

# ACCOUNTING & FINANCE

YEAR 11 ATAR COURSE – UNITS 1 & 2

THIRD EDITION



**Kathy Kania &  
Elizabeth Criddle**



WACE STUDY GUIDE

# ACCOUNTING & FINANCE

YEAR 11 ATAR COURSE

Kathy Kania & Elizabeth Criddle



# ACADEMIC GROUP

■ ACADEMIC TASK FORCE ▲ ACADEMIC ASSOCIATES ■ THE EXAM EXPERTS

**Achieve Success at School**

Academic Group Pty Ltd  
P.O. Box 627, Applecross  
Perth, Western Australia 6953

Tel: (08) 9314 9500  
Email: [learn@academicgroup.com.au](mailto:learn@academicgroup.com.au)  
Website: [www.academicgroup.com.au](http://www.academicgroup.com.au)

First published 2014  
Second Edition 2020  
Third Edition 2022

© Academic Group Pty Ltd (ABN 50 151 087 286)

National Library of Australia ISBN 978-0-6451888-6-8

## Copyright ©

Copyright in this book is owned by Academic Group, unless otherwise indicated.

Except as permitted under the Act (for example a fair dealing for the purposes of study, research, criticism or review) no part of this book may be reproduced, stored in a retrieval system, communicated or transmitted in any form or by any means without prior written permission. All enquiries should be made to the Publisher.

Printed in Western Australia on paper from responsible sources.



## About the Author

Liz has been a Head of Learning Area in WA independent schools. With a Commerce degree and Master of Education, she has taught Accounting and Finance and Business Management and Enterprise in WA and NSW schools. Liz has been a WACE Chief Examiner, WACE Marker, and served on a number of syllabus committees and SCSA reference groups.

Kathy is a passionate Head of Humanities who is experienced teaching ATAR Accounting & Finance, Economics, BME, Modern History and Religion & Life. She has experience both as a SCSA Examiner and Curriculum Advisory Council member.

## Acknowledgements

- Images by Adobe Stock and iStock
- School Curriculum and Standards Authority – with permission to reproduce the Unit Content.

## TO THE STUDENT

---

This study guide covers the Accounting and Finance ATAR Units 1 and 2. The guide has deliberately been kept short so that students use it and view it as a manageable revision tool and not just one kept to the side.

Each chapter starts with a checklist taken from the School Curriculum and Standards Authority Unit Content. The chapter then goes on to provide a brief summary of the required content for students to revise. Questions covering the content are provided at the end of each chapter. Answers to these questions are provided at the end of the book.

Trial Tests covering the Unit Content for both Unit 1 and Unit 2 have also been provided at the end of the book along with full solutions. Students are advised to practise the Trial Tests and the Chapter Review Questions many times over throughout the course of the Unit.

*Kathy Kania and Elizabeth Criddle*

# CONTENTS

---

To the Student

iii

## UNIT 1

<b>1.</b>	<b>Small Business in Australia</b>	<b>1</b>
1.1	Sources of finance, other than equity, available to small businesses	2
1.2	The factors financial institutions consider when approving finance	3
1.3	Characteristics of the main types of small business ownership	3
1.4	Different types and characteristics of business undertakings	3
1.5	Main types of small business ownership	4
<b>2.</b>	<b>Introduction to Financial Accounting</b>	<b>7</b>
2.1	Fundamental concepts and conventions of financial accounting	8
2.2	GST and the GST system	10
2.3	Accounting and reporting for GST	11
<b>3.</b>	<b>Financial Accounting Terminology</b>	<b>13</b>
3.1	Accounting principles and conventions	14
3.2	Purpose of financial statements	16
<b>4.</b>	<b>The General Journal, General Ledger and Financial Statements</b>	<b>19</b>
4.1	Calculation of GST receivable or payable	20
4.2	Summary of errors disclosed and not disclosed by the trial balance	21
4.3	Preparing the general journal to process financial transactions to the general ledger and trial balance	21
4.4	Manual preparation of the general journal	27
4.5	Manual preparation of simple classified financial statements for a sole trader excluding balance day adjustments	29
<b>5.</b>	<b>Principles of Internal Control</b>	<b>34</b>
5.1	The nature and importance of Internal Control	35
<b>6.</b>	<b>Government and the Community</b>	<b>38</b>
6.1	The Importance of legislation relating to the formation of sole traders and partnerships	39
6.2	Taxation	40
6.3	The impact of GST legal requirements on small businesses	40
6.4	Costs and benefits for small business of engaging in socially, environmentally and ethically responsible behaviour	41

## UNIT 2

<b>7.</b>	<b>Fundamental Principles</b>	<b>46</b>
7.1	Nature, benefits and risks to small business of electronic processing	47
7.2	Distinction between cash and accrual methods of accounting	48
7.3	Recognition criteria for: assets; liabilities; incomes; expenses	48
7.4	Classification of income, expenses, assets and liabilities by nature and function	49
7.5	Classification of assets and liabilities	50
7.6	Purpose and nature of balance day adjustments	50
<b>8.</b>	<b>Depreciation</b>	<b>53</b>
8.1	Depreciation and non-current assets	54
8.2	Recording depreciation	56
8.3	Disposal of asset	56
8.4	Inventory costing methods	59
<b>9.</b>	<b>Recording and Processing</b>	<b>64</b>
9.1	Balance day adjustments	65
9.2	Closing the accounts and preparing final statements	69
<b>10.</b>	<b>Ratios</b>	<b>76</b>
10.1	Profitability, liquidity and stability	77
10.2	Preparation and interpretation of ratios	77
10.3	Ratio comparisons	80
<b>11.</b>	<b>The Accounting Profession</b>	<b>83</b>
11.1	Professional accounting and financial associations	84
TRIAL TEST 1		87
TRIAL TEST 2		96
TRIAL TEST 3		108
TRIAL TEST 4		113
TRIAL TEST 5		120
TRIAL TEST 6		128
ANSWERS TO REVIEW QUESTIONS		139
SOLUTIONS TO TRIAL TESTS		163



# ACCOUNTING & FINANCE

## UNIT 1







## SYLLABUS CHECKLIST

**On completion of this chapter you should be able to:**

- ☐ describe sources of finance, other than equity, available to small businesses
- ☐ discuss advantages and disadvantages of these sources of finance
- ☐ identify the factors financial institutions consider when approving finance
  - risk (collateral, liquidity, history, guarantors) and return (interest rate, future business).
- ☐ identify the characteristics of the main types of small business ownership: sole trader, partnership and small proprietary company
  - number of owners
  - liability of owners
  - ability to raise capital or borrow funds
  - distribution of profits
  - transfer of ownership
  - separate accounting or legal entity
  - continuity of existence
- ☐ discuss advantages and disadvantages of the main types of small business ownership
- ☐ describe different types and characteristics of business undertakings
  - manufacturing
  - trading/retailing
  - service providing.



## 1.1 SOURCES OF FINANCE, OTHER THAN EQUITY, AVAILABLE TO SMALL BUSINESSES

*Short term finance* must be repaid within the next 1-2 years  
*Medium term finance* must be repaid within the next 3-7 years  
*Long term finance* must be repaid after 7 or more years

SHORT TERM	
Family or friends	Generally used to purchase small assets.
Overdraft	Obtained for seasonal fluctuations and working capital requirements. Generally available for 1-30 days.
Retained profits	Retaining profits in the business instead of paying to owner, using to fund the purchase of assets or repayment of loans.
Asset sale	Selling stock, collecting accounts receivable, selling current assets.
Bridging finance	Occurs if an asset is sold to buy another. Usually available for 1-30 days.
Trade credit	Purchase of inventory or supplies. Usually for 7-60 days.
Hire purchase	The business retains asset. For assets such as office equipment, factory equipment, furniture.
Short term loan	Used to fund large non-current assets.
MEDIUM TERM	
Family or friends	Used to purchase small assets.
Mortgage	A loan for the purchase of property.
Government loan	Funds for research and development, exporting or technology.
Venture capital	Funding for new and innovative ideas.
Lease	The business returns the asset at the end of the period. For larger assets such as a vehicle, office equipment, factory equipment, fittings.
Medium term loan	Used to purchase large non-current assets
LONG TERM	
Mortgage	A loan for the purchase of property.
Government loan	Funds for research and development, exporting or technology.
Venture capital	Funding for new and innovative ideas.

### Advantages and disadvantages of sources of finance

SOURCE OF FINANCE	ADVANTAGE	DISADVANTAGE
Family or friends	Lower or no interest rates	Strain on relationships
Sale of assets	Quick	Difficult to name price
Overdraft/Bridging finance/ Trade credit/Short term loan	Easy to organise	Very short term High interest
Hire purchase	Own asset at end	Documentation costs
Lease	Able to upgrade to newest version of asset at end. Tax incentives.	May wish to own asset
Medium term loan	Can be modelled to requirements	Interest payments
Mortgage	Lower interest	Long term investment
Government loan	Lower interest	Restrictions on use
Venture capital	High-risk venture possible	Risky

## 1.2 THE FACTORS FINANCIAL INSTITUTIONS CONSIDER WHEN APPROVING FINANCE

### Elements of Risk

1. **Collateral:** This is assets that are offered as security for a debt. If the borrower defaults on the debt, these assets will be seized by the lender, e.g. for a mortgage loan, the property being purchased is the collateral.
2. **Liquidity:** This is the ability of the business to repay short term debts, e.g. the lender will consider the budgeted cash flows of the borrower in order to ensure that the debt can be regularly repaid.
3. **History:** The credit history of the borrower.
4. **Guarantors:** This is a business or person who guarantees they will repay the debt if the borrower defaults.

### Elements of Return

1. **Interest rate:** Different types of investment have different levels of interest return. Generally, the higher the potential interest earning, the higher the risk.
2. **Future business:** Involves considering the future business that the borrower may provide to the lender, or the future earnings that may be made by the lender.

## 1.3 CHARACTERISTICS OF THE MAIN TYPES OF SMALL BUSINESS OWNERSHIP

CHARACTERISTIC	SOLE TRADER	PARTNERSHIP	SMALL PROPRIETARY COMPANY
Number of owners	One	2-20*	Less than 50 non-employee shareholders
Liability of owners	Unlimited	Unlimited	Limited
Ability to raise capital or borrow funds	Owner investment	Partner investment	Others who are known to the business. Limits: Assets under \$12.5 million. Less than 50 employees. Consolidated revenue under \$25 million.
Distribution of profits	Owner	Partners	Shareholders
Transfer of ownership/continuity of existence	Business ceases to exist if owner leaves/ dies	Partnership ceases to exist if partner leaves, unless otherwise provided for in Agreement	Can continue to exist if Constitution allows transfer of shares
Separate accounting or legal entity	Not a separate legal entity. Is a separate accounting entity.	Not a separate legal entity. Is a separate accounting entity.	Separate accounting and legal entity

\*some businesses can have more partners

## 1.4 DIFFERENT TYPES AND CHARACTERISTICS OF BUSINESS UNDERTAKINGS

- **Manufacturing:** a business which processes raw materials to produce a finished product for sale, e.g. soft drink manufacturer, furniture manufacturer.
- **Trading/retailing:** a business which sells products directly to customers, e.g. pizza shop, cafe.
- **Service providing:** a business which provides a service, e.g. video rental, gym, beautician.

## 1.5 MAIN TYPES OF SMALL BUSINESS OWNERSHIP



### Sole trader

#### Advantages:

- The owner can keep all profits.
- The owner makes all their own decisions.
- Potentially flexible hours.
- Easy and cheap to form.

#### Disadvantages:

- Unlimited liability for the debts of the business.
- Limited potential investment.
- All losses impact on owner.
- The owner may not be able to take holiday or sick leave as there is no-one to share the workload with.



### Partnership

#### Advantages:

- More capital than available to a sole trader business because there could be several partners.
- Range of specialist skills compared to a sole trader.
- Less expensive to form than a company.
- Flexibility in sharing workload, taking holidays and when one partner is unwell.

#### Disadvantages:

- Unlimited liability. If the partnership cannot repay debts, then every partner's personal property could be used to repay the debt (Note: Partnership ceases to exist if partner leaves, unless otherwise provided for in Agreement).
- Any decisions made by one partner must be met by all other partners.
- The profits are shared depending on the number of partners.
- Different personalities and partners could result in disagreements.



### Small proprietary company

#### Advantages:

- Separate legal existence from its owners; less concern for owners about debt. Liability limited to the value of shares.
- Transfer of ownership simple.
- Easier to raise capital because more potential investors/owners.
- Small proprietary companies do not need to have their financial statements audited unless ordered to do so by ASIC or members holding 5% of the voting shares.
- Continuity of existence not dependent on owners.
- Retained profits taxed at company tax rate, which might be lower than the personal rate.

#### Disadvantages:

- Set up and ongoing administration costs high compared to other business formats.
- Complex record keeping and reporting.
- Much greater statutory requirements from income tax and Corporations Law.
- Income losses and capital losses are retained by the company.
- Complicated legal form.



## REVIEW QUESTIONS

### Chapter 1: Small Business in Australia

- The owner of a business will have a differing liability for the debts of the business, depending on the type of business. Explain the legal liability of the owners for each of the following types of business:
  - Partnership.
  - Small proprietary company.
- A partnership business is expanding its operations from one shop front, to five. Describe three possible sources of finance for the expansion and give the advantages and disadvantages of each one.
- Compare the main advantage and main disadvantage of venture capital finance from the point of view of a small proprietary company.
- Explain the difference between hire purchase and leasing to a small business owner.
- Clearly explain the best source of finance for each of the following business situations:
  - A sole trader seeking to purchase a motor vehicle.
  - A partnership wanting to buy a building.
  - A small proprietary company investing in a marron farm.
- Define a “sole trader” business and explain the liability of the owner for the debts of the business.
- Which type of business undertaking would be most suitable for the formation of each of the following businesses? Give reasons.
  - Coffee shop
  - Furniture manufacturer
  - Home hairdressing service
  - Web page designer
- Compare the liability of the owners of a partnership with the liability of the owners of a small proprietary company.
- A business owner is considering purchasing blue chip shares. Explain the relationship between risk and return with regard to this investment opportunity.
- Explain how profits are distributed in a partnership business.
- Outline the main advantage and main disadvantage of each of the following sources of finance, then classify them as short, medium or long-term.

SOURCE OF FINANCE	MAIN ADVANTAGE	MAIN DISADVANTAGE	TIME PERIOD
Credit card			
Mortgage			

---

2 year loan

---

Family

---

Hire Purchase

---

12. Clearly explain the best source of finance in each of the following situations and classify this as short, medium or long term finance.
  - A small proprietary company needing five motor vehicles.
  - A sole trader needing to purchase new office equipment.
  - A new small business venture that will invest in multimedia research.
13. Explain the four elements of risk that would be taken into consideration by a small business owner who wants to purchase land and a building for their new cafe business. Give examples for each element.
14. A small business owner is considering going into partnership with a friend. Explain to them three advantages and three disadvantages of this decision.
15. A gym owner owns their business as a sole trader. They are about to form a proprietary limited company. Explain to them the different characteristics of the two types of business ownership, giving examples in relation to this specific business.



16. What is the main difference between the three main types of business undertakings?
17. Define a manufacturing business and give one example of this type of business.
18. What is the main characteristic that distinguishes a service business from a retail store?



## SYLLABUS CHECKLIST

**On completion of this chapter you should be able to:**

- ☐ discuss fundamental concepts and conventions of financial accounting
  - the accounting equation
  - double entry accounting
  - the accounting cycle: documents, journals, ledger, adjusting entries, closing entries and financial statements
  - principles of the perpetual inventory system
- ☐ describe the principles and features of GST
  - taxable supplies, GST-free supplies and input taxed supplies
  - accounting and reporting for GST, including the Business Activity Statement (BAS).



## 2.1 FUNDAMENTAL CONCEPTS AND CONVENTIONS OF FINANCIAL ACCOUNTING

### The Accounting Equation

$$\begin{aligned}\text{Assets} &= \text{Equities} \\ \text{Assets} &= \text{Internal Equities} + \text{External Equities} \\ \text{Assets} &= \text{Owner's Equity} + \text{Liabilities} \\ \text{Assets} &= \text{Equity}^* + \text{Liabilities}\end{aligned}$$

$$A = Eq + L$$

*\*Also called "Proprietorship" or "Owner's Equity"*

Owner's Equity also consists of the profit or loss made by the business, and so the equation can be expanded as follows:

$$\text{Assets} + \text{Expenses} = \text{Equity} + \text{Income} + \text{Liabilities}$$

$$A + Ex = Eq + I + L$$

### Double Entry Accounting

The accounts of the business must always be "in balance" and for every transaction:

**The total of all debit entries must equal the total of all credit entries.**

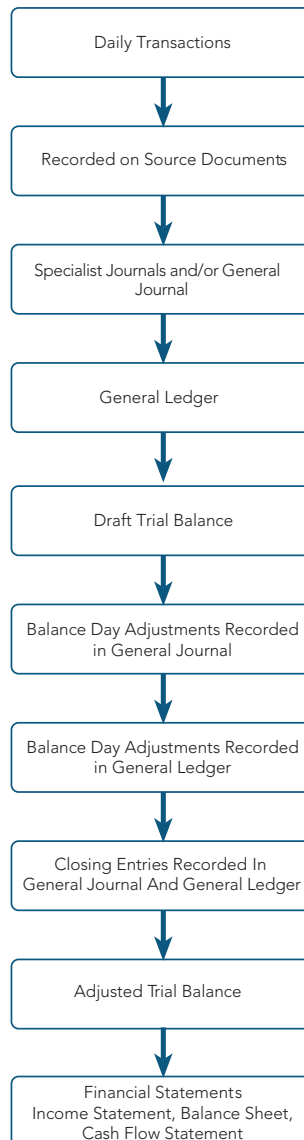
Note that double entry does NOT mean "only two accounts are affected" by each transaction.

### The Accounting Cycle

The accounting cycle shows the relationship between documents, journals, the ledger, adjusting entries, closing entries and financial statements in a business.



## Accounting Cycle (Manual System)



## Principles of the Perpetual Inventory System

Manufacturing and trading/retailing businesses need to separately account for the purchase and sale of stock. The perpetual system records stock movements in and out of the business on a continual basis throughout the reporting period. The quantities of any stock item that the business has on hand are always known. Barcode scanners enable this system to be used by any business.

The two main ledger accounts that are required are:

- **Inventory (A)**
- **Cost of Sales (Ex)**

Cost of Sales is calculated as follows:

**Cost of Sales =**

**Cost of stock sold + Other stock expenses (Freight inwards, Customs duty, Import duties etc) – discount received.**

A stocktake is used under this system to check for losses through spoilage, theft and so on. The number of stock takes required is much less than those required under the periodic system. Under the periodic inventory system a stock take is required to determine the amount of stock in the business. The physical stock take is compared with the Stock Card for the item being checked. A Stock Card keeps a record of the quantity and cost of each item of stock that comes in and out of the business.

## 2.2 GST AND THE GST SYSTEM

The **Goods and Services Tax (GST)** is a broad base consumption tax charged at 10% on the sale of most goods and services in Australia. It is charged at every stage of the supply chain (e.g. Wholesaler, distributor, retailer) and a business must register to include GST in the price of their goods and/or services if they have an annual turnover above \$75 000.

**GST sales:** sale of goods, lease of premises, hire of equipment, advice, export, and supply of other things.

**GST purchases:** purchase of goods, purchase of services, leasing, and other things.

### Taxable supplies/Taxable sales

A business that is registered for GST makes a taxable sale if they:

- make the sale for payment
- make the sale in the course of a business enterprise, and
- the sale is connected with Australia.

Some sales may be partly taxable and partly GST-free or input taxed.

**EXAMPLE 2.1:** The sale of non-current assets, such as business equipment is a taxable sale and GST must be included.

### GST-free supplies/GST-free sales

A business should not include GST in certain GST-free sales, and can claim credits for the GST included in taxable purchases relating to GST-free sales.

**GST-free items include:**

- basic food such as fruit and vegetables
- some medicines
- some medical and health care services
- some child care services
- salaries and financial services
- existing home sales
- exported goods and most exported services
- anything bought overseas costing less than \$1000.

**EXAMPLE 2.2:** A farmer who grows and sells basic food items such as vegetables at the local markets will not include GST in the selling price of the vegetable. They will claim credits for the GST paid for items used to grow the vegetable though, such as fertiliser and vehicle costs.

### Input taxed supplies/ Input taxed sales

Common input taxed sales for small businesses are financial supplies and specific examples of rent/sale of residential premises.

**EXAMPLE 2.3:** A small business selling whitegoods may sell on credit and charge interest to the customer. The provision of credit is a type of financial supply so GST is not charged on the interest. GST is still charged on the sale price of the goods.





## 2.3 ACCOUNTING AND REPORTING FOR GST

A business registered for GST includes GST in the price of most goods and services sold. For a small business, a Business Activity Statement (BAS) is completed every month or quarter which reports on GST sales, pays for GST sales and claims credits for any GST included in purchases. The Business Activity Statement is a report showing the business tax entitlements and obligations including GST, pay as you go instalments, pay as you go withholding and fringe benefit tax instalments.

ACCOUNTING METHOD	SALES	PURCHASES	EXAMPLES
<b>Cash basis</b>	Include GST payable on the sales made in the same reporting period as payment received	Claim GST credits for purchases in the same reporting period as payment made	A GST-registered CD wholesaler sells CDs to a retailer and issues a tax invoice in January. The invoice is paid in February. If the wholesaler reports GST monthly, it accounts for the GST in the month it is collected – February, and if the retailer reports monthly, it claims the GST credits in the month of purchase – February also.
<b>Accrual basis</b>	Include GST payable on sales in the same reporting period as the tax invoice is issued or the payment is received (whichever is first)	Claim GST credits for purchases in the reporting period that the supplier issues a tax invoice or payment is made (whichever is first)	A GST registered book wholesaler sells books to a retailer and issues a tax invoice in January. The invoice is paid in February. The wholesaler accounts for the GST in the month the invoice was issued – January, and the retailer claims the GST credits in the months of receiving the tax invoice – January also. (If both account for GST monthly)

**GST record keeping:** A business with a manual record keeping system will add a GST Amount column to the cash receipts and the cash payments journals. Alternatively, they will enter GST amounts in the general journal. A business is more likely to use electronic records. Accounting software packages allow for the recording of GST and the automatic generation of a BAS.

### Reporting the GST for a small business

A small business with GST turnover of less than \$20 million can report and/or pay GST quarterly to the Australian Taxation Office. There are two reporting options:

1. Calculate, report and pay GST quarterly. Usually done electronically.
2. Calculate and pay GST quarterly and report annually in an Annual GST Information Report.

A small business with an annual turnover of less than \$2 million, has a third option:

3. Pay GST quarterly and report annually in an Annual GST Return.

## REVIEW QUESTIONS

### Chapter 2: Introduction to Financial Accounting

1. Determine the equity for each of the following situations:
  - (a) A business with \$30 000 assets and \$12 000 liabilities.
  - (b) A business with \$56 000 assets, \$31 000 liabilities, \$5 000 expenses and \$7 000 income.
  - (c) A business has reported a profit of \$4 000 for the previous financial year and currently has assets valued at \$20 000 and liabilities of \$11 000.
2. Is owner's equity a type of liability? Explain the reasons for your answer.
3. What is the opening capital of a business that was commenced with a cash injection of \$50 000, the contribution of a delivery van worth \$20 000, and a trade credit debt of \$5 000?
4. Show two different formats of the accounting equation.
5. Explain the principle of double entry accounting and how this impacts on a businesses's Statement of Financial Position.
6. Why is Discount Received subtracted from Cost of Stock Sold to obtain the Total Cost of Sales?
7. A small local supermarket is using the periodic inventory system. Describe the main principles of the perpetual inventory system to the owner of this small business. Which system should the supermarket use and why?
8. Explain the purpose of a stocktake under the perpetual inventory system.
9. Clearly explain the difference between taxable supplies, GST-free supplies and input taxed supplies, giving examples.
10. A clothing distributor makes a sale to a surf shop on 3 May, and invoices the surf shop on that date. The surf shop pays for the goods on 6 July.  
  
Both businesses use the accrual basis of reporting and account for GST monthly. When should the GST payable or GST credits be recognised for each business? Would your answer be different if the two businesses account for the GST quarterly?
11. Explain the GST reporting options for a small business with an annual turnover of \$230 000.
12. The Trial Balance forms an important stage of the Accounting Cycle. What is its main purpose?
13. Define the Business Activity Statement and explain its purpose.

## FINANCIAL ACCOUNTING TERMINOLOGY

Account	Amount
Revenues	\$42,385
Expenses	5,255
Net Income	47,640
Operating Expenses	(34,252)
Non-Operating Expenses	(4,075)
Other Expenses	(33)
Net Loss	(38,360)
Net Income	9,280
Net Loss	80
Net Income	(2,191)
Net Loss	(1,591)
Net Income	7
Net Loss	5,585
Net Income	51
Net Loss	(211)
Net Income	5,405
Net Loss	(1,520)

### SYLLABUS CHECKLIST

On completion of this chapter you should be able to:

- ☐ explain accepted accounting principles and conventions
  - accounting entity
  - monetary
  - historical cost
  - materiality
  - accounting period
  - going concern.
- ☐ describe accounting for inventory
  - perpetual versus periodic inventory methods.
- ☐ define the elements of the financial statements
  - assets, liabilities, equity, income and expenses.
- ☐ outline the purpose of financial statements including:
  - performance
  - financial position
  - liquidity.



### 3.1 ACCOUNTING PRINCIPLES AND CONVENTIONS

<b>ACCOUNTING ENTITY</b>	The business is a separate entity to the owner(s)	EXAMPLE: All business transactions are recorded from the business point of view and any transactions of the owner(s) are separate
<b>MONETARY</b>	<p>All transactions are recorded in nominal monetary units</p> <p>Transactions which cannot be quantified are not recorded in the financial reports</p>	EXAMPLE: Recording transactions in Australian dollar units
<b>HISTORICAL COST</b>	<p>Assets are recorded at the amount paid or the value of the consideration given when the transaction occurred</p> <p>Liabilities are recorded at the amount received or the amount expected to be paid</p> <p>The monetary value reported for assets and liabilities does not therefore change over time, unless the "fair value" method is used</p>	EXAMPLE: The cost of an asset at the time of its purchase is recorded in the accounts, as that is a verifiable transaction and not a subjective estimate
<b>MATERIALITY</b>	<p>If omission or misstatement of information from the financial report could influence the economic decisions of users, then it is material</p> <p>Depends on size of the item</p> <p>Depends on likely error in the particular circumstances of the omission/misstatement</p>	EXAMPLE: Major losses from fires or natural disasters would be reported
<b>ACCOUNTING PERIOD</b>	Business life is divided into time periods for reporting purposes	EXAMPLE: Financial reports are prepared on a regular basis
<b>GOING CONCERN</b>	<p>Financial reports prepared on the assumption that an entity is a going concern</p> <p>The entity will continue operating for the foreseeable future</p> <p>The entity has no intention to liquidate</p> <p>The entity does not need to downscale its operations</p>	EXAMPLE: The business does not continually revalue assets, as they are not about to liquidate

## Perpetual versus periodic inventory methods

The perpetual system is used because it allows the business to have a continual record of the levels of stock. Advances in electronic technology have made it possible for most small businesses to use the perpetual system. The periodic system is easier to use but may only be used by a very small business which does not have computerised records, such as a small newsagent or deli.

PERPETUAL INVENTORY SYSTEM	PERIODIC INVENTORY SYSTEM
ADVANTAGES	ADVANTAGES
Stock control	Simple to use
Slow moving stock easily identified	
Shortages from loss or theft apparent	
Value of stock always known	
Easy to produce Income Statement at any point in time	
DISADVANTAGES	DISADVANTAGES
May require expensive computing technology	Difficult to ascertain stock levels
Annual stocktake still required	Cost of stocktakes
	Shortages difficult to track

## Comparison of journal entries

PERPETUAL SYSTEM	PERIODIC SYSTEM
<b>When inventory is purchased on credit</b>	
DR Inventory – use cost price DR GST Paid CR Creditors/Accounts Payable	DR Purchases DR GST Paid CR Creditors/Accounts Payable
<b>When inventory is sold on credit</b>	
DR Debtors/Accounts Receivable CR Sales – use sale price CR GST Collected DR Cost of Sales CR Inventory – use cost price	DR Debtors/Accounts Receivable CR Sales CR GST Collected
<b>When inventory purchases are returned</b>	
DR Creditors/Accounts Payable CR Inventory – use cost price CR GST Paid	DR Creditors/Accounts Payable CR Purchase Returns and Allowances CR GST Paid
<b>When inventory sold is returned</b>	
DR Sales Returns and Allowances DR GST Collected CR Debtors/Accounts Receivable DR Inventory – use cost price CR Cost of Sales	DR Sales Returns and Allowances DR GST Collected CR Debtors/Accounts Receivable

## Simple definition of the elements of financial statements

An **asset** is something OWNED by the business. It is a present economic resource controlled by the entity as a result of past events.

**EXAMPLE 3.1:** A machine is controlled by a business if it owns it. It is an economic resource because it can be used to produce goods sold by the business. A past event occurred in the transaction to purchase the machinery.

A **liability** is something OWED by the business. It is a present obligation of the entity to transfer an economic resource as a result of past events.

**EXAMPLE 3.2:** A loan is money received in a past event when funds were transferred to the business. It is a present obligation agreed upon in the signed loan document. The economic resource cash will need to be used to repay the loan.

**Equity** is the residual interest in the assets of the entity after deducting all its liabilities.

**EXAMPLE 3.3:** Capital is the residual remaining if assets are greater than liabilities.

**Income** is earnings coming INTO the business. It is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

**EXAMPLE 3.4:** Sales increase the assets cash and debtors, which then increases equity.

**Expenses** are amounts going OUT of the business. They are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

**EXAMPLE 3.5:** Cost of sales decreases the assets inventory and cash, which then decreases equity.

## 3.2 PURPOSE OF FINANCIAL STATEMENTS

Financial Statements are used to assist in determining:

- performance
- financial position
- liquidity.

	FINANCIAL STATEMENT	EXPLANATION	ELEMENTS
PERFORMANCE	Income Statement	Profitability: the ability of a business to earn a return on its investment in assets and equities.	Income Expenses
FINANCIAL POSITION	Statement of Financial Position	Leverage: the relationship between debt (externally owed equity) and equity (internally owed equities).	Assets Liabilities Equity
LIQUIDITY	Cash Flow Statement	Liquidity: the ability of the business to repay short term debt.	Income Statement elements Changes in Statement of Financial Position elements

## Preparation of Financial Statements

Financial Statements are prepared on the Accrual Basis.

- Transactions are recognised when they occur.
- Transactions reported in the period to which they relate.
- Include past transactions involving the payment and receipt of cash.
- Also include obligations to pay cash in the future or receive cash in the future.



## REVIEW QUESTIONS

### Chapter 3: Financial Accounting Terminology

1. Explain how the accounting entity assumption forms the basis of the accounting equation.
2. A vehicle has a market value of \$30 000, and was purchased for a business entity for \$40 000 two years ago. What is its historical cost?
3. Define the accounting entity and going concern assumptions. Explain how these two accounting assumptions are important to record keeping in a business.
4. When is information considered to be material to the financial statements, and required to be reported separately?
5. Which accounting assumptions or principles have been breached in each of the following situations:
  - Credit purchases of inventory are recorded when cash is paid for the inventory.
  - When the owner takes cash out of the business it is recorded as an expense.
  - A business sells goods on credit and sales are recorded when tax invoices are issued, while expenses are recorded when they are actually paid.
  - Assets are recorded at their cost unless the owner believes they would be worth more when sold, and so they are revalued upwards.
  - Financial reports for a business are prepared when the owner feels it is relevant, usually every 6 to 9 months.
  - The owner uses their personal computer to record business transactions.
6. Describe the main differences between the perpetual and periodic inventory systems, giving examples of businesses that would use each type.
7. What is equity?
8. Is plant and equipment an asset? Explain using the three main elements that define an asset.
9. Describe the circumstances under which a patent would be an asset.
10. If an exploration business discovers mineral deposits, is this considered to be a past event that meets the definition of an asset? Explain.
11. Is a mortgage a liability? Explain using the three main elements that define liabilities.
12. A business has a policy of fixing product faults even after the warranty has expired. Does this create a present obligation for the business and meet the definition of a liability?
13. Are the following examples of income? Explain.
  - Fees
  - Dividends
  - Interest
14. Are the following examples of expenses? Explain.
  - Wages
  - Depreciation
  - Rent
15. Clearly define the following purposes of financial statements:
  - Performance
  - Financial Position
  - Liquidity





## SYLLABUS CHECKLIST

**On completion of this chapter you should be able to:**

- ☐ calculate GST receivable or payable.
- ☐ state the purpose of a trial balance
  - Errors disclosed by the trial balance
  - Errors not disclosed by the trial balance.
- ☐ manually prepare the general journal and general ledger (including GST) to include:
  - Entries to commence business
  - Cash and credit transactions to include cash receipts, cash payments, sales, purchases, sales returns, purchase returns, discount allowed, discount received
  - Perpetual inventory system given the cost of sales
  - Purchase of non-current assets
  - Write-off bad debts
  - Withdrawal of inventory or cash by the proprietor
  - Correction of errors
  - Closing entries.
- ☐ prepare the trial balance.
- ☐ prepare simple classified financial statements for a sole trader excluding balance day adjustments.
  - income statements
  - Statement of financial positions (statement of financial position) for a trading/merchandising/service business.

## 4.1 CALCULATION OF GST RECEIVABLE OR PAYABLE

### GST Outlay or GST Credits Received (ASSET) GST Collected (LIABILITY)

**Input tax credits** are claimed back from the ATO by a GST registered business for any purchase of a taxable supply. Registration is required if an enterprise is being carried on and annual turnover is \$75 000 or more (\$150 000 for non-profit entities).

GST adjustments (ignore Balance Day Adjustments in Unit 1) change the GST payable to the ATO, as follows:

#### Adjustments that increase GST payable:

- Owner's drawings of asset/s
- Discount received
- Bad debt recovery
- Purchase returns.

#### Adjustments that decrease GST payable:

- Discount allowed
- Bad debt written off
- Sales returns.

**EXAMPLE 4.1:** The following transactions have occurred for a business during the last month. Calculate the GST paid and GST received.

TRANSACTION	GST PAID	GST COLLECTED
Purchase of a motor vehicle for \$57 200 (GST inclusive).	\$5200	
Stock of \$30 000 (GST exclusive) purchased on credit.	\$3000	
Paid electricity bill \$550 (GST included).	\$50	
Sold goods on credit to for \$75 350. The cost of these goods recorded in the inventory account is \$40 000.		\$6850
Received \$4620 from a client in settlement of their account.	GST PREVIOUSLY CHARGED	
Paid \$40 645 wages to employees.	GST- FREE SUPPLY	
Paid commercial rent \$660	\$60	
Sold \$11 000 inventory to a client. Half of this was paid for immediately.		\$1000
<b>TOTAL</b>	<b>\$8310</b>	<b>\$7850</b>

The Trial Balance is a document, which lists the balances of all the ledgers in debit and credit columns. A sole trader will prepare this usually at the end of every reporting period. If the total debits equal the total credits then the Trial Balance is said to balance and there should not be any mathematical errors in the double-entry accounting system. However, this does not mean there are no errors in the business accounting system. For example, transactions classified improperly or those simply missing from the system may still occur.

## 4.2 SUMMARY OF ERRORS DISCLOSED AND NOT DISCLOSED BY THE TRIAL BALANCE

<b>ERRORS DISCLOSED BY TRIAL BALANCE</b>	<ul style="list-style-type: none"> <li>• Incorrect balancing of ledger account.</li> <li>• Transposition error.</li> <li>• Incorrectly transferring one total.</li> <li>• Omitting one account balance.</li> </ul>
<b>ERRORS NOT DISCLOSED BY TRIAL BALANCE</b>	<ul style="list-style-type: none"> <li>• Correct amount posted to incorrect ledger account.</li> <li>• Incorrect amount being posted to correct ledger accounts.</li> <li>• Journal entry being completely missed.</li> <li>• Entries that compensate for each other.</li> </ul>

## 4.3 PREPARING THE GENERAL JOURNAL TO PROCESS FINANCIAL TRANSACTIONS TO THE GENERAL LEDGER AND TRIAL BALANCE

The following example illustrates how to prepare entries for:

- Cash and credit transactions (including GST)
- Correction of errors
- Closing entries.

**EXAMPLE 4.2:** Show the manual preparation of the general journal and general ledger, using the perpetual inventory system, for the retailing business “Jeans n’ Tops” for the month of August, given the opening balances listed in the Trial Balance below:

**Simplified Trial Balance 1 August**

	<b>Debit \$</b>	<b>Credit \$</b>
Inventory Control	5 600	
Sales		2 000
Cost of Sales	500	
Cash at Bank	6 000	
Creditor – Trendz Wholesalers		0
Creditor – Winter Wear		5 500
GST Credits Received	300	
GST Collected		50
Debtor – B. Pears	726	
Debtor – J. Lake	2 200	
Capital		7 776
	<u>15 326</u>	<u>15 326</u>

## Transactions for August:

1	Stock purchased on credit from Trendz Wholesalers for \$4 400 (GST inclusive).	<b>Purchase of inventory</b> <i>Credit transaction</i>
2	Sale of stock with a cost price of \$500 for \$880 (GST inclusive) for cash.	<b>Sale of inventory</b> <i>Cash transaction</i>
3	It was recognised that the purchase of \$500 supplies had been incorrectly recorded as a \$50 purchase.	<b>Error not disclosed by trial balance</b>
4	Damaged jeans returned to Trendz Wholesalers and credit note to the value of \$110 received.	<b>Purchase return</b>
5	The customer Brittnee Pears returned two shirts containing imperfections and was given a credit note to the value of \$165. This stock had a cost price of \$70.	<b>Sale return</b>
6	Debtor Justine Lake paid their account of \$2 200 (GST inclusive), allowing a discount of \$110 (including GST adjustment of \$10).	<b>Receipt from debtor/ Discount allowed</b> <i>Cash transaction</i>
7	Paid creditor Winter Wear the full amount owing of \$5 500 receiving \$220 discount (including \$20 GST adjustment).	<b>Payment to creditor/ Discount received</b> <i>Cash transaction</i>
8	Paid advertising expenses of \$825 (GST inclusive).	<b>Expenses/GST payable</b> <i>Cash transaction</i>
9	Paid wages of \$730.	<b>Expense/ GST not applicable</b> <i>Cash transaction</i>

**JEANS n' TOPS**  
**General Journal (extract)**

**STEP ONE:** Prepare general journal entries for each transaction.

DATE	DETAILS	DEBIT \$	CREDIT \$
August 1	Inventory Control GST Credits Received Trendz Wholesalers <b>Purchase of stock</b>	4 000 400	4 400
2	Cash at bank Sales GST Collected <b>Sale of stock</b>	880	800 80
	Cost of Sales Inventory Control <b>Cost of sales</b>	500	500
3	Supplies Asset GST Credits Received Cash at Bank <b>Correction of error</b>	450 45	495
4	Trendz Wholesalers Inventory Control GST Credits Received <b>Purchase returns</b>	110	100 10
5	Sales Returns GST Collected B. Pears <b>Sales returns</b>	150 15	165
	Inventory Control Cost of Sales <b>Cost of stock returned</b>	70	70
6	Cash at Bank Discount Allowed GST Collected Debtor – J. Lake <b>Received payment of account</b>	2 090 100 10	2 200
7	Winter Wear Cash at Bank Discount Received GST Credits Received <b>Payment of amount owing</b>	5 500	5 280 200 20
8	Advertising expense GST Credits Received Cash at Bank <b>Advertising cost paid</b>	750 75	825
9	Wages Cash at Bank <b>Wages paid</b>	730	730



**STEP TWO:** Prepare general ledger entries for each transaction, then balance or close the ledger accounts.

**JEANS n' TOPS**  
**General ledger (Extract)**

**Inventory Control**

	Balance	5 600			
Aug 1	Trendz Wholesalers	4 000	Aug 2	Cost of Sales	500
5	Cost of Sales	70	4	Trendz Wholesalers	100
			10	Balance c/d	9 070
		<u>9 670</u>			<u>9 670</u>
	Balance b/d	9 070			

**Cash at Bank**

	Balance	6 000			
Aug 2	Sales/GST	880	Aug 3	Supplies/GST	495
6	J. Lake	2 090	7	Winter Wear	5 280
			8	Advertising/GST	825
			9	Wages	730
			10	Balance c/d	1 640
		<u>8 970</u>			<u>8 970</u>
	Balance b/d	1 640			

**Trendz Wholesalers**

Aug 4	Inventory/GST	110	Aug 1	Inventory/GST	4 400
10	Balance c/d	4 290			<u>4 400</u>
		<u>4 400</u>		Balance b/d	4 290

**B. Pears**

Balance	726	Aug 5	Sales Returns/GST	165
			Balance c/d	561
	<u>726</u>			<u>726</u>
Balance b/d	561			

**GST Credits**

	Balance	300			
Aug 1	Trendz Wholesalers	400	Aug 7	Winter Wear	20
3	Cash at bank	45	10	GST payable	<u>800</u>
8	Cash at bank	<u>75</u>			

**Sales**

				Balance	2 000
Aug 10	Profit and loss	2 800	Aug 2	Cash at bank	800
		<u>2 800</u>			<u>2 800</u>

**Cost of Sales**

	Balance	500			
Aug 2	Inventory	500	Aug 5	Inventory	70
			10	Profit and loss	930
		<u>1 000</u>			<u>1 000</u>

**Winter Wear**

Aug 7	Cash at bank/Discount/GST	<u>5 500</u>	Balance	<u>5 500</u>
-------	---------------------------	--------------	---------	--------------

**J. Lake**

Balance	<u>2 200</u>	Aug 6	Cash at bank/ Discount/GST	<u>2 200</u>
---------	--------------	-------	----------------------------	--------------

**GST Collected**

			Balance			50
Aug 5	B. Pears	15	Aug 2	Cash at bank	80	
6	J. Lake	10	4	Trendz Wholesalers	<u>10</u>	
10	GST payable	115				

Capital					
			Balance		7 776
	Balance c/d	8 116	Profit and loss		340
		<u>8 116</u>			<u>8 116</u>
			Balance b/d		8116
Sales Returns					
Aug 5	B. Pears	<u>150</u>	Aug 10	Profit and loss	<u>150</u>
Discount Allowed					
Aug 6	J. Lake	<u>100</u>	Aug 10	Profit and loss	<u>100</u>
Wages					
Aug 9	Cash at bank	<u>730</u>	Aug 10	Profit and loss	<u>730</u>
Advertising					
Aug 8	Cash at bank	<u>750</u>	Aug 10	Profit and loss	<u>750</u>
Discount Received					
Aug 10	Profit and loss	<u>200</u>	Aug 7	Winter Wear	<u>200</u>
Supplies Asset					
Aug 3	Cash at bank	450	Aug 10	Balance c/d	450
		<u>450</u>			<u>450</u>
	Balance b/d	450			
GST Payable					
Aug 10	GST Credits	800	Aug 10	GST Collected	115
				Balance c/d	685
		<u>800</u>			<u>800</u>
	Balance b/d	685			
Profit and Loss Summary					
Aug 10	Cost of Sales	930	Aug 10	Sales	2 800
	Sales Returns	150		Discount received	<u>200</u>
	Advertising	750			
	Discount Allowed	100			
	Wages	730			
	Capital	<u>340</u>			
		3000			3000

**STEP THREE:** Prepare closing general journal entries.

**Jeans n' Tops  
General Journal Extract**

DATE	DETAILS	DEBIT \$	CREDIT \$
August 10	Profit and Loss	3 000	
	Sales		2 800
	Discount Received		200
	<b>To close income accounts to profit and loss</b>		
	Cost of Sales	930	
	Sales Returns	150	
	Advertising	750	
	Discount Allowed	100	
	Wages	730	
	Profit and Loss		2 660
	<b>Close expense accounts to profit and loss</b>		
	Profit and loss	340	
	Capital		340
	<b>Transfer profit to capital account</b>		

**STEP FOUR:** Prepare a Trial Balance.

**Adjusted Trial Balance 10 August**

	DR \$	CR \$
Inventory Control	9 070	
Cash at Bank	1 640	
Supplies	450	
Creditor - Trendz Wholesalers		4 290
Creditor – Winter Wear		0
GST Clearing (Payable)	685	
Debtor – B. Pears	561	
Debtor – J. Lake	0	
Capital		8 116
	<u><b>\$12 406</b></u>	<u><b>\$12 406</b></u>

*Note: GST Clearing is a debit balance, indicating that no money is owed to the ATO.*

## 4.4 MANUAL PREPARATION OF THE GENERAL JOURNAL

### Entries to commence business

**EXAMPLE 4.3:** A business commenced on 1 January with \$40 000 cash, a \$50 000 motor vehicle, office equipment worth \$2 000, \$500 supplies and a loan from the bank of \$60 000.

$$A = L + Eq$$

$$40\,000 + 50\,000 + 2\,000 + 500 = 60\,000 + \text{Equity}$$

$$\text{Equity} = \$32\,500$$

DATE	DETAILS	DEBIT \$	CREDIT \$
January 1	Cash at bank	40 000	
	Motor vehicle	50 000	
	Office equipment	2 000	
	Supplies asset	500	
	Loan		60 000
	Capital		32 500
	<b>Entry to establish the business</b>		

### Purchase of non-current assets

**EXAMPLE 4.4:** Machinery was purchased on credit for \$330 000 (GST inclusive) on the 4 January.

DATE	DETAILS	DEBIT \$	CREDIT \$
January 4	Machinery	300 000	
	GST Credits Received	30 000	
	Creditor		330 000
	<b>Purchase of machinery on credit</b>		

### Write-off bad debts

**EXAMPLE 4.5:** A debtor became bankrupt, owing a \$4400 (GST inclusive) debt to the business, on 7 January.

DATE	DETAILS	DEBIT \$	CREDIT \$
January 7	Bad debts	4 000	
	GST Collected	400	
	Debtor		4 400
	<b>Write off of bad debt</b>		

### Withdrawal of inventory or cash by the proprietor

**EXAMPLE 4.6:** The owner withdrew \$5000 cash on the 9 January.

DATE	DETAILS	DEBIT \$	CREDIT \$
January 9	Drawings	5 000	
	Cash at bank		5 000
	<b>Owner's drawings</b>		

### Correction of errors

**EXAMPLE 4.7:** An electricity expense of \$100 has been incorrectly debited to the telephone expense account, and this was rectified on 11 January.

DATE	DETAILS	DEBIT \$	CREDIT \$
January 11	Electricity	100	
	Telephone		100
	<b>Correction of error</b>		



## 4.5 MANUAL PREPARATION OF SIMPLE CLASSIFIED FINANCIAL STATEMENTS FOR A SOLE TRADER EXCLUDING BALANCE DAY ADJUSTMENTS

### EXAMPLE 4.8: Service business.

Given the following Trial Balance for “Salamander Services” for the month of December, prepare an Income Statement and Statement of Financial Position.

	DR \$	CR \$
Rent income		8 970
Advertising	3 480	
Rent expense	1 290	
Office staff wages	34 900	
Accounts payable		6 590
Loan		60 980
Interest expense	4 500	
Drawings	50 000	
Delivery expenses	21 770	
Petty cash	210	
Fees		78 950
Cash at bank	8 790	
Motor vehicles	40 000	
Capital		40 000
Fixtures and fittings	32 000	
Accounts receivable	2 110	
GST Clearing		3 560
	<b>\$199 050</b>	<b>\$199 050</b>

### Salamander Services Income Statement for the period ended 31 December

INCOME	\$	\$	\$
Fees			78 950
<b>ADD: OTHER INCOME</b>			
Rent income			8 970
			<u>87 920</u>
<b>LESS: EXPENSES</b>			
<i>Selling and Distribution</i>			
Advertising	3 480		
Delivery expenses	<u>21 770</u>	25 250	
<i>General and Administration</i>			
Rent	1 290		
Office staff wages	<u>34 900</u>	36 190	
<i>Financial</i>			
Interest		<u>4 500</u>	<u>65 940</u>
<b>PROFIT</b>			<b><u>21 980</u></b>

**Salamander Services**  
**Statement of Financial Position as at 31 December**

	<b>\$</b>
<b>CURRENT ASSETS</b>	
Petty cash	210
Cash at bank	8 790
	<u>9 000</u>
<b>NON-CURRENT ASSETS</b>	
Motor vehicles	40 000
Fixtures and fittings	32 000
Accounts receivable	2 110
	<u>74 110</u>
<b>TOTAL ASSETS</b>	<u>83 110</u>
<b>CURRENT LIABILITIES</b>	
GST Clearing	3 560
Accounts Payable	6 590
	<u>10 150</u>
<b>NON-CURRENT LIABILITIES</b>	
Loan	60 980
<b>TOTAL LIABILITIES</b>	<u>71 130</u>
<b>NET ASSETS</b>	<u><u>11 980</u></u>
<b>EQUITY</b>	
Capital	40 000
Less: Drawings	50 000
Add: Profit	21 980
	<u><u>11 980</u></u>

**EXAMPLE 4.9:** Trading/retail business

Given the following Trial Balance for “Monkey Merchandise”, prepare an Income Statement and Statement of Financial Position.

	<b>DR \$</b>	<b>CR \$</b>
Cost of sales	342 900	
Discount expense	4 390	
Inventory	120 000	
Interest income		32 300
Insurance expense	43 900	
Furniture	65 100	
Debtors	32 000	
Mortgage		109 200
Salaries	102 900	
Electricity	89 700	
Cash in cash register	700	
Sales		607 900
Cash at bank	43 000	
Land and buildings	230 900	
Machinery	80 900	
GST Collected		4 390
Office equipment	60 900	
Creditors		54 000
Capital		500 500
Drawings	89 000	
GST Credits received	2 000	
	<u><u>1 308 290</u></u>	<u><u>1 308 290</u></u>

**Monkey Merchandise Income Statement**  
For the period ended 31 December

	\$	\$	\$
<b>INCOME</b>			
Sales		607 900	
Less Discount allowed		4 390	
Net Sales		603 510	
Less: Cost of sales		342 900	
<b>GROSS PROFIT</b>		260 610	
<b>ADD: OTHER INCOME</b>			
Interest		32 300	292 910
<b>LESS: OTHER EXPENSES</b>			
<i>General and Administration</i>			
Salaries	102 900		
Electricity	89 700		
Insurance	43 900		236 500
<b>PROFIT</b>			<b>56 410</b>

**Monkey Merchandise Statement of Financial Position**  
As at 31 December

<b>CURRENT ASSETS</b>	<b>\$</b>
Cash in register	700
Inventory	120 000
Cash at bank	43 000
	<u>163 700</u>
<b>NON-CURRENT ASSETS</b>	
Debtors	32 000
Furniture	65 100
Office equipment	60 900
Machinery	80 900
Land and buildings	230 900
	<u>469 800</u>
<b>TOTAL ASSETS</b>	<b>633 500</b>
<b>CURRENT LIABILITIES</b>	
GST payable	2 390
Creditors	54 000
	<u>56 390</u>
<b>NON-CURRENT LIABILITIES</b>	
Mortgage	109 200
<b>TOTAL LIABILITIES</b>	<u>165 590</u>
<b>NET ASSETS</b>	<b>467 910</b>
	<u><u>467 910</u></u>
<b>EQUITY</b>	
Capital	500 500
Less: Drawings	89 000
Add: Profit	56 410
	<u>467 910</u>
	<u><u>467 910</u></u>

## REVIEW QUESTIONS

### Chapter 4: The General Journal, General Ledger and Financial Statements

- How much should a business charge in GST for the following goods and services if they are GST taxable?
  - A \$5 000 boat.
  - Three cakes worth \$30 each.
  - Tax return completion of \$300.
- Can a seller of goods claim input tax credits? If yes, under what circumstances? If no, why not?
- What is the input tax credit (GST outlay) for each of the following transactions:
  - Paid \$5 500 for shop shelving.
  - Purchased \$66 000 inventory on credit.
  - Sold goods on credit for \$64 900. The goods have a cost of \$33 000.
  - Paid \$440 internet bill.
  - Paid salaries of \$36 300.
  - Received a payment of \$330.
- Prepare general journal entries using the perpetual inventory system to record the following transactions for the business “Trendy Trader”, a music retailer, for the month of May. Include GST.
  - A package of CDs and DVDs purchased on credit from Movin’ Music for \$4 000 (GST exclusive).
  - A customer purchased LPs with a cost price of \$300 for \$660 (GST included) cash.
  - It was recognised that the purchase of \$220 (GST included) paper and pens had been incorrectly recorded as a purchase of inventory.
  - Faulty CDs were returned to the supplier Movin’ Music and a credit note to the value of \$300 was received (GST exclusive).
  - A customer returned faulty DVDs and was given a credit note to the value of \$150. This stock had a cost price of \$70.
  - The debtor Party DJ paid their account of \$900, and was given a discount of \$44 (including GST adjustment of \$4).
  - Paid creditor Movin’ Music the amount owing.
- A. Mouse has just commenced her own business. She invested \$30 000 of her savings and her motor vehicle worth \$23 000 in the business. The business has been established in a new warehouse using a loan from the bank of \$200 000. Complete the opening general journal entry plus journal entries to record the following cash and credit transactions that occurred in the first week of business. All transactions are quoted GST exclusive.
  - Purchase of \$12 000 stock for cash.
  - Sale of stock valued at \$2 000 for \$3 800 on credit to D. Smith.
  - Purchase of \$21 900 stock on credit from G. Brown Enterprises.
  - Cash sale of \$3 000 stock, valued at \$1 600.
- Complete general journal entries for the following transactions:
  - The purchase of a \$40 000 motor vehicle on credit (GST exclusive)
  - The write off of a \$330 bad debt owing from XYZ Limited (GST inclusive).
  - A business owner withdrawing \$132 stock for personal use (GST inclusive).
- Following is a list of transactions for the service business “Fitness Physiotherapy” for the month of October.

- Commenced business with \$12 000 office equipment.
- Purchased consulting room equipment for \$5 720 (GST inclusive) from “Medic Suppliers”, receiving tax invoice 987.
- Received fees of \$55 from P. Noir, receipt A001 (GST inclusive)
- Paid internet connection expenses of \$495 (GST inclusive) to “Net Nerds Inc.” using cheque 001.
- Fees of \$55 charged to client R. White, issuing tax invoice A002 (GST inclusive).
- Received fees of \$110 for services provided to Q. Black issuing tax invoice receipt A003 (GST inclusive).
- Paid printing expenses to “Letterhead R Us” of \$390 (GST exclusive) using cheque 002.
- Fees of \$110 charged to client X. Rouge, invoice number A004 (GST inclusive).

Required:

- Complete ledger entries for these transactions.
- Extract a Trial Balance as at 31 October.

- Mar Berber is the owner of “Mar Berber Rugs”, a carpet and flooring retail business. Using the following Trial Balance, complete a classified Income Statement and Statement of Financial Position.

	DR \$	CR \$
Electricity and rates	6 700	
Sales		1 560 000
Cash at bank	51 000	
Building	1 000 000	
Showroom furniture	16 000	
GST Collected		1 110
Office equipment	21 000	
Accounts payable		54 600
Salaries – Office staff	56 000	
Capital – M. Berber		600 000
Drawings	75 000	
GST Credits received	450	
Cost of sales	1 260 000	
Discount received		1 700
Inventory	423 000	
Interest income		3 190
Insurance expense	32 000	
Furniture	21 900	
Accounts Receivable	32 400	
Mortgage		900 000
Salaries - Sales staff	123 000	
Internet and telephone	2 150	
<b>TOTAL</b>	<b>3 120 600</b>	<b>3 120 600</b>

- Explain two errors that are disclosed by preparing a Trial Balance, and two errors that would not be revealed by a Trial Balance.
- Why are closing general journal and general ledger entries made?





### SYLLABUS CHECKLIST

**On completion of this chapter you should be able to:**

- ☐ outline the principles of internal control.
- ☐ apply the principles of internal control over cash, inventory, accounts receivable, accounts payable and non-current assets.
- ☐ discuss the limitations of internal control.

## 5.1 THE NATURE AND IMPORTANCE OF INTERNAL CONTROL

Internal control comprises of “systematic measures (such as reviews, checks and balances, methods and procedures) instituted by an organization to conduct its business in an orderly and efficient manner, safeguard its assets and resources, deter and detect errors, fraud, and theft, ensure accuracy and completeness of its accounting data, produce reliable and timely financial and management information, and ensure adherence to its policies and plans.”<sup>1</sup>

### Application of the principles of internal control over cash

Some internal control procedures, which may be implemented, to ensure that cash does not get lost or stolen are:

1. All cash receipts must be recorded so that evidence of the transaction exists.
2. Cash should be banked as often as possible.
3. Cash must be counted in an area where it is safe and won't get stolen.
4. Cash should be locked away securely.
5. Cash which has been locked should only be accessible to the manager or one other person.
6. If possible the person who receives the cash should not have the duty of recording the cash. A separate person should be in charge of this.

### Application of the principles of internal control over inventory

Internal control over inventory deals with ensuring that the inventory of the business is protected and managed in the most ideal manner possible. This is done through:

1. Storing inventory in a safe place so that it is not stolen.
2. Storing inventory in a place where it will not get spoilt or broken.
3. Making sure that inventory is not wasted or used incorrectly.

### Application of the principles of internal control over accounts receivable

1. Invoices should be issued as soon as possible.
2. Invoices should be issued according to when the sale occurred.
3. If possible the person who is in charge of billing should not also be in control of receiving the payments. A separation of these duties is needed.
4. Accounts receivable that have not yet been paid should be followed up regularly to facilitate payment and should be written off when it becomes apparent that they will be a bad debt.

### Application of the principles of internal control over accounts payable

1. Try to send payments early if it means a discount will be given.
2. Be aware of when payment deadlines are due.
3. If a payment cannot be met due to cash flow shortages then contact the creditor straight away to make another arrangement.

### Application of the principles of internal control over non-current assets

1. Must be kept secure so cannot be stolen.
2. Must be efficiently utilised
3. Must be recorded correctly in an asset register.
4. Must be stored where they cannot be spoiled.
5. Must be used properly that they do not suffer damage through incorrect usage.

## Administrative Controls

Administrative controls include the following:

- the organisational structure
- all procedures and documents that are used in management's decision-making activities that result in authorised activities and transactions.<sup>2</sup>

**EXAMPLE 5.1:** An example of an administrative control is a manual explaining how to correctly approve an employee's request for a reimbursement.

## Accounting Controls

Accounting Controls are the methods and procedures that are mainly concerned with:

- the authorisation of transactions,
- the safeguarding of assets and
- the accuracy of the financial records.

**EXAMPLE 5.2:** An example of an accounting control is a register to record use of the business car for work related travel.

Good accounting controls help maximise efficiency, they help minimise waste, unintentional errors and fraud.<sup>3</sup>

## Limitations of Internal Control

1. Impossible to overcome all human error.
2. Needs to be cost effective.
3. Employees can conspire to commit fraud together.
4. Smaller businesses may not have enough staff to segregate duties effectively.
5. Reviews are needed to ensure the controls are adequate.

2. Trenerry A, (1999), *Principles of Internal Control*, UNSW Press, Sydney, Australia, pp8.

3. Shiraz N, Management Accounting, the Journal of the Institute of Cost and Management Accounting, (March/April 1997).

## REVIEW QUESTIONS

### Chapter 5: Principles of Internal Control

1. What is Internal Control?
2. Jax owns a sole trader business selling craft supplies. Explain to him why it is important to have internal control processes in his business.
3. What are four internal control procedures that could be implemented to ensure that cash does not go missing from a business?
4. Susan Cathedral runs a small boarding school. The students in the boarding house are each given \$100 pocket money per term. There are 20 students in the boarding house. Susan is responsible for this money until the students ask for some of it to spend.
  - (a) What are two problems Susan may encounter?
  - (b) List and explain three control procedures Susan should adopt to ensure the safe keeping and correct recording of the cash.
5. Bob Fintle operates a small business which manufactures wooden spinning tops. Bob hires three part-time workers to operate the machinery and to package and store away the inventory. As the business is operated from Bob's garage there is not a lot of storage space. At Christmas time Bob has so many orders to fill that sometimes inventory is left in boxes outside the garage. As Bob lives in Albany it sometimes rains in December. He also lives near a caravan park which has a lot of people staying there on holiday.
  - (a) List two problems Bob may encounter.
  - (b) List and explain two internal control procedures Bob could implement.
6. List two principles of internal control over accounts receivable and explain why each of these is important.
7. List two principles of internal control over accounts payable and explain why each of these is important.
8. Chester Goodfellow operates a small business manufacturing fishing rods. He currently has no internal control procedures over his non-current assets. List and explain four controls which Chester could implement.
9. What is the difference between administrative controls and accounting controls?
10. List and explain five limitations of internal control.
11. It can be expensive to set up an ideal internal control system in a small business. What effect might this have on the decisions made by the business owner?



## SYLLABUS CHECKLIST

**On completion of this chapter you should be able to:**

- ☐ apply legislation relating to the formation of sole traders and partnerships, including:
  - GST Act 1999 (WA)
  - Business Names Registration Act 2011 (Cth)
  - Partnership Act 1895 (WA)
- ☐ outline the impact of GST legal requirements on small businesses
  - registering for GST
  - Australian Business Number (ABN).
- ☐ define the concept of bankruptcy as defined by the Bankruptcy Act 1966 (WA)
- ☐ discuss the costs and benefits for small business of engaging in socially, environmentally and ethically responsible behaviour
  - sponsorship
  - resource conservation
  - taxation responsibility.

## 6.1 THE IMPORTANCE OF LEGISLATION RELATING TO THE FORMATION OF SOLE TRADERS AND PARTNERSHIPS

### *Business Names Registration Act 2011 (Cth)*

Business names are registered with the Australian Securities and Investments Commission (ASIC). Under the *Business Names Registration Act 2011 (Cth)* the following occurs:

- Only a name that is not already in existence can be used.
- Once the name is registered it will have national effect.
- The entity must have an Australian Business Number (ABN) to register a new business name. An entity that is exempt from holding an ABN may still register a business name.
- Entities other than legal entities may register for a business name, e.g. sole traders and partnerships.
- The entity must include the business name in written communication.
- The business name should be prominently displayed at every place at which the entity carries on the business that is open to the public.

### Sole trader

A sole trader is not a separate legal entity therefore if the sole trader operates the business under their own name they will not need to be registered.

If the sole trader operates the business under a different name to his or her own then the business will need to be registered.

### Partnership

Partnerships are regulated by the *Partnership Act 1895 (WA)* and by a Partnership Agreement if there is one in place. Where there is no agreement in place, each partner is deemed to own equal shares of each asset as prescribed by the *Partnership Act 1895 (WA)*.

The name of the business only needs to be registered if it is different to the names of the partners involved, as like sole traders, partnerships are not separate legal entities. The business can use the surnames of all the partners involved if it does not wish to register a business name.

### *Partnership Act 1895 (WA)*

A partnership involves two or more people going into business together. It is advisable to prepare a Partnership Agreement covering the following:

- Each partner's role
- Authority of each partner
- Financial contribution by each partner
- How profits and losses will be distributed
- How disputes between partners will be resolved
- The procedure for ending the partnership

### Business Premises Regulations (to be adhered to by all business structures)

The Department of Commerce regulates most business premises regulations. Some of the regulations, which apply to small businesses, cover:

1. Consumer protection laws
2. Discharge of waste restrictions
3. Environment regulations
4. Fire regulations
5. Hazardous chemicals
6. Health regulations
7. Industrial awards for the staff employed
8. Measuring equipment inspections
9. Occupational Health and Safety
10. Workers' Compensation.



Each council has different regulations so the owner of the business will also need to enquire about regulations for areas such as:

1. Access
2. Alterations or extension guidelines
3. Approved business use
4. Building permits
5. Health regulations
6. Landscaping
7. Licenses or permits required
8. Noise restrictions
9. Parking requirements
10. Signs.

The business premises regulations set out by the Department of Commerce, as well as the regulations laid down by the Council, aim to ensure that the business is operating in an environment that will not have an adverse impact on its employees or members of the general public.

### Occupational Registration, Health and Safety

Depending on the type of business being operated, extra permits or licenses may be needed in order to operate. For example all construction firms need special licenses and permits. The State Government provides information on this through the business license centre.

If the business employs any staff then legally they need to make sure their employees are working in a safe environment. The business needs to contact Worksafe WA to make sure they are operating a safe work place.

Occupational health and safety is important as it protects the employees as well as the general public to ensure that accidents do not occur.

## 6.2 TAXATION

### State tax

Payroll tax, land tax and stamp duty are the state taxes that may apply to some small businesses.

### Federal tax

Sole traders and partnerships are not legal entities therefore the business is not required to pay tax. Instead the sole trader and the partners pay tax individually on any profit made. The business should have an ABN (Australian Business Number), which the tax office uses to identify them.

Tax legislation is imperative as it clearly sets out what taxes the business does and does not need to pay; as well as how much tax needs to be paid. This is important so that the business can do the right thing and not try to avoid paying tax.

### GST: GST Act 1999 (WA)

A business only has to register for GST purposes if it has an annual turnover greater than \$75 000. If a business does not register they will still have to pay the 10% GST on all goods and services they purchase instead of being able to claim this back from the government. They will also not be able to charge the 10% GST on any goods and services they sell. This is important as a business should only be paying GST or claiming GST if it is registered to do so.

### Other legal requirements

Businesses who employ staff need to:

1. Register as a PAYG withholding payer with the ATO
2. Make a minimum 9.5% contribution to all employees' superannuation funds
3. Have workers' compensation insurance.

## 6.3 THE IMPACT OF GST LEGAL REQUIREMENTS ON SMALL BUSINESSES

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

### Registering for the GST

A business has to register for GST if it has an annual turnover above \$75 000.

### Australian Business Number (ABN)

An ABN is a unique 11-digit identifying number. The Australian Taxation Office uses this number to identify a business in all their dealings.

### The impact of GST legal requirements

Once a business is registered for the GST they can legally charge GST on all their invoices and they can claim back GST from the government on purchases of goods and services for the business, which have involved a GST payment.

Along with this the business has to lodge a Business Activity Statement (BAS) with the ATO, which summarises all the GST the business collected and that the business paid. A business can choose to lodge their BAS either monthly or quarterly or in some cases per annum. The BAS can be lodged electronically via the ATO website or by mail.

### Bankruptcy

The definition of bankruptcy means the state of not having enough money or assets to pay all debts. Bankruptcy is a legal status that a person has under the *Bankruptcy Act 1966* (Cth) where, once they are declared bankrupt:

- with some exceptions, creditors are prevented from further pursuing them for payment;
- certain restrictions are placed on them; and
- their property (with some exceptions, e.g. household furniture, personal injuries compensation and certain vehicles) is made available, through a trustee, for distribution amongst creditors.

## 6.4 COSTS AND BENEFITS FOR SMALL BUSINESS OF ENGAGING IN SOCIALLY, ENVIRONMENTALLY AND ETHICALLY RESPONSIBLE BEHAVIOUR

### What is socially, environmentally and ethically responsible behaviour?

A workplace that is socially and ethically responsible would focus on making the right economic, social and environmental decisions. They would believe that the business has a responsibility to the public by conducting their business in an ethical manner, respecting the environment through the manner in which they go about their daily business and being loyal to employees.

Some of the simple steps a small business can take to become more socially, environmentally and ethically responsible are:

1. Donate to charity
2. Sponsorship
3. Conduct business ethically, free of bribery and corruption
4. Support community projects
5. Introduce environmental practises into the workplace such as resource conservation
6. Implement a code of ethics for all employees
7. Make sure the workplace is free of discrimination
8. Listen to employees so that they feel valued

9. Engage in taxation responsibility.

### Benefits of small business engaging in socially, environmentally and ethically responsible behaviour

1. It may result in increased customer loyalty
2. It may result in new customers
3. It may result in lower employee turnover, which will decrease recruitment costs and staff training costs
4. Shows a business which cares for the community.

### Costs of small business of engaging in socially, environmentally and ethically responsible behaviour

1. Lack of finance
2. Lack of knowledge
3. Lack of resources
4. Lack of time
5. Sourcing environmentally friendly products can be difficult
6. Having to train employees in new ways could be a burden.

**EXAMPLE 6.1:** An example of a business being socially minded is engaging in sponsorship.

#### What is Sponsorship?

Sponsorship is when a business provides either resources, funding or services to an individual or an organization or event.

#### Why does a business engage in Sponsorship?

By sponsoring an individual, event or specific cause, such as Diabetes Fundraising, a business shows that it is community minded and interested in helping society in a positive manner. It is a way to give back to the community.

It is a way for the business to get its name noticed, for example if the business sponsored a sports star who was about to compete in an international competition then the star might have to advertise the business in certain ways in exchange for the sponsorship by displaying the business name on their clothing or doing adverts for the business etc.

**EXAMPLE 6.2:** An example where a business can be environmentally minded is resource conservation.

#### What is Resource Conservation?

Resource conservation is when a business implements ways that they can manufacture their product or operate their business using the least amount of resources.

#### What are some examples of resource conservation?

1. Minimising product packaging
2. Using materials which can be recycled
3. Recycling
4. Disposing of waste in an environmentally friendly way
5. Replenishing resources where possible, e.g. replanting trees.

**EXAMPLE 6.3:** An example where a business can behave in an ethical manner is through taxation responsibility.

## What is Taxation Responsibility?

This is where a business pays their tax on time and the right amount of tax without abusing the system by trying to avoid paying the correct amount of tax.

Legally businesses can claim tax deductions and take advantage of any tax loopholes. There is nothing wrong with this. A business would be silly to pay more tax than they were required to by not deducting what they are legally entitled to. However, sometimes businesses lodge incorrect information knowingly so that their tax is lower. A business that does this would not have any taxation responsibility.

[illegible]

## REVIEW QUESTIONS

### Chapter 6: Government and the Community

1. Under what circumstances does a sole trader need to register for a business name?
2. Why is it important for a small business that employs staff to have workers' compensation insurance?
3. Why is tax legislation important?
4. Under what circumstance is it compulsory for a business to register for the GST?
5. What is an ABN used for?
6. Why does a business registered for the GST need to lodge a Business Activity Statement with the Australian Taxation Office?
7. Sally Jones has just started her own small business manufacturing lip-gloss. She employs four staff. She will be using materials in the manufacturing process that cannot be recycled. There are materials which are recyclable which she could use instead, but she did not like the colour of them. She has been demanding that her employees work overtime for free or else they will be fired. One employee missed her daughter's high school graduation through having to do overtime. A reporter from the local newspaper is going to come and write a story about the business in two months time.
  - (a) Is Sally operating a business that is socially or environmentally aware? Support your answer.
  - (b) What is one thing Sally could do to make her business more environmentally aware?
  - (c) What is one thing Sally could do to make her business more socially aware?
8. List three benefits of a business engaging in socially, environmentally and ethically responsible behaviour.
9. List three reasons why a business may find it difficult to become a more socially, environmentally and ethical business.
10. What benefits are there for a business which decides to sponsor a community event?
11. Define resource conservation and give two examples of it.
12. How can a business practise taxation responsibility?
13. Explain how a partnership is formed, and the main elements of the Partnership Agreement.
14. What is bankruptcy, and what effect does it have on the owner of a sole trader business?



# ACCOUNTING & FINANCE

## UNIT 2







## SYLLABUS CHECKLIST

**On completion of this chapter you should be able to:**

- ☐ Explain the nature, benefits and risks to small business of the following types of electronic processing:
  - EFTPOS
  - bill payments – electronic payment system
  - credit cards
  - online banking
  - direct debits
- ☐ Define the accrual basis of accounting as per the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*)
  - distinguish between cash and accrual methods of accounting
- ☐ Define, as per the *Conceptual Framework*:
  - assets
  - liabilities
  - equity
  - income
  - expenses
- ☐ Recognition criteria, as per the *Conceptual Framework*, for:
  - assets
  - liabilities
  - income
  - expenses
- ☐ Classify income, expenses, assets and liabilities by nature and function
- ☐ Outline the purpose and nature of the following balance day adjustments:
  - accrued expenses
  - prepaid expenses
  - stock of supplies
  - accrued income
  - income in advance
  - doubtful debts
  - depreciation

## 7.1 NATURE, BENEFITS AND RISKS TO SMALL BUSINESS OF ELECTRONIC PROCESSING

### Different Types of Electronic Processing

TYPE	NATURE	BENEFITS	RISK
<b>EFTPOS</b>	This acronym (EFTPOS) stands for Electronic Funds Transfer at Point of Sale. It can be carried out when a consumer has a debit or credit card. The debit card is linked to their bank account. When the card is used the customer's funds are transferred from their account to the relevant businesses account.	<ul style="list-style-type: none"> <li>• Efficient as funds are cleared straight away.</li> <li>• Secure as it lowers the risk of theft as there is less cash on the premises.</li> <li>• Low cost as can be cheaper than clearing payment by cheque.</li> <li>• Reconciliation problems are reduced.</li> <li>• Can be used internationally across currencies.</li> </ul>	<ul style="list-style-type: none"> <li>• The system is electronic so can be subject to outages.</li> <li>• Risk of fraud from stolen debit or credit cards.</li> </ul>
<b>BILL PAYMENTS – ELECTRONIC BANKING SYSTEM</b>	This is when a business or customer uses the internet to pay bills.	<ul style="list-style-type: none"> <li>• Low cost as can be cheaper than paying by cheque.</li> <li>• Easier and quicker than posting a cheque or going to the place to pay.</li> <li>• Automatic clearance of funds.</li> <li>• Electronic proof that the bill has been paid.</li> <li>• Can be used anytime.</li> <li>• Can be used internationally and across currencies.</li> </ul>	<ul style="list-style-type: none"> <li>• The system is electronic so can be subject to outages.</li> <li>• Risk of fraud with stolen debit or credit cards being used.</li> <li>• Data theft.</li> <li>• Hackers.</li> </ul>
<b>ONLINE BANKING</b>	When the business uses the internet to do their banking. They log onto their bank's website and use a password to access their account.	<ul style="list-style-type: none"> <li>• Automatic clearance of funds.</li> <li>• Electronic proof that the bill has been paid.</li> <li>• Convenient as can be used anytime.</li> <li>• Can be used internationally.</li> </ul>	<ul style="list-style-type: none"> <li>• The system is electronic so can be subject to outages.</li> <li>• Risk of fraud if someone steals log on details and password.</li> </ul>
<b>CREDIT CARDS</b>	Credit cards are issued by financial institutions and can be used by the card's owner to purchase goods and services on credit.	<ul style="list-style-type: none"> <li>• Efficient as funds are cleared straight away.</li> <li>• Secure as it lowers the risk of theft as there is less cash on the premises.</li> <li>• Can be used internationally across currencies.</li> </ul>	<ul style="list-style-type: none"> <li>• The system is electronic so can be subject to outages.</li> <li>• Risk of fraud with stolen credit cards.</li> <li>• The business has to pay various fees to set up credit card facilities and to process credit cards. This can be costly, especially for small businesses.</li> </ul>
<b>DIRECT DEBIT</b>	Where the customer gives their financial institution instructions to pay certain bills automatically at specific times of the month.	<ul style="list-style-type: none"> <li>• Convenient.</li> <li>• Electronic proof that the bill has been paid.</li> </ul>	<ul style="list-style-type: none"> <li>• Fees are incurred.</li> <li>• Incorrect amount could be taken out so it is up to the customer to check.</li> </ul>

## 7.2 DISTINCTION BETWEEN CASH AND ACCRUAL METHODS OF ACCOUNTING

### Accrual Basis of Accounting

Most businesses use the accrual system of accounting. This method of accounting follows the income recognition assumption. Under the accrual basis of accounting, the transactions are recognised and recorded on the day they occur and not when the cash is paid or received.

**EXAMPLE 7.1:** If Theo Armon-Jones gave a concert on the 29th of June and was only paid for his services on the 28th of July, his accounting records would record the income amount owing on the day the service was performed.

Similarly, if concert expenses were incurred at the time of the concert, with a 7 day billing period, they would be recognised in the accounts on the day they were used, not the date of cash payment.

### Cash Basis of Accounting

Under the cash basis of accounting, income is not recognised in the financial records until it is actually received in cash.

**EXAMPLE 7.2:** If Dr. Smith sees a patient on the 10th of 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 the 20th of 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.

The same happens with expenses. They are not recognised until they have been paid for in cash.

## 7.3 DEFINITION AND RECOGNITION OF ASSETS, LIABILITIES, INCOME AND EXPENSES

Even though an item might be defined as an asset, liability, income or expense, that does not necessarily mean it can automatically be recognised in the financial statements. If an item meeting the definition of an asset or liability is not recognised, the business may need to provide information about it in the notes to the financial statements.

ELEMENT	DEFINITION	RECOGNITION CRITERIA
ASSET	<p><b>A present economic resource controlled by the entity as a result of past events.</b></p> <p>An economic resource is a right that has the potential to produce economic benefits.</p> <p>Three criteria:</p> <ul style="list-style-type: none"><li>• right</li><li>• potential to produce economic benefits</li><li>• control.</li></ul>	<p>Recognition of asset and of any resulting income, expenses or changes in equity only if it provides information that is:</p> <ul style="list-style-type: none"><li>• <b>relevant</b> to the asset and any resulting income, expenses or changes in equity and</li><li>• a <b>faithful representation</b> of the asset and of any resulting income, expenses or changes in equity</li></ul>
LIABILITY	<p><b>A present obligation of the entity to transfer an economic resource as a result of past events.</b></p> <p>Three criteria:</p> <ul style="list-style-type: none"><li>• the entity has an obligation</li><li>• the obligation is to transfer an economic resource</li><li>• the obligation is a present obligation that exists as a result of past events.</li></ul>	<p>Recognition of liability and of any resulting income, expenses or changes in equity only if it provides information that is:</p> <ul style="list-style-type: none"><li>• <b>relevant</b> to the liability and any resulting income, expenses or changes in equity and</li><li>• a <b>faithful representation</b> of the liability and of any resulting income, expenses or changes in equity</li></ul>

ELEMENT	DEFINITION	RECOGNITION CRITERIA
<b>EQUITY</b>	The residual interest in the assets of the entity after deducting all its liabilities	<i>The recognition criteria for assets and liabilities provide for the recognition of equity.</i>
<b>INCOME</b>	Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims	Occurs at the same time as: <ul style="list-style-type: none"> <li>the initial recognition of an asset or an increase in the carrying amount of an asset, or</li> <li>the derecognition of a liability or a decrease in the carrying amount of a liability</li> </ul>
<b>EXPENSES</b>	Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims	Occurs at the same time as: <ul style="list-style-type: none"> <li>the initial recognition of a liability or an increase in the carrying amount of a liability, or</li> <li>the derecognition of an asset or decrease in the carrying amount of an asset</li> </ul>

## 7.4 CLASSIFICATION OF INCOME AND EXPENSES BY NATURE AND FUNCTION

Income and expenses that are classified by nature are grouped in accordance with their type, and when classified by function are grouped according to the activity for which they were incurred.

**EXAMPLE 7.3:** An example of how to classify expenses by **nature** is below.

Expenses classified by nature are grouped in relation to the type of cost they are.

GREEN MEADOWS COUNTRY CLUB Income Statement (Extract)		
<b>LESS EXPENSES</b>		
<b>Vehicles</b>		
Service costs	900	
Petrol and oil	700	1 600
<b>Employee expenses</b>		
Salaries of sales staff	80 000	
Salaries of office staff	50 000	
Salaries of tennis coaches	80 000	210 000
<b>Depreciation</b>		
Depreciation of tennis equipment	5 000	
Depreciation of vehicles	8 000	
Depreciation of fixtures and fittings	2 000	15 000
<b>Finance costs</b>		
Interest on loan	2 000	
Doubtful debts	400	2 400
<b>Office costs</b>		
Advertising	8 000	
Office supplies	4 000	
Telephone	6 000	18 000
TOTAL EXPENSES		247 000

**EXAMPLE 7.4:** Classification of expenses by **function**.

The same expenses which were classified by nature will now be classified by function.

GREEN MEADOWS COUNTRY CLUB Income Statement (Extract)		
<b>LESS EXPENSES</b>		
<b>Selling &amp; Distribution Expenses</b>		
Advertising	8 000	
Distribution vehicle service costs	900	
Petrol & oil	700	
Depreciation of vehicles	8 000	
Salaries paid to sales people	80 000	97 600
<b>Administration &amp; General Expenses</b>		
Office supplies	4 000	
Telephone	6 000	
Depreciation of fixtures & fittings	2 000	
Depreciation of tennis equipment	5 000	
Salaries of office staff	50 000	
Salaries of tennis coaches	80 000	147 000
<b>Financial Expenses</b>		
Interest	2 000	
Doubtful debts	400	2 400
TOTAL EXPENSES		247 000

## 7.5 CLASSIFICATION OF ASSETS AND LIABILITIES

Assets can be classified as:

1. Current Assets – held for less than a year
2. Non-current Assets – expected to be held in the business for longer than a year.

Liabilities can be classified as:

1. Current Liabilities – due in under one year
2. Non-current Liabilities – long term obligation that is not due in current period.

## 7.6 PURPOSE AND NATURE OF BALANCE DAY ADJUSTMENTS

TYPE	PURPOSE	NATURE
<b>ACCRUED EXPENSES</b>	A payment which has not yet been made by the business but is owed. For example, telephone bill.	Liability
<b>PREPAID EXPENSES</b>	This is a prepayment. The business has paid an expense in advance. For example, insurance.	Asset
<b>ACCRUED INCOME</b>	Income which has been earned but has not yet been received by the business. For example, rent.	Asset
<b>INCOME IN ADVANCE</b>	Income which has been received but has not yet been earned. For example, subscriptions.	Liability
<b>DOUBTFUL DEBTS</b>	Based on an estimation it is a provision made which results in the profit figure being more conservative in case of a bad debt occurring.	Expense
<b>DEPRECIATION</b>	An allocation process spreading the cost of the asset over the period of time the asset is used to generate income.	Expense

## REVIEW QUESTIONS

### Chapter 7: Fundamental Principles

- Rupert Harris has just started his own law practise. He finds that he is working long hours and cannot easily pop into the post office to pay his telephone and electricity bills.
  - Discuss the advantages for Rupert of using online banking.
  - Are there any disadvantages to Rupert using this system?
  - What would your advice to Rupert be?
- Nicholas Savage has opened up a large music retail store. He is considering installing EFTPOS facilities but does not understand what it is all about.
  - Explain what acronym EFTPOS stands for.
  - What are the benefits of EFTPOS for the store?
  - Are there any disadvantages using EFTPOS?
  - What would your advice to Nicholas be?
- What are two advantages and two disadvantages of a business having credit card facilities?
- Using an example, explain the accrual method of accounting.
- Using an example, explain the cash method of accounting.
- What are the two conditions which need to be met before an asset can be recognised?
- Jenny Garrett has a \$4 000 bank loan. She does not know how to classify this in her Statement of Financial Position. Explain to Jenny why she should recognise the loan as a liability.
- When is income recognised? Give an example.
- Neil Brown cannot understand the difference between a liability and an expense.
  - Explain to Neil the recognition criteria for an expense.
  - Using an example, discuss the difference between a liability and an expense.
- Complete the table below:

TYPE	PURPOSE	NATURE
	Income which has been received but not yet earned.	
Prepaid Expense		
	It is an allocation process of spreading the cost of the asset over the period of time the asset is used to generate income.	
Doubtful Debt		Expense
	Income which has been earned but has not yet been received by the business.	
Accrued Expense		



11. Explain what it means to classify expenses by function, giving examples.
12. Is a businesses mobile phone an asset that should be recognised in the Statement of Financial Position?
13. Explain why salaries should be defined as an expense in the financial statements.
14. Shasha Ford's business has received a payment of \$5 500 for a sale of goods. Detail why she should recognise this as income in the business income statement.
15. Outline how a retail business with a number of sales outlets might classify income by nature.



## 8.1 DEPRECIATION AND NON-CURRENT ASSETS

### Depreciation of non-current assets

All manufactured non-current assets decline in value from the day they are first purchased. This decline is an expense to the business. In accounting this expense is known as depreciation.

AASB 116 states that depreciation only relates to “*non-current assets that have physical substance.*” The main exception to this is land which usually appreciates over time and therefore is not subject to depreciation.

### Definition of depreciation

AASB 116 refers to depreciation as the allocation of the cost of an asset, or its revalued amount, over the period in which benefits are expected to be derived. In other words depreciation is a cost allocation process. It spreads the cost of an asset over the period of time the asset is used to generate income.

### Depreciation as a cost allocation concept

#### What does cost allocation mean?

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.

#### Why depreciate non-current assets?

Asset depreciation occurs due to the matching principle, which requires the matching of all income in an accounting period against all the associated expenses. This means that if a delivery truck has been used to earn income for a courier business, then the decline in value of the truck needs to be offset against the income that has been earned.

#### Reasons for depreciation

- Wear and tear
- Commercial obsolescence
- Technical obsolescence.

### Determining the cost of a depreciable non-current asset

The cost of a non-current asset is the acquisition cost (initial cost) plus any other subsequent costs which add value to the asset. For example, air conditioning (costing \$700) may be installed inside a vehicle which originally cost \$20 000. This would make the cost of the non-current asset  $\$20\,000 + \$700 = \$20\,700$ .

### Factors to consider when calculating depreciation

Four factors affect the calculation of depreciation. These are:

1. The cost
2. The estimated useful life
3. The residual value
4. The chosen method, i.e. straight line or diminishing/reducing balance.

### Depreciation methods

The two most commonly used methods of depreciation are:

1. Straight-line
2. Diminishing balance.

These two methods allocate different amounts of depreciation expense to each period. However, they should result in the same total amount of depreciation by the end of the life of the asset.

## Straight-line method

Using the straight-line method a fixed (set) amount is written off over the number of years that the asset will be used by the business.

$$\text{Straight-line depreciation} = \frac{\text{Original cost} - \text{Estimated Residual Value}}{\text{Estimated Life}}$$

**EXAMPLE 8.1:** A business bought a packaging machine worth \$10 000, with an estimated resale value of \$2 000 after a 4 year estimated life.

$$\begin{aligned}\text{Straight-line depreciation} &= \frac{\$10\,000 - \$2\,000}{4} \\ &= \$2\,000\end{aligned}$$

Therefore \$2 000 will be written off each year as the depreciation expense.

## Diminishing balance method

Using this method, a fixed percentage is written off the diminishing balance rather than off the original cost of the asset.

**EXAMPLE 8.2:** A printing press was purchased for \$50 000, to be depreciated at 10% per annum.

Diminishing balance depreciation:

Year 1 depreciation is 10% of \$50 000 = 5 000 (Diminished balance is 45 000)

Year 2 depreciation is 10% of \$45 000 = 4 500 (Diminished balance is 40 500)

Year 3 depreciation is 10% of \$40 500 = 4 050 (Diminished balance is 36 450)

Year 4 depreciation is 10% of \$36 450 = 3 645 (Diminished balance is 32 805)

The above example shows that with the diminishing value method a greater amount of depreciation is charged in the early years of the assets' useful life.

## When should the straight-line method be used?

The straight-line method is best used in a situation where the non-current asset does not need more repairs later in its life than in the beginning. Also when the age, the efficiency and the usage of the asset are equal in each accounting period. For example, furniture.

## When should the diminishing balance method be used?

The diminishing balance method is best used in situations where the non-current asset will require more repairs later in its useful life. For example, machinery and vehicles. These non-current assets are more useful earlier on in their life, therefore it makes sense to depreciate them at a higher dollar value earlier on.

## 8.2 RECORDING DEPRECIATION

To record the depreciation of an asset, an entry is made in the general journal then posted to the general ledger.

**EXAMPLE 8.3:** A printing press is being depreciated at \$6 000 a year.

### The entry in the general journal

Once the depreciation expense for the year has been calculated an entry is made in the general journal.

- 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 Journal (extract)

DATE	DETAILS	DEBIT	CREDIT
30 Jun	Depreciation of printing press	6 000	
	Accumulated depreciation of printing press		6 000
	<b>Depreciation of asset</b>		

### The entries in the ledger accounts

The general journal entry is then posted to the depreciation account and the accumulated depreciation account in the general ledger. 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.

#### General Ledger (extract)

##### Depreciation of Printing Press (Expense) Account

30 Jun	Accumulated depreciation	6 000
--------	--------------------------	-------

##### Accumulated depreciation of Printing Press (Contra Asset) Account

30 Jun	Depreciation	6 000
--------	--------------	-------

## 8.3 DISPOSAL OF ASSET

### Identification of over- or under-depreciation on sale of non-current asset

When a business wants to sell a non-current asset they will calculate the carrying amount and try to sell it for as close (or more than) to this figure as they possibly can. The carrying amount is the cost of the asset minus the accumulated depreciation. Accumulated depreciation is the total amount of depreciation which has been deducted over the life of the asset.

If the business sells a non-current asset either for cash or as a trade in value, to offset a new purchase, then the accounting records need to be adjusted to show whether there was either an over- or under-depreciation of the asset. If the business makes a **gain** on the disposal of the asset then this means they over-depreciated the asset. If the business makes a **loss** on the sale of the asset then this means the business under-depreciated the asset.

**EXAMPLE 8.4:** Dexter Harris bought a printing press machine on 1<sup>st</sup> July 2016 for \$40 000. On 1<sup>st</sup> July 2020 the machine was sold for \$15 000. The accumulated depreciation to date was \$20 000.

The steps to record the sale and the disposal of the asset would be as follows:

**STEP 1:** Transfer the cost of the asset from the Printing Press (Asset) account to the Sale of Asset account.

**General Journal (extract)**

DATE	DETAILS	DEBIT	CREDIT
1 Jul 2020	Sale of asset Printing Press <i>Transfer of cost of printing press sold</i>	40 000	40 000

**General Ledger (extract)**

**Printing Press (Asset) Account**

1 Jul	<b>Balance</b>	40 000	1 Jul	<b>Sale of asset</b>	40 000
-------	----------------	--------	-------	----------------------	--------

**Sale of Asset Account**

1 Jul	<b>Printing Press</b>	40 000
-------	-----------------------	--------

**STEP 2:** Transfer the accumulated depreciation of the asset from the Accumulated Depreciation account into the Sale of Asset account.

**General Journal (extract)**

DATE	DETAILS	DEBIT	CREDIT
1 Jul 2020	Accumulated depreciation of Printing Press Sale of asset <i>Transfer of accumulated depreciation of printing press sold</i>	20 000	20 000

**General Ledger (extract)**

**Accumulated Depreciation of Printing Press Account**

1 Jul	<b>Sale of asset</b>	20 000	1 Jul	<b>Balance</b>	20 000
-------	----------------------	--------	-------	----------------	--------

**Sale of Asset Account**

1 Jul	<b>Printing Press</b>	40 000	1 Jul	<b>Accumulated depreciation</b>	20 000
-------	-----------------------	--------	-------	---------------------------------	--------

**STEP 3:** Enter the cash received into the Cash at Bank account and the Sale of Asset account.

**General Journal (extract)**

DATE	DETAILS	DEBIT	CREDIT
1 Jul 2020	Cash at bank	15 000	
	Sale of asset		15 000
	<i>Proceeds received from sale of asset</i>		

**General Ledger (extract)**

**Cash at Bank Account**

1 Jul	<b>Sale of asset</b>	15 000	
-------	----------------------	--------	--

**Sale of Asset Account**

1 Jul	<b>Printing Press</b>	40 000	1 Jul	<b>Accumulated depreciation</b>	20 000
				<b>Cash at bank</b>	15 000

**STEP 4:** Calculate the gain or loss on the disposal.

$$\begin{aligned}
 \text{Gain or loss} &= \text{Proceeds} - \text{Carrying amount} \\
 &= \$15\,000 - (\$40\,000 - \$20\,000) \\
 &= \$15\,000 - \$20\,000 \\
 &= (\$5\,000) \text{ LOSS}
 \end{aligned}$$

**General Journal (extract)**

DATE	DETAILS	DEBIT	CREDIT
1 Jul 2020	Loss on disposal	5 000	
	Sale of asset		5 000
	<i>Loss on disposal of printing press</i>		

**General Ledger (extract)**

**Sale of Asset Account**

1 Jul	<b>Printing Press</b>	40 000	1 Jul	<b>Accumulated depreciation</b>	20 000
				<b>Cash at bank</b>	15 000
				<b>Loss on disposal</b>	5 000

**Loss on Disposal Account**

1 Jul	<b>Sale of asset</b>	5 000	
-------	----------------------	-------	--



## Profit on disposal

Had a profit of \$5 000 been made in this example instead of a loss, then the final journal entry would have been as follows:

DATE	DETAILS	DEBIT	CREDIT
1 Jul	Sale of asset	5 000	
	Profit on disposal		5 000
	<b><i>Profit on disposal of printing press</i></b>		

## 8.4 INVENTORY COSTING METHODS

### Weighted Average Method

Under the weighted average cost method, it is assumed that the cost of inventory is based on the average cost of the goods available for sale during the accounting period.

The average cost is worked out using the formula:

$$\text{Weighted average cost} = \frac{\text{Total Cost of goods for sale}}{\text{Total Number of goods for sale}}$$

The average-cost method aims to level out the effects of cost increases and decreases.

**EXAMPLE 8.5:** A clothing store purchased eighty T-shirts for \$10 each and twenty T-shirts for \$5 each. They then sell thirty T-shirts to a customer. The cost of the inventory sold is calculated by averaging the cost of all the T-shirts.

$$\begin{aligned}\text{Weighted average cost} &= \frac{\text{Cost of items for sale}}{\text{Number of items for sale}} \\ &= \frac{(80 \times \$10) + (20 \times \$5)}{80 + 20} \\ &= \$9\end{aligned}$$

The average cost of a T-shirt is \$9

$$\begin{aligned}\text{The cost of the thirty T-shirts sold} &= 30 \times \$9 \\ &= \$270\end{aligned}$$

### First-in First-out Method

As the name suggests, this method assumes that the first stock to come in will be the first sold. The cost of the inventory sold is calculated by adding up the cost of the number of items sold that were purchased by the business first.

**EXAMPLE 8.6:** An office supplies distributor purchased twenty boxes of paper for \$10 each on the 1 July and forty boxes for \$20 each on the 8 July. They then sell fifteen boxes to a customer on 18 July. The cost of the inventory is calculated by assuming that the boxes purchased at \$10 on the 1 July are sold first.

$$\begin{aligned}\text{Cost of the fifteen boxes sold} &= 15 \times 10 \\ &= \$150 \\ \text{Cost of remaining inventory} &= (5 \times \$10) + (40 \times \$20) \\ &= \$850\end{aligned}$$

## REVIEW QUESTIONS

### Chapter 8: Depreciation

1. Define depreciation.
2. Why are non-current assets depreciated?
3. List a non-current asset which is not subject to depreciation and explain why.
4. What do the words “cost allocation” mean? Explain using an example.
5. List two reasons for depreciation.
6. List three factors which are considered when calculating depreciation.
7. Define the straight line method and show its formula.
8. Complete the table below using the straight-line method of depreciation.

ORIGINAL COST	ESTIMATED RESIDUAL VALUE	ESTIMATED LIFE	DEPRECIATION EXPENSE PER ANNUM
\$10 000	\$2 000	4	\$2 000
\$40 000	\$8000	6	
\$30 000	\$3 000	3	
\$25 000	\$4 000	7	
\$20 000	\$5 000	5	
\$12 000	\$0	4	

9. How is the diminishing balance method of depreciation different to the straight-line method?
10. Complete the table below using the diminishing balance method.

ORIGINAL COST	DEPRECIATION RATE	YEAR 1	YEAR 2	YEAR 3
\$50 000	10%	\$5 000	\$4 500	\$4 150
\$40 000	25%			
\$100 000	20%			
\$25 000	15%			
\$30 000	30%			
\$15 000	10%			
\$8 000	5%			

11. Give an example of an asset the straight line method is best used with and state why.
12. Give an example of an asset the diminishing balance method is best used with and state why.
13. Marjorie Withers purchased a motor vehicle for \$20 000 on 3 Dec 2015. The vehicle has been depreciated at 20% per annum for the last 3 years using the straight line method. On 3 Dec 2018 she sells the vehicle for \$5 000.

You are required to:

- (a) Work out the total accumulated depreciation.
  - (b) Calculate the profit or loss on disposal.
  - (c) Complete the general ledger entries required to recognise the sale of the vehicle.
  - (d) Complete the general ledger entries required for the disposal of the vehicle.
14. Julian Windspeare has just purchased a motor vehicle for \$20 000. He decided to have air conditioning valued at \$1 000 installed in the vehicle. He also paid \$380 for the vehicle registration and \$700 to insure the vehicle for the year.
    - (a) What subsequent costs can Julian add on to the original purchase price of \$20 000 to value the vehicle? Back up your answer.
    - (b) Which of the costs cannot be added to the value of the vehicle? Explain why.
  15. Brenda Baxter owns a Florist, “Fabulous Flowers”. On 2 January 2017 she purchased a new delivery van for \$40 000 cash. She decided to use the diminishing balance method of depreciation at a rate of 20% per annum.

You are required to:

- (a) Enter the purchase of the delivery van in the appropriate journal and ledger accounts.
  - (b) Calculate the depreciation expense for the delivery van for the year ending 30 June 2017.
  - (c) Show the general journal entry for depreciation for the delivery van.
  - (d) Show the entry in the general ledger to record depreciation expense and the accumulated depreciation for the delivery van.
16. Felicity Higgins owns a small detective agency, “Get a clue”. On 1 July 2016 she purchased office furniture valued at \$3 000 from “Funky Place” on credit. The estimated useful life is 4 years and the residual value of the furniture is estimated to be \$400.

You are required to:

- (a) Enter the purchase of the furniture in the appropriate journal and ledger accounts.
  - (b) Calculate the depreciation expense for the furniture for the year ending 30 June 2017.
  - (c) Show the general journal entry for depreciation for the furniture.
  - (d) Show the entry in the general ledger to record depreciation expense and the accumulated depreciation for the furniture.
17. What does the weighted average inventory costing method assume?
  18. Explain the First-in First-out inventory costing method.

19. Tim Oliver owns a farm. He decides to buy a new tractor for his farm and sells the old one making a gain on the disposal. Explain the following to Tim:
- (a) How a loss on disposal is recorded in the Statement of Financial Position.
  - (b) How a loss on disposal is recorded in the Income Statement.
  - (c) How a gain on disposal is recorded in the Statement of Financial Position.
  - (d) How a gain on disposal is recorded in the Income Statement.
20. Brent Howe buys two motor vans costing \$41,000 in total. They are depreciated on the reducing-balance basis at the rate of 40% per annum. Which of the following statements is not true?
- (a) The carrying amount of the vans after one year will be \$24,600.
  - (b) The carrying amount of the vans after two years will be \$14,760.
  - (c) The charge to the Income Statement for depreciation in Year 2 will be \$26,240.
  - (d) The charge to the Income Statement for depreciation in Year 3 will be \$5,904.
21. A machine was bought for \$100 000. Its estimated useful life is four years with a residual value of \$10 000. Depreciation is charged on the straight-line method. What is the percentage of depreciation rate on an annual basis?
- (a) 15%
  - (b) 22.50%
  - (c) 35%
  - (d) 25%
22. A fixed asset cost \$12,000 and sold for \$5,000. At the date of disposal, its carrying amount is \$2,000. What is the profit or loss on disposal of this fixed asset?
- (a) \$2,000 (loss)
  - (b) \$3,000 (loss)
  - (c) \$2,000 (profit)
  - (d) \$3,000 (profit)
23. A motor vehicle was purchased for \$20 000 on 1st July 2012 with a residual value of \$2,000. Depreciation was charged at 20% by the reducing balance method on a yearly basis. It was sold for \$18,000 after three years of use. Calculate the profit on the sale of asset.
- (a) \$7,760
  - (b) \$505
  - (c) \$5,201
  - (d) \$990
24. A machine with a five-year life was purchased for \$20,000 and has a \$2,000 salvage value. Its annual operating cost is \$14,000 per year. According to the straight line method, the depreciation charge in year 2 is nearest to:
- (a) \$3,600
  - (b) \$4,000
  - (c) \$11,600
  - (d) \$12,000
25. Sam bought a delivery van for \$14,000 on 1 July 2012. It is expected to have a useful life of 4 years and a value at the end of that time of \$3,000. If depreciation is to be provided at 30% on the reducing-balance basis, the depreciation charge for the year ended 30 June 2014 will be:
- (a) \$2,940
  - (b) \$1,260
  - (c) \$4,200
  - (d) \$2,310

26. Sasha bought a machine for \$39,000, which she expects to have a useful life of four years and a residual value of \$4,000 at the end of that time. If depreciation is to be provided on the straight-line basis, the carrying amount after two years will be:
- (a) \$17,500
  - (b) \$19,500
  - (c) \$21,500
  - (d) \$30,250
27. On January 1, 2016, the Morgan Foundation purchased a machine at a cost of \$55,000. The machine was expected to have a service life of 10 years and no residual value. The straight-line depreciation method was used. In 2018 the estimate of residual value was revised from zero to \$6,000. Depreciation for 2018 should be:
- (a) \$3,800
  - (b) \$4,400
  - (c) \$4,750
  - (d) \$5,500
28. Using the straight-line method of depreciation, calculate the annual depreciation expense for an asset that has an original value of \$40,000, a salvage value of \$6,000, and an estimated life of 10 years.
- (a) \$3,000
  - (b) \$3,400
  - (c) \$4,600
  - (d) \$4,400
29. The manufacturing department of Brady Enterprises recently purchased a piece of equipment for \$150,000. It had an estimated life of 12 years and an expected salvage value of \$8,000. Using the straight-line method of depreciation, what will be the depreciation value applied to each year of the asset's life?
- (a) \$11,833
  - (b) \$11,300
  - (c) \$13,166
  - (d) \$17,040
30. Which of the following types of subsequent expenditures is not normally depreciated:
- (a) Additions
  - (b) Improvements
  - (c) Cost of installation
  - (d) Repairs and maintenance.



## SYLLABUS CHECKLIST

**On completion of this chapter you should be able to:**

- ☐ manually prepare general journal and ledger entries for balance day adjustments (asset and liability method only) to prepare financial reports (GST not included)
- ☐ manually prepare closing general journal entries
- ☐ manually prepare trial balance
- ☐ manually prepare classified financial statements for a sole trader including balance day adjustments
  - Income Statements
  - Statement of Financial Position for a trading/merchandising/service business

## 9.1 BALANCE DAY ADJUSTMENTS

### 1. Prepaid Expenses

**EXAMPLE 9.1:** The business pays for a 12 month insurance policy on 31 Jan 2023 for \$1200. (Prepaid Expense)

**STEP 1:** Work out how much of the insurance is the expense for the accounting period and how much is prepaid expense for the next accounting period. Insurance is \$100 a month so by 30 June, 5 months insurance (\$500) has been consumed and 7 months still remain (\$700). Therefore the prepaid expense amount for insurance is \$700.

#### Prepaid Expense General Journal Entry

DATE	DETAILS	DEBIT \$	CREDIT \$
30 June	Insurance Expense	500	
	Prepaid Insurance		500
	<i>Adjusting entry to recognise insurance for the accounting period</i>		

The Insurance account is debited as it is an expense. The Prepaid Insurance is credited as it is an asset account which has decreased.

#### Prepaid Expense General Ledger Entry

**STEP 2:** The journal entry is now posted to the Insurance Expense account and the Prepaid Insurance account.

Insurance (Expense)			
30 June	Prepaid Insurance	500	
Prepaid Insurance (Asset)			
	30 June	Insurance	500

### 2. Accrued Expenses

**EXAMPLE 9.2:** On June 30 the business has accrued but not yet been billed for \$500 worth of phone calls. The current balance in the Telephone Expense account is \$4 000. (Accrued Expense)

**STEP 1:** The business needs to record their telephone expenses for the accounting period. The problem lies in the fact that some phone calls (expense) have been incurred in the current accounting period but will only be paid in the next accounting period when the bill is received. According to the matching principle we have to record the expense on balance day as if it has been paid.

On balance day the business will record the \$500 telephone expense with the \$4 000 already recorded.



### Accrued Expense General Journal Entry

DATE	DETAILS	DEBIT \$	CREDIT \$
30 June	Telephone Expense	500	
	Accrued Expenses		500
	<i>Adjusting entry to recognise telephone expense owing on balance day</i>		

The Telephone account is debited as it is an expense. The Accrued Expenses account is credited as it is a liability account which has increased.

### Accrued Expense General Ledger Entry

**STEP 2:** The journal entry is now posted to the Telephone Expense account and the Accrued Expenses account.

Telephone (Expense)			
	Balance	4 000	
30 June	Accrued expenses	500	
Accrued Expenses (Liability)			
	30 June	Telephone	500

## 3. Unearned Income

**EXAMPLE 9.3:** The business receives an order for \$120 000 worth of inventory. The order is paid for and will be split into 3 equal deliveries on 1<sup>st</sup> of June, July, August.

**STEP 1:** The initial \$120 000 will be recorded in the Sales in Advance account (Liability) on the credit side. Work out how much of the income is for the current accounting period and what amount is for the following accounting period. In this example the income earned for the current accounting period is \$40 000 and the unearned income (liability) is \$80 000.

### Unearned Income General Journal Entry

DATE	DETAILS	DEBIT \$	CREDIT \$
30 June	Sales in advance	40 000	
	Sales		40 000
	<i>Adjusting entry to recognise sales earned on balance day</i>		

The Sales in Advance account is debited as it is a liability which has decreased. The Sales account is credited as this is an income account which has increased.

### Unearned Income General Ledger Entry

**STEP 2:** The previous journal entry is now posted to the Sales in Advance account and the Sales account. As you can see the original figure of \$120 000 is recorded as the balance on the credit side of the Sales in Advance ledger.

Sales In Advance (Liability) Account				
30 June	Sales	40 000	Balance	120 000

Sales Account (Income)				
	30 June	Sales in advance	40 000	

#### 4. Accrued Income

This is income that has been earned but not yet paid, such as bank interest or commission fees.

**EXAMPLE 9.4:** On June 30 the business is owed \$375 interest from an investment management account they hold with the local bank.

Accrued Income General Journal Entry				
DATE	DETAILS		DEBIT \$	CREDIT \$
30 June	Accrued Income		375	
	Interest			375
	<i>Adjusting entry to recognise interest earned on balance day</i>			

**STEP 1:** The Accrued Income Account is debited as it is an asset account. The Interest account is credited as it is income earned in this accounting period.

#### Accrued Income General Ledger Entry

**STEP 2:** The journal entry is now posted to the Accrued Income account and the Interest account.

Accrued Income (Asset)				
30 June	Interest	375		

Interest (Income)				
	30 June	Accrued income	375	

#### 5. Inventory Adjustment

At the end of the financial year most businesses will do a stocktake to see how much inventory has been misplaced or stolen.

**EXAMPLE 9.5:** On balance day “Jones’ Retailing” does a stocktake. The accounting records show that there should be \$50 000 worth of stock on the shelves and in the store room. The physical stocktake counts it as \$49 500. The missing \$500 is recorded as an expense to the business and a decrease in the inventory (asset).

### Inventory Adjustment General Journal Entry

DATE	DETAILS	DEBIT \$	CREDIT \$
30 June	Inventory Adjustment	500	
	Inventory		500
	<i>Adjusting entry to record inventory loss</i>		

**STEP 1:** The Inventory Adjustment account is debited as it is an expense account. The Inventory account is credited as it is an asset account which has decreased.

### Inventory Adjustment General Ledger Entry

**STEP 2:** The journal entry is now posted to the Inventory Adjustment account and the Inventory account.

Inventory Adjustment (Expense)			
30 June	Inventory	500	
Inventory (Asset)			
	30 June	Inventory adjustment	500

## 9.2 CLOSING THE ACCOUNTS AND PREPARING FINAL STATEMENTS

The example below covers the following unit content:

- balance day adjustments
- closing general journal entries
- trial balance
- income statement
- statement of financial position.

**EXAMPLE 9.6:** Thomas Blake operates a successful hardware retail business, “Hammer and Tongs”. He has asked you to prepare the final reports for the business using the unadjusted trial balance below:

**Hammer and Tongs**  
**Unadjusted Trial Balance as at 30 June 2020**

	DEBIT \$	CREDIT \$
Cash at bank	8 540	
Long term investment	12 000	
Furniture	28 000	
Capital – T. Blake		37 200
Prepaid insurance	4 800	
Sales		996 000
Cost of sales	796 100	
Accounts receivable	17 400	
Stock	11 380	
Bad debts	880	
Allowance for doubtful debts		2 000
Gain on disposal of oak furniture		9 820
Rent	12 000	
Accounts payable		49 460
Discount received		8 600
Utilities	23 580	
Telephone	5 000	
Wages	121 600	
Drawings	61 800	
<b>TOTAL</b>	<b>1 103 080</b>	<b>1 103 080</b>

The following balance day adjustments need to be taken into account:

- Staff are owed \$2 000 wages.
- The prepaid insurance was paid on 28 February 2020 and is a per annum fee.
- The furniture is depreciated at 10% using the straight-line method. The furniture was purchased on 1 July 2019.

STEP 1: The General Journal entries to record the balance day adjustments would be as follows:

**Hammer and Tongs**  
General Journal extract as at 30 June 2020

DETAILS	DEBIT \$	CREDIT \$
Wages	2 000	
Accrued Wages		2 000
<b>Adjusting entry to show wages owing on balance day</b>		
Insurance Expense	1 600	
Prepaid Insurance		1 600
<b>Adjusting entry to show insurance used this accounting period</b>		
Depreciation	2 800	
Accumulated depreciation		2 800
<b>Depreciation expense for the accounting period</b>		

STEP 2: The adjusted trial balance is shown below, the adjustments are in bold:

**Hammer and Tongs**  
Adjusted Trial Balance as at 30 June 2020

	DEBIT \$	CREDIT \$
Cash at bank	8 540	
Long term investment	12 000	
Furniture	28 000	
Capital – T. Blake		37 200
<b>Prepaid insurance</b>	<b>3 200</b>	
<b>Insurance expense</b>	<b>1 600</b>	
Sales		996 000
Cost of sales	796 100	
Accounts receivable	17 400	
Stock	11 380	
Bad debts	880	
Allowance for doubtful debts		2 000
Gain on disposal of oak furniture		9820
Rent	12 000	
Accounts payable		49 460
Discount received		8 600
Utilities	23 580	
Telephone	5 000	
<b>Wages</b>	<b>123 600</b>	
<b>Accrued wages</b>		<b>2000</b>
Drawings	61 800	
Depreciation	<b>2 800</b>	
Accumulated depreciation		<b>2 800</b>
<b>TOTAL</b>	<b>1 107 880</b>	<b>1 107 880</b>

**STEP 3:** the income and expense accounts are closed to the profit and loss account, the closing general journal entries are shown below:

**Hammer and Tongs**  
General Journal extract as at 30 June 2020

	DEBIT \$	CREDIT \$
Profit and Loss account	965 560	
Insurance		1 600
Cost of sales		796 100
Bad debts		880
Rent		12 000
Utilities		23 580
Telephone		5 000
Wages		123 600
Depreciation		2 800
<b>Closing of expense accounts to Profit and Loss</b>		
Sales	996 000	
Gain on disposal of oak furniture	9 820	
Discount received	8 600	
Profit and Loss account		1 014 420
<b>Closing of income accounts to Profit and Loss</b>		
Profit and Loss account	44 860	
Capital		44 860
<b>Transfer of profit to capital account</b>		

**STEP 4:** The Income Statement and Statement of Financial Position can now be prepared.

**Hammer and Tongs**  
Income Statement as at 30 June 2020

	\$	\$	\$	\$
<b>Income</b>				
Sales		996 000		
Less: Cost of sales	796 100			
Discount received	(8 600)			
Total Cost of sales		787 500		
<b>GROSS PROFIT</b>			208 500	
<b>Add: Other Income</b>				
Gain on disposal of oak furniture			9 820	
				218 320
<b>Less: Expenses</b>				
<i>General and Administration Expenses</i>				
Insurance		1 600		
Rent		12 000		
Utilities		23 580		
Telephone		5 000		
Wages		123 600		
Depreciation		2 800	168 580	
<i>Financial Expenses</i>				
Bad debts			880	169 460
<b>PROFIT</b>				<b>\$48 860</b>

**Hammer and Tongs**  
**Statement of Financial Position as at 30 June 2020**

	\$	\$	\$
<b>Current Assets</b>			
Cash at Bank		8 540	
Accounts Receivable	17 400		
Less: Allowance for DD	<u>(2 000)</u>	15 400	
Stock		11 380	
Prepaid Insurance		<u>3 200</u>	<u>38 520</u>
<b>Non-current Assets</b>			
Long Term Investment		12 000	
Furniture	28 000		
Less accumulated Depreciation	<u>(2 800)</u>	25 200	37 200
<b>TOTAL ASSETS</b>			<b><u>75 720</u></b>
<b>Current Liabilities</b>			
Accrued Wages		2 000	
Accounts Payable		<u>49 460</u>	
		51 460	
<b>Non-current Liabilities</b>			
Nil			
<b>TOTAL LIABILITIES</b>			<b><u>51 460</u></b>
<b>NET ASSETS</b>			<b><u>\$24 260</u></b>
<b>Equity</b>			
Capital – T. Blake	37 200		
Add Profit	48 860	86 060	
Less Drawings	<u></u>	(61 800)	
<b>TOTAL EQUITY</b>			<b><u>\$24 260</u></b>

### 9.3 REVERSING ENTRIES

In modern day accounting, reversing entries are no longer required. In the subsequent accounting period the following action is taken:

**Accrued Expenses** – the accrued account is closed by debiting the relevant Accrued Expense Account when the cash owed is paid and crediting the Cash at Bank Account.

**Accrued Income** – the accrued account is closed by debiting the Cash at Bank Account when the income has been received and crediting the relevant Accrued Income Account.



## REVIEW QUESTIONS

### Chapter 9: Recording and Processing

#### 1. Prepaid Expenses (Balance Day is June 30)

- (a) The business pays \$4 800 for a 12 month insurance policy on 1 February. Calculate the expense amount for the year and the remaining prepaid insurance amount.
- (b) The business pays \$3 000 for a 3 month advertising campaign on 1 June. Calculate the expense amount for the year and the remaining prepaid advertising amount.
- (c) The business pays \$600 for 12 months vehicle registration for the company truck on 1 April. Record the relevant general journal and general ledger entries required on balance day to account for this registration.
- (d) The business pays \$2 400 for a 12 month gym membership for the Director on 1 March. Record the relevant general journal and general ledger entries required on balance day to account for this gym membership.

#### 2. Accrued Expenses

- (a) On June 30 the business owes a \$400 phone bill. The current balance in the telephone expense account is \$2 000. Record the relevant general journal and general ledger entries required on balance day to account for this telephone expense.
- (b) On June 30 the business owes \$5 000 in wages. The current balance in the wages expense account is \$70 000. Record the relevant general journal and general ledger entries required on balance day to account for this wages expense.
- (c) The business pays wages each fortnight of \$5 000. The balance currently in the wages account is \$125 000. On balance day one weeks wages is owed. Record the relevant general journal and general ledger entries required on balance day to account for this wages expense.

#### 3. Unearned Income

- (a) The business receives an order for \$60 000 worth of inventory. The order is paid for and will be split into 2 equal deliveries on 1<sup>st</sup> of May and 1 August. Record the relevant general journal and general ledger entries required on balance day to account for this unearned income.
- (b) The business receives an order for \$100 000 worth of inventory. The order is paid for and will be split into 4 equal deliveries on 1<sup>st</sup> of April, July, September and November. Record the relevant general journal and general ledger entries required on balance day to account for this unearned income.
- (c) The business receives an order for \$20 000 worth of inventory. The order is paid for in June but will be delivered on July 28. Record the relevant general journal and general ledger entries required on balance day to account for this unearned income.

#### 4. Accrued Income

- (a) On June 30 the business is owed \$175 interest from an investment management account they hold with the local bank. Record the relevant general journal and general ledger entries required on balance day to account for this accrued income.
- (b) On June 30 the business is owed \$1500 commission fees. Record the relevant general journal and general ledger entries required on balance day to account for this accrued income.

5. **Inventory Adjustment**

- (a) On balance day Harper Retailing does a stocktake. The accounting records show that there should be \$40 000 worth of stock on the shelves and store room. The physical stock take counts it as \$39 000. Record the relevant general journal and general ledger entries required on balance day to account for this stock loss.
  - (b) On balance day Tackworth Supplies does a stocktake. The accounting records show that there should be \$100 000 worth of stock on the shelves and store room. The physical stock take counts it as \$89 000. Record the relevant general journal and general ledger entries required on balance day to account for this stock loss.
  - (c) On balance day Miller Hardware does a stocktake. The accounting records show that there should be \$88 500 worth of stock on the shelves and store room. The physical stock take counts it as \$86 700. Record the relevant general journal and general ledger entries required on balance day to account for this stock loss.
6. Maxine Harpo operates a clothing retail business, “Happening Chic”. She has asked you to prepare the final reports for the business using the unadjusted trial balance below:

**Happening Chic**  
**Unadjusted Trial Balance as at 30 June 2017**

	DEBIT \$	CREDIT \$
Capital – M. Harpo		124 400
Cost of sales	1 592 200	
Accounts receivable	84 800	
Inventory	22 760	
Electricity	1 760	
Loan payable in 2015		4 000
Gain on disposal of office equipment		19 640
Cash at bank	17 080	
Wages	243 200	
Drawings	123 600	
Prepaid insurance	9 600	
Sales		1 992 000
Shares	24 000	
Office Equipment	56 000	
Rent	24 000	
Accounts payable		98 920
Discount received		17 200
Advertising	47 160	
Discount allowed	10 000	
<b>TOTAL</b>	<b>2 256 160</b>	<b>2 256 160</b>

The following balance day adjustments need to be taken into account:

- Staff are owed \$4 000 wages
- The prepaid insurance was paid on 1 June 2017 and is a per annum fee.
- The office equipment is depreciated at 20% using the straight-line method. The equipment was purchased on 1 July 2016.

- The business receives an order for \$80 000 worth of inventory. The order is paid for and will be delivered in equal instalments on 30 June 2017 and 30 September 2017.

**REQUIRED:**

- (a) Show the General Journal entries to record the balance day adjustments.
  - (b) Complete the adjusted trial balance.
  - (c) Show the General Journal entries to close the income and expense accounts to the Profit and Loss Account.
  - (d) Prepare an Income Statement.
  - (e) Prepare the Statement of Financial Position.
7. Explain why balance day adjustments are prepared.
  8. Outline the main difference between the Statement of Financial Position for a service and a trading business.



### Syllabus Checklist

On completion of this chapter you should be able to:

- ☐ prepare the following ratios:
  - profitability:
    - profit
    - gross profit
    - expense
    - rate of return on assets
  - liquidity:
    - working capital
    - quick asset
  - leverage:
    - debt to equity.
- ☐ interpret the following ratios to evaluate the profitability and stability of a business:
  - profitability:
    - profit
    - gross profit
    - expense
    - rate of return on assets
  - liquidity:
    - working capital
    - quick asset
  - leverage:
    - debt to equity.

## 10.1 PROFITABILITY, LIQUIDITY AND STABILITY

The purpose of ratios is to evaluate profitability, liquidity and leverage:

### Profitability

The business's ability to generate a return from its investment in assets or equity, involves comparing some measure of profit made with the assets or owner's equity of the business.

### Liquidity

The ability businesses have to pay all debts on the date they fall due, requires a comparison of current assets with current liabilities.

### Leverage

This is a comparison of the internally generated debt (owner's equity) of the business with the externally owed debt (liabilities). Liabilities are usually due to be paid on a specific date and have other requirements such as interest payments tied to them. If a business is highly geared, then it has a high proportion of externally generated debt. A business with low gearing has a low proportion of externally generated debt.

## 10.2 PREPARATION AND INTERPRETATION OF RATIOS

The following tables summarise the calculation of each ratio and how to interpret a general increase or decrease in that ratio.

PROFIT RATIO	
$= \frac{\text{Profit}}{\text{Fees/Sales}}$	
INCREASING	DECREASING
<ul style="list-style-type: none"><li>Profit has increased in comparison to sales/fees</li><li>Could be a decrease in expenses.</li><li>More high profit stock may have been sold, or more income received.</li></ul>	<ul style="list-style-type: none"><li>Profit has decreased in comparison to sales.</li><li>Could be an increase in expenses.</li><li>More low profit stock may have been sold, or less income received from other sources.</li></ul>

GROSS PROFIT RATIO	
$= \frac{\text{Gross Profit}}{\text{Net Sales}}$	
INCREASING	DECREASING
<ul style="list-style-type: none"><li>Gross profit has increased in comparison to sales.</li><li>Cost of sales may be less (Lower freight etc).</li><li>The mark-up on stock may have increased.</li><li>More high profit stock may have been sold.</li></ul>	<ul style="list-style-type: none"><li>Gross profit has decreased in comparison to sales.</li><li>Cost of sales may be more (Higher cost price etc.)</li><li>The mark-up may have decreased.</li><li>More low profit stock may have been sold.</li></ul>

EXPENSE RATIO	
$= \frac{\text{Expense Total}}{\text{Net Sales}}$	
INCREASING	DECREASING
<ul style="list-style-type: none"><li>Expenses are increasing in relation to sales.</li><li>The business has become less efficient in spending expenses.</li></ul>	<ul style="list-style-type: none"><li>Expenses are decreasing in relation to sales.</li><li>The business has become more efficient, and is spending more wisely.</li></ul>

## RATE OF RETURN ON ASSETS

$$= \frac{\text{Profit}}{\text{Average Assets}}$$

INCREASING	DECREASING
<ul style="list-style-type: none"> <li>Profit has increased in comparison to assets.</li> <li>The business is using assets more efficiently, to generate a better return.</li> </ul>	<ul style="list-style-type: none"> <li>Profit has decreased in comparison to assets.</li> <li>The business is using assets less efficiently, to generate a reduced return.</li> </ul>

### Profitability ratio calculations

**EXAMPLE 10.1:** From the following simplified Income Statement and Statement of Financial Position information, profitability ratios can be calculated as follows.

Sales	\$129 000
Less: Cost of Sales	<u>57 000</u>
<b>GROSS PROFIT</b>	<b>72 000</b>
Less: Expenses	32 000
Selling and distribution	<u>7 000</u>
Administrative	39 000
<b>PROFIT</b>	<u><b>\$ 33 000</b></u>

Total assets at the start of the accounting period was \$23 000, and at the end of the period \$34 000.

Profit ratio	=	$\frac{33\,000}{129\,000}$
	=	26% or 0.26:1.0
Gross profit ratio	=	$\frac{72\,000}{129\,000}$
	=	56% or 0.56:1.0
Expenses ratio	=	$\frac{39\,000}{129\,000}$
	=	30% or 0.30:1.0
Selling and distribution expenses ratio	=	$\frac{32\,000}{129\,000}$
	=	25% or 0.25:1.0
Administrative expenses ratio	=	$\frac{7\,000}{129\,000}$
	=	5% or 0.05:1.0
Rate of return on assets	=	$\frac{33\,000}{(23\,000 + 34\,000)/2}$
	=	$\frac{33\,000}{28\,500}$
	=	116% or 1.16: 1.0



**WORKING CAPITAL RATIO/ CURRENT RATIO**

$$= \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

**INCREASING**

- Movement toward a ratio of 2.0:1.0 or 200% recommended.
- Current assets are increasing in comparison to current liabilities.
- Idle cash can be invested.
- There may be slower stock sales or debtor receipts.

**DECREASING**

- Current assets decreasing compared to current liabilities.
- There may be increased creditors or short term borrowings.

**QUICK ASSET RATIO**

$$= \frac{\text{Current assets (not including stock and prepayments)}}{\text{Current liabilities (not including overdrafts)}}$$

**INCREASING**

- If ratio is above 1.0:1.0 or 100% all short term debt can be paid.
- Debtors could have increased or creditors lowered.
- Other current assets such as cash may have increased.

**DECREASING**

- If below 100% short term debt might not be able to be paid.
- Debtors could have lowered or creditors increased.

**Liquidity ratio calculations**

**EXAMPLE 10.2:** From the following information extracted from an Income Statement and Statement of Financial Position, liquidity ratios can be calculated.

Cash	\$ 20 000
Debtors	32 000
Inventory	45 000
Prepaid advertising	21 000
Furniture and fittings	96 000
Office equipment	83 000
Overdraft	4 000
Creditors	54 000
Mortgage	130 000

$$\text{Working capital} = \frac{20\,000 + 32\,000 + 45\,000 + 21\,000}{4\,000 + 54\,000}$$

$$= \frac{118\,000}{58\,000}$$

$$= 203\% \text{ or } 2.03:1.0$$

$$\text{Quick asset ratio} = \frac{20\,000 + 32\,000}{54\,000}$$

$$= \frac{52\,000}{54\,000}$$

$$= 96\% \text{ or } 0.96:1.0$$

## DEBT TO EQUITY RATIO

$$= \frac{\text{Liabilities}}{\text{Equity}}$$

### INCREASING

- Higher level of externally owed debt (liabilities) compared to internally generated debt (owner's equity).
- If interest rates are high this could be concerning.
- Liabilities may have increased.

### DECREASING

- Higher level of internally generated debt (owner's equity) compared to externally owed debt (liabilities).
- Owner's equity may have increased.
- A ratio of 1.0:1.0 or 100% indicates the business does not rely too heavily on external finance.

## Leverage ratio calculation

**EXAMPLE 10.3:** The business information listed in the liquidity ratio calculation above shows total liabilities of \$188 000. Equity is calculated using the accounting equation:

$$\begin{aligned}
 \text{Eq} &= A - L \\
 &= 297\,000 - 188\,000 \\
 &= \$109\,000 \\
 \text{Debt to equity} &= \frac{188\,000}{109\,000} \\
 &= 172\% \text{ or } 1.72: 1.0
 \end{aligned}$$

## 10.3 RATIO COMPARISONS

Ratios may be calculated and then compared with:

- Previous year's results
- Budgeted or predicted results
- Industry averages
- Other businesses.

## REVIEW QUESTIONS

### Chapter 10: Ratios

1. Explain why a business owner might use ratio analysis, giving an example.
2. Define liquidity and profitability. Explain how a business can have both high profitability and low liquidity.
3. Over a long period of time what results are most likely to occur for a highly geared business?
4. The following information is for the business “Ball Sports”, which sells basketball and football related goods to Western Australian sporting teams. This information was compiled by the business owner on the 30 June 2025.

STATEMENT OF FINANCIAL POSITION EXTRACT		INCOME STATEMENT EXTRACT	
Cash at bank	5 000	Cash sales	123 000
Debtors	22 000	Cost of sales	82 000
Inventory	38 000	Administrative expenses	1 000
Prepaid advertising	3 300	Selling expenses	6 000
Furniture and fittings	96 000	Marketing expenses	5 000
Delivery van	66 000	Financial expenses	7 000
Office equipment	83 000		
Accrued wages	8 900		
Overdraft	7 000		
Creditors	76 000		
Mortgage	129 000		
<b>Total assets at 30 June 2024 = \$313 300</b>			

#### 2024 ratio calculations:

Gross profit ratio	=	20%
Expense ratio	=	25%
Rate of return on assets	=	7.0%
Working capital	=	50%
Debt to equity	=	203%

- (a) Calculate profitability, liquidity and leverage ratios for the 2025 financial year.
- (b) Interpret the results of these calculations for the owner, in comparison to the 2024 information.
- (c) Are selling and marketing expenses very different to each other? Which expense ratio is of most concern if these two categories are combined together as “advertising expenses”? Explain.

5. Consider the following comparative data for the business “Day Cafe”, over 3 years.

YEAR	2025	2026	2027
<b>Assets</b>			
Prepaid rent	8 000	11 000	12 000
Prepaid advertising	2 000	2 000	3 000
Accounts receivable	43 000	25 000	28 000
Petty cash	400	600	100
Cash at bank	0	25 000	28 000
Stock	290 000	260 000	230 600
Café furniture	89 000	89 000	89 000
Computer equipment	11 000	5 000	5 000
Kitchen fittings	230 000	230 000	340 000
Accumulated depreciation	-100 000	-120 000	-140 000
<b>Liabilities</b>			
Loan - due 2030	320 000	300 000	290 000
Accrued wages	5 000	6 000	8 000
Overdraft	7000	0	0
Accounts payable	39 000	40 800	45 000
<b>Owner's equity</b>			
Capital	200 000	200 000	200 000
Add: Profit	2 400	(19 200)	52 700

- Calculate liquidity and gearing ratios for the business for the 2026 and 2027 financial years.
- Analyse each ratio.
- Advise the business owner on their best course of action to finance a renovation of the cafe.



### Syllabus Checklist

**On completion of this chapter you should be able to:**

- ☐ explain the role of the professional accounting and financial associations, including:
  - CPA Australia
  - Chartered Accountants Australia and New Zealand
  - The Institute of Public Accountants
  - Financial Planning Association of Australia Limited
- ☐ outline the nature and purpose of the professional codes of conduct for members of professional accounting service providers associations.

## 11.1 PROFESSIONAL ACCOUNTING AND FINANCIAL ASSOCIATIONS

The accounting associations, business advisor groups and financial service providers are employed in a range of specialist areas such as shown below.

- Taxation planning
- Auditor
- Business financing
- Personal financial planning
- Superannuation information
- Investment counselling
- Insurance advice
- Stock market investment

### Role and function

Members of these groups can be involved in government decision making committees and advisory groups, giving feedback and input into the development of accounting and finance regulations. Professional accounting and financial associations require their members to follow their standards using a range of methods such as; by continuing to be educated in their area of expertise, attending professional learning workshops, using the journals and libraries of the association for support, using quality assurance and following the ethical Code of Conduct of the association.

### Main accounting and financial associations

There are four main professional bodies:

**1. CPA Australia (CPAA)**

Is the professional body representing certified practicing accountants in Australia. Members complete an accredited undergraduate degree in accounting, finance and business areas to satisfy minimum core knowledge.

**2. Chartered Accountants Australia and New Zealand**

Is the professional body representing Chartered Accountants. Members undertake postgraduate professional training while gaining three years experience with a Chartered Accountant mentor.

**3. The Institute of Public Accountants (IPA)**

Is a professional organisation for accountants, representing members and students working in industry, commerce, government, academia and private practice.

**4. Financial Planning Association of Australia (FPAA)**

Is the organisation representing the financial planning sector in Australia. Members must hold an Australian Financial Services Licence issued by the Australian and Investment Commission (ASIC), have professional indemnity insurance and current membership of FICS or another ASIC approved scheme.

### Code of conduct

A code of conduct gives advice on the how the professional accountant or financial association member is to carry out their role in an ethical and fair manner.

There are many codes of conduct that have been developed for different industry areas and financial service providers within Australia. One typical example is *The Financial Planners' Code of Ethics*<sup>1</sup> which requires general standards of integrity, objectivity, competence and fairness.



*The Financial Planners' Rules of Professional Conduct* instruct members on how to disclose information to potential clients, prepare financial information for clients how to handle complaints and explain what a competent planner should be capable of.

## APES 110: Code of Ethics for Professional Accountants<sup>2</sup>

This outlines principles of professional ethics:

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour.

<b>Integrity</b>	Straightforward Honest Fair dealing Truthfulness
<b>Objectivity</b>	Consider: <ul style="list-style-type: none"><li>• bias</li><li>• conflict of interest</li><li>• undue influence of others</li></ul>
<b>Professional Competence and Due Care</b>	Maintain: <ul style="list-style-type: none"><li>• professional knowledge</li><li>• skill</li><li>• diligence</li><li>• professional standards</li></ul>
<b>Confidentiality</b>	Confidential information must not be: <ul style="list-style-type: none"><li>• disclosed</li><li>• misused</li></ul>
<b>Professional Behaviour</b>	Comply with laws and regulations Avoid discrediting the profession

The code also acknowledges threats to professional ethics:

- Self-interest
- Self-review
- Advocacy
- Familiarity
- Intimidation.

The code is to be applied to:

- Professional appointments
- Conflicts of interest
- Second opinions
- Fees and other types of remuneration
- Marketing professional services
- Gifts and hospitality
- Custody of client assets
- Objectivity
- Independence.

<sup>1</sup> [www.fpa.asn.au](http://www.fpa.asn.au)

<sup>2</sup> [www.apesb.org.au](http://www.apesb.org.au)

## REVIEW QUESTIONS

### Chapter 11: The Accounting Profession

1. Explain how these following business situations could be responded to in an ethical manner:
  - (a) A financial services provider has been approached by an “environmentally friendly” business owner and asked to cover up their investment in a non-carbon neutral business proposition.
  - (b) A tax agent is having difficulty being objective. A close friend has asked them to sign off on an incorrectly completed tax return, which has deductions that cannot be substantiated. In the tax agents professional judgement, the unsubstantiated deductions should not be claimed.
  
2. Kai is a recently qualified graduate who studied banking at University. He has said to you, “I’m so glad that my study is finished, I can now become an accountant and never need to upgrade my professional knowledge base.”
 

Why is Kai incorrect? Explain to him about the concept of professional competence and due care.
  
3. Explain the ethical conduct issues that arise in the following case studies:
  - (a) A superannuation funds manager has been asked by a third party (another superannuation advisor) to reveal details of the funds invested by an elderly couple. He agrees to give the other business advisor this information. How is this a breach of confidentiality?
  - (b) A stockbroker has obtained “inside” information about a soon to be released share issue for a new mining company. She ensured that her husband purchased a bundle of shares in the company. What regulations have been breached? Explain how this decision discredits the stockbroker and is poor professional behaviour.
  
4. What role do professional accounting and financial associations perform in the community?
  
5. What is the main intent behind a professional code of conduct for professional accountants?

# TRIAL TEST 1: FINANCIAL INSTITUTIONS AND SYSTEMS



**Time allowed: 80 minutes**

**Total marks: 90**

**Section 1 – Multiple Choice**

**Section 2 – Short Answer**

**Section 3 – Extended Answer**

10 marks

40 marks

40 marks

## SECTION 1 – MULTIPLE CHOICE (10 MARKS)

1. A sole trader business is expecting income from the sale of goods in the next fortnight, however there is a bill for raw materials due within a week. The business does not currently have enough cash in the bank for the raw materials purchase, however it will after the sale of the goods. What is the best source of finance for the owner to use?
  - (a) Bridging finance
  - (b) Share issue
  - (c) Overdraft
  - (d) Lease.
2. Which of the following lists financial assets in order of **decreasing** risk and return?
  - (a) Bonds, cash, property
  - (b) Shares, property, cash
  - (c) Bonds, equipment, property.
3. The **main** advantage of the small proprietary company form of business ownership is:
  - (a) The owner can make all their own decisions
  - (b) Inexpensive to form
  - (c) Capital available from any member of the public
  - (d) Separate legal existence to owners.
4. Which of the following formats for the accounting equation is **incorrect**?
  - (a)  $\text{Expenses} + \text{Assets} = \text{Income} + \text{Liabilities} + \text{Equity}$
  - (b)  $\text{Assets} = \text{Internal Equities} + \text{External Equities}$
  - (c)  $\text{Assets} + \text{Equity} = \text{Expenses} + \text{Income} + \text{Liabilities}$
  - (d)  $\text{Assets} = \text{Owner's Equity} + \text{Liabilities}.$
5. Which of the following is a GST-free supply?
  - (a) A business that is registered for GST, sells a \$50 meal
  - (b) The sale of \$12 milk
  - (c) The sale of a \$12 milkshake
  - (d) None of the above.
6. When commencing her new cafe, Mehusa was given funds by her best friend. She used all the money to purchase cafe furniture. When writing up her first Statement of Financial Position for the business, Mehusa recorded these funds as a non-current liability. This violates which of the following:
  - (a) Accrual basis assumption
  - (b) Accounting entity principle
  - (c) Going concern assumption
  - (d) None of the above.

7. Which of the following is income to be included in the accounts for the month of January?
- (a) Deposit received on 2 January for services to be performed in February
  - (b) Goods sold on credit on 2 January
  - (c) Receipts from customers for goods sold on 2 December
  - (d) Loan borrowed from the bank on 2 January.
8. Which of the following is **not** a business asset?
- (a) Cash management account
  - (b) Motor bike used to deliver goods
  - (c) Money in the cash register
  - (d) Vehicle used for owner's private use.
9. Which of the following is **not** an advantage of the perpetual inventory method?
- (a) Easy to identify slow moving inventory
  - (b) Stock take not required
  - (c) Inexpensive for a large supermarket
  - (d) Easy to identify value of closing stock.
10. What is the main reason a small business would run a credit check on a customer?
- (a) To see how much they are worth
  - (b) To ensure they have references from financial institutions
  - (c) To estimate bad debts
  - (d) To determine if they will extend credit to them.

## SECTION 2 – SHORT ANSWER (40 MARKS)

Answer each question in the space provided.

1. Rajani owns a tourism business “Raj’s Rides” which takes overseas tourists on day trips to country Western Australia.
- (a) Describe three sources of finance, other than equity, which would be available to Raj’s Rides if she were to decide to operate as a small proprietary company.

---

---

---

---

---

---

---

---

---

---

---

---

- (b) Rajani currently operates as a sole trader but is considering expanding her business to operate as a partnership or small proprietary company. Outline for Rajani the different characteristics of a partnership and of a small proprietary company.

Partnership:

---

---

---

---

---

---

[3 marks]

Small proprietary company:

---

---

---

---

---

---

[3 marks]

2. On the 1st of July, Mila prepaid the bill for a new phone with a contract starting in August, and she plans to include this as the phone expense in the July monthly Income Statement of the business, because she considers it to be a decrease in the asset cash that will result in a decrease in the equity of the business, as required by the definition of 'expenses' in the Framework.

- (a) Which accounting principle should be applied here and why?

---

---

---

[2 marks]

(b) Has Mila recorded the transaction correctly? Why or why not?

---

---

---

---

---

[2 marks]

(c) How should Mila record payment of the business electricity bill?

---

---

---

---

---

[2 marks]

3. An organic food cafe that is registered for GST has an annual turnover above \$100 000. The cafe sells both fresh fruit and meals.

(a) Clearly explain the difference between taxable supplies and GST free supplies for this business, using examples.

---

---

---

---

---

[2 marks]

(b) Outline the function of the Business Activity Statement for this business.

---

---

---

---

---

[2 marks]

(c) Who must register for GST?

---

---

---

---

---

---

[2 marks]

(d) Explain the meaning of 'tax period', and the most likely reporting period for this business.

---

---

---

---

---

---

[2 marks]

4. (a) Is an office computer a business asset?

---

---

---

---

[3 marks]

(b) Explain if an office computer can be recognised in the financial statements as an asset.

---

---

---

---

[3 marks]



5. A business owner has recently commenced a business but now wants to sell it to take an extended overseas trip. They prepared the following report for potential purchasers:

STATEMENT OF FINANCIAL POSITION AS AT 31 JANUARY 2020	
<b>Assets</b>	<b>\$</b>
Bank	3 500
Debtors	500
Vehicle	12 000
Office equipment	15 000
<b>Liabilities</b>	
Loan	8 500
<b>Equity</b>	
Capital	22 500

The owner tells you they omitted \$3 000 creditors in the Statement of Financial Position as they intend to pay them off before the business is sold. Additionally they will repay the \$400 borrowed from the business for personal use. A 300 Euro computer has not been included in the accounts (the exchange rate is currently one Euro for \$1.50 AUS). The vehicle actually belongs to their partner, but as they use public transport to get to work, the vehicle is used in the business.

Required:

- (a) Explain which accounting assumptions/principles are not being followed.

---

---

---

---

---

---

---

---

[3 marks]

- (b) Make corrections to the report and rewrite it here.

---

---

---

---

---

[8 marks]

Pablo owns a small book shop and does his own accounting, preparing an Income Statement and Statement of Financial Position every six months. His business owns furniture, shelving, a computer and office furniture and he records information about these non-current assets in an Asset Register at their original cost depreciating them annually. He uses the perpetual inventory system and does a stock take biannually. Pablo uses his moped vehicle for occasional deliveries and records no transactions related to deliveries in the business accounts. Sales and purchases are on cash and on credit, depending on the particular customer or supplier. Source documents relating to business transactions are kept in the filing cabinet.

1. Using the information provided above, explain four accounting assumptions/principles used by Pablo, giving examples.

93

---

---

---

---

[8 marks]

2. Explain the difference between cash and accrual accounting to Paz.

---

---

---

---

---

---

---

---

[4 marks]

3. Should Pablo have included the goodwill as an asset? Give reasons for your answer.

---

---

---

---

---

---

---

---

---

---

[8 marks]

4. Explain to Pablo the main advantages and disadvantages of expanding to a partnership with Paz and recommend a course of action to him.

Advantages:

---

---

---

---

---

---

---

---

[6 marks]

Disadvantages:

---

---

---

---

---

---

---

---

---

---

[6 marks]

Recommendation:

---

---

---

---

---

---

---

---

---

---

[8 marks]



## TRIAL TEST 2: RECORDING, USING AND EVALUATING INFORMATION

**Time allowed: 80 minutes**

**Total marks: 110**

**Section 1 – Multiple Choice**

**Section 2 – Short Answer**

**Section 3 – Extended Answer**

10 marks

60 marks

40 marks

### SECTION 1 – MULTIPLE CHOICE (10 MARKS)

1. What is the total input tax credits that can be claimed for the following transactions:
  - Payment of \$3 586 cash for advertising.
  - Purchased \$891 inventory on credit.
  - Sold inventory on credit for \$2860. The goods have a cost of \$1 500.
  - (a) \$667
  - (b) \$407
  - (c) \$341
  - (d) \$147.
2. Which of the following transactions would increase the GST payable by a business?
  - (i) The business providing for sales returns in the ledgers
  - (ii) Discount received
  - (iii) A customer repaying a debt previously written off
  - (iv) Discount allowed
  - (a) (ii)
  - (b) (iv)
  - (c) (i) and (iv)
  - (d) (ii) and (iii).
3. A bookkeeper has made a number of errors in the accounts and their Trial Balance does not balance. Which of the following errors would not be apparent in the Trial Balance?
  - (a) Entry recording the purchase of the Motor Vehicle (Asset) account was omitted.
  - (b) Machinery (Asset) ledger account was incorrectly added up.
  - (c) The balance of the Loan (Liability) account was transposed, and the total was written the wrong way around.
  - (d) Debtors (Asset) account was transferred as a total of \$4 300 instead of \$43 000.
4. The following transaction occurred in a business: A debtor paid an amount of \$2 200 (GST inclusive) and was allowed a discount of \$110. The original debtor account balance was \$4 400. What is the GST adjustment to be made by the business?
  - (a) \$400
  - (b) \$200
  - (c) \$10
  - (d) No adjustment is required.
5. A client paid \$6 000 for one months rent on the 1 May. The business owner receiving this rent income mistakenly recorded it as rent expense. What journal entry will assist to correct this error?
  - (a) Debit Rent Income; Credit Cash at Bank
  - (b) Debit Rent Expense; Credit Creditors
  - (c) Debit Rent Income; Credit Debtors
  - (d) Debit Cash; Credit Rent Income.

6. A retail business earned an annual profit of \$12 600. Sales for the year totalled \$102 600 and the cost of sales was equal to \$60 600. What is the gross profit earned?
- (a) \$29 400
  - (b) \$42 000
  - (c) \$36 000
  - (d) \$90 000.
7. If a business registered for GST makes a cash sale at its online store located in Perth, this is considered to be:
- (a) Not a GST transaction
  - (b) A taxable sale
  - (c) A GST free sale
  - (d) Input taxed.
8. Which of the following is NOT a GST free item:
- (a) Education Course
  - (b) Fruit
  - (c) Juice
  - (d) Smoothie.
9. What is the total equity of a business with a computer worth \$1 000, owner's personal car \$10 000, loan \$6 000, sales of \$40 000, office furniture and fittings \$30 000, and cost of sales \$40 000?
- (a) \$75 000
  - (b) \$87 000
  - (c) \$25 000
  - (d) \$65 000.
10. Which of the following errors WOULD be revealed in the compilation of a Trial Balance?
- (a) One total being placed in the incorrect account.
  - (b) One journal entry missing
  - (c) Two journal entries being omitted
  - (d) One total being written with correct numerals, but incorrect order.

## SECTION 2 – SHORT ANSWER (60 MARKS)

1. (a) On the 2 February, the following transactions occurred for the office cleaning business “Shine and Polish.” The business is registered for GST.
  - Charged \$99 fees, client paid in cash.
  - Received fees of \$110 from a client in payment of tax invoice AZX21.
  - Paid \$550 for a trade magazine subscription.
  - A bad debt of \$55 was written off.
  - Purchased cleaning products from “Cleaning Suppliers Inc.” for \$1056, recorded on tax invoice PL98943.

### Required

- Prepare general journal entries to record the above transactions on the 2 February.

## Shine and Polish General Journal

[illegible]

[10 marks]



- (b) Prepare general ledger accounts for GST Collected and GST Credits Received.

**GST Credits Received**

--	--

**GST Collected**

--	--

[4 marks]

2. Leif Green owns a gardening business “Green Makeovers” providing gardening services. The business is **not** registered for GST. She has asked you to use the Trial Balance for 30 June 2026 to complete final financial statements for the business.

	\$	\$
Fees		82 000
Advertising	3 000	
Cash at bank	3 400	
Creditor - P. Rose		3 000
Debtor - X. Pine	400	
Office salaries	13 000	
Gardener salaries	18 000	
Interest expense	200	
Gardening equipment	7 000	
Drawings	35 000	
Telephone	2 700	
Loan (repayable in 8 years)		20 700
Petrol	4 000	
Electricity	3 500	
Capital L Green		?
Vehicle	19 000	
Trailer	4 000	

## Required

- (a) Prepare a classified financial statement for the period ending 30 June 2026 that will indicate the profit for the year of “Green Makeovers”.

---

---

---

---

---

---

---

---

---

---

[8 marks]

- (b) Prepare a fully classified financial statement for the period ending 30 June 2026 showing the assets, liabilities and equity of “Green Makeovers”.

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

[10 marks]

- NOTE: All transactions are quoted GST **inclusive**. To calculate cost of sales, use 55% of the sale price.

- (a) Complete the opening general journal entry, plus journal entries for the first week of business.

# Rigg's Hardware General Journal

[illegible]

---

---

---

---

---

---

---

---

---

---

---

[9 marks]

- (b) Enter the transactions in the ledgers shown below, then balance and close relevant ledgers.

**Inventory Control**

--	--

**Cost of Sales**

--	--

**Easy Equipment – Creditor**

--	--

**Sales**

--	--

[9 marks]

- (c) Extract a Trial Balance at the end of the first week of business.

## Rigg's Hardware Trial Balance

[illegible]

[10 marks]

## SECTION 3 – EXTENDED ANSWER (40 MARKS)

1. Sascha Gastronome owns a gourmet deli which sells both processed and packaged gourmet items and organic vegetables. She uses the perpetual inventory system.

The following lists transactions for the last week of June 2028.

DATE	TRANSACTION
23	Sascha took \$700 cash and vegetables to the value of \$55. (Vegetables are GST free).
24	Paid telephone bill \$440 (GST inclusive).
25	Purchase of signage from Andy's Signs for \$3 300 (GST inclusive).
26	Packaged stock was purchased from "Foodie Wholesalers" for \$4 400 (GST inclusive).
27	It was found that the purchase of \$500 shelving had been incorrectly entered into supplies expense instead of shop equipment. This error was corrected.
29	Weekly cash sales of vegetables were \$4 800. Cost price of the vegetables was \$1 200. (Vegetables are GST free).
30	Sales of processed gourmet items for the week were \$2 915 (GST inclusive). The cost price of these inventory items is 60% of their sale price.

On the 23 June, account balances were as follows:

Cash at bank	\$ 5 000
Telephone	460
Shop equipment	7 800
Stock: Organic vegetables	1 400
Stock: Packaged items	500
Supplies asset	1 000

### Required

- (a) General Journal entries for the transactions.

## Gastronome Deli General Journal

[illegible]

(b) Complete the general ledgers shown here: [16 marks]

[16 marks]

(b) Complete the general ledgers shown here:

Shop Equipment	

[6 marks]



- (c) Extract a Trial Balance as at 30 June 2028.

**Gastronome Deli Trial Balance  
as at 30 June 2028**

[illegible]

[6 marks]



- (d) Complete an Income Statement and Statement of Financial Position for the business.

**Gastronome Deli Income Statement  
for the period ended 30 June 2028**

DATE	DETAILS	DR	CR

[6 marks]

**Gastronome Deli Statement of Financial Position  
as at 30 June 2028**

DATE	DETAILS	DR	CR

[6 marks]



## TRIAL TEST 3: INTERNAL CONTROL & GOVERNMENT AND THE COMMUNITY

**Time allowed: 35 minutes**

**Total marks: 40**

**Section 1 – Multiple Choice**

**Section 2 – Short Answer**

**Section 3 – Extended Answer**

10 marks

18 marks

12 marks

### SECTION 1 – MULTIPLE CHOICE (10 MARKS)

1. Which one of the following is NOT an example of internal control?
  - (a) The petty cash is locked in a safe and then placed in a locked cupboard.
  - (b) An office window is left open overnight for fresh air.
  - (c) Inventory is stored in a locked, guarded warehouse.
  - (d) The business separates duties so that one person receives the cash, another records it and a third banks it.
2. Having a different person responsible for receiving cash, recording cash, banking cash and paying the bills is an example of:
  - (a) Good internal control
  - (b) An efficient accounts employee
  - (c) Segregation of duties
  - (d) Inadequate internal control.
3. Internal Controls are concerned with:
  - (a) Manipulating employees
  - (b) Helping the community
  - (c) Minimising revenue
  - (d) Safeguarding assets.
4. Which of the following is NOT an objective of good accounting controls?
  - (a) Minimising waste
  - (b) To be written down but don't have to be strictly followed
  - (c) Maximise efficiency
  - (d) Detect fraud.
5. Which of the following is NOT an example of resource conservation?
  - (a) Using materials which can be recycled
  - (b) Minimising product packaging
  - (c) Using products that come from Third World countries
  - (d) Replenishing resources wherever possible.
6. Bankruptcy means:
  - (a) The business can pay its debts as they fall due
  - (b) The business can buy assets on credit
  - (c) The business is not able to pay its debts
  - (d) The business can employ staff.
7. A business only has to register for GST if it has a turnover greater than:
  - (a) \$5 000
  - (b) \$15 000
  - (c) \$75 000
  - (d) \$100 000.

8. GST is charged at:
- (a) 8%
  - (b) 10%
  - (c) 12.5%
  - (d) 15%.
9. Tim Smith owns a small business trading under his own name. The business has a \$500 000 turnover each year. Which option below does not apply to Tim.
- (a) Tim's business must be registered for GST.
  - (b) Tim must lodge an annual tax return
  - (c) Tim must register the business name, Tim Smith.
  - (d) Tim can employ staff.
10. Which of the following is NOT an example of Sponsorship?
- (a) Paying for the printing of all the tickets and T-shirts for a comedy festival.
  - (b) Paying for the advertising for a Fun Run raising money for kids in care.
  - (c) Donating \$250 000 towards the prize cheque for a surfing competition.
  - (d) Giving a relative money for lunch.

## SECTION 2 – SHORT ANSWER (18 MARKS)

1. Outline three forms of internal control that a business could implement for the asset cash.

---

---

---

---

---

---

[3 marks]

2. Reginald Harper runs a small business, which has never bothered recycling, treats their employees badly by never listening to anything they approach management about and uses unethical business practises to gain new clients from the opposition. The business has often been portrayed in a bad light by the local newspaper.

- (a) Explain to Reginald what a socially and ethically responsible business is.

---

---

---

---

---

---

[4 marks]

- (b) What are four simple measures that Reginald could introduce to become a more socially and ethically responsible business?

---

---

---

---

---

---

---

---

[4 marks]

3. Percy Quinlan is complaining that there is a financial cost involved with becoming a more ethically responsible business. Explain to Percy two possible financial benefits of being a business which is more socially, ethically and environmentally responsible.

---

---

---

---

---

---

---

---

[2 marks]

4. Brightwater Harper sells gourmet ice-cream. The product is packaged in a plastic container which is sealed with plastic and then put in a cardboard box. He has been receiving negative publicity for his packaging.

- (a) Explain to Brightwater what resource conservation is.

---

---

---

---

---

---

[2 marks]

- (b) List three steps Brightwater could introduce to show the public his business is engaging in resource conservation.

---

---

---

---

---

[3 marks]

### SECTION 3 – EXTENDED ANSWER (12 MARKS)

1. Dotty Dawkins wants to operate a delivery service *Quick Sticks*. She is planning on operating the business from her home and will employ five drivers. Advise Dotty on the following.

- (a) Does she need to register the business name?

---

---

---

---

---

---

---

---

---

[2 marks]

- (b) Explain to Dotty what the GST is and whether she needs to register for it.

---

---

---

---

---

---

---

---

---

[2 marks]

(c) Does Dotty need to contact her local council?

---

---

---

---

---

[2 marks]

(d) Will Dotty need an ABN?

---

---

---

---

[1 mark]

(e) What other legal requirements will Dotty need to be aware of?

This image shows a blank sheet of white paper with horizontal ruling lines. The lines are evenly spaced and extend across the width of the page. There are no margins, text, or other markings on the paper.

[5 marks]

## TRIAL TEST 4: FINANCIAL INSTITUTIONS AND SYSTEMS 2



**Time allowed: 65 minutes**

**Total marks: 75**

**Section 1 – Multiple Choice**

**Section 2 – Short Answer**

**Section 3 – Extended Answer**

10 marks

35 marks

30 marks

### SECTION 1 – MULTIPLE CHOICE (10 MARKS)

1. Which of these is not an advantage of the straight line method of depreciation?
  - (a) It is easy to work out due to a simple formula
  - (b) Calculated once for all the years
  - (c) Depreciation added to maintenance costs rise as the asset ages
  - (d) The cost of the asset is spread evenly through its useful life.
2. When calculating the cost of an asset, which of the following is not considered?
  - (a) Installation
  - (b) Insurance during transit
  - (c) Depreciation
  - (d) Transport.
3. Which of the following is not correct regarding depreciation?
  - (a) It is due to the use of an asset
  - (b) Is not incurred if the asset is not used
  - (c) It is a portion of a long term expense
  - (d) It is value which is used up.
4. Which method of depreciation is the best for showing the decline in value of the asset being proportional to the diminishing benefits as the asset gets older?
  - (a) Reducing balance
  - (b) Straight-line
  - (c) Fixed instalment
  - (d) Units of production.
5. How is depreciation recorded in the Trial Balance?
  - (a) As a debit and as a credit
  - (b) As a debit
  - (c) As a credit
  - (d) Not recorded.
6. If a loss is made on the disposal of an asset then it may imply that the asset was:
  - (a) Over utilised
  - (b) Under depreciated
  - (c) Over depreciated
  - (d) Not a good investment.



7. Depreciation is:
  - (a) the writing off of the cost of fixed assets over their estimated useful life in ever decreasing amounts
  - (b) a way of setting aside money to provide for the eventual replacement of fixed assets
  - (c) the writing off of the cost of fixed assets over their estimated useful lives
  - (d) a way of writing off the cost of fixed assets over their estimated income generating period.
8. Obsolescence means:
  - (a) the decline in the book value of a fixed asset due to it being depreciated using the reducing balance method of depreciation
  - (b) the decline in the book value of a fixed asset due to it being depreciated using the straight-line method of depreciation
  - (c) the decline in the book value of a fixed asset due to it becoming outdated by technological improvement and invention
  - (d) none of the above.
9. A business bought a computer system for \$12 000. It expects to use the system for 5 years then to sell it for \$2 000. If the business calculates depreciation by way of the straight-line method, the annual depreciation charge, in respect of this system, will be:
  - (a) \$2 000
  - (b) \$2 400
  - (c) \$3 000
  - (d) \$2 800.
10. A computer which was bought at a cost of \$3 200 is not expected to have any residual value. If it is depreciated at a rate of 25% per annum, using the reducing balance method, its book value after two years will be:
  - (a) \$2 400
  - (b) \$1 600
  - (c) \$1 800
  - (d) none of the above.

[10 marks]

## SECTION 2 – SHORT ANSWER (35 MARKS)

1. Bronwyn Macintosh has just started a small craft business. She is currently selling her home made cards by word of mouth. She charges her customers cash. She has missed out on numerous sales as she does not have the facilities to electronically process customer credit and debit cards.
  - (a) Explain to Bronwyn three benefits and two risks associated with having EFTPOS facilities.

---



---



---



---



---



---

[5 marks]

(b) Explain to Bronwyn what electronic banking is and whether it would suit her business.

---

---

---

---

---

---

---

[4 marks]

(c) Bronwyn has been operating her business under the cash basis of accounting. She does not understand the difference between the cash basis of accounting and the accrual basis. Explain using examples the difference between the two systems.

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

[4 marks]

2. (a) Are accounts payable a liability to a business?

---

---

---

---

[2 marks]

- (b) Should advertising be recognised as an expense in the financial statements?

---

---

---

---

[3 marks]

- (c) Should sales be recognised as income in the financial statements?

---

---

---

---

[3 marks]

3. Finish the following sentences:

- (a) Depreciation of non-current assets occurs due to the \_\_\_\_\_ principle.  
This principle requires that:

---

For example:

---

---

[2 marks]

- (b) List and explain two reasons for depreciation:

Reason One

---

---

---

Reason Two

---

---

---

[4 marks]

(c) How is the cost of a depreciable non-current asset calculated?

---

---

---

---

---

---

---

---

---

---

[2 marks]

(d) List and explain three factors which are considered when calculating depreciation

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

[6 marks]

**SECTION 3 – EXTENDED ANSWER (30 MARKS)**

1. Tami Jones operates a design business. On 1 January 2030 he purchased a computer at a cost of \$5 000 and a laser printer for \$2 000. The computer is depreciated at 20% per annum on a reducing balance basis. The laser printer, which has an estimated useful life of 6 years and an estimated residual value of \$200, is depreciated on a straight-line basis.

(a) What is the depreciation expense figure per annum for the printer?

---

---

---

[2 mark]

(b) Show the General Journal entry for the purchase of the computer.

---

---

---

---

---

---

---

---

---

---

[2 mark]

(c) Show the relevant ledger accounts to record the depreciation of the computer as at 30 June 2031.

---

---

---

---

---

---

---

---

[5 marks]

2. (a) On 1 June a Printing Press machine that originally cost \$100 000, has been depreciated for 4 years and has accumulated depreciation totalling \$60 000, is sold for \$38 000.

Show the relevant journal and ledger entries to account for the disposal of the asset and any loss or gain realised.

This image shows a blank sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

[20 marks]

- (b) After the sale of the Printing Press the owner remarked that, “in future we must increase the depreciation rate because we underestimated the amount of cash needed to replace this asset”. What does he mean by this?

---

---

---

[1 mark]



## TRIAL TEST 5: RECORDING, USING AND EVALUATING FINANCIAL INFORMATION 2

**Time allowed: 80 minutes**

**Total marks: 90**

**Section 1 – Multiple Choice**

**Section 2 – Short Answer**

**Section 3 – Extended Answer**

10 marks

20 marks

60 marks

### SECTION 1 – MULTIPLE CHOICE (10 MARKS)

1. When preparing financial statements the bad debts account is closed by a transfer to:
  - (a) the profit and loss account
  - (b) the provision for bad debts account
  - (c) the trading account
  - (d) the Statement of Financial Position.
2. Which of the following statements is correct:
  - (a) The Bad Debts account has a credit balance
  - (b) Bad Debts are added to debtors
  - (c) Bad debts are deducted from the outstanding debtors
  - (d) Bad debts are added to current assets.
3. The general journal entry required to write off a bad debt is posted by:
  - (a) Debiting debtors
  - (b) Crediting bad debts
  - (c) Debiting bad debts
  - (d) None of the above.
4. The rationale for making a provision in respect of doubtful debts is that the provision:
  - (a) records the expense of bad debts as they are incurred
  - (b) matches the estimated cost of future bad debts against the income earned in giving rise to potential bad debts
  - (c) is an estimate of future bad debts
  - (d) records bad debts without taking them out of the books of a business, therefore showing the full amount owed by debtors as a current asset.
5. If \$300 accrued wages was accidentally treated as a prepayment, the profit would be:
  - (a) overstated by \$300
  - (b) understated by \$300
  - (c) overstated by \$600
  - (d) understated by \$600.
6. Expenses relevant to an accounting period which remain unpaid at the end of the period should:
  - (a) be shown as part of the non-current liabilities in the Statement of Financial Position at the end of the accounting period
  - (b) be shown as an expense in the Income Statement for the period and shown as a non-current liability in the Statement of Financial Position at the end of the period
  - (c) be shown as an expense in the Income Statement for the period and shown as a non-current asset in the Statement of Financial Position at the end of the period
  - (d) be shown as an expense in the Income Statement for the period and shown as a current liability in the Statement of Financial Position at the end of the period.

7. An error adding Unearned Income of \$100 instead of deducting it from the income received is corrected by:
- (a) Adding \$100
  - (b) Deducting \$100
  - (c) Adding \$200
  - (d) Deducting \$200.
8. In the Statement of Financial Position of a sole trader, prepayments should be shown as:
- (a) part of current assets
  - (b) part of creditors
  - (c) a deduction from capital
  - (d) None of the above.
9. In the Statement of Financial Position of a sole trader, accruals should be shown as part of:
- (a) current liabilities
  - (b) current assets
  - (c) fixed assets
  - (d) equity.
10. Which one of the following is recorded in the Statement of Financial Position as a current asset?
- (a) Expense due
  - (b) Prepayment
  - (c) Expense incurred
  - (d) Expense paid.

## SECTION 2 – SHORT ANSWER (20 MARKS)

1. Define each of the following terms and give one example of each:

(a) Unearned income

---

---

---

[2 marks]

(b) Accrued expenses

---

---

---

[2 marks]

(c) Prepaid expenses

---

---

---

[2 marks]



(d) Accrued income

---

---

---

[2 marks]

2. Write the journal entry required to record the following transactions:

(a) On 31 March 2028 the business pays \$2 400 for a twelve-month insurance policy.

---

---

---

---

---

---

[2 marks]

(b) On Balance Day a business has accrued but not yet been billed for \$75 worth of phone calls. (Ignore GST).

---

---

---

---

---

---

[2 marks]

(c) On balance day the accounting records show that there should be \$20 000 worth of stock on the shelves and in the store room. The physical stock take counts it as \$18 750.

---

---

---

---

---

---

[2 marks]

3. (a) Do you agree or disagree with the following statement, "Income should not be shown in the Profit and Loss Account unless the associated money has been received." Justify your answer.

[illegible]

[4 marks]

- (b) How should expenses be treated that remain unpaid at the end of the accounting period that they are relevant to?

---

---

---

---

---

[2 marks]

## SECTION 3 – EXTENDED ANSWER (60 MARKS)

1. Jenny Rogers operates a toy retail business, “The Toy Box”. The business is not registered for GST. She has asked you to prepare the final reports for the business using the unadjusted trial balance below:

**The Toy Box Unadjusted Trial Balance as at 30 June 2019**

	DEBIT \$	CREDIT \$
Capital – J. Rogers		10 755
Cost of sales	199 025	
Accounts receivable	4 350	
Prepaid advertising	2 845	
Electricity	3 220	
Discount received		400
Cash at bank	17 585	
Wages	30 400	
Prepaid insurance	1 200	
Sales		249 000
Contingency Fund	500	
Office equipment	7 000	
Rates	2 000	
Accounts payable		12 365
Loan payable in 2021		5 250
Inventory	6 895	
Discount allowed	1 250	
Interest	1 500	
<b>TOTAL</b>	<b><u>277 770</u></b>	<b><u>277 770</u></b>

The following balance day adjustments need to be taken into account:

- Staff are owed \$2 000 wages.
- The prepaid insurance was paid on 1 August 2018 and is a per annum fee.
- The prepaid advertising is for two TV Commercials, one aired on 20 June 2019 and the second will air 20 November 2019.
- The office equipment is depreciated at 20% using the reducing balance method. The equipment was purchased on 1 July 2018.
- A stocktake has revealed that there is \$75 inventory misplaced or stolen.

**Required**

- (a) Show the General Journal entries to record the balance day adjustments.

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

[12 marks]

- (b) Complete the adjusted trial balance.

---

---

---

---

---

---

---

---

---

---

[6 marks]

- (c) Show the General Journal entries to close the income and expense accounts to the Profit and Loss Account.

[illegible]

[14 marks]

- (d) Prepare the Income Statement.

[illegible]

---

---

---

---

---

---

---

---

[14 marks]

(e) Prepare the Statement of Financial Position.

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

[14 marks]



## TRIAL TEST 6: FINANCIAL INFORMATION/GOVERNMENT AND COMMUNITY

**Time allowed: 70 minutes**

**Total marks: 80**

**Section 1 – Multiple Choice**

**Section 2 – Short Answer**

**Section 3 – Extended Answer**

10 marks

50 marks

20 marks

### SECTION 1 – MULTIPLE CHOICE (10 MARKS)

Questions 1-6 relate to the information below:

The following information was provided by the owner of “Cards and Candles”, a small gift store, for the financial year ending 31 December 2025.

STATEMENT OF FINANCIAL POSITION	\$	INCOME STATEMENT INFORMATION	\$
Cash at bank	4 000	Sales	32 000
Debtors	6 000	Cost of sales	15 000
Inventory	2 000	Wages	8 000
Prepaid advertising	3 000	Rent	4 000
Furniture and fittings (net)	45 000	Interest	3 000
Delivery van (net)	67 000	Advertising	1 000
Accrued wages	7 000		
Creditors	5 000		
Mortgage	100 000		

Capital includes profit for the year, and the owner made no drawings.

Total assets on the 31 December 2024 = \$130 000 and on 31 December 2026 = \$140 000.

- The working capital ratio is equal to:
  - 0.09: 1.0
  - 1.25: 1.0
  - 1.13: 1.0
  - 0.83: 1.0.
- The quick asset ratio is equal to:
  - 9.0%
  - 125.0%
  - 113.0%
  - 83.0%.
- The return on assets is equal to:
  - 25%
  - 13%
  - 0.8%
  - 0.7%.

4. The gross profit ratio is equal to:
- (a) 3.1%
  - (b) 53.1%
  - (c) 50%
  - (d) There is insufficient information available to calculate this ratio.
5. The profit ratio is equal to:
- (a) 0.78: 1.0
  - (b) 0.06: 1.0
  - (c) 0.03: 1.0
  - (d) 0.05: 1.0.
6. The debt to equity ratio is equal to
- (a) 747%
  - (b) 847%
  - (c) 947%
  - (d) 13%.
7. A member of an accounting professional body has been asked to reveal some sensitive information about the investment decisions of one of their clients. This ethical dilemma relates to:
- (a) Integrity
  - (b) Objectivity
  - (c) Due care
  - (d) Confidentiality.
8. Which of the following would NOT be used for ratio comparison?
- (a) Last year's budget ratios
  - (b) The ratios achieved by competitors
  - (c) Recommended industry levels
  - (d) Current year ratios.
9. Which of the following situations is an example of a self-interest threat for a member of a professional association?
- (a) Close business relationship
  - (b) Discovering an error in a co-worker's work
  - (c) Litigation pressure
  - (d) Promoting shares in an entity that is a client.
10. A member of a professional association will have breached the professional behaviour principle of their code of ethics if they:
- (a) Communicate private information
  - (b) Make unsubstantiated comparisons to competitors
  - (c) Do not maintain professional knowledge
  - (d) Provide misleading information.



## SECTION 2 – SHORT ANSWER (50 MARKS)

1. Petronilla owns a small retail shop located in a large regional town in Western Australia. The shop specialises in selling tradespeople's clothing, such as safety gear and overalls. It has been open for five years, and Petronilla has always kept very good records of her finances though she has done very little in the way of forward planning for the future. She is considering expanding her business by investing in a second shop front in a neighbouring town. Petronilla has never completed a ratio analysis for her business.

(a) Explain to Petronilla why she should use ratio analysis.

---

---

---

---

---

[2 marks]

(b) Petronilla has heard that ratios are useful when compared with other results. What information could be used to provide comparisons?

---

---

---

---

---

---

---

[2 marks]

(c) Explain to Petronilla the meaning of the terms **liquidity** and **gearing** and give an example of a ratio that could be used to analyse each one.

---

---

---

---

---

---

[3 marks]

- 
- This image shows a blank sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

3. Interpret the following information about the business “Juliet’s Jewellery” a retail business owned by Romeo Verona. Information has been provided for the financial year ending 30 June 2029.

**Total assets 30 June 2029: \$ 2 000 500**

RATIOS AT 30 JUNE 2029	
General expenses ratio:	10.1%
Profit ratio:	3.4%
Gross profit ratio:	47.8%
Return on assets:	5.5%
Working capital ratio:	119%
Quick asset ratio:	71%
Debt to equity:	153%

(a) Calculate the following ratios for 2030.

General expenses ratio:

---

---

---

---

---

Profit ratio:

---

---

---

---

---

Gross profit ratio:

---

---

---

---

---

Return on assets:

---

---

---

---

---

Working capital ratio:

---

---

---

---

---

---

Quick asset ratio:

---

---

---

---

---

---

Debt to equity:

[21 marks]

- (b) Choose the four ratios that would be of most assistance in interpreting the **profitability** of the business.
- i) Comment on the profitability of the business in the 2030 financial year.

---

---

---

---

[8 marks]

- ii) Suggest TWO changes that the business owner could implement in order to improve profitability.

---

---

---

---

---

---

---

---

[4 marks]

- iii) What is an ideal liquidity ratio result and why? Explain what this business could do to improve liquidity.

---

---

---

---

---

---

---

---

---

---

---

---

[3 marks]

4. A financial service provider has run an advertisement in the local paper with the following claim: *“For the best and most correct financial advice in Western Australia, you can’t beat Con’s Consultants. I am the most highly qualified financial services provider south of the river. Results always guaranteed.”*

(a) Explain two potential ethical problems that could arise from this advertisement.

---

---

---

---

---

---

---

---

---

---

---

---

[2 marks]

(b) What role does the professional association for “Con’s Consultants” have in relation to the carrying out of business in an ethical and fair manner?

---

---

---

---

---

---

---

---

---

---

---

---

[2 marks]

### SECTION 3 – EXTENDED ANSWER (20 MARKS)

Following are ratios which were calculated for the service business “Edwina’s Electricals”, over the previous two accounting periods. Edwina employs a number of electricians and provides electrical services to new homes and established businesses.

YEAR:	2025	2026	2027
Profit ratio	25%	27%	30%
Return on assets	5%	6%	7%
Working capital ratio	205%	190%	205%
Quick asset ratio	102%	95%	100%
Debt to equity	200%	190%	185%
Expenses ratio	30%	25%	26%

Industry averages for these ratios are shown below.

INDUSTRY AVERAGE	
Profit ratio	31%
Return on assets	10%
Working capital ratio	150%
Quick asset ratio	80%
Debt to equity	120%
Expenses ratio	26%

**Required:**

- (a) Analyse and interpret the information provided for “Edwina’s Electricals”, in relation to the profitability, liquidity and leverage of the business over time and compared to the industry average.

This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are approximately 20 lines visible. The paper has a slight shadow on its right side, suggesting it's resting on a surface.

---

---

---

---

---

---

---

---

---

---

[9 marks]

- (b) What other information would be required in order to be able to make a full analysis of the business' situation?

---

---

---

---

[3 marks]

- (c) Edwina is considering investing in new motor vehicles for her business. Use the ratio information to respond to this plan.

---

---

---

---

---

---

---

---

---

---

---

---



Recommendation:

---

---

---

---

---

---

---

---

---

---

---

[8 marks]



## ANSWERS TO REVIEW QUESTIONS

### 1: SMALL BUSINESS IN AUSTRALIA

- Partnership – personally liable for the debts of the business.
  - Small proprietary company – companies generally have a separate status and owners (shareholders) are only liable for debts to the limit of their shareholding. Note that a shareholder might have no further liability, however a director can be liable if the company continued trading while insolvent.
- Mortgage: lower interest but a long term commitment to repayments.  
 Government loan: low interest but has restrictions on how it can be used (inflexible)  
 Venture capital: can try a new and innovative approach, however this is risky.
- Advantage: not risking the share capital investment of shareholders.  
 Disadvantage: documentation required and high risk nature of new venture.
- Hire purchase: asset owned at end.  
 Leasing: asset returned to finance company
- Motor vehicle: hire purchase, or lease or short term loan.  
 Building: mortgage.  
 Marron farm: government loan or venture capital.
- Business owned by one person.  
 Unlimited liability.  
 Personally responsible for all debts
- All responses are dependent upon the assumptions made and the related advantages/disadvantages chosen and following are suggestions only -

  - Coffee shop – sole trader
  - Furniture manufacturer – small proprietary company
  - Home hairdressing service – sole trader
  - Web page designer – sole trader or partnership
- Partnership owners have unlimited liability for the debts of the business, and their personal property could be used to repay debt. In contrast, the owners of a small proprietary company have their liability limited to the value of the shares.
- Risk: lower than speculative shares and higher than property. Collateral.  
 Return: generally a lower dividend than speculative shares (if paid at all) and higher than property interest.

- They are distributed among partners according to the requirements outlined in the Partnership Agreement.

11.

Credit Card	Highly liquid	High interest	Short
Mortgage	Low Interest	Long term investment which is safe	Long
2 year loan	Relatively straight forward to organise	Medium interest	Medium
Family	May not charge interest and may be accessible straight away.	Family fallouts	Can be any
Hire Purchase	Own asset at end	Will have paid more for it	Medium

- Five vehicles:** lease. Medium term.  
**Equipment:** lease. Short term or Medium term loan.  
**Research:** government loan. Long term.
- Collateral:** own property  
**Liquidity:** budgeted predicted cash flows  
**History:** bank credit history  
**Guarantors:** family.
- Advantages:  
 1) More capital  
 2) More skills  
 3) Less expensive  
 Disadvantages:  
 1) Unlimited liability  
 2) Decisions binding  
 3) Profits shared.
- Sole trader:** one owner, unlimited liability, owner investment, not a separate legal entity.  
**Proprietary company:** several shareholders, limited liability, share investment, separate legal entity.
- The product or service being manufactured or sold.
- Processes raw materials to produce a finished product for sale.
- A service business provides professional expertise or support to a customer, whereas a retail business provides a good, often obtained from a manufacturing business.

## 2: INTRODUCTION TO FINANCIAL ACCOUNTING

1.
  - (a)  $Equity = A - L$   
 $= 30\,000 - 12\,000$   
 $= \$18\,000$
  - (b)  $Profit = I - Ex$   
 $= 7\,000 - 5\,000$   
 $= \$2\,000$   
 $A = L + Eq$   
 $A = L + Eq + Profit$   
 $Eq = A - L - Profit$   
 $= 56\,000 - 31\,000 - 2\,000$   
 $= \$23\,000$
  - (c)  $Equity = \$5\,000$
2.
  - Owner's equity is the owner's investment.
  - If the business is wound up the owner receives that equity.
  - It could be seen that this equity is "owed" to the owner.
  - Liabilities are amounts owing.
3.  $Opening\ capital = 50\,000 + 20\,000 - 5\,000$   
 $= \$65\,000$
4.  $A = L + Eq$   
 $A + Ex = L + Eq + I$
5.
  - For every debit there must be an equal amount credited.
  - Each transaction affects two or more accounts.
  - These accounts may be  
 $\uparrow A \downarrow A; \uparrow L \uparrow A; \uparrow Eq \uparrow A; \downarrow Eq \downarrow A; \downarrow L \downarrow A$
6. Trade discounts, rebates and similar items are deducted in determining the costs of purchasing inventories.
7. Continual recording of stock levels
  - Computerised / scanners required
  - Stocktake less important
  - Use perpetual – much more information.
8. To check for stock losses.
9. **Taxable supplies:**
  - Registered for GST
  - Sale for payment
  - Business.**GST free:**
  - Basic food
  - Some education
  - Some medical.**Input taxed:**
  - Financial
  - Some rent.
10. Clothing: GST payable, 3 May  
 Surf shop: GST credits, 3 May  
 No change for quarterly accounting.
11. Quarterly reporting, electronically or in annual report.
12. It lists the end balance of every General Ledger account, and is used to check that all the entries are correctly balanced – so that total debits equal total credits.
13. The BAS is lodged by every business registered for GST. Purpose is to report and

pay the GST collected by the business and claim GST credits.

## 3: FINANCIAL ACCOUNTING TERMINOLOGY

1. Business separate to owner.  
 Owner's investment recorded as equity
2. \$40 000.
3. **Entity:** business and owner separate so recording of transactions separate.  
**Concern:** business will continue so assets not constantly revalued.
4. Information that has a similar nature or function can be added together in the financial statements, however material amounts of similar items must be separated.
5. Accrual basis.  
 Accounting entity.  
 Accrual.  
 Historical cost/going concern.  
 Accounting period.  
 Accounting entity.
6. **Perpetual:** up to date record of stock levels, e.g. supermarket.  
**Periodic:** specific quantities of stock unknown until stocktake, e.g. small newsagent.
7. Equity is the residual interest in the assets of the entity after deducting all its liabilities.
8. Yes.
  - Resource controlled by business because it has access.
  - Past event of a purchase needs to have occurred.
  - Future economic benefits will flow from the sale of goods produced by the plant and equipment.
9. Controlled by business, e.g. through patent registration.
  - Past events such as research or contractual agreements need to exist.
  - Future economic benefits from the sale of the product/ service derived from the patent must be possible. This can be difficult to determine.
10. Yes, it has occurred and is not a planned or future event.
11.
  - Present obligation because a loan document stating this exists.
  - Past event from the receipt of funds.
  - Outflow of cash resources required to repay the mortgage.
12. Even though it is uncertain what quantity is required, if the business knows it will meet the requirements, it is prudent to estimate the liability. Therefore yes a present obligation does exist.
13. Fees increase asset cash and are not from equity participants. Yes these are income.  
 Dividends and interest are the same.
14. Yes, all decrease an asset (cash or property/ plant/ equipment) and are not a payment of equity.

15. *Performance: the returns achieved.*

*Financial position: relationship between assets, liabilities and equity.*

*Liquidity: the cash position.*

- Taxable supply
- Not claimed when
  - not registered
  - not GST taxable.

#### 4: THE GENERAL JOURNAL/ GENERAL LEDGER & FINANCIAL STATEMENTS

1. Boat \$500; Cakes \$9; Tax return \$30

2. *Input tax credits:*

- Claimed when
  - GST registered

3. (a) Shelving \$500  
 (b) Inventory \$6 000  
 (c) Goods \$6 490 – no outlay GST collected  
 (d) Internet \$40  
 (e) Salaries – no GST  
 (f) Receipt – no outlay.

#### 4. Trendy Trader – General Journal (Extract)

DATE	DETAILS	DEBIT	CREDIT
May1	Inventory Control	4 000	
	GST Credits Received	400	
	Movin Music		4 400
	<b>Purchase of stock</b>		

DATE	DETAILS	DEBIT	CREDIT
2	Cash at Bank	660	
	Sales		600
	GST Collected		60
	<b>Sale of stock</b>		
	Cost of Sales	300	
	Inventory Control		300
	<b>Cost of Sales</b>		

DATE	DETAILS	DEBIT	CREDIT
3	Stock of Supplies	200	
	Inventory Control		200
	<b>Correction of error</b>		

DATE	DETAILS	DEBIT	CREDIT
4	Movin Music	300	
	Inventory Control		273
	GST Credits Received		27
	<b>Purchase return</b>		

DATE	DETAILS	DEBIT	CREDIT
5	Sales Returns	135	
	GST Collected	15	
	Debtor		150
	<b>Sale return</b>		
	Inventory Control	70	
	Cost of Sales		70
	<b>Cost of item returned</b>		

DATE	DETAILS	DEBIT	CREDIT
6	Cash at Bank	856	
	Discount Expense	40	
	GST Collected	4	
	Debtor – Party DJ		900
	<b>Receipt of account owing</b>		

DATE	DETAILS	DEBIT	CREDIT
7	Movin Music Cash at Bank <b>Payment of account</b>	4 100	4 100

5. A. Mouse – General Journal for Week One of business

TRANSACTION	DETAILS	DEBIT	CREDIT
1	Inventory Control GST Credits Received Cash At Bank <i>Purchase of stock</i>	12 000 1 200	13 200
2	D. Smith Sales GST Collected <i>Sale of stock</i> Cost of Sales Inventory Control <i>Cost of Sales</i>	4 180  2 000	3 800 380 2 000
3	Inventory Control GST Credits Received G. Brown <i>Purchase of stock</i>	21 900 2 190	24 090
4	Cash at Bank Sales GST Collected <i>Sale of stock</i> Cost of Sales Inventory Control <i>Cost of Sales</i>	3 300  1 600	3 000 300 1 600

General Journal for opening entry

DETAILS	DEBIT	CREDIT
Cash at bank	30 000	
Motor vehicle	23 000	
Building	200 000	
Mortgage		200 000
Capital		53 000
<i>Entry to commence business</i>		

6.

TRANSACTION	DETAILS	DEBIT	CREDIT
1	Motor vehicle GST Credits Received Creditor <i>Purchase of vehicle</i>	40 000 4 000	44 000
2	Bad debts GST Collected Debtor <i>Write off of bad debt</i>	300 30	330
3	Drawing Inventory Control GST Collected <i>Owner withdrew stock</i>	132	12 120

## 7. Fitness Physio: General Ledger (Extract)

Room and Office Equipment					
1 Oct	Capital	12 000			
2	Medic supplies	5 200			
			31 Oct	Balance c/d	17 200
		<u>17 200</u>			<u>17 200</u>
	Balance b/d	17 200			
Medic Suppliers					
			2 Oct	Equipment/GST	5 720
Cash at Bank					
3 Oct	Fees/GST	55	4 Oct	Office Expenses/GST	495
6	Fees/GST	110	7	Office Expenses/GST	429
31	Balance c/d	759			
		<u>924</u>			<u>924</u>
				Balance b/d	759
R. White					
5 Oct	Fees/GST	<u>55</u>			
GST Credits					
2 Oct	Medic supplies	520			
4	Cash at bank	45			
7	Cash at bank	39	31 Oct	GST Clearing	604
		<u>604</u>			<u>604</u>
Capital					
			1 Oct	Equipment	12 000
Fees					
			3 Oct	Cash at bank	50
			5	R. White	50
			6	Cash at bank	100
31 Oct	Profit and Loss	300	8	X. Rouge	100
		<u>300</u>			<u>300</u>
Office Expenses					
4 Oct	Cash at bank	450			
7	Cash at bank	390	31 Oct	Profit and Loss	840
		<u>840</u>			<u>840</u>

GST Collected					
			3 Oct	Cash at bank	5
			5	R. White	5
			6	Cash at bank	10
31 Oct	GST Clearing	30	8	X. Rouge	10
		<u>30</u>			<u>30</u>
X. Rouge					
8 Oct	Fees	<u>110</u>			

#### Fitness Physio – Trial Balance for the month of October

	DR	CR
Equipment	17 200	
Capital		12 000
Medic Supplies		5 720
Fees		300
Cash at bank (overdraft)		759
Office expenses	840	
R. White	55	
X. Rouge	110	
GST Clearing	574	
	<u>\$18 779</u>	<u>\$18 779</u>

#### 8. Mar Berber's Rugs – Income Statement

Income Statement		
Sales		\$ 1 560 000
Less: Cost of sales	1 260 000	
Discount received	(1 700)	
Total cost of sales	<u></u>	<u>1 258 300</u>
GROSS PROFIT		301 700
<b>Add: Other income</b>		
Interest income		<u>3 190</u>
		304 890
<b>Less: Expenses</b>		
SELLING		
Salaries – Sales staff		123 000
GENERAL		
Electricity and rates	6 700	
Salaries – Office staff	56 000	
Insurance	32 000	
Internet and telephone	<u>2 150</u>	<u>96 850</u>
		219 850
<b>PROFIT</b>		<b>\$ 85 040</b>

Statement of Financial Position	
<b>Current Assets</b>	
Cash at bank	51 000
Inventory	423 000
Accounts Receivable	32 400
<b>Non-Current Assets</b>	
Showroom furniture	16 000
Office equipment	21 000
Furniture	21 900
Building	1 000 000
<b>TOTAL ASSETS</b>	<b>\$ 1 565 300</b>
<b>Current Liabilities</b>	
GST Clearing	660
Accounts payable	54 600
<b>Non-Current Liabilities</b>	
Mortgage	900 000
<b>NET ASSETS</b>	<b>610 040</b>
<b>Equity</b>	
Capital	600 000
Add: Profit	85 040
Less: Drawings	(75 000)
<b>TOTAL EQUITY</b>	<b>610 040</b>

9. *Disclosed = incorrect balancing, transposition, one total incorrect, omission.  
Not disclosed = Incorrect posting, incorrect amount, missing entry, compensation error.*
10. *To transfer the balances out of the temporary income and expense accounts for the accounting period.*

## 5: PRINCIPLES OF INTERNAL CONTROL

- Internal Control is when a business uses good business practices to ensure that their assets are safeguarded and that the effectiveness and efficiency of business operations are improved whenever and however they can be.*
- Internal control is important because without it the business is left vulnerable to fraud and ineffective and inefficient operating procedures.*
- Four internal control procedures that could be implemented to ensure that cash does not go missing from a business 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.*

- Cash should be banked either at the end of each day or weekly depending on how large the amounts are.*
  - Cash should be counted in a secure area where the person is free from interruptions.*
  - There should be a chain of accountability immediately upon receipt of the initial cash. Transfers between two people should be jointly verified and documented.*
- 4.
- Two problems Susan may encounter are:*
    - How much cash to keep on hand each week as it is an unknown as to how much cash each student may want to withdraw.*
    - She is in charge of running the boarding house and may not have any experience in how to record and manage the money going out.*
  - 1. She may keep some cash on hand for students who need it immediately, she will need to ensure this is stored in a secure place in a locked petty cash box or safe.  
2. She needs to ensure she is keeping an accurate record of which students have*



*withdrawn cash, how much they have withdrawn and the remaining balance each student has.*

3. *She could get another staff member to be with her when students are withdrawing cash to ensure the accuracy of her record-keeping.*
5.
  - (a)
    1. *Inventory being left outside is exposed to the elements and may become sun damaged or ruined with the rain.*
    2. *Inventory left outside could be stolen.*
  - (b)
    1. *Bob needs to store the inventory in a safe place which is locked so that it is not stolen. He also needs to ensure inventory is not kept outside where it can become ruined from the sun and rain.*
    2. *Bob needs to ensure his part-time workers know how to use the equipment in the correct way. He could do this by implementing an in-house training program.*
6.
  1. *Invoices should be issued as soon as possible so that customers pay as soon as possible as every business needs liquidity for survival.*
  2. *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 to ensure accurate record keeping and so that fraud does not occur by way of stolen funds.*
7.
  1. *Take advantage of any discounts for prompt payment as this saves the business money.*
  2. *If a payment cannot be met due to cash flow shortages then get in touch with the creditor straight away to make another arrangement to keep business reputation intact and to ensure that the business does not get listed as a bad debt.*
8. *Chester could implement the following:*
  1. *Safety guidelines and operating instructions to ensure all machines used to manufacture and package the fishing rods are operated efficiently.*
  2. *Secure locks on all factory doors to prevent theft or vandalism of either the inventory or the machinery.*
  3. *Ensure the inventory is kept where it cannot be spoiled or stolen.*
  4. *Staff training in the correct use of equipment.*
9. *Accounting controls are concerned with financial records, i.e. ensuring proper recording, no fraud etc. Whereas Administrative controls are concerned with the organization structure such as how the chain of command operates.*
10. *Five limitations of internal control are:*
  - *Businesses design internal control systems to be cost effective, this objective*

*means that some errors may never be detected.*

- *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.*
  - *If the business does not have enough staff then this may prevent the business from implementing a system of segregating duties.*
  - *People in management can override a control making the overall system vulnerable.*
11. *Internal control systems need to be cost effective, meaning that some errors could never be found. The business owner needs to weigh up the cost of a control with the benefits that it might provide.*

## 6: GOVERNMENT & COMMUNITY

1. *If they are using a name other than their own.*
2. *It is important for a small business that employs staff to have workers' compensation insurance as this ensures that a worker will be compensated if the need arises such as a workplace accident that leaves them unable to work.*
3. *Tax legislation is important as it clearly sets out what taxes the business does and does not need to pay as well as how much tax needs to be paid. This is important so that the business can do the right thing and not try to avoid paying tax.*
4. *It is compulsory for a business to register for the GST if it has an annual turnover greater than \$75 000.*
5. *An ABN is a number assigned to a business so that the Australian Tax Office can identify the business in all their dealings.*
6. *A business has to lodge a Business Activity Statement (BAS) to the ATO, as this summarises all the GST the business collected and that the business paid.*
7.
  - (a) *No the business is not socially aware, if it were then it would not be making the demands it is on its employees. It would be paying employees overtime, allowing time off if they have already worked a full time load and it would allow exception to be made if an employee needed time off to attend a special function. The business is not environmentally aware if it were then Sally would be using the recyclable material.*

- (b) *She could use recyclable materials.*
- (c) *She could not place unreasonable demands on her employees.*
8. *It may result in increased customer loyalty. It may result in new customers. It may result in lower employee turnover, which will decrease recruitment costs and staff training costs.*
9. *Lack of finance. Lack of knowledge. Lack of resources.*
10. *By sponsoring an individual, event or specific cause such as Diabetes Fundraising a business shows that it is community minded and interested in helping society in a positive manner. It is a way to give back to the community. It is also a way for the business to get its name noticed for example if the business sponsored a sports star who was about to compete in an international competition then the star might have to advertise the business in certain ways in exchange for the sponsorship by displaying the business name on their clothing or doing adverts for the business etc.*
11. *Resource Conservation is when a business looks at and implements ways that they can manufacture their product or operate their business using the least amount of resources possible.*  
*Some examples of resources conservation are:*
1. *Minimising product packaging*
  2. *Using materials, which can be recycled.*
12. *By paying their tax on time and the right amount of tax without abusing the system by trying to avoid paying the correct amount of tax.*
13. *Partners prepare a formal Partnership agreement that covers items such as role, authority, financial contribution, sharing of profits/losses, dispute resolution and winding up.*
14. *Bankruptcy is declared when the sole trader is acknowledging by law they are unable to pay debts. It usually lasts for three years, however, is included on the sole trader's credit report for longer and so the sole trader cannot run another business in that time.*
- should just be careful to protect his log on details and password and he should check his online statement to make sure no funds have been withdrawn without his authorisation.*
- 2.
- (a) *The acronym stands for Electronic Funds Transfer at Point of Sale. It can be carried out when a consumer has a debit or credit card. The debit card is linked to their bank account. When the card is used the customers funds are transferred from their account to the relevant businesses account.*
- (b) *Benefits of EFTPOS for the store include the fact that it is efficient as funds are cleared straight away, it is secure as it lowers the risk of theft as there is less cash on the premises. It is low cost as can be cheaper than clearing payment by cheque.*  
*Reconciliation problems are reduced. Can be used internationally across currencies.*
- (c) *Two disadvantages are that the system is electronic so can be subject to outages. There is a risk of fraud with a customer using a stolen debit or credit cards.*
- (d) *Nicholas should install the EFTPOS system as the advantages far outweigh the disadvantages.*
3. *Two advantages are that they are efficient as funds are cleared straight away and they are secure as it lowers the risk of theft as there is less cash on the premises. Two disadvantages are that there is a risk of fraud with a customer using stolen credit cards and the Business has to pay various fees to set up credit card facilities and to process credit cards, this can be costly especially for small businesses.*
4. *Under the accrual basis of accounting, the transactions are recognised and recorded on the day they occur and not when the cash is paid or received. For Example if Donny Farnham gave a concert on the 29<sup>th</sup> of June and was only paid for his services on the 28<sup>th</sup> of July, his accounting records would record the income amount owing on the day the service was performed.*
5. *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 the 10<sup>th</sup> of 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 the 20<sup>th</sup> of 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. The same happens with expenses. They are not recognised until they have been paid for in cash.*

## 7: FUNDAMENTAL PRINCIPLES

- 1.
- (a) *Some of the advantages of Online Banking are automatic clearance of funds, electronic proof that the bill has been paid, convenient as can be used anytime and it can be used internationally.*
- (b) *Two disadvantages are that The system is electronic so can be subject to outages and there is a risk of fraud if someone else uses your log on details and password.*
- (c) *The advantages of using online banking far outweigh the disadvantages for Rupert. He*

6. Assets are recognised when this provides information relevant to the asset and any resulting income, expenses or changes in equity and is a faithful representation of the asset and of any resulting income, expenses or changes in equity.
7. The loan is a liability because there is a present obligation of the entity to transfer an economic resource as a result of past events.
8. Income is recognised when there is initial recognition of an asset or an increase in the carrying amount of an asset, or the derecognition of a liability or a decrease in the carrying amount of a liability
9. Expenses are recognised when there is the initial recognition of a liability or an increase in the carrying amount of a liability, or the derecognition of an asset or decrease in the carrying amount of an asset.
10. Complete the table below:

TYPE	PURPOSE	NATURE
Income in advance	Income which has been received but not yet earned.	Liability
Prepaid Expense	This is a prepayment. The business has paid an expense in advance for example insurance.	Asset
Depreciation	It is an allocation process of spreading the cost of the asset over the period of time the asset is used to generate income.	Expense
Doubtful Debt	Based on an estimation it is a provision made which results in the profit figure being more conservative in case of a bad debt occurring.	Expense
Accrued Income	Income which has been earned but has not yet been received by the business.	Asset
Accrued Expense	A payment which has not yet been made by the business but is owed for example telephone bill.	Liability

11. Grouping expenses into business activities eg. Manufacturing, selling, general administrative, financial.
12. Yes, it is a present economic resource, would be controlled (owned) by the business, as a result of the past event of purchasing the phone. It has the potential to produce economic benefits for the business.
13. It is a decrease in the asset cash that results in a decrease in equity.

14. A sale results in an increase in the asset cash or accounts receivable, which corresponds to an increase in equity when a profit is recognised.
15. The business would group the types of income together – for example: interest received from various sources (bank account, investments etc), sales from different outlets, dividends from multiple shareholdings.

## 8: DEPRECIATION

1. Depreciation is a cost allocation process. It spreads the cost of an asset over the period of time the asset is used to generate income.
2. Asset depreciation occurs due to the matching principle, which requires the matching of all income in an accounting period against all the associated expenses. Non-current 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. Land is not depreciated as it usually appreciates over time.
4. If a delivery truck has been used to earn income for a courier business, then the decline in value of the truck needs to be offset against the income that has been earned. In this instance cost allocation means working out the decline in value and allocating this cost by way of depreciation expense.
5. Wear and tear and technical obsolescence.
6. The cost, the estimated useful life, the residual value.
7. Using the straight-line method a fixed (set) amount is written off over the number of years that the asset will be used by the business.

$$\text{Straight-line depreciation} = \frac{\text{Original cost} - \text{Est. Residual Value}}{\text{Estimated Life}}$$

### 8. Straight line method of depreciation.

ORIGINAL COST	ESTIMATED RESIDUAL VALUE	ESTIMATED LIFE	DEPRECIATION EXPENSE PER ANNUM
\$10 000	\$2 000	4	\$2 000
\$40 000	\$8000	6	\$5 333
\$30 000	\$3 000	3	\$9 000
\$25 000	\$4 000	7	\$3 000
\$20 000	\$5 000	5	\$3 000
\$12 000	\$0	4	\$3 000

9. Unlike the straight-line method where a fixed (set) amount is written off over the number of years that the asset will be used by the business, the diminishing balance method writes off a fixed % against the diminishing balance rather than off the original cost of the asset.

10.

ORIGINAL COST	DEPREC. RATE	YEAR 1	YEAR 2	YEAR 3
\$50 000	10%	\$5 000	\$4 500	\$4 150
\$40 000	25%	\$10 000	\$7500	\$5 625
\$100 000	20%	\$20 000	\$16 000	\$12 800
\$25 000	15%	\$3 750	\$3 188	\$2 709
\$30 000	30%	\$9 000	\$6 300	\$4 410
\$15 000	10%	\$1 500	\$1 350	\$1 215
\$8 000	5%	\$400	\$380	\$361

11. The straight line method is best used in a situation where the non-current asset does not need more repairs later in its life than in the beginning. Also when the age, the efficiency and the usage of the asset are equal in each accounting period. For example furniture.

12. The diminishing balance method is best used in situations where the non-current asset will require more repairs later in its useful life for example machinery and vehicles. These non-current assets are more useful earlier on in their life, therefore it makes sense to depreciate them at a higher dollar value earlier on.

13.

(a) Accumulated depreciation = \$12 000

(b) Carrying Amount = \$8 000 Sale price = \$5 000 so loss on sale is \$3 000.

13. (c) and (d)

Motor Vehicle					
Dec 1	Balance	20 000	Dec 1	Sale of Asset	20 000
Sale of Asset					
Dec 1	Motor vehicle	20 000	Dec 1	Accum Dep of Motor vehicle	12 000
				Cash at bank	5 000
				Loss on disposal	3 000
Accumulated Depreciation Motor Vehicle					
Dec 1	Sale of Asset	12 000	Dec 1	Balance	12 000
Cash at Bank					
Dec 1	Sale of Asset	5 000			
Loss on Disposal					
Dec 1	Sale of Asset	3 000			

14.

(a) The \$1 000 for air-conditioning as this adds value to the asset.

(b) The vehicle registration and the insurance costs do not add value to the asset, they are normal expenses used up in a year and therefore they cannot be added to the cost of the asset.

15. (a)

**General Journal (Extract)**

DATE	PARTICULARS	DR	CR
2017 2 Jan	Delivery Van Cash at bank <b>Purchase of Delivery Van for cash</b>	40 000	40 000

**General Ledger (Extract)**

**Cash at Bank**

2017 2 Jan	Delivery Van	40 000
---------------	--------------	--------

**Delivery Van**

2017 2 Jan	Delivery Van	40 000
---------------	--------------	--------

(b) *Depreciation expense for Year 1 = 20 % of \$40 000 = \$8 000*  
*However Brenda only owned the van for 6 months by the end of the financial year therefore the depreciation figure is \$4 000.*

(c)

**General Journal (Extract)**

DATE	PARTICULARS	DR	CR
30 June	Depreciation of Delivery Van Accumulated Depreciation of Delivery Van <b>Depreciation of asset</b>	4 000	4 000

(d)

**Delivery Van Depreciation**

30 Jun	Accum. Dep. Delivery Van	4 000
--------	--------------------------	-------

**Delivery Van Accumulated Depreciation**

30 Jun	Dep. Delivery Van	4 000
--------	-------------------	-------



16. (a)

DATE	PARTICULARS	DR	CR
2016 1 July	Furniture Funky Place <b>Purchase Furniture on Credit</b>	3 000	3 000

**General Ledger (Extract)**

**Funky Place**

Jul 1	Furniture	3 000
-------	-----------	-------

**Furniture**

Jul 1	Funky Place	3 000
-------	-------------	-------

(b)  $\text{Dep exp} = \frac{\$3\,000 - \$400}{4}$   
 $= \$650 \text{ per annum}$

(c)

**General Journal (Extract)**

DATE	PARTICULARS	DR	CR
2017 June 30	Depreciation of furniture Accumulated Depreciation of Furniture <b>Depreciation of furniture</b>	650	650

(d)

**Furniture Depreciation**

Jun 30	Accum. Dep.	650
--------	-------------	-----

**Furniture Accumulated Depreciation**

Jun 30	Depreciation	650
--------	--------------	-----

17. Under the weighted average cost method, it is assumed that the cost of inventory is based on the average cost of the goods available for sale during the accounting period.

18. This method assumes that the first stock to come in will be the first sold. The cost of the inventory sold is calculated by adding up the cost of the number of items sold that were purchased by the business first.

19.

(a) A loss on disposal is **not** shown in the Statement of Financial Position.

(b) A loss on disposal is shown in the Expenses section of the Income Statement.

(c) A gain on disposal is **not** recorded in the Statement of Financial Position.

(d) A gain on disposal is shown in the "Other Income" section of the Income Statement.

20. c

21. b

22. d

23. a

24. a

25. a

26. c  
27. c  
28. b  
29. a  
30. d

## 9: RECORDING AND PROCESSING

1.

- (a)  $\$4800/12 = \$400$  per month  $\times 5$  months is \$2000 insurance expense has been consumed for the year and \$2800 remains as Prepaid Insurance.  
(b)  $\$3000/3 = \$1\,000$  per month. By end of the financial year 1 month has been consumed so advertising expense is \$1 000 and Prepaid Advertising is \$2 000.  
(c)  $\$600/12 = \$50$  per month. By end of financial year 3 months have been consumed so Vehicle Registration expense is \$150 and the Prepaid Vehicle Registration balance is \$450.

### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Vehicle Rego Expense Prepaid Vehicle Registration <i>Adjusting entry to recognise vehicle registration expense for the period</i>	150	150

### General Ledger Entry

#### Delivery Van Depreciation

30 Jun	Prepaid Vehicle Reg	150	
--------	---------------------	-----	--

#### Prepaid Vehicle Registration (Asset)

1 Apr	Cash at bank	600	30 Jun	Vehicle Reg	150
				Balance c/d	450
		<u>600</u>			<u>600</u>
	Balance b/d	450			

- (d)  $\$2\,400/12 = \$200$  per month. By end of financial year 4 months have been consumed so Gym fees expense is \$800 and the balance in the Prepaid Gym fees is \$1 600.

### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Gym Fees Expense Prepaid Gym Fees <i>Adjusting entry to recognise gym fees expense for period</i>	800	800

### General Ledger Entry

#### Gym Fees (Expense)

30 Jun	Prepaid Gym Fees	800	
--------	------------------	-----	--

**Prepaid Gym Fees (Asset)**

1 Mar	Cash at bank	2 400	30 Jun	Gym Fees (Expense)	800
				Balance c/d	1 600
		<u>2 400</u>			<u>2 400</u>
	Balance b/d	<b>1 600</b>			

2. (a)

**General Journal Entry**

DATE	PARTICULARS	DR	CR
Jun 30	Telephone Expense	400	
	Accrued Telephone		400
	<b><i>Adjusting entry to recognise telephone expense owing on balance day</i></b>		

**General Ledger Entry**

**Telephone (Expense)**

30 Jun	Balance	2 000
	Accrued telephone	400
		<u>2 400</u>

**Accrued Telephone (Liability)**

30 Jun	Telephone (Expense)	400
--------	---------------------	-----

(b)

**General Journal Entry**

DATE	PARTICULARS	DR	CR
Jun 30	Wages expense	5 000	
	Accrued wages		5 000
	<b><i>Adjusting entry to recognise wages expense owing on balance day</i></b>		

**General Ledger Entry**

**Wages (Expense)**

30 Jun	Balance	70 000
	Accrued wages	5 000
		<u>75 000</u>

**Accrued Wages (Liability)**

30 Jun	Wages (Expense)	5 000
--------	-----------------	-------



(c)

### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Wages Expense Accrued wages <i>Adjusting entry to recognise wages expense owing on balance day</i>	2 500	2 500

#### Wages (Expense)

30 Jun	Balance	125 000	
	Accrued wages	2 500	
		<u>127 500</u>	

#### Accrued Wages (Liability)

	30 Jun	Wages (Expense)	2 500
--	--------	-----------------	-------

3. (a)

### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Sales in advance Sales <i>Adjusting entry to recognise sales earned on balance day</i>	30 000	30 000

### General Ledger Entry

#### Sales in Advance (Liability)

30 Jun	Sales	30 000	Balance	60 000
	Balance c/d	30 000		
		<u>60 000</u>		<u>60 000</u>
			Balance b/d	30 000

#### Sales Account (Income)

	30 Jun	Sales in advance	30 000
--	--------	------------------	--------

(b)

#### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Sales in advance Sales <b>Adjusting entry to recognise sales earned on balance day</b>	25 000	25 000

#### General Ledger Entry

##### Sales in Advance (Liability)

30 Jun	Sales	25 000	Balance	100 000
	Balance c/d	75 000		
		<u>100 000</u>		<u>100 000</u>
			Balance b/d	75 000

##### Sales Account (Income)

30 Jun	Sales in advance	25 000
--------	------------------	--------

(c) No sale entry will be required on balance day, however the unearned income will be recognised.

#### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Cash at bank Sales in advance <b>Sales in advance</b>	20 000	20 000

#### General Ledger Entry

##### Sales in Advance (Liability)

30 Jun	Cash at bank	20 000
--------	--------------	--------

4. (a)

#### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Accrued Income Interest <b>Adjusting entry to recognise interest earned on balance day</b>	175	175

### General Ledger Entry

#### Accrued Income (Asset)

30 Jun	Interest	175	
--------	----------	-----	--

#### Interest (Income)

			30 Jun	Accrued income	175
--	--	--	--------	----------------	-----

(b)

### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Accrued income	1 500	
	Commission		1 500
	<b>Adjusting entry to recognise commission earned on balance day</b>		

### General Ledger Entry

#### Accrued Income (Asset)

30 Jun	Commission	1 500	
--------	------------	-------	--

#### Commission (Income)

			30 Jun	Accrued income	1 500
--	--	--	--------	----------------	-------

5. (a) Stock loss of \$1 000.

### General Journal Entry

DATE	PARTICULARS	DR	CR
Jun 30	Inventory Adjustment	1 000	
	Inventory		1 000
	<b>Adjusting entry to record inventory loss</b>		

### General Ledger Entry

#### Inventory Adjustment Account (Expense)

30 Jun	Inventory	1 000	
--------	-----------	-------	--

#### Inventory (Asset)

30 Jun	Balance	40 000	30 Jun	Inventory adjustment	1 000
				Balance c/d	39 000
		<u>40 000</u>			<u>40 000</u>
	Balance b/d	39 000			

(b) Stock loss of \$11 000.

**General Journal Entry**

DATE	PARTICULARS	DR	CR
Jun 30	Inventory Adjustment Inventory <i>Adjusting entry to record inventory loss</i>	11 000	11 000

**General Ledger Entry**

**Inventory Adjustment Account (Expense)**

30 Jun	Inventory	11 000	
--------	-----------	--------	--

**Inventory (Asset)**

30 Jun	Balance	100 000	30 Jun	Inventory adjustment	11 000
				Balance c/d	89 000
		<u>100 000</u>			<u>100 000</u>
	Balance b/d	89 000			

(c) Stock loss of \$1 800.

**General Journal Entry**

DATE	PARTICULARS	DR	CR
Jun 30	Inventory Adjustment Inventory <i>Adjusting entry to record inventory loss</i>	1 800	1 800

**General Ledger Entry**

**Inventory Adjustment Account (Expense)**

30 Jun	Inventory	1 800	
--------	-----------	-------	--

6. (a)

**General Journal Entry**

PARTICULARS	DR	CR
Wages Accrued Wages <i>Adjusting entry to show wages owing on balance day</i>	4 000	4 000
Insurance Expense Prepaid Insurance <i>Adjusting entry to show insurance used this accounting period</i>	800	800
Dep (Office Equip) Accum Dep (Office Equip) <i>Depreciation expense for the accounting period</i>	11 200	11 200
Sales Sales in advance <i>Adjusting entry to recognise sales earned on balance day</i>	40 000	40 000

(b)

### Adjusted Trial Balance

	DR	CR
Capital		124 400
Cost of Sales	1 592 200	
Accounts receivable		8 000
Inventory	22 760	
Electricity	1 760	
Loan		4 000
Gain on Disposal		19 640
Cash at Bank	17 080	
Wages	247 200	
Accrued Wages		4 000
Drawings	123 600	
Prepaid Insurance	8 800	
Insurance	800	
Sales		1 952 000
Sales in Advance		40 000
Shares	24 000	
Office Equipment	56 000	
Depreciation of Office Equipment	11 200	
Accumulated Depreciation of Office Equipment		11 200
Rent	24 000	
Accounts Payable		98 920
Discount Received		17 200
Advertising	47 160	
Discount Allowed	10 000	
	<b>2 271 360</b>	<b>2 271 360</b>

(c)

### General Journal Closing Entries

PARTICULARS	DR	CR
Profit and Loss Account	1 934 320	
Cost of Sales		1 592 200
Electricity		1 760
Wages		247 200
Insurance		800
Depreciation		11 200
Rent		24 000
Advertising		47 160
Discount Allowed		10 000
<b>Closing of Expense to Account Profit/Loss</b>		
Sales	1 952 000	
Gain on disposal	19 640	
Discount received	17 200	
Profit/Loss		1 988 840
<b>Closing of Income Account to Profit/Loss</b>		
Profit/Loss	54 520	
Capital		54 520
<b>Transfer of Profit to the Capital Account</b>		

(d)

income statement			
<b>Income</b>			
Sales	1 952 000		
Less: Discount allowed	( 10 000)		
Total Sales		1 942 000	
Less: Cost of sales	1 592 200		
Discount received	( 17 200)		
Total cost of sales		1 575 000	
<b>GROSS PROFIT</b>			367 000
<b>Add: Other income</b>			
Gain on Disposal			19 640
<b>Less: Expenses</b>			
<i>Selling and Distribution</i>			
Advertising		47 160	
<i>General and Administration</i>			
Electricity	1 760		
Wages	247 200		
Insurance	800		
Dep of Office Equipment	11 200		
Rent	24 000	284 960	332 120
<b>Profit</b>			<b>\$54 520</b>

(e)

statement of financial position			
<i>Current Assets</i>			
Cash at bank		17 080	
Prepaid Insurance		8 800	
Inventory		22 760	
Accounts Receivable		84 800	133 440
<i>Non-Current Assets</i>			
Office equipment	56 000		
Less Accum Dep	11 200	44 800	
Shares		24 000	68 800
<b>TOTAL ASSETS</b>			<b>202 240</b>
<i>Current Liabilities</i>			
Accounts Payable	98 920		
Sales in Advance	40 000		
Accrued Wages	4 000	142 920	
<i>Non-current Liabilities</i>			
Loan		4 000	146 920
<b>NET ASSETS</b>			<b>\$55 320</b>
<b>EQUITY</b>			
Capital	124 400		
Add Net Profit	54 520	178 920	
Less Drawings		123 600	<b>\$55 320</b>

7. Under the accrual accounting principle, income and expenses must be recognised in the accounts in the correct accounting period, which is not necessarily when the transaction occurred.
8. The Statement of Financial Position is basically the same for the two types of business. The main difference is that, because a service business does not sell goods, there will be no Inventory in the Asset section.

## 10: RATIOS

1. Review of past performance, e.g. Were profit goals met?  
Planning for future financial goals, e.g. What changes are required so the business can reduce its gearing?  
Comparison with competitors, e.g. Has the industry average been bettered?
2. **Liquidity:** ability to pay short term debt.  
**Profitability:** return on investment.  
**High profit:** could be due to non-cash items such as credit sales.  
**Low liquidity:** if sales cannot be quickly converted to cash the business may not be able to meet short term cash requirements.
3. High gearing, especially in time of high interest rates, can place pressure on the business to find cash to repay regular interest commitments – thus affecting overall profit.
4. (a) **Gross profit ratio**

$$\frac{(123\,000 - 82\,000)}{123\,000} \times 100 = 33.3\%$$

$$\text{Profit ratio} = \frac{22\,000 \times 100}{123\,000} = 17.9\%$$

$$\text{Expense ratio} = \frac{19\,000}{123\,000} \times 100 = 15.4\%$$

Rate of return on assets

$$\begin{aligned} &= \left( \frac{22\,000 \times 100}{\frac{323\,200 - 313\,300}{2}} \right) \times 100 \\ &= \frac{22\,000}{318\,250} = 6.9\% \end{aligned}$$

Working capital

$$\begin{aligned} &= \frac{5\,000 + 22\,000 + 38\,000 + 3\,300}{8\,900 + 7\,000 + 76\,000} \times 100 \\ &= \frac{68\,300}{91\,900} = 74.3\% \end{aligned}$$

$$\begin{aligned} \text{Quick asset ratio} &= \frac{5\,000 + 22\,000}{8\,900 + 76\,000} \times 100 \\ &= \frac{27\,000}{84\,900} = 84\% \end{aligned}$$

Debt to equity

$$\begin{aligned} &= \frac{8\,900 + 7\,000 + 76\,000 + 129\,000}{(313\,300 - 220\,900)} \\ &= \frac{220\,900}{92\,400} \times 100 = 239\% \end{aligned}$$

(b) **Profitability**

- Has shown an improvement as the gross profit ratio has increased and the expense ratio decreased.
- Needs more investigation. Perhaps sales or sale price have increased, or cost of sales may have decreased.
- If expenses decreased, must find out which expenses were affected.
- Return on assets has remained the same, indicating assets are being used at the same level of efficiency.

**Liquidity**

- This has improved, moving closer to the desired ratio of at least 100%.
- It is still at a concerning level, especially the quick asset ratio, as the business would not be able to quickly pay short term debt.

**Gearing**

- Very high and increasing.
- More than \$2 liabilities for every \$1 of owners equity.
- If interest rates are high, this is very concerning.

- (c) Of the four possible expense ratios, Financial Expenses is currently the highest. If selling and meeting are combined, this would be the highest ratio, and by a large proportion. The business owner needs to be cautious in their interpretation of information, as the real effect of the combined Advertising Expenses is highest and they may miss this fact.

5. (a)

	2016	2017
Working capital	<u>323 600</u> 46 800	<u>301 700</u> 53 000
Quick asset	<u>50 600</u> 46 800	<u>56 100</u> 53 000
Gearing	<u>346 800</u> 180 800	<u>343 000</u> 252 700

(b)

**Liquidity**

- This has declined slightly, the working capital ratio is unusually high and not likely to be sustained.
- The business has large quantities of idle cash and stock which needs to be invested or on sold.
- A good improvement from the overdraft situation in 2015.

- (c) Not recommended to further increase external financing through a loan, especially if interest rates are high. Consider additional owner investment, use of idle cash, improving movement of stock or other asset use.

**Gearing**

- The businesses reliance on external financing has decreased, lessening the risk
- This ratio is still above the ideal of 100% so the business should consider decreasing liabilities.

## 11: The Accounting Profession

1.

(a) **Integrity**

- Requires honesty.
- Need to be fair and truthful.
- Should not omit or obscure information.
- Should not provide misleading financial reports.

(b) **Objectivity**

- Need to not compromise.
- No bias or undue influence from others should be given in to.
- Don't allow professional judgement to be incorrectly influenced.

2. **Professional competence**

- Kai needs to maintain professional knowledge and skill.
- This needs to be at the level required by his accounting clients.
- He must keep up to date with technical standards in his area.
- He has to undertake continual professional development to keep a competent level of awareness of changes and updates to accounting.



3.

(a) **Confidentiality**

- *Confidential details can only be revealed to others with a clients permission (unless legally required).*
- *The funds manager cannot allow someone to use this information to their advantage.*
- *The funds manager has a professional business relationship with the elderly couple.*

(b) **Professional behaviour**

- *Laws and regulations must be followed.*
  - *The stockbroker must not do anything that would discredit their professional association.*
  - *The stockbroker has to uphold the good reputation of the profession.*
4. *Members can give feedback into the development of regulations. Members are required to maintain their knowledge base, meet quality standards and follow Codes of Conduct.*
5. *To give advice on how to carry out their role in an ethical and fair manner.*



## TT 1: Financial Institutions and Systems

### Section 1

- |      |       |
|------|-------|
| 1. a | 2. b  |
| 3. d | 4. c  |
| 5. b | 6. b  |
| 7. b | 8. d  |
| 9. b | 10. b |

[10 marks]

### Section 2

1.

- (a) **Loans:** medium or long term and mortgage for purchase of major assets.  
**Hire purchase or lease:** for purchase of computers, vehicles and equipment.  
**Mortgage:** for purchase of office building.

[3 marks]

(b) **Partnership:**

2 – 20 owners  
Unlimited liability.  
Funds invested by partners.  
Profits shared by partners.  
Not a separate legal entity.

[3 marks]

**Small proprietary company:**

Less than 50 shareholders.  
Limited liability.  
Under \$12.5 million assets.  
Under 50 employees.  
Dividends paid to shareholders.  
Separate legal and accounting entity.

[3 marks]

2.

- (a) Accrual accounting requires recognition of the transaction in the period to which it relates. Income is recognised when the transaction occurs in February. The asset cash has increased the economic benefits of the business and so the money received should be recorded as income. Include as an asset in February, then recognise as income in March.

[2 marks]

- (b) This payment is an asset in the month of July because the business has a present economic resource – the right to use the phone – which it will not use to produce economic benefits – by using the phone – until the month of August.

[2 marks]

- (c) The electricity bill is an expense because it decreases the asset cash, which then results in a lower profit thus decreasing equity.

[2 marks]

3.

- (a) Taxable supplies are sales of meals for payment.  
GST free supplies are the fresh fruit which is a GST free item.

[2 marks]

(b) Report GST sales (meals).

Pay for GST sales.

Claim GST credit for the GST inclusive purchases made for the business.

[2 marks]

(c) *Businesses with annual turnover above \$75 000.  
Not for profits with turnover above \$150 000.* [2 marks]

(d) *Most likely reporting period for this business.  
The tax period is the period of time for which a Business Activity Statement is completed.  
Quarterly completion is most likely.  
Small business with low annual turnover.* [2 marks]

4.

(a) *The computer is:*

- a present economic resource – it has the potential to produce economic benefits by being used in the business*
- controlled by the entity – is located in the business office*
- there is a right to use the asset – an event such as the computer being purchased or leased*

[3 marks]

(b) *Yes it can be recognised. This would provide information in the financial statements that is:*

- relevant to the asset and income produced*
- a faithful representation.*

[3 marks]

5.

(a) *Materiality – omission of creditors.  
Accounting entity – repayment of drawings.  
Monetary – recording in Australian dollars.* [3 marks]

(b) *Correct report:*

<b>Assets</b>	\$
Bank	3 500
Debtors	500
Computer	450
Office equipment	15 000
<b>TOTAL ASSETS</b>	<b>\$19 450</b>

<b>Liabilities</b>	
Loan	8 500
Creditors	3 000

<b>Equity</b>	
Capital	8 350
Less: Drawings	(400)
<b>TOTAL EQUITIES</b>	<b>\$19 450</b>

[8 marks]

### Section 3

1. *Accounting period: regular preparation of reports  
Historical cost: non-current assets are depreciated annually  
Accounting entity: moped not owned by business  
Accrual basis: reporting and recording of business transactions.* [8 marks]

2. *Cash and accrual accounting:  
Cash: transactions are recorded in the business records on the day cash is received or paid  
Accrual: transactions are recorded in the period to which they relate and recognised on the date the goods are received or the service is performed.* [4 marks]

3. *An intangible asset*  
*Controlled by Pablo who owns the business*  
*A past transaction to purchase has occurred*  
*Future economic benefits will flow in the form of cash paid by customers who are loyal to the business.*

[8 marks]

4. **Advantages:**  
*More capital from more investors.*  
*Paz will have different specialist skills.*  
*Company formation more expensive.*  
*They can share the workload and take holidays.*

[6 marks]

**Disadvantages:**

*Unlimited liability.*  
*Their business decisions are binding on each other, if Pablo disagrees with Paz they must discuss this beforehand.*

*Profits are shared, Pablo does not receive all profits himself.*

*Possible differences and disagreements.*

[6 marks]

**Recommendation:**

*As Pablo is expanding the business, sharing the workload is wise.*

*A partnership is easier and cheaper than a company.*

*Alternatively remaining a sole trader and employing staff is possible.*

*Involving family members is probably useful as he would already be aware of potential conflicts and differences in opinion.*

[8 marks]

## TT 2: Recording Using and Evaluating Financial Information

### Section 1

- |             |              |
|-------------|--------------|
| 1. <i>b</i> | 2. <i>d</i>  |
| 3. <i>a</i> | 4. <i>c</i>  |
| 5. <i>d</i> | 6. <i>b</i>  |
| 7. <i>b</i> | 8. <i>d</i>  |
| 9. <i>c</i> | 10. <i>d</i> |

[10 marks]

### Section 2

1. (a)

#### Shine & Polish General Journal

DATE	DETAILS	DR	CR
2 Feb	Cash at Bank	99	
	Fees		90
	GST Collected		9
	<b>Fees collected</b>		
2	Cash at bank	110	
	Debtor		110
	<b>Receipt of account payment</b>		
2	Subscription	500	
	GST Credits	50	
	Cash at bank		550
	<b>Payment of subscription</b>		
2	Bad debts	50	
	GST Collected	5	
	Debtor		55
	<b>Write off bad debt</b>		
2	Cleaning supplies	960	
	GST Credits	96	
	Creditor: Cleaning Supplies Inc		1056
	<b>Purchase of supplies</b>		

[10 marks]

(b)

**GST Credits Received**

Feb 2	Cash at bank	50	
	Clearing Supplies Inc.	96	

**GST Collected**

Feb 2	Debtor	5	Feb 2	Cash at bank	9
-------	--------	---	-------	--------------	---

[4 marks]

2. (a)

<b>Green Makeovers</b>			
<b>Income Statement for the period ending 30 June 2026</b>			
<b>INCOME</b>	\$	\$	\$
Fees			82 000
<b>LESS: EXPENSES</b>			
<b>OFFICE/ADMINISTRATIVE</b>			
Advertising	3 000		
Office salaries	13 000		
Interest	200		
Telephone	2 700		
Electricity	3 500	22 400	
<b>GARDENING</b>			
Petrol	4 000		
Gardener salaries	18 000	22 000	
Total expenses			44 400
<b>PROFIT</b>			<b>37 600</b>

[8 marks]

(b)

<b>Statement of Financial Position</b>		
<b>as at 30 June 2026</b>		\$
<b>CURRENT ASSETS</b>		
Cash at bank	3 400	
Debtor – X Pine	400	
<b>NON-CURRENT ASSETS</b>		
Gardening equipment	7 000	
Vehicle	19 000	
Trailer	4 000	
<b>TOTAL ASSETS</b>	<b>33 800</b>	
<b>CURRENT LIABILITIES</b>		
Creditors – P Rose	3 000	
<b>NON-CURRENT LIABILITIES</b>		
Loan	20 700	
<b>TOTAL LIABILITIES</b>	<b>23 700</b>	
<b>NET ASSETS</b>	<b>10 100</b>	
<b>EQUITY</b>		
Capital	7 500	
Add: Profit	37 600	
Less: Drawings	(35 000)	
	<b>10 100</b>	

[10 marks]

3. (a)

**Rigg's Hardware General Journal**

TRANSACTION	DETAILS	DR	CR
1	Cash at bank Fittings Loan Capital <b>Opening entry to commence business</b>	100 000 55 000	55 000 100 000
2	Inventory control GST credits received Easy equipment <b>Purchase of stock</b>	60 000 6 000	66 000
3	Base Camping inc Sales GST collected <b>Sale of stock</b>	25 300	23 000 2 300
	Cost of sales Inventory control <b>Cost of sales</b>	12 650	12 650
4	Cash at bank Sales GST collected <b>Sale of stock for cash</b>	15 400	14 000 1 400
	Cost of sales Inventory control <b>Cost of sales</b>	7 700	7 700
5	Easy equipment Cash at bank Discount received GST credits received <b>Payment of half account owing</b>	33 000	29 700 3 000 300

[9 marks]

(b)

**Inventory Control**

2	Easy Equipment	60 000	3	Cost of sales	12 650
			4	Cost of sales	7 700
				Balance c/d	39 650
		<u>60 000</u>			<u>60 000</u>
	Balance b/d	39 650			

**Cost of Sales**

3	Inventory	12 650			
4	Inventory	<u>7 700</u>		Profit and loss	<u>20 350</u>

### Easy Equipment – Creditor

5	Cash at bank/ Discount/ GST	33 000		2	Inventory/GST	66 000
	Balance c/d	33 000				66 000
		66 000			Balance b/d	33 000

### Sales

				3	Base camping	23 000
	Profit and loss	37 000		4	Cash at bank	14 000
		37 000				14 000

[9 marks]

(c)

### Trial Balance

	DR \$	CR \$
Fittings	55 000	
Loan		55 000
Capital		100 000
Inventory	39 650	
Easy equipment		33 000
Base camping	25 300	
Sales		37 000
Cost of sales	20 350	
Discount received		3 000
GST credits received	5 700	
GST collected		3 700
Cash at bank	85 700	
	\$231 700	\$231 700

[10 marks]

## Section 3

(a)

### Gastronome Deli General Journal

DATE	DETAILS	DR	CR
23 June	Drawings	755	
	Cash at bank		700
	Stock – Vegetables		55
	<b>S Gastronome drawings</b>		

DATE	DETAILS	DR	CR
24 June	Telephone GST credits received Cash at bank <b>Telephone bill paid</b>	400 40	440
DATE	DETAILS	DR	CR
25 June	Shop equipment GST credits received Andy's signs <b>Purchase of sign</b>	3 000 300	3 300
DATE	DETAILS	DR	CR
26 June	Stock – Packaged items GST credits received Foodie wholesalers <b>Purchase of stock</b>	4 000 400	4 400
DATE	DETAILS	DR	CR
27 June	Shop equipment Supplies expense <b>Correction of error</b>	500	500
DATE	DETAILS	DR	CR
29 June	Cash at bank Sales <b>Sale of stock</b>	4 800	4 800
	Cost of sales Stock – Vegetables <b>Cost of vegetables sold</b>	1 200	1 200
DATE	DETAILS	DR	CR
30 June	Cash at bank Sales GST collected <b>Sale of stock</b>	2 915	2 650 265
	Cost of sales Stock – Packaged items <b>Cost of packaged items sold</b>	1 590	1 590

[16 marks]

(b)

#### Cash at Bank

June 23	Balance	5 000	June 23	Drawings	700
29	Sales	4 800	24	Telephone/GST	440
30	Sales/GST	2 915	30	Balance c/d	11 575
		<u>12 715</u>			<u>12 715</u>
	Balance b/d	11 575			



Shop Equipment					
June 23	Balance	7 800	June		
25	Andy's signs	3 000			
27	Supplies	500	30	Balance c/d	11 300
		<u>11 300</u>			<u>11 300</u>
	Balance b/d	11 300			

Telephone					
June 23	Balance	460			
24	Cash at bank	<u>400</u>	June 30	Profit and loss	<u>860</u>

[6 marks]

(c) Working out:  $A = L + Eq$

$$Eq = 5000 + 460 + 780 + 450 + 500 + 1000 = \$16\,160$$

**Gastronome Deli  
Trial Balance  
as at 30 June 2028**

	DR \$	CR \$
Capital		16 160
Cash at bank	11 575	
Telephone	860	
Shop equipment	11 300	
Stock – Vegetables	145	
Stock – Packaged	2 910	
Supplies asset	500	
Andy's signs		3 300
Foodies Wholesalers		4 400
Cost of sales	2 790	
Sales		7 450
GST credits	740	
GST collected		265
Drawings	755	
	<u>\$31 575</u>	<u>\$31 575</u>

[6 marks]

(d)

**Gastronome Deli  
Income Statement  
for the period ended 30 June 2028**

<b>INCOME</b>	<b>\$</b>	<b>\$</b>
Sales	7 450	
Less Cost of sales	(2 790)	
<b>Gross profit</b>	4 660	
Less Telephone expenses	(860)	
<b>PROFIT</b>	<u>\$3 800</u>	

[6 marks]

**Gastronome Deli  
Statement of Financial Position  
as at 30 June 2028**

	<b>\$</b>	<b>\$</b>
<b>ASSETS</b>		
Cash at bank	11 575	
Shop equipment	11 300	
Stock – Vegetables	145	
Stock – Packaged	2 910	
Supplies	500	
GST balance	<u>475</u>	26 905
<b>LIABILITIES</b>		
Andy's Signs	3 300	
Foodie Wholesalers	<u>4 400</u>	<u>7 700</u>
<b>NET ASSETS</b>		<u>19 205</u>
<b>EQUITY</b>		
Capital	16 160	
Add: Profit	3 800	
Less: Drawings	<u>(755)</u>	
<b>TOTAL EQUITY</b>		<u>19 205</u>

[6 marks]

## TT 3: Internal Control and Government and the Community

### Section 1

- |             |              |
|-------------|--------------|
| 1. <i>b</i> | 2. <i>c</i>  |
| 3. <i>d</i> | 4. <i>b</i>  |
| 5. <i>c</i> | 6. <i>c</i>  |
| 7. <i>c</i> | 8. <i>b</i>  |
| 9. <i>c</i> | 10. <i>d</i> |

[10 marks]

### Section 2

1. *Record all cash receipts, bank cash frequently, count in a safe location, secure storage such as a safe, limited access by personnel, separate the roles of recording of cash received from the handling of cash.*

[3 marks]

2.

- (a) *A workplace that is socially and ethically responsible would focus on making the right economic, social and environmental decisions. They would believe that the business has a responsibility to the public by conducting their business in an ethical manner, respecting the environment through the manner in which they go about their daily business and being loyal to its employees.*

[4 marks]

- (b) a. *Start recycling.*

b. *Listen to what employees have to say.*

c. *Stop any unethical business practises they may be using.*

d. *Work on promoting a positive business image to the community by letting the community know about the changes in the business and maybe by sponsoring some community events.*

[4 marks]

3. *It may result in increased customer loyalty.*

*It may result in new customers.*

[2 marks]

4.

- (a) *Resource Conservation is when a business looks at and implements ways that they can manufacture their product or operate their business using the least amount of resources possible.*

[2 marks]

(b)

- i. *Minimise the product packaging, to begin with he could stop using the cardboard box and the plastic seal.*

ii. *Make the container the ice-cream comes in recyclable.*

iii. *Work on promoting a positive public image by letting the press know about the positive changes they have made.*

[3 marks]

### Section 3

1.

- (a) *If Dotty Dawkins used her own name for the business then she would not need to register the business name however as she is calling the business Quick Sticks she will need to register this name.*

[2 marks]

- (b) *The Goods and Services Tax (GST) is a broad based tax of 10%, which is charged on most goods and services. Dotty only has to register for GST if her business has an annual turnover over \$75 000. If the business earns less than this amount then she has a choice whether or not she will register for the GST.*

[2 marks]

(c) Yes Dotty will need to contact her local council as every council has different requirements that she will need to adhere to. She will need to contact her council to find out what the business restrictions and regulations are for things such as:

- Access.
- Alterations or extension guidelines.
- Approved business use.
- Building permits.
- Health regulations.
- Landscaping.
- Licenses or permits required.
- Noise restrictions.
- Parking requirements.
- Signs.

[2 marks]

(d) Dotty does not have to register for an ABN. However if Dotty does not register for an ABN then other entities might withhold tax from payments to her 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 return. This tax will not be withheld if an ABN is available.

[1 mark]

(e) Dotty will need to ensure that she follows the Business Premises Regulations set out by the Department of Commerce. She will also need to pay the required amount of tax to the ATO. If Dotty employs staff she needs to adhere to the following legal requirements:

- Register as a PAYG withholding payer with the ATO.
- Make a minimum 9.5% contribution to all employees' superannuation fund.
- Have workers' compensation insurance.
- Make sure the employees have a safe working environment as set out by WorkSafe.

[5 marks]

## TT 4: Financial Institutions and Systems

### Section 1

- |      |       |
|------|-------|
| 1. c | 2. c  |
| 3. b | 4. a  |
| 5. b | 6. b  |
| 7. c | 8. c  |
| 9. a | 10. c |

[10 marks]

### Section 2

1.

(a) **Benefits:** Efficient as funds are cleared straight away and some customers may not have cash on them but will have their EFTPOS card. Secure as it lowers the risk of theft as there is less cash on the premises. Reconciliation problems are reduced.

**Risks:** The system is electronic so can be subject to outages. Also there is a risk of fraud with the potential for a customer to use a stolen debit or credit card.

[5 marks]

(b) Electronic banking is when someone uses the internet to do their banking. They log onto their bank's website and use a password to access their account.

**Advantages include:** Automatic clearance of funds. Electronic proof that the bill has been paid. Convenient as can be used anytime. Can be used internationally.

**Disadvantages include:** The system is electronic so can be subject to outages. Risk of fraud if someone else uses your log on details and password. Yes Electronic Banking would suit Bronwyn as it is convenient.

[4 marks]

(c) The accrual system of accounting follows the income recognition assumption. Under the accrual basis of accounting, the transactions are recognised and recorded on the day they occur and not when the cash is paid or received. **Example:** If Joe Brown gave a concert on the 29<sup>th</sup> of June and was only paid for his services on the 28<sup>th</sup> of July, his accounting records would record the income amount owing on the day the service was performed.

### **Cash Basis of Accounting**

Under the cash basis of accounting, income is not recognised in the financial records until it is actually received in cash. **Example:** If Dr. Smith sees a patient on the 10<sup>th</sup> of 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 the 20<sup>th</sup> of 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. The same happens with expenses. They are not recognised until they have been paid for in cash.

[4 marks]

2.

(a) **Accounts payable meet the criteria for a liability:**

- the entity has an obligation to another business
- the obligation is to transfer the economic resource cash
- the obligation is a present obligation that exists as a result of past events, probably a purchase

[2 marks]

(b) Yes, there would either be initial recognition of a liability if the advertising was not paid but owing because an accrued expense for advertising payable is recognised, or there would be derecognition of the asset cash due to the payment of advertising.

[3 marks]

(c) Yes, there is initial recognition of an asset. Either cash is recognised for a cash sale, or accounts receivable is recognised for credit sales.

[3 marks]

3.

(a) Depreciation of non-current assets occurs due to the matching principle. This principle requires the matching of all income in an accounting period against all the associated expenses. For example, if a delivery truck has been used to earn income for a courier business, then the decline in value of the truck needs to be offset against the income that has been earned.

[2 marks]

(b)

1. Wear and tear – most non-current assets decline in value due to wear and tear. Ongoing maintenance and repairs to these non-current assets can help to extend the useful life of the asset however at some stage the asset will come to the end of its useful life.
2. 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 for which the asset is used. For example the DVD is largely replacing the video cassette. Eventually it is predicted that there will not be a demand for the video cassette. When this happens the video cassette and the equipment used to produce them will be commercially obsolete.

[4 marks]

(c) The cost of the asset consists of all the costs which need to be paid to purchase the non-current asset and to make it ready for its intended use. For example, the purchase price, any freight costs, and any transit insurance costs, which had to be paid by the purchaser. It also includes any expenditure, which needed to be paid for any assembling, installing or testing of the asset. Any additions, which increase the value of the asset such as air-conditioning, can also be included.

[2 marks]

(d) Three factors which are considered when calculating depreciation are:

1. The cost – consists of all the costs which need to be paid to purchase the non-current asset and to make it ready for its intended use.
2. The estimated useful life – is an estimate of how long the business expects the asset to be productive. Management bases the estimate on what the asset is to be used for, the need for repair, the service life and the likelihood of the asset becoming obsolete.
3. The residual value – is how much the business expects the asset to be worth at the end of its productive life. For example, an entity may estimate the useful life of a motor-vehicle to be five years. At the end of this time period they will replace the asset. The business may then sell the motor vehicle. The business has to estimate at the beginning of the assets' useful life what the asset will be worth at the end of its useful life.

[6 marks]

### Section 3

1.

(a) The depreciation expense for the printer is charged at \$300 per annum.

$$\begin{aligned}\text{Depreciation of printer} &= \frac{2\,000 - 200}{6} \\ &= \$300 \text{ per annum.}\end{aligned}$$

[2 marks]

(b)

DATE	DETAILS	DR	CR
2020 Jan 1	Computer Cash at bank <b>Purchased computer for cash</b>	5 000	5 000

[2 marks]

$$\begin{aligned}\text{(c) Year One Depreciation} &= \$5\,000 \times 20/100 \\ &= \$1\,000 \times 6/12 \\ &= \$500 \\ \text{Year Two Depreciation} &= \$4\,500 \times 20/100 \\ &= \$900\end{aligned}$$

#### Depreciation

2020 30 June	Accumulated Depreciation	500	30 June	Profit and Loss	500
2021 30 June	Accumulated Depreciation	900			

#### Accumulated Depreciation Account

2020 30 June	Depreciation	500
2021 30 June	Depreciation	900

[5 marks]

2.

$$\begin{aligned}\text{(a) Gain or loss on disposal} &= 38\,000 - (100\,000 - 60\,000) \\ &= 38\,000 - 40\,000 \\ &= (2\,000) \text{ LOSS}\end{aligned}$$

**General Journal (extract)**

DATE	DETAILS	DR	CR
1 June	Sale of asset Printing Press <i>Transfer of cost of printing press sold</i>	100 000	100 000
1 June	Accum Dep of Printing Press Sale of asset <i>Transfer of Accumulated depreciation of asset sold</i>	60 000	60 000
1 June	Cash at bank Sale of asset <i>Proceeds from sale of asset</i>	38 000	38 000
1 June	Loss on disposal Sale of asset <i>Loss on disposal of asset</i>	2 000	2 000

**General Ledger (Extract)**

**Printing Press**

1 Jun	Balance	100 000	1 Jun	Sale of asset	100 000
-------	---------	---------	-------	---------------	---------

**Accumulated Depreciation of Printing Press**

1 Jun	Sale of asset	60 000	1 Jun	Balance	60 000
-------	---------------	--------	-------	---------	--------

**Cash at Bank**

1 Jun	Sale of asset	38 000			
-------	---------------	--------	--	--	--

**Sale of Asset**

1 Jun	Printing Press	100 000	1 Jun	Accum. Dep. of PP	60 000
				Cash at bank	38 000
				Loss on disposal	2 000

**Loss on Disposal**

1 Jun	Sale of asset	2 000			
-------	---------------	-------	--	--	--

[20 marks]

(b) The fact that a loss was made showed that the asset had been under depreciated by \$2000.

[1 mark]

## TT 5: Recording, Using and Evaluation Financial Information

### Section 1

1. *a*
2. *c*
3. *c*
4. *c*
5. *c*
6. *d*
7. *d*
8. *a*
9. *a*
10. *b*

[10 marks]

### Section 2

1.
  - (a) *Income which has been received but not yet earned, treated as a liability. Eg. sales in advance.*
  - (b) *A payment which has not yet been made by the business but is owed, treated as a liability. Eg. telephone bill.*
  - (c) *A prepayment of an expense paid in advance, treated as an asset. Eg. insurance.*
  - (d) *Income which has been earned but not yet received by the business, treated as an asset. Eg. interest.*

[8 marks]

2.
  - (a)

DATE	DETAILS	DR	CR
2018 Mar 31	Prepaid insurance Cash at bank <b>Paid for 12 months insurance</b>	2 400	2 400

[2 marks]

- (b)

DATE	DETAILS	DR	CR
June 30	Telephone expense Accrued expenses <b>Adjusting entry to recognise telephone expense owing on balance day</b>	75	75

[2 marks]

- (c)

DATE	DETAILS	DR	CR
June 30	Inventory Adjustment Inventory <b>Adjusting entry to record inventory loss</b>	1 250	1 250

[2 marks]

3.
  - (a) *The income may never be received if the account turns into a bad debt. On the other hand an allowance for doubtful debts has been made which should take into account this scenario. Due to the matching principle income should be shown in the accounting period it is earned not when payment is received so disagree with the statement.*

[4 marks]

- (b) *Due to the matching principle and accrual accounting, expenses must be recorded in the accounting period they occurred. If expenses are unpaid at the end of the accounting period then an adjusting entry must be made to account for this expense.*

[2 marks]



## Section 3

1.  
(a)

### The Toy Box General Journal (extract)

DATE	DETAILS	DR	CR
	Wages Accrued Wages <b>Adjusting entry to recognise wages owing on balance day</b>	2 000	2 000
	Insurance expense Prepaid insurance <b>Adjusting entry to recognise insurance consumed</b>	1 100	1 100
	Advertising expense Prepaid advertising <b>Adjusting entry to recognise advertising consumed</b>	1 422	1 422
	Depreciation Accumulated Depreciation <b>Depreciation of Office Equipment</b>	1 400	1 400
	Inventory adjustment Inventory <b>Inventory loss shown by stocktake</b>	75	75

[12 marks]

(b)

### The Toy Box Adjusted Trial Balance as at 30 June 2019

	DR \$	CR \$
Capital – J. Rogers		10 755
Cost of sales	199 025	
Accounts receivable	4 350	
Prepaid advertising	1 423	
Advertising expense	1 422	
Electricity	3 220	
Discount received		400
Cash at bank	17 585	
Depreciation	1 400	
Accumulated Depreciation		1 400
Wages	32 400	
Accrued wages		2 000
Prepaid insurance	100	
Insurance expense	1 100	
Sales		249 000
Contingency fund	500	
Office equipment	7 000	
Rates	2 000	
Accounts payable		12 365
Loan payable in 2021		5 250
Inventory	6 820	
Inventory adjustment	75	
Discount allowed	1 250	
Interest	1 500	
	<b>281 170</b>	<b>281 170</b>

[6 marks]

(c)

DATE	DETAILS	DR	CR
2019	Profit & Loss Summary	243 392	
30 June	Cost of sales		199 025
	Advertising		1 422
	Electricity		3 220
	Depreciation		1 400
	Wages		32 400
	Insurance		1 100
	Rates		2 000
	Inventory Adjustment		75
	Discount Allowed		1 250
	Interest		1 500
	<b>Closing of expenses to Profit/Loss</b>		
	Sales	249 000	
	Discount received	400	
	Profit & Loss Summary		249 400
	<b>Closing of income accounts to Profit/Loss</b>		
	Profit & Loss Summary	6 008	
	Capital		6 008
	<b>Transfer of profit to capital</b>		

[14 marks]

(d)

The Toy Box Income Statement for the period ended 30 June 2019			
INCOME	\$	\$	
Sales	249 000		
Less: Discount allowed	( 1 250)		
Total sales		247 750	
Less: Cost of sales	199 025		
Discount received	( 400)		
Total cost of sales		198 625	
<b>GROSS PROFIT</b>			49 125
<b>Less Expenses</b>			
<i>General Shop Expenses</i>			
Advertising		1 422	
Electricity		3 220	
Depreciation		1 400	
Wages		32 400	
Insurance		1 100	
Rates		2 000	
Inventory adjustment		75	
<i>Financial Expenses</i>			
Interest		1 500	43 117
<b>PROFIT</b>			<b>6 008</b>

[14 marks]

(e)

**The Toy Box**  
**Statement of Financial Position**  
**as at 30 June 2019**

	\$	\$	\$
<b>CURRENT ASSETS</b>			
Cash at bank	17 585		
Prepaid insurance	100		
Prepaid advertising	1 423		
Accounts receivable	4 350		
Contingency fund	500		
Inventory	<u>6 820</u>	30 778	
<b>NON-CURRENT ASSETS</b>			
Office Equipment	7 000		
Less Accumulated Depreciation	<u>1 400</u>	<u>5 600</u>	
<b>TOTAL ASSETS</b>			<b>36 378</b>
<b>Current Liabilities</b>			
Accrued wages	2 000		
Accounts payable	<u>12 365</u>	14 365	
<b>Non-current Liabilities</b>			
Loan		<u>5 250</u>	<u>19 615</u>
<b>NET ASSETS</b>			<b>16 763</b>
<b>EQUITY</b>			
Capital		10 755	
Add Profit		<u>6 008</u>	<u>16 763</u>

[14 marks]

## TT 6: Financial Information/Government and Community

### Section 1

- |             |              |
|-------------|--------------|
| 1. <i>b</i> | 2. <i>d</i>  |
| 3. <i>c</i> | 4. <i>b</i>  |
| 5. <i>c</i> | 6. <i>a</i>  |
| 7. <i>d</i> | 8. <i>d</i>  |
| 9. <i>a</i> | 10. <i>b</i> |

[10 marks]

### Section 2

1.
  - (a) *For planning*  
*To review results*  
*For comparisons*
  - (b) *Previous year results*  
*Budgets*  
*Industry averages*  
*Similar businesses*

[2 marks]

[2 marks]

(c) *Liquidity – a businesses ability to repay short term debts as they fall due, e.g. working capital ratio.*

*Gearing – comparison of internal debt or equity with external debt or liabilities, e.g. debt to equity ratio. Also called 'leverage'.*

[3 marks]

2. *Details of individual transactions not known*

*Non-financial issues are not considered*

*Only shows one point in time*

*Difficult to get comparative information outside business*

[3 marks]

3.

(a) *General expenses ratio:*

$$= \frac{34\,100}{254\,800} \times 100$$

$$= 13.4\%$$

*Profit ratio:*

$$= \frac{(1\,800)}{254\,800} \times 100$$

$$= -0.7\%$$

*Gross profit ratio:*

$$= \frac{111\,800}{254\,800} \times 100$$

$$= 43.9\%$$

*Return on assets:*

$$= \left( \frac{\frac{(1\,800)}{2} + \frac{2\,000\,500 + 1\,673\,100}{2}}{1\,836\,800} \right) \times 100$$

$$= \frac{(1800)}{1\,836\,800}$$

$$= -0.1\%$$

*Working capital ratio:*

$$= \frac{32\,000 + 67\,000 + 89\,700 + 67\,000}{7\,800 + 17\,900 + 78\,000 + 67\,000} \times 100$$

$$= \frac{255\,700}{170\,700}$$

$$= 141\%$$

*Quick asset ratio:*

$$= \frac{32\,000 + 67\,000}{7\,800 + 78\,000 + 67\,000} \times 100$$

$$= \frac{99\,000}{152\,800}$$

$$= 65\%$$

*Debt to equity:*

$$= \frac{1\,070\,700}{602\,400} \times 100$$

$$= 178\%$$

[21 marks]

(b)

i. Profitability

*Expenses ratio has increased, showing that costs have gone up relative to sales. Need to investigate individual expenses accounts.*

*Both profit ratios have declined of most concern is the negative results.*

*This may be due to the increased expenses or lower sales prices, lower mark-up or perhaps decreased stock levels.*

*Return on assets very concerning, a negative result, the business is not earning a good return on their investment in buildings and vehicles.*

[8 marks]

ii. Changes

*The business must decrease expenses, by investigating which areas have changed the most over the last year and why.*

*The business must use assets such as computers and vehicles more efficiently and set up clear instructions for employees.*

*Sale of stock, use of discounts, mark-up and slow moving items must all be improved.*

[4 marks]

iii. Liquidity

*Ideally a working capital ratio of 2.00: 1.00 or 200%.*

*Ensures \$2 of current assets are available for each \$1 of current liabilities.*

*The business has an increasing working capital and quick asset ratio.*

*Need to ensure accounts receivable pay more promptly by offering discounts and only extending credit to good customers.*

*Ensure idle cash is invested (cash management account quite high – is the best return being earned?).*

*Overdraft very high, the business needs to reconsider how it obtains short term funds.*

[3 marks]

4.

(a) Ethical problems:

- *This is poor professional behaviour. It is an exaggerated claim and unsubstantiated. It may bring the financial services association into disrepute.*
- *The advertisement raises questions about integrity. It is probably not honest or truthful and can be misinterpreted.*

[2 marks]

(b) Professional association role:

- *Providing education for members.*
- *Developing workshops.*
- *Quality assurance.*

[2 marks]

### Section 3

(a) Profitability

- *Improving and close to industry.*
- *May be due to lower expenses.*
- *Stock sales might have increased if higher profit stock is being sold.*
- *The business is achieving a good return from their investment in assets.*

Liquidity

- *Remaining constant, much better than industry.*
- *The business has \$2 of current assets for every \$1 of current liabilities.*
- *Able to meet short term debt requirements.*

Leverage

- *This is declining, though still a long way from industry.*
- *At a concerning level, very reliant on liabilities.*

[9 marks]

(b) Specific details of accounts, e.g. which expenses are affecting profitability? Which assets improved? Information on prices, e.g. did the mark-up change?

[3 marks]

(c) Gearing (or leverage) relatively high, she needs to be cautious about increasing loans, especially if interest rates are high. She should consider either investing more capital or explore the possibility of hire purchase/ leasing.

[8 marks]





# Titles available from Academic Group



## STUDY GUIDES - YEAR 11 & 12

- Accounting & Finance
- Biology
- Business Management & Enterprise
- Chemistry
- Drama (Year 12 Only)
- Economics
- Human Biology
- Mathematics Applications
- Mathematics Methods
- Mathematics Specialist
- Physics
- Psychology



## REVISION SERIES - YEAR 11 & 12

- Chemistry
- Human Biology
- Mathematics Application
- Mathematics Methods
- Mathematics Specialist
- Physics



## TEXT BOOKS - YEAR 11 & 12

- Mathematics Methods
- Mathematics Specialist



## EXAM QUESTIONS - YEAR 12

- Accounting & Finance
- Biology
- Business Management & Enterprise
- Chemistry
- Economics
- Geography
- Human Biology
- Mathematics Applications
- Mathematics Methods
- Mathematics Specialist
- Physical Education Studies
- Physics
- Politics and Law
- Psychology



Order online at [www.academicgroup.com.au](http://www.academicgroup.com.au)



# Achieve great ATAR results!

Found this study guide helpful? Academic Group offers a range of ATAR programs to help you achieve your academic goals.

## About our ATAR Help Programs

### Term Programs



#### Tuition Classes

Small group tutoring classes available throughout the year to provide on-going help as you need it. For years 7 - 12.



#### Master Classes

Weekly teaching classes by top ATAR teachers who will extend you and teach you how to gain maximum marks.



#### Exam Boost Workshops

Exam Boost Workshops provide targeted exam preparation answering practice exam questions. You will receive feedback from an exam marker and tips and strategies to improve your exam performance.

### Holiday Programs



#### Head Start Program

Held in the January School Holidays. You will gain an overview of the syllabus for your ATAR courses, preview important concepts and get an academic boost for the year ahead.



#### ATAR Holiday Revision Program

Specially designed programs to help revise ATAR course content and teach you how to maximise your results. Held in the April, July and October school holidays.

**Enrol in programs at [www.academicgroup.com.au](http://www.academicgroup.com.au)**

### Get in touch with us.



(08) 9314 9500



[learn@academicgroup.com.au](mailto:learn@academicgroup.com.au)



872 Canning Highway Applecross



# ACCOUNTING & FINANCE

## YEAR 11 ATAR COURSE

### THIRD EDITION

This Study Guide covers the current ATAR syllabus and is a valuable resource for students preparing for their ATAR examinations.

#### Key Features:

- Track progress against the ATAR syllabus checklist
- Improve learning with clearly explained and illustrated core theory
- Enhance your understanding by completing the wide range of practice questions with detailed answers
- Make yourself exam ready with trial tests and marking key

*Make success a reality with this essential student guide for test and exam preparation.*

## ACADEMIC ASSOCIATES STUDY GUIDES - YEAR 11 ATAR COURSE

