			
Employee expenses			
Wages - Staff	13950		
Commission paid to staff	4398	18348	
Depreciation expenses			
Depreciation of Office equipment	1560		
depreciation of Motor vehicles	7600	9160	
Finance expenses			
Interest expense		890	
Office expenses			
Bad debts	26		
Insurance expense	12450		
Supplies expense	4000		
Rent expense - Office	24000		
Electricity expense - Office	5790		
Stock adjustment	300	47 456	74964
Loss			**$(7153)**

Happy Hour
Balance Sheet

ASSETS	**$**	**$**
Cash at bank		560
Stock		34680
Stock of office supplies		200
Accrued commission		4400
Accounts receivable	3800	
Less: Allowance for doubtful debts	76	3724
Office equipment		15600
Land and buildings	32000	
Accumulated depreciation of Office equipment	9360	22640
Motor vehicles	43000	
Accumulated depreciation of Motor vehicles	12600	30400
Total Assets		$112204
EQUITIES		
Liabilities		
Accrued wages		500
Accounts payable		7890
GST Clearing		5290
Loan		35677
Equity		
Capital	70000	
Less: Loss	(7153)	62847
Total Equities		$112204

D. Emilo

Emilio's Fitness and Gym
Adjusted Trial Balance

Sales		202000
Interest income		4000
Accrued interest income	100	
Government grant	56000	
Cost of sales	65000	
Prepaid advertising	200	
Advertising	3600	
Capital		250000
Drawings	67000	
GST Clearing (Payable)		7900
Supplies expense	5600	
Wages	66500	
Accrued wages		1500
Interest expense	860	
Accrued interest expense		300
Bad debts	750	
Administration expenses	32700	
Allowance for doubtful debts		1350
Cash management account	3000	
Cash at bank	560	
Patent	43000	
Land and buildings	89070	
Laboratory equipment	67600	
Accumulated depreciation of Laboratory equipment		55233
Depreciation of Laboratory equipment	10140	
Stock	65333	
Debtors	45000	
Creditors		6430
Mortgage		93300
	$622013	**$622013**

Emilio's Fitness and Gym
Income Statement

Sales		202000
Cost of sales		65000
Gross profit		**137000**
Add: Other income		
Interest income		4000
Less: Expenses		
Advertising	3600	
Supplies expense	5600	
Wages	66500	
Interest expense	860	
Bad debts	750	
Administration expenses	32700	
Depreciation of Laboratory equipment	10140	120150
Profit		**$20850**

Emilio's Fitness and Gym
Balance Sheet

Assets	***$***	***$***
Cash management account		3000
Cash at bank		560
Accrued interest income		100
Prepaid advertising		200
Stock		65333
Debtors	45000	
Less: Allowance for doubtful debts	1350	43650
Patent		43000
Land and buildings		89070
Laboratory equipment	67600	
Less: Accumulated depreciation of Laboratory equipment	55233	12367
Government grant		56000
Total Assets		**313280**
Liabilities		
GST Clearing (Payable)		7900
Accrued interest expense		300
Accrued wages		1500
Creditors		6430
Mortgage		93300
Total Liabilities		**109430**
NET ASSETS		**$203850**
Equity		
Capital		250000
Add: Profit		20850
Less: Drawings		67000
Total Equity		**$203850**

E. *The Spanish Bull.*

The Spanish Bull
Adjusted Trial Balance
as at 30 June 2020

Cash in cash register	440	
Cash at bank	4 270	
Goodwill	6 000	
Café furniture and fittings	14 000	
Depreciation café furniture and fittings	1 400	
Accumulated depreciation café furniture and fittings		1 400
Inventory	5 690	
Accounts receivable	8 700	
Sales		498 000
Discount received		4 300
Gain on disposal of café furniture		2 910
Cost of sales	398 050	
Prepaid advertising	2 200	
Advertising	200	
Prepaid rent	1 500	
Rent expense	4 500	
Wages	61 400	
Accrued wages		600
Power and water expense	14 290	
Accounts payable		15 730
Capital		38 600
Drawings	40 900	
GST Clearing (Payable)		2 000
	$563540	**$563540**

The Spanish Bull
Income Statement
for the period ended 30 June 2020

Sales		$498 000
Less: Cost of sales		
Less: Discount received	4 300	
Total Cost of Sales		(393 750)
GROSS PROFIT		**104 250**
Add: Other income		
Gain on disposal of café furniture		2 910
Less: Expenses		
Advertising	200	
Rent expense	4 500	
Wages	60 200	
Depreciation café furniture and fittings	1 400	
Power and water expense	14 290	(80 590)
PROFIT		**$26 570**

The Spanish Bull
Balance Sheet
as at 30 June 2020

Assets		
Prepaid rent		1500
Prepaid advertising		2200
Cash in cash register		440
Cash at bank		4270
Inventory		5690
Accounts receivable		8700
Café furniture and fittings	14000	
Accumulated depreciation café furniture and fittings	1400	12600
Goodwill		6000
Total Assets		**41400**
Equities		
Liabilities		
Accrued wages	600	
GST Clearing (Payable)	2000	
Accounts payable	15730	18330
Owner's equity		
Capital	38600	
Less: Drawings	40900	
Add: Profit	25370	23070
Total Equities		**41400**

CHAPTER 16: ANALYSIS OF LIQUIDITY AND LEVERAGE

Review Questions 16.1

1. Summarise the main liquidity ratios.

The liquidity ratios for a business are:

- Working capital
- Quick asset ratio

Working capital or current ratio = $\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

Quick asset ratio = $\dfrac{\text{Current assets (not including inventory and prepayments)}}{\text{Current liabilities (not including bank overdraft)}}$

2. What is an ideal result for the working capital ratio and the quick asset ratio?

The ideal level or result for the working capital ratio is a ratio of 2.0:1.0 or 200%, as this indicates that for every dollar of current liabilities the business has two dollars of current assets to meet that obligation.

The ideal level or result for the quick asset ratio is a ratio of 2.0:1.0 or 200%, as this indicates that for every dollar of current liabilities the business has two dollars of current assets to meet that obligation. For the quick ratio, as long as the result is above 1.0:1.0 or 100% there are no concerns.

3. What does an increase in the liquidity ratios generally indicate?

An increase generally indicates the business might be able to immediately pay all short term debt. Current assets may have increased or current liabilities decreased.

4. What does a decrease in liquidity ratios generally indicate?

A decrease generally indicates the business might NOT be able to immediately pay all short term debt. Current assets may have decreased or current liabilities increased.

5. Calculate liquidity ratios using the following information, expressing your final result as both a ratio and a percentage. Interpret the results.

Working capital ratio = $\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

= $\dfrac{(500 + 12\ 000 + 24\ 090 + 1\ 300)}{(4\ 400 + 33\ 000)}$

= $\dfrac{37\ 890}{37\ 400}$

= 101% or 1.01: 1.00

Quick asset ratio = $\dfrac{\text{Current assets (not including inventory and prepayments)}}{\text{Current liabilities (not including bank overdraft)}}$

= $\dfrac{(500 + 12\ 000)}{33\ 000}$

= 38% or 0.38: 1.0

Review Questions 16.2

1. Define 'leverage'.

Leverage is the relationship between the debt and the equity of a business. If a business has high leverage, there is a high level of borrowed external funds compared to internal equity. A low leverage means that there is a low portion of external debt compared to internally generated equity.

2. What effect do interest rates have on decisions that are made about leverage?

A business will usually prefer to have low leverage, because that means that it is providing funds through daily trading and from the owners, who are less likely to require the repayment of capital. When more funds are provided from external debt, there is a requirement to repay this debt at a specific point in time, as well as to pay interest, and this places pressure on the business. The pressure can affect the cash flow of the business.

3. Summarise the debt to equity ratio.

Debt to Equity ratio:

$$\text{Leverage} = \frac{\text{Total Debt (Liabilities)}}{\text{Total Equity}}$$

4. What is an ideal result for the leverage ratio?

The ideal level or result for the Debt to Equity ratio is below 1.0:1.0 or 100%, as this indicates that the business is less reliant on external financing pressures than on internal finance.

5. What does an increase in the leverage ratio generally indicate?

If this ratio is increasing or above the ideal amount, generally, this indicates there is a high level of borrowed external funds. Liabilities might have increased.

6. What does a decrease in the leverage ratio generally indicate?

If this ratio is decreasing or below the ideal amount, generally, this indicates there is a low level of borrowed external funds. Equity might have increased.

7. Summarise the steps to follow in appraising business performance.

Steps:

- List the main needs of the user of the information
- Collect all the financial and non-financial information
- Decide on the required standards that the business needs to achieve
- Define WHY the data has been selected
- Complete the analysis of the data
- Compare the analysis with the expectations and required standards
- Use this information to decide on an ACTION PLAN for the business
- Make recommendations for change and stability

8. What is an action plan?

A targeted pan for what the business needs to do to achieve its mission and goals.

9. Why is non-financial information important in measuring business success or failure?

Items that are not included in financial information can still form an important part of performance analysis. Possible areas of the business to examine would include:

- The customer service policy
- Health and safety standards
- Quality control procedures
- Strategies for employee learning and business growth
- Manufacturing or sales targets
- Environmental objectives and achievements
- Community involvement.

10. What are the limitations of ratio analysis in assessing performance from given data?

Limitations:

- Past performance does not predict future results.
- Lack of detail.
- The limited perspective due to one set of financial information at a point in time.
- The difficulty of making meaningful comparisons.

11. Complete a summary table, indicating whether an increase or decrease in each ratio is generally a favourable or an unfavourable indicator of business results. Use these headings:

No answer supplied for this question.

RETURN ON ASSETS

If this ratio is increasing:

- Generally, the money invested in the business is being used more efficiently.
- A greater return may be being earned from the same quantity of assets.

If this ratio is decreasing:

- Generally, the business is using assets less efficiently.
- The business might need to consider reducing the amount invested in assets, ensuring that assets are not idle, or examine profits using any of the points mentioned previously.

GROSS PROFIT

If this ratio is increasing:

- Generally, this means that the profit being earned from the sale of stock or inventory has risen in proportion to total sales.
- The business might be selling a greater portion of high profit items.
- Cost of Sales may have decreased for some reason, such as lower freight costs or customs duty.
- The method of valuing stock may have altered – ie: beginning inventory may be lower or ending inventory higher than usual.
- Perhaps the difference between the selling and purchasing price has increased – ie: the business has a higher 'mark up'.

If this ratio is decreasing:

- Generally, this means that the profit being earned from the sale of stock has decreased in proportion to total sales.
- The business might be selling a higher proportion of low profit items. Perhaps the business is offering a discount, or has decided to have a sale of slow-moving stock.
- Cost of Sales may have increased for some reason, such as higher freight costs.
- The method of valuing stock may have altered.
- Perhaps the difference between the selling and purchasing price has decreased – ie: the business has lowered the sales price and costs have not changed.

PROFIT RATIO

If this ratio is increasing:

- Generally, this means that the profit being earned has risen in proportion to the total sales.
- The business might be selling a greater portion of high profit items, or have a high amount of income from a source other than sales.
- Cost of Sales may have decreased for some reason, such as discounts provided from bulk purchasing.
- Expenses may have decreased.
- Perhaps the difference between fixed expenses and sales income has changed, and the same amount of expense is allocated over a higher income amount.

If this ratio is decreasing:

- Generally, this means that the profit being earned decreased in proportion to total sales
- The business might be selling a higher proportion of low profit items.
- Cost of Sales may have increased for some reason, such as higher discounts allowed.
- Expenses may have increased – investigate the expense ratios carefully.
- Perhaps the fixed expenses are now allocated over a lower income amount.

EXPENSE RATIOS

If these ratios are increasing:

- Generally, this is indicating that the expenses are increasing in proportion to sales (or fees).
- There might have been an extraordinary expense incurred.
- Look at the impact of all changes to expense ratios.

If these ratios are decreasing:

- Generally, this is indicating that the expenses are decreasing in proportion to sales (or fees).
- Look at the impact of all expense ratio changes, to find out where the business has become more efficient and why.

WORKING CAPITAL

If this ratio is increasing:

- Generally, this indicates that the short term asset base is increasing, in proportion to the short term liabilities of the business.
- Inventory might be being sold more slowly.

- Debtors may be taking longer to pay.
- There may be 'idle cash', which could be invested in cash accounts to earn interest, or used to purchase needed assets.

If this ratio is decreasing:

- Generally, this indicates that the short term asset base is decreasing, in proportion to the short term liabilities of the business.
- Inventory might be being sold more quickly.
- Debtors may paying more promptly.

QUICK RATIO

If this ratio is increasing:

- Generally, this indicates the business might be able to immediately pay all short term debt.
- Debtors, short term investments or cash might have increased.
- Creditors might have decreased.

If this ratio is decreasing:

- Generally, this indicates the business might not be able to immediately pay all short term debt.
- Debtors, short term investments or cash might have decreased.
- Creditors might have increased.

Chapter 16 Activities

1. THE IMPORTANCE OF LIQUIDITY

A. **Working capital ratio:** the difference between current assets and current liabilities, calculates the excess of liquid assets over short term debts.

Quick ratio: compares current assets that can be quickly converted into cash, such as cash, short term investments and debtors with the current liabilities that must be paid immediately, such as creditors.

A merchandising or retail business with very high amounts in their debtor and creditors accounts might find the quick ratio more useful as the purchase and sale of stock could be their main source of funds.

B. High profitability can occur with the inclusion of non-cash items, such as high credit sales. Non-cash income and expense items can have a significant effect on final profit/ loss calculation. The businesses ability to repay short term debt can be in doubt because of low current assets and high current liabilities. These are not measured in the profit of the business.

C. Working capital is a comparison of current assets and current liabilities. It is funds required to maintain the business and to pay for ongoing expenses, as compared to finds for long term capital investment. The working capital ratio is one method to gauge liquidity.

2. LEVERAGE

A. **Internal finance (Equity)** is provided to the business by the owner, earned from trading or from selling assets for cash. It is capital and not required by any written contract to be repaid to the owner.

External finance (Liabilities) is supplied to the business by a financial institution or loan provider who is paid interest, or a trade creditor who supplies products before being paid. A loan must be repaid with interest by a due date.

B. If a business has high gearing, there is a high level of borrowed external funds compared to internal equity. This means that interest payments will have a greater effect on the expenses of the business. A business with high gearing may be able to meet interest payments, though under a regime of high interest rates this is difficult. When more funds are provided from external debt, there is a requirement to repay interest and this places pressure on the business, affecting the cash flow of the business.

C. Discussion question. Responses should consider the purpose of the business and its goals, and relate these to the leverage issues raised. As equity investment increases, this might result in a corresponding increase in liabilities which have a compulsory commitment to regular repayments. Issues of paying interest, especially in times of high interest rates, should be raised.

3. LIMITATIONS OF RATIO ANALYSIS

A. Problems can arise from the fact that the past performance of the business does not predict future results, the lack of specific detail in aggregated ratio information, the limited perspective from looking at only one set of financial information at a point in time. There is also the challenge of finding other businesses in similar industries in order to be able to make meaningful comparisons.

B. For example:

BUSINESS	SITUATION	FINANCIAL INFORMATION TO CONSIDER	NON-FINANCIAL INFORMATION TO CONSIDER
Café	Customers have been complaining about service and sales are falling	Sages of service staff, cost of training, cafe expenses	Staff morale, customer feedback surveys
Computer parts manufacturer	Gross profit is decreasing	Profitability, cost of sales	Customer advertising
Florist	Staff are charging incorrect amounts for product, profit is unchanged	Complexity of pricing, gross margin	Training of staff
"Ready to eat dinners" manufacturer and distributor	Petrol prices have increased, however distribution expenses have not changed	Profitability	Delivery routes
Land developer	An environmental audit requires the business to invest more into waste management	Leverage, working capital	Corporate social responsibility
Music shop	Employees are resigning and wages are rising	Wages, profitability	Staff morale, time sheets

4. THE IMPORTANCE OF NON-FINANCIAL INFORMATION

RATIO	WISSE'S WINERY	HENRIETTA'S HAUTE COUTURE
Gross profit ratio	0.65: 1.0	0.67: 1.0
Profit margin	0.13: 1.0	0.10: 1.0
Expense ratio	0.53: 1.0	0.76: 1.0
Administrative expenses ratio	0.03: 1.0	0.07: 1.0
Current/Working capital ratio	338%	202%
Quick ratio	177%	91%
Gearing	1.62: 1.0	2.15: 1.0

5. DECISIONS ABOUT BUSINESS FINANCING

A. i. 150%

ii. 50%

iii. 106%

iv. 150%

v. Equity = A – L. Ratio = $\frac{125\ 000}{220\ 000}$ = 57%

B. Before investing, ratio = $\frac{16\ 000}{15\ 000}$ = 107%

If fittings purchased on credit, new ratio = $\frac{18\ 000}{15\ 000}$ = 120%

C. *Tremendous Traders*

Ratios for 2020 and 2021:

Ratio	2020		2021	
Gearing	= $\frac{390\ 000}{390\ 000}$	100%	= $\frac{385\ 000}{385\ 000}$	100%
Return on assets	= $\frac{42000}{(160000 + 780000)/2}$	8.9%	= $\frac{4000}{(780000 + 770000)}$	0.5%

6. IMPROVING BUSINESS PERFORMANCE

RATIO	BUSINESS	TO IMPROVE
Gearing	Clothing manufacturer	• If borrowed funds are too high, how might these be more quickly repaid? • Can equities be increased through further owner investment?
Inventory turnover	Surf shop	• If sales of surfboards are becoming less frequent, has stock management become inefficient? • Is there a seasonal element given that surfing is more likely to be a summer recreation? • Has there been a permanent decline in popularity for the boards? • Is there any obsolete or unpopular brands of board?
Working capital ratio	Bakery	• If the ratio is too low, the short term asset base requires investigating – are some inventory lines (types of bread) being sold more quickly? Are some debtors paying more quickly? • Note: if ratio is too high, is there idle cash that should be invested?
Quick ratio	Mobile phone store	• If the ratio is decreasing then the creditors may have increased. • Have short term cash sources such as debtors and investments decreased? • Will the business be able to pay short term debt?

7. CALCULATE AND INTERPRET LIQUIDITY RATIOS

A. *Business P*

Ratio	Calculation	Percentage expression	Ratio expression
Working capital/ Current ratio	74 400 / 74 000	100.5%	1.00: 1.0
Quick asset ratio	1 000 + 25 000 / 66 000	39.4%	0.39: 1.0
Gearing	8 000 + 66 000 + 50 800 / (179 400 – 124 800)	228%	2.28: 1.0

B. *Business Q*

Ratio	Calculation	Percentage expression	Ratio expression
Working capital/ Current ratio	63900 / 90500	70.6%	0.71: 1.0
Quick asset ratio	11000 + 45000 / 14500 + 76000	61.9%	0.62: 1.0
Gearing	997400 / 1476900 - 997400	20.8%	0.21: 1.0

C. *Business R*

Ratio	Calculation	Percentage expression	Ratio expression
Working capital/ Current ratio	645 000 / 400 500	161.0%	1.61: 1.0
Quick asset ratio	645000 – 100000 – 5500 / 400500	134.7%	1.35: 1.0
Gearing	400500 + 60000 / (965000 – 460500)	91.3%	0.91: 1.0

8. CALCULATE AND INTERPRET LIQUIDITY AND GEARING RATIOS

Kieran's Kitchenware Kapers

Liquidity and Gearing Ratios

Ratio	2026	2027
Current ratio	63.7%	210.7%
Quick ratio	102.8%	153.4%
Gearing	101.5%	117.1%

The liquidity of the business has increased over the previous two years, indicating the possibility of idle cash becoming available. This could potentially be considered as part of Kieran's financing options. Inventory levels have fallen, with turnover increasing and so more stock appears to be being sold more rapidly. Gearing has increased slightly, though it is still manageable. With an additional $40000 loan, gearing would increase to 134.4% which is a serviceable level of debt as long as interest rates are not too high, and as lone as the profit of the business moves into positive range.

9. ANALYSIS OF RATIO INFORMATION

Jive Jewellery

Liquidity:

- Working capital ratio good, strong short term asset base and potentially idle cash which should be invested or used to fund purchases.
- Concern with quick asset ratio, though are creditors quite high relative to the inventory and prepayments which are excluded from this ratio? Indicates a concern which is not apparent from just looking at working capital.
- Ideally should be at 200% as for every dollar of liability there is two dollars of current asset for repayment – very safe.
- Industry average is lower than the business for both – appears to be much stronger than its competition.

Leverage:

- Low gearing, trend toward a further decrease.
- Industry is lower still which means it has better results in this area
- If interest rates are not a concern there is no pressure on cash flow
- More internally generated funds than external.

10. FINANCIAL INFORMATION AND ANALYSIS

Pepperoni Pete's Pizza Treats

Liquidity ratios

2022 current ratio $= \frac{158000}{36000} = 438\%$

2023 current ratio $= \frac{109500}{44000} = 249\%$

2022 quick ratio $= \frac{19500}{36000} = 54.1\%$

2023 quick ratio $= \frac{24000}{44000} = 54.5\%$

Stability

2022 gearing $= \frac{236000}{668000} = 35.3\%$

2023 gearing $= \frac{224000}{696500} = 32.2\%$

CHAPTER 17: ANALYSIS OF PROFITABILITY

Review Questions 17.1

1. *Compare and contrast the terms 'profit' and 'profitability'.*

The term profitability is different from the word profit. An Income Statement results in a profit when there is an excess of income over expenses. Profitability requires a comparison between the profit figure and a base figure – it is a measure of the return that the business has learnt from the owner's investment in the assets of the business.

2. *Summarise the main items found in profitability ratios.*

Profitability ratios for a business are:

- Return on fees (service business) or gross profit ratio (trading / retail / merchandising business)
- Profit ratio
- Expense ratios
- Rate of return on assets.

3. *Explain the difference between profitability ratios for a service and for a merchandising business.*

Return on fees applies to a service business and the gross profit ratio to a trading or merchandising business.

4. *Why would a business owner compare their business results with industry averages, budgeted amounts and results from previous accounting periods?*

Comparisons allow the business owner to have a benchmark against which to measure the progress of the business toward it goals.

A business owner makes comparison for the following reasons:

- Industry averages to consider how the business is performing compared to businesses offering a similar product or service.
- Budgeted amounts to analyse if the goals of the business for the financial period were achieved. If budgets are not achieved, the business owner will consider how to reduce costs or increase income so that the budgeted profit figure for the following period can be achieved.
- Comparison over time the owner compares the current profit figure with that earned over the last few accounting periods to place the figure into perspective. Comparisons show if profit is gradually decreasing or increasing over time, then the owner must find reasons for any trends.

5. *Calculate the return on fees ratio for Abigail's Dressmaking Service from this information:*

	2020	2021
Fees	$100 000	$98 000
Expenses	53 000	50 000

a. What is the return on fees for 2020?
b. What is the return on fees for 2021?
c. Suggest a reason for this trend.

Return on fees = Profit / Fees

a. For 2020 = 47%

b. For 2021 = 49%

c. The ratio has increased slightly which is a positive indication. It is relatively high reflecting a high profitability.

6. *Calculate the gross profit ratio for Kim's Cakes Online from this information:*

	2020	2021
Gross profit/Loss	$50 000	$(2 000)
Net sales	145 000	66 000

a. What is the gross profit ratio for 2020?
b. What is the gross profit ratio for 2021?
c. Suggest a reason for this trend.

Gross profit ratio = Gross Profit / Net Sales

a. For 2020 = 34%

b. For 2021 = -3%

c. The ratio has declined excessively, to a very poor negative result, reflective of an overall loss.

7. *Calculate the profit ratio for Kim's Cakes Online from this information:*

	2020	2021
Gross profit/Loss	$50 000	$(2 000)
Net sales	145 000	66 000
Profit/Loss	6 000	(5 500)

A. What is the profit ratio for 2020?
B. What is the profit ratio for 2021?
C. Suggest a reason for this trend.

Profit ratio (Profit margin) = Profit / Net Sales

A. For 2020 = 4%

B. For 2021 = -8.3%

C. The ratio is declining and a very poor result. It appears to be reflective of the poor sales.

8. *What is an ideal result for the gross profit ratio and the profit margin?*

The ideal level or result for the gross profit margin and the profit ratio is any positive amount, the higher the better. A negative result indicates that a gross loss or overall loss has been made.

9. *What does an increase in the profitability ratios generally indicate?*

If these ratios are increasing or above the ideal amount, generally, this means that the profit has risen in proportion to total sales. The business might be selling a greater portion of high profit items, cost of sales may have decreased, the method of valuing stock may have altered or the price mark up could have changed.

10. *What does a decrease in profitability ratios generally indicate?*

If these ratios are decreasing or below the ideal amount, generally, this means that the profit being earned decreased in proportion to total sales. The business might be selling a higher proportion of low profit items, cost of sales may have increased for some reason, expenses may have increased or perhaps fixed expenses are now allocated over a lower income amount.

Review Questions 17.2

1. *Summarise the main expense ratios.*

Expense ratios:

$$\text{Selling and Distribution Expense ratio} = \frac{\text{Selling and Distribution Expenses}}{\text{Net Sales}}$$

$$\text{General and Administration Expense ratio} = \frac{\text{General and Administration Expenses}}{\text{Net Sales}}$$

$$\text{Financial Expense ratio} = \frac{\text{Financial Expenses}}{\text{Net Sales}}$$

2. *What is an ideal result for any expense ratio?*

There is no ideal level (as such) for the expense ratios, preferably these ratios should be as low as possible, and the trend should be toward lower expense ratios. They will never give a negative result.

3. *What does an increase in the expense ratios generally indicate?*

If these ratios are increasing, generally, this is indicating that the expenses are increasing in proportion to sales (or fees).

4. *What does a decrease in expense ratios generally indicate?*

If these ratios are decreasing, generally, this is indicating that the expenses are decreasing in proportion to sales (or fees).

5. *Define 'rate of return on assets'.*

The rate of return on assets is the return (usually in the form of profits) that the business is achieving from the owner's investment in the assets of the business.

6. *Summarise the return on assets ratio.*

Return on assets ratio: This ratio indicates how efficiently the business is using its assets to generate profit.

7. *What is an ideal result for the return on assets?*

The ideal level or result for the return on assets ratio is a positive amount, as a negative result indicates that a loss has been made.

8. *What does an increase in the return on assets ratio generally indicate?*

If this ratio is increasing, generally it indicates that the money and assets that are invested in the business, and being used by the business to earn economic benefits, are being used in a more efficient manner.

9. *Calculate profitability ratios using the following information, expressing your final result as both a ratio and a percentage. Interpret the results.*

- Net sales = 220 000
- Cost of sales = 156 980
- Gross profit = 63 020
- Administrative expenses = 39 500
- Selling expenses = 26 444
- Financial expenses = 5 690
- Profit/(Loss) = (8 614)

Selling Expense ratio $= \frac{\text{Selling Expenses}}{\text{Net Sales}} = \frac{26\,444}{220\,000} = 12\%$

Administrative Expense ratio $= \frac{\text{Administrative Expenses}}{\text{Net Sales}} = \frac{39\,500}{220\,000} = 18\%$

Financial Expense ratio $= \frac{\text{Financial Expenses}}{\text{Net Sales}} = \frac{5\,690}{220\,000} = 3\%$

Expense ratio $= \frac{\text{Operating Expenses}}{\text{Net Sales}} = \frac{71\,634}{220\,000} = 33\%$

Gross profit ratio $= \frac{\text{Gross Profit}}{\text{Net Sales}} = \frac{63\,020}{220\,000} = 29\%$

Profit ratio (Profit margin) $= \frac{\text{Profit}}{\text{Net Sales}} = \frac{(8\,614)}{220\,000} = -4\%$

Chapter 17 Activities

1. PROFITABILITY COMPARISONS

A. Ratios for 2020 and 2021:

Ratio	2020		2021	
Gross profit	$\frac{19000}{66000}$	28.8%	$\frac{31000}{77000}$	40.2%
Profit	$\frac{(5000)}{66000}$	-7.6%	$\frac{12000}{77000}$	15.6%
Administrative expenses	$\frac{13000}{66000}$	19.7%	$\frac{5000}{77000}$	6.5%
Rate of return on assets	$\frac{(5000)}{150000}$	-3.3%	$\frac{12000}{149000}$	8.0%

Ratios for 2019:

Ratio	2019
Gross profit	30%
Profit	16.7%
Administrative expenses	4.7%
Rate of return on assets	8.7%

B. Interpretation of ratios:

Ratio	Discussion
Gross profit	Has increased over the three years, but still under the industry average. Profit being earned from the sale of stock is increasing in proportion to the total sales. There might be more high profit items or lower costs of sales.
Profit	Stable in 2019 and 2021, with a concerning loss in 2020. Still under the industry average. Budgeted profit was much higher in 2020, and in contrast 2021 was a much better year for achieving close to the budgeted profit figure of $10000.
Administrative expenses	Very high ratio in 2020 requires further investigation, administrative expenses were extraordinarily high compared to the prior and post years. The business was very inefficient in this year however longer term trends could indicate that this was a once-off problem.
Rate of return on assets	This is constant in 2019 and 2021 with the negative result in 2019 being due to the loss made. The business returns from asset investment is lower than the returns being earned in the industry.

2. TRENDS IN PROFITABILITY RATIOS

The gross profit ratio is gradually improving, a positive trend. This might indicate:

- That the profit being earned from the sale of stock or inventory has risen in proportion to total sales.
- The business might be selling a greater portion of high profit items.
- Cost of Sales may have decreased for example: lower freight costs or customs duty.
- Method of valuing stock may have altered for example: beginning inventory may be lower or ending inventory higher than usual.
- The business may have a higher 'mark up'.

The profit ratio is also showing gradual improvement. This might be due to:

- Profit being earned rising in proportion to total sales.
- The business selling a greater portion of high profit items, or receiving a high amount of income from a source other than sales.
- Cost of Sales may have decreased for example: through discounts provided from bulk purchasing.
- Expenses may have decreased.
- The difference between fixed expenses and sales income changing, and the same amount of expense being allocated over a higher income amount.

The expense ratio is dropping, also a positive trend, which might be due to decreased expenses – this requires further, more detailed investigation to find out which expenses are affected.

The return on assets ratio has increased slightly and is generally quite stable. This indicates that the business is using the money and assets invested in the business in a more efficient manner to earn economic benefits.

3. CALCULATE AND INTERPRET GROSS PROFIT AND EXPENSE RATIOS

A. *Business D*

Ratio	Calculation	Percentage expression	Ratio expression
Gross profit ratio	$= \frac{140\ 000}{330\ 000}$	42.4%	0.42: 1.00
Administrative expense ratio	$= \frac{59\ 000}{330\ 000}$	17.9%	0.18: 1.00
Selling expense ratio	$= \frac{33\ 000}{330\ 000}$	10.0%	0.10: 1.0
Financial expense ratio	$= \frac{9\ 000}{330\ 000}$	2.7%	0.03: 1.0
Expense ratio	$= \frac{59000 + 33000 + 9000}{330\ 000}$	30.6%	0.31: 1.0

B. *Business E*

Ratio	Calculation	Percentage expression	Ratio expression
Gross Profit	= $\frac{370\ 000}{780\ 000}$	47.4%	0.47: 1.0
Expense	= $\frac{120\ 000}{780\ 000}$	15.4%	0.15: 1.0

C. *Business F*

Ratio	Calculation	Percentage expression	Ratio expression
Gross profit ratio	= $\frac{9\ 000}{20\ 000}$	45.0%	0.45: 1.0
Distribution expense ratio	= $\frac{900}{20\ 000}$	4.5%	0.045: 1.0
Selling expense ratio	= $\frac{3\ 400}{20\ 000}$	17.0%	0.17: 1.0
Financial expense ratio	= $\frac{2\ 500}{20\ 000}$	12.5%	0.12: 1.0
Expense ratio	= $\frac{900 + 3400 + 2500}{20\ 000}$	34.0%	0.34: 1.0

4. CALCULATE AND INTERPRET PROFITABILITY RATIOS

Business	Gross Profit ($)	Profit/Loss ($)	Sales ($)	Expenses ($)	Average Assets ($)
Red	50 000	20 000	102 000	30 000	170 000
Blue	100 000	8 000	210 000	92 000	230 000
Purple	17 000	(12 000)	44 000	29 000	180 000
Orange	99 000	(15 000)	198 000	114 000	609 000
Green	27 000	(3 000)	81 000	30 000	201 000

Business	Gross Profit Ratio	Profit Margin	Expense Ratio	Return on Assets
Red	49%	19.6%	29.4%	11.8%
Blue	47.6%	3.8%	43.8%	3.5%
Purple	38.6%	-27.3%	65.9%	-6.7%
Orange	50.0%	-7.6%	57.6%	-2.5%
Green	33.3%	-3.7%	37.0%	-1.5%

5. CALCULATE PROFITABILITY RATIOS AND CONSIDER A LOAN

Sally's Surf Store.

RATIO	CALCULATION ON 2013 INFORMATION	CALCULATION IF LOAN TAKEN
Gross profit ratio	55%	42%
Profit margin	35%	37%
Selling expenses ratio	6%	6%
Return on equity	500%	616%
Return on assets	75%	92%
Debt to equity	85%	9%

6. CALCULATE RATIOS FOR A MANUFACTURING BUSINESS AND MAKE SUGGESTED COMPARISONS

Clyde Dale's Carpets and Horsehair Rugs

A. Gross profit ratio $= \dfrac{200\,000}{440\,000}$

$= 45.4\%$

Profit margin $= \dfrac{21\,000}{440\,000}$

$= 4.8\%$

Selling costs ratio $= \dfrac{92\,000}{440\,000}$

$= 20.9\%$

Office costs ratio $= \dfrac{52\,000}{440\,000}$

$= 11.8\%$

Transport costs ratio $= \dfrac{25\,000}{440\,000}$

$= 5.7\%$

Finance costs ratio $= \dfrac{30\,000}{440\,000}$

B. The profitability of the business has declined. Sales have not altered over the two years, meaning that there must have been a relative increase in cost of sales, as well as in some or all of the expense categories.

The gross profit ratio decrease may be due to more low profit carpets being sold than high mark-up carpets, or increase in cost of sales such as purchasing or freighting the carpets.

The profit margin has decreased by a larger proportion and so the number of low mark-up items being sold and the use of specials must be investigated. Any large increases in expense must be considered. The transport costs ratio has remained constant, so the other expense categories should be considered. For the overall expense ratio to increase by 15% is a very negative trend.

7. STABILITY, PROFITABILITY, EFFICIENCY AND LIQUIDITY

Burke's Bikes

RATIO	2021	2022
STABILITY		
Return on assets	0.5%	- 1.8%
Return on equity	1.4%	- 5.2%
Gearing	179%	195%
PROFITABILITY		
Gross profit ratio	66%	61%
Profit margin	3.2%	12.7%
Expense ratio	101%	109%
EFFICIENCY		
Debtors turnover	90 days	103 days
Creditors turnover	263 days	256 days
Inventory turnover	0.95 times	1.14 times
LIQUIDITY		
Working capital ratio	2.7: 1.0	2.0: 1.0
Quick ratio	1.3: 1.0	0.9: 1.0

CHAPTER 18: GOVERNMENT, THE COMMUNITY, AND FINANCIAL INSTITUTIONS

Review Questions 18.1

1. *What is the difference between bookkeeping and accounting?*

An accountant might develop the accounting system for a specific business in response to its unique needs, while it is the role of the bookkeeper to ensure that records are kept and the system is used to an optimal level.

2. *Why do professional associations require registration and a specific level of study?*

Members are require to have a high level of professional expertise, and may be called upon to assist with decision making for a variety of business and personal needs. Individuals in these roles are needed to interpret information, develop policies and enable risk management.

3. *Summarise the membership requirements of the three major professional accounting bodies in Australia.*

Membership:

CPA Australia

- Education and training
- Technical support of members
- Advocacy
- Represent the profession

Chartered Accountants Australia and New Zealand (CA ANZ)

- Advocacy and leadership
- Influence policy
- Act in the public interest
- Educating candidates and members

Institute of Public Accountants (IPA)

- Support member needs
- Provide education
- Lobby on legislative issues
- Products and services for members

4. *List areas of specialisation in the provision of financial services.*

Specialist areas:

- information and communication technology
- auditing
- insolvency
- management accounting
- financial planning
- taxation and treasury.

5. *What are the main categories of financial association found in Australia?*

Categories:

- Stock market
- Business financing
- Superannuation
- Investing
- Insurance

6. *What are the expectations of the professional accounting and financial associations in Australia, as outlined in the Australian Financial Service Reform Act 2001?*

Expectations of A&F professionals

- Independence
- Integrity
- Truthfulness
- Objectivity
- Honesty
- Reliability
- Fairness

Review Questions 18.2

1. *Draw a mind map summarising key ethical business principles.*

Ethical principles to map (for example): Integrity, objectivity, professional competence and due care, confidentiality, professional behaviour.

2. *Draw a diagram showing the decisions to be made when resolving an ethical dilemma.*

Resolving an ethical dilemma:

- Outline all relevant facts
- List the ethical issues
- Decide which of the Fundamental Ethical Principles apply
- List the businesses established internal procedures
- List all alternative courses of action and the consequences of each one

3. *List and define eight types of ethical dilemma. Give one example of each.*

Types of ethical dilemmas:

- **Professional Appointment:** Ensure there are no questionable matters in relation to the client, and only agree to perform work if competent
- **Conflict of Interest:** Make sure business interests or client relationships do not clash with objectivity or confidentiality
- **Second Opinion:** Can be asked to give a judgment on the use of accounting or auditing principles by a company that is not presently a client
- **Remuneration:** Quote a fee for services that will allow the work to be carried out properly, and disclose all relevant referral fees
- **Marketing Services:** Advertise truthfully and don't make embellished claims about services offered or qualifications possessed, nor make disparaging references to others

- **Gifts:** Consider the nature and intent behind any gifts from customers or clients
- **Custody of Assets:** Don't take clients' assets into safekeeping, unless legally required to
- **Objectivity:** Be able to give an independent conclusion without prejudice, conflict of interest or influence from others

4. *List three financial or accounting ethical dilemmas that have appeared in the media recently.*

Discussion questions, based on current research.

5. *Compare and contrast the main principles of the APESB Code of Ethics and the FPA Code of Ethics. Organise your comparison in a table and show how the two codes are both similar and different.*

APESB Code: Integrity, objectivity, professional competence and due care, confidentiality, professional behaviour.

FPA Code: Client first, integrity, objectivity, fairness, professionalism, competence, confidentiality, diligence.

Review Questions 18.3

1. *Create a table summarising the advantages and disadvantages of five different forms of electronic processing for the owner of a small business.*

For example:

TYPE OF ELECTRONIC PROCESSING	ADVANTAGES	DISADVANTAGES
EFTPOS	• Reliable • Efficient	• Bank fees for customers • Limits on transfers • Bank fees
Electronic Payment of Bills	• Less cash on premises • Convenience for customer • Direct transfer	• Keeping clear records • Ensuring goods arrive • Credit checks
Credit Card	• Reliable • Easy to use	• Card fraud • Merchant fees
Online Banking	• Convenience • Easy for customer	• Difficult to get assistance after hours • May be difficult for business to keep track of transactions
Direct Debit	• Encourage customer to set up regular repayments • Less paperwork • Inexpensive	• Fraudulent use • Errors • Security

2. What are the main risks to small business of using electronic processing?

Risks:

- The customer may not check for errors
- Requires a secure site and secure storage of confidential details
- Data theft and fraud
- Some systems are expensive eg. Merchant fees
- Hackers
- Security
- Can be difficult to get after hours assistance

3. Clearly explain the main business requirements that an e-commerce business would have. Assume that the business owner wishes to complete all financial transactions online.

E-commerce set up requirements:

- An online shop, usually entered through a secure website
- A database 'behind' the website to store customer information, track orders and provide product details
- A merchant account or a payment gateway so that credit cards can be accepted
- Reliable delivery service to transport goods to the customer
- Listing for the business in search engines, online advertising and/or interactive newsletters
- Resourcing staff, storage for inventory, computer equipment/server, etcetera.

4. Describe the main benefits to small business of using electronic processing.

Benefits:

- Convenient for the customer
- The business can sell product at any time
- Cheaper to provide
- Less paperwork
- Discounting may be possible due to the lower costs
- Faster delivery to customer
- A wide variety of transactions and requests possible.

Chapter 18 Activities

1. ETHICAL DILEMMAS

Threat:	SELF-INTEREST	SELF-REVIEW	ADVOCACY	FAMILIARITY	INTIMIDATION
THE ACCOUNTANT/ FINANCIAL SERVICE PROVIDER IS CONCERNED BECAUSE:					
They are representing a client and acting on their behalf in a dispute with another retailer who is also a client			✓		
Their sibling has just become engaged to the owner of the manufacturing business they audit				✓	
They might lose their client, because they did not manage to find a 'high enough' tax deduction this year					✓
A client has just given them two overseas airline tickets as a gift	✓				
They have found an error in a client's total sales amount		✓			
There is pressure to reduce the amount of audit work required to an unacceptable level, in order to lessen the fee					✓
They prepared the original accounts and generated the financial reports for the business they are to audit		✓			

2. PROFESSIONAL ETHICS: ACCEPTING A PROFESSIONAL APPOINTMENT

A.

i. Objectivity: Owen is ensuring that bias or conflict of interest is not a part of the work that he performs for customers. He is applying this principle because it is important to support an ethical code that allows for professional relationships to be formed so that individuals can trust and rely on the accounting profession.

ii. Owen can involve a colleague in the project, discuss the ethical dilemma with a colleague or recommend another individual to complete part of the work.

B. *Discussion question. Responses could include:*

- Integrity – being straightforward and honest in all professional and business relationships
- Objectivity – now allowing bias, conflict of interest or undue influence of others override professional or business judgments
- Respecting the confidentiality of information acquired as a result of professional and business relationships. Do not disclose information without proper and specific authority
- Compliance with relevant laws and regulations and using professional behaviour
- Issues around independence, honesty and truthfulness.

3. CONFLICTS OF INTEREST

A. This would breach the ethical principles of integrity as the financial advisor is not being straightforward and honest in setting up this relationship with the clothing retailer, and the ethical principle of confidentiality as the financial advisor may not be able to respect the privacy of information and not disclosing this information to the competitor, even by accident.

B. This accountant has ensured they do not breach integrity and they are also showing professional behaviour in complying with relevant regulations of their professional association.

C. The accounting firm cannot compel the owner of the veterinary practice to agree, and could be in breach of the ethical principles of professional competence and professional behaviour depending on the circumstances.

D. This financial services provider is ensuring employees are provided with an environment where they can take appropriate steps to ensure confidentiality by respecting the privacy of information acquired from professional relationships and not disclosing this information to others unless there is a legal requirement to do so.

4. REFERRAL FEES AND MARKETING

A. *Poppy Fleur*

Poppy is not being objective. She is allowing bias toward a specific product and has a conflict of interest because she is receiving payment for the promotion of this software package. This is taking priority over her professional judgment. She should not be marketing or making embellished claims about the software.

B. *Pete Petrol*

Pete appears to have strong integrity, he is aware of the needs to maintain objectivity in his assessment of clients. His professional competence is high as he has maintained his knowledge and skills at the level required to ensure that a client receives competent service. One potential concern is his habit of speaking socially about clients, and he needs to reconsider this as confidentiality may be compromised. He must respect the privacy of information acquired from his professional and working relationships and not disclose this information to others unless there is a legal requirement.

5. INTERNAL CONTROL SYSTEMS

Outline all the relevant facts of the dilemma

- Cash is not recorded correctly
- Cash is not banked
- No cash management processes
- Wages not recorded properly
- Employees not paid correct wage
- Loss of cash

List the ethical issues involved

For the accountant who is advising the small business owner, ethical dilemmas to be aware of include:

- **Objectivity** – to not let the employees or business owner to influence the decisions their professional judgment calls them to make.
- **Professional competence and due care** – being certain that their training and knowledge provide them with abilities at the level required to ensure the business owner receives competent service.
- **Confidentiality** – information on employees wages and the businesses financial records must not be disclosed to others unless there is a legal requirement to do so – which could occur here as fraud is likely
- **Professional behaviour** – the accountant needs to be aware of relevant laws which may come into place concerning the incorrect treatment of funds.

Decide which of the above fundamental principles are related to the matter in question

All of these are relevant.

List the established internal procedures for the business

- The business does not have procedures in place

Decide on the alternative courses of action, and the consequences of each.

- A cash control system: separate recording and banking of money
- Education for employees on the correct recording of financial information
- Education for the business owner on employee wage entitlements and superannuation requirements
- Integrity of being straightforward and honest in all dealings with the owner and their employees.

6. SMALL BUSINESS AND ELECTRONIC PROCESSING

A.

- **EFTPOS:** allows the customer to transfer funds from their bank account directly to the business, using electronic funds transfer at point of sale. It is usually relatively inexpensive for both the customer and business.
- **Credit cards:** Charge the customers credit account so that they do not have to have funds available instantly and can repay later. Can be more expensive for the business due to merchant fees and some credit card companies charge the business more than others.

B. Of the options available, EFTPOS would be the best alternative because it is convenient for the customer, the funds are received directly by the business, generally there is only one level of merchant fee, and it will encourage more customers to use Clara's café because they have options other then having to have cash in their pocket.