

Exercise 1.1 Accounting Assumptions

a

Accounting Assumption	Accounting Entity
Explanation	<i>The business is assumed to be an entity separate from the owner and other businesses, and its records should be kept on this basis. The orthodontist fees are a personal expense of the owner, not the business, and therefore do not reduce the firm's Owner's Equity.</i>

b

Accounting Assumption	Going Concern
Explanation	<i>Financial reports are prepared on the assumption that the business will continue to operate indefinitely. The credit purchase of inventory will lead to the recognition of an Accounts Payable, which can then be recorded as a Current Liability as the amount will be paid by the business in the future.</i>

c

Accounting Assumption	Period
Explanation	<i>The life of the business is divided into arbitrary periods to allow for reports to be prepared.</i>
	<i>According to tax requirements, reports must be prepared at least yearly.</i>

d

Accounting Assumption	Accrual
Explanation	<i>In order to calculate an accurate net profit, revenues should be recognised when they are earned, and expenses when they are incurred. The revenue should be recorded when the sale occurred, and the goods were transferred,</i>
	<i>not when the cash was received.</i>

e

Accounting Assumption
Explanation

f

Accounting Assumption	<i>Accounting Entity</i>
Explanation	<i>The business is assumed to be an entity separate from the owner and other businesses, and its records should be kept on this basis.</i>
	<i>Casee has used her personal funds for a business expense, so this represents a transaction between two separate entities.</i>

g

Accounting Assumption	<i>Accrual</i>
Explanation	<i>In order to calculate an accurate net profit, revenues should be recognised when they are earned, and expenses when they are incurred. The revenue should be recorded when the goods are transferred to the customer, not on the receipt of the deposit, which rather, is recorded as a Current Liability.</i>

Exercise 1.2 Qualitative Characteristics

a

Qualitative Characteristic	Relevance
Explanation	<i>Any transaction that is capable of affecting decision making must be recorded. The withdrawal of business cash to fund a personal expense is relevant to the entity and should be recorded as Drawings to ensure that the Owner's Equity of the business is not overstated.</i>

b

Qualitative Characteristic	Verifiability
Explanation	<i>The premises should be valued at its original purchase price as this value is verifiable by a source document. By recording the premises at this value, the financial information will allow different knowledgeable and independent observers to be assured that it is faithfully represented.</i>

c

Qualitative Characteristic	Comparability
Explanation	<i>If a business uses consistent reporting periods, this allows for the direct comparison of financial information from one period to the next. This comparison will then inform decision making by interested users of the financial reports.</i>

d

Qualitative Characteristic	Verifiability OR Faithful Representation
Explanation	<i>All expenses should be recorded at values that are verifiable by a source document. By recording the electricity at an estimated and biased value, the financial information will not allow different knowledgeable and independent observers to be assured that it is faithfully represented.</i>

e

Qualitative Characteristic	Timeliness
Explanation	<i>Financial information should be available to decision makers in time to be capable of influencing their decisions. Given that inventory losses indicate concerns over inventory/stock management, knowing of their occurrence in a timely manner will allow for more urgent investigation and corrective action.</i>

f

Qualitative Characteristic	Understandability
Explanation	<i>Financial information should be presented in a manner that makes it readily understandable by users who have a reasonable knowledge of business and economic activities. The accountant should be mindful to refrain from using overly technical language.</i>

g

Qualitative Characteristic	Faithful Representation
Explanation	<i>The selling price is an estimate of what the inventory may be sold for, and there is no guarantee that this will eventuate. Recording the inventory at its selling price would therefore overstate the value of the asset, making the financial information not free from bias or material error.</i>

h

Qualitative Characteristic	Relevance OR Faithful Representation
Explanation	<i>The revenue should be recorded when the sale occurred in 2024, not when the cash will be received in 2025. By including the revenue in the relevant period, accurate decisions and predictions can be made off information that is faithfully represented and free from bias or material error.</i>

Exercise 1.3 Accounting Assumptions and Qualitative Characteristics

a

Accounting Assumption	Accounting Entity
Explanation	<i>The business is assumed to be an accounting entity separate from the owner</i>
	<i>and other businesses, and its records should be kept on this basis. The</i>
	<i>holiday is an expense of the owner, not an expense of the business, and</i>
	<i>therefore does not represent a reduction to the firm's Owner's Equity.</i>

b

Explanation	<i>The reports will not contain all the information that is useful for decision-making because they will not show the owner's Drawings.</i>

Exercise 1.4 Qualitative Characteristics

a

Explanation	<i>The inventory should be valued at its original purchase price as this value is</i>
	<i>verifiable by a source document. By recording the inventory at this value,</i>
	<i>the financial information will allow different knowledgeable and independent</i>
	<i>observers to be assured that it is faithfully represented.</i>

b

Explanation	<i>The selling price is an estimate of what the inventory may be sold for, and</i>
	<i>there is no guarantee that this will eventuate. Recording the inventory at its</i>
	<i>selling price would therefore overstate the value of the asset, making the</i>
	<i>financial information not free from bias or material error.</i>

Exercise 1.5 Qualitative Characteristics

a

Explanation	<i>If a business uses consistent accounting methods between different periods, this allows for the direct comparison of financial information from one period to the next. Results can then be linked to performance, not just differences in accounting methods. This comparison will then inform decision making.</i>
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b

Explanation	<i>Comparability refers to the consistent use of methods to allow for comparison between accounting periods. It doesn't mean that identical amounts should be reported from one period to the next. The amount recorded as Depreciation may differ each period if NCA are disposed or Reducing Balance is used.</i>
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Exercise 1.6 Accounting Assumptions and Qualitative Characteristics

a

Explanation	<i>Going Concern</i>

b

Explanation	<i>Financial information must be relevant so that users of the reports can be assured that the amounts reported are complete, free from material error and neutral. The market value represents what an external third party values the business as worth, and will not be realised until the business is sold.</i>
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Exercise 1.7 Accounting Assumptions and Qualitative Characteristics

a

Qualitative Characteristic	<i>Understandability</i>
Explanation	<i>Financial information should be presented in a manner that makes it readily understandable by users who have a reasonable knowledge of business and economic activities. As the employees have limited accounting knowledge, the reports will not fulfil their intended function.</i>

b

Explanation	<i>The employees are dependent on the long-term survival and viability of their employer for their livelihoods. If the business is in financial trouble, the employees should be aware and informed so that they are able to make any necessary arrangements to protect their own and their families' future.</i>
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c

Explanation	<i>Use of graphs; plain language reports; explanatory notes; Information sessions; headings and columns</i>

Exercise 1.8 Accounting Assumptions and Qualitative Characteristics

a

Explanation	<i>Relevance or Faithful representation</i>

b

Explanation	<i>Verifiability</i>

c

Explanation	<i>Timeliness requires that financial information is available to users in time to influence their decisions. If relevant information about the likely damages is excluded from the financial reports, the ability to form predictions about future profit and available cash will be compromised.</i>

d

Discussion

Exercise 1.9 Accounting Assumptions, Qualitative Characteristics and Elements of the Reports

a

Accounting Assumption	<i>Period OR Accrual basis</i>
Explanation	<i>Financial reports should be prepared for a period of time.</i>
	<i>Only revenues that have been earned during the current</i>
	<i>period should be recognised in the calculation of profit. The</i>
	<i>revenue should be recorded upon delivery in 2025.</i>

b

Qualitative Characteristic	<i>Faithful Representation OR Relevance</i>
Explanation	<i>If the revenue is recorded in 2024, the financial reports will</i>
	<i>include information that is not relevant to decision making</i>
	<i>about the current period's profit. The financial information will</i>
	<i>not be free from material error or bias.</i>

c

Explanation	<i>The inflow of economic benefit (cash) increases assets but also</i>
	<i>increases liabilities (the goods are still owed to the customer).</i>
	<i>As a result, there is no increase to Owner's Equity, so it cannot be</i>
	<i>recognised as revenue.</i>

Exercise 1.10 Elements of the reports

Item	Report/Classification	Definition
a Vehicle	<i>Balance Sheet Asset</i>	<i>a present economic resource controlled by the entity (as a result of past events) that is not held for resale and will be used for more than 12 months.</i>
b Cash sales	<i>Income Statement Revenue</i>	<i>an increase in assets (Bank), which leads to an increase in owner's equity, other than those relating to contributions from the owner</i>
c Loan – principal	<i>Balance Sheet Liability</i>	<i>a present obligation of the entity to transfer an economic resource (as a result of past events) sometime in the future (when the loan is repaid)</i>
d Interest on loan	<i>Income Statement Expense</i>	<i>a decrease in assets (Bank), which leads to a decrease in owner's equity, other than those relating to distributions to the owner</i>
e Owner's capital	<i>Balance Sheet Owner's Equity</i>	<i>the residual interest in the assets of the entity after the deduction of its liabilities</i>
f Amount owing from credit sales	<i>Balance Sheet Asset</i>	<i>a present economic resource controlled by the entity (as a result of past events) that is reasonably expected to be converted into cash within the next 12 months (when the cash is received from the Accounts Receivable)</i>
g Wages incurred	<i>Income Statement Expense</i>	<i>a decrease in assets (Bank), which leads to a decrease in owner's equity, other than those relating to distributions from the owner</i>
h Wages owing	<i>Balance Sheet Liability</i>	<i>a present obligation of the entity to transfer an economic resource (as a result of past events) that is reasonably expected to be settled within 12 months (when the employees are paid)</i>

Exercise 1.11 Elements of the reports

a

Explanation	<i>An asset is a present economic resource controlled by the entity.</i>
	<i>An expense is a decrease in assets that decreases Owner's Equity.</i>
	<i>An asset will provide the entity with some future benefit, whereas</i>
	<i>an expense consumes this benefit.</i>

b

Explanation	<i>Going Concern assumes that the business will operate indefinitely.</i>
	<i>Recording the vehicle as a Non-Current Asset assumes that it will</i>
	<i>provide a benefit for a period greater than 12 months, and that the</i>
	<i>business will be in existence beyond this point.</i>

c

Explanation	<i>If the vehicle was purchased as inventory and intended for resale, it</i>
	<i>would be a present economic resource that would convert into cash</i>
	<i>within the next 12 months (when it was sold).</i>

d

Explanation	<i>If the vehicle was purchased for internal use within the business, it</i>
	<i>would be a present economic resource that would provide a benefit for</i>
	<i>a period greater than the next 12 months.</i>

e

Explanation	<i>If the vehicle was considered inventory and sold, it would create an</i>
	<i>expense called Cost of Sales.</i>
<i>OR</i>	<i>If the vehicle was considered inventory and recorded as a Stock Loss</i>
<i>OR</i>	<i>If the vehicle was fully depreciated</i>

Exercise 1.12 Goodwill

a

Discussion	<i>The loyal clientele and repeat customers will ensure that the business will receive economic benefits into the future. In this way, the 'goodwill' is of benefit to the entity. However, it is difficult to place a dollar value on the amount of goodwill because there is no source document to support it. Given that it isn't Verifiable, recording it as an asset would result in financial information that is not free from bias or material error, breaching Faithful Representation.</i>

b

Discussion	<i>Elaine is faced with an ethical dilemma.</i>
	<i>If she were to purchase her inventory from a cheaper supplier but maintain a consistent selling price, the gross profit margin that she makes from each sale would increase. Furthermore, she is also certain that her loyal customers would remain as such, not compromising the volume of sales. Elaine would be financial advantaged.</i>
	<i>However, the new supplier offers its workers poor employment conditions. These overseas workers (given that the inventory is imported) may be earning minimum wage and have no other potential employment opportunities. Their financial future and livelihoods may be entirely dependent on their current employment. Elaine would therefore be supporting a business that does not value the health and wellbeing of its staff, and by extension, the social community in which it operates.</i>
	<i>For Elaine to be a 'good' global citizen, it would be unwise for her to change suppliers for her own financial gain.</i>

Exercise 2.1 Classifying items

Item	Classification
Accounts Payable	<i>Current Liability</i>
Bank Overdraft	<i>Current Liability</i>
Cash on Hand	<i>Current Asset</i>
Capital	<i>Owner's Equity</i>
Accounts Receivable	<i>Current Asset</i>
Equipment	<i>Non-Current Asset</i>
Mortgage – this year	<i>Current Liability</i>
Mortgage – remainder	<i>Non-Current Liability</i>
Premises	<i>Non-Current Asset</i>
Inventory	<i>Current Asset</i>
Vehicles	<i>Non-Current Asset</i>
Wages owing to employees	<i>Current Liability</i>
Rent paid in advance	<i>Current Asset</i>
GST Payable	<i>Current Liability</i>

Exercise 2.2 Balance Sheet

a

Explanation *Equities are claims on the assets of the business, consisting of both liabilities (claims by outsiders) and owner's equity (claims by the owner),*

b

Calculation

$$\begin{aligned}
 \text{Capital} &= \text{Assets} \quad \text{less} \quad \text{Liabilities} \\
 &= \$92\,600 \quad \text{less} \quad \$33\,400 \\
 &= \$59\,200
 \end{aligned}$$

Capital \$ 59 200

c **PONTE JEWELLERS**

Balance Sheet as at 31 May 2025

Current Assets	\$	\$	Current Liabilities	\$	\$
<i>Inventory</i>	62 000		<i>Accounts Payable</i>		3 400
<i>Bank</i>	5 900		<i>Loan – NAB</i>		30 000
<i>Accounts Receivable</i>	8 600	76 500			
			Non-Current Liabilities		
Non-Current Assets					
<i>Shop Fittings</i>	12 000		Owner's Equity		
<i>Office Equipment</i>	4 100	16 100	<i>Capital – M. Florence</i>		59 200
Total Assets	\$	92 600	Total Equities	\$	92 600

d

Explanation *It is classified as a Current Liability as it is a present obligation of the entity to transfer an economic resource (as a result of past events), that is reasonably expected to be settled within 12 months (when Accounts Payable are paid).*

e

Explanation *Financial information must be capable of making a difference to the decisions made by users of the financial reports. Including the entity's current Bank balance represents important information about the entity's current cash position which will shape future cash flow activities and highlight areas of concern regarding Liquidity.*

Exercise 2.3 Balance Sheet

a

Calculation

$$\begin{aligned}
 \text{Capital} &= \text{Assets} \quad \text{less} \quad \text{Liabilities} \\
 &= \$83\,190 \quad \text{less} \quad \$38\,000 \\
 &= \$45\,190
 \end{aligned}$$

Capital **\$ 45 190**

b GREG'S GARDENING SUPPLIES

Balance Sheet as at 31 January 2025

Current Assets	\$	\$	Current Liabilities	\$	\$
<i>Accounts Receivable</i>	2 490		<i>Wages Owing</i>	600	
<i>Inventory</i>	50 000		<i>Accounts Payable</i>	1 400	
<i>Bank</i>	700		<i>Loan – ANZ</i>	2 000	4 000
<i>Term Deposit</i>	8 000	61 190			
			Non-Current Liabilities		
Non-Current Assets			<i>Loan – ANZ</i>		34 000
<i>Motor vehicle</i>	22 000	22 000			
			Owner's Equity		
			<i>Capital – Miller</i>		45 190
Total Assets	\$	83 190	Total Equities	\$	83 190

c

Explanation *It is classified as a Current Asset as it is a present economic resource controlled by the entity, as a result of past events, which is reasonably expected to be converted to cash, sold or consumed within the next 12 months (when the stock is sold).*

d

Chapter 2 *The Accounting equation* – Solutions to exercises

Explanation *The estimated price of \$15 200 is more up to date, and hence may be argued to be more Relevant (useful for decision-making). However, only the original purchase price is verifiable (using a source document): using this valuation ensures that the information in the Balance Sheet is Faithfully Represented, and free from bias or error.*

Exercise 2.4 Balance Sheet

a MALLACOOTA WINES

Balance Sheet as at 30 June 2025

Current Assets	\$	\$	Current Liabilities	\$	\$
<i>Inventory</i>	12 000		<i>Bank Overdraft</i>	2 500	
<i>Accounts Receivable</i>	10 500	22 500	<i>Accounts Payable</i>	5 000	
			<i>GST Payable</i>	1 700	
Non-Current Assets			<i>Mortgage</i>	6 000	15 200
<i>Premises</i>	100 000				
<i>Shelving</i>	43 000	143 000	Non-Current Liabilities		
			<i>Mortgage</i>		54 000
			Owner's Equity		
			<i>Capital – Destio</i>		96 300
Total Assets	\$	165 500	Total Equities	\$	165 500

b

Explanation *Because it is accurate only on that particular date; after that date it is likely that the items will change, and a new Balance Sheet will need to be prepared.*

c Accounts Receivable:

Explanation *It is classified as a Current Asset as it is a present economic resource controlled by the entity, as a result of past events, which is reasonably expected to be converted to cash within the next 12 months (when the cash is received from the Accounts Payable)*

Bank Overdraft:

Explanation *It is classified as a Current Liability as it is a present obligation of the entity to transfer an economic resource, as a result of past events, that is reasonably expected to be settled within 12 months (when the overdraft is repaid).*

d

User 1	<i>Banks and other lenders; customers; suppliers</i>
User 2	<i>Potential buyers/investors</i>

Exercise 2.5 Transactions and the accounting equation

	Item	Classification (A/L/Oe)	Increase/Decrease	Amount \$
a	<i>Bank</i>	<i>Asset</i>	<i>Increase</i>	<i>5 000</i>
	<i>Loan – ANZ Bank</i>	<i>Liability</i>	<i>Increase</i>	<i>5 000</i>
b	<i>Office Furniture</i>	<i>Asset</i>	<i>Increase</i>	<i>19 000</i>
	<i>Bank</i>	<i>Asset</i>	<i>Decrease</i>	<i>19 000</i>
c	<i>Accounts Payable</i>	<i>Liability</i>	<i>Decrease</i>	<i>450</i>
	<i>Bank</i>	<i>Asset</i>	<i>Decrease</i>	<i>450</i>
d	<i>Vehicle</i>	<i>Asset</i>	<i>Increase</i>	<i>25 000</i>
	<i>Capital</i>	<i>Owner's Equity</i>	<i>Increase</i>	<i>25 000</i>
e	<i>Loan – ANZ</i>	<i>Liability</i>	<i>Decrease</i>	<i>1 000</i>
	<i>Bank</i>	<i>Asset</i>	<i>Decrease</i>	<i>1 000</i>
f	<i>Inventory</i>	<i>Asset</i>	<i>Increase</i>	<i>3 000</i>
	<i>Accounts Payable – HP Enterprises</i>	<i>Liability</i>	<i>Increase</i>	<i>3 000</i>
g	<i>Bank</i>	<i>Asset</i>	<i>Increase</i>	<i>800</i>
	<i>Accounts Receivable</i>	<i>Asset</i>	<i>Decrease</i>	<i>800</i>

Exercise 2.6 Transactions and the accounting equation

a

Calculation

$$\begin{aligned}
 \text{Capital} &= \text{Assets} \quad \text{less} \quad \text{Liabilities} \\
 &= \$77\,300 \quad \text{less} \quad \$11\,000 \\
 &= \$66\,300
 \end{aligned}$$

Capital \$ 66 300

b

Explanation The \$4 600 represents the price paid for the computer by Pete privately, a different Accounting Entity. This price is not relevant to the business at the point of contribution. Recording it at \$4 600 would breach Faithful Representation, as the amount would not be free from material error or bias.

c

	Item	Classification (A/L/Oe)	Increase/Decrease	Amount \$
April 1	Accounts Payable	Liability	Decrease	3 000
	Bank	Asset	Decrease	3 000
2	Delivery Van	Asset	Increase	28 000
	Loan – NAB	Liability	Increase	28 000
3	Bank	Asset	Increase	2 400
	Accounts Receivable	Asset	Decrease	2 400
4	Drawings	- Owner's Equity	Increase	1 500
	Inventory	Asset	Decrease	1 500
5	Wages Owing	Liability	Decrease	2 000
	Bank	Asset	Decrease	2 000
6	Computer	Asset	Increase	4 000
	Capital	Owner's Equity	Increase	4 000

d PETE'S PAINT EMPORIUM

Balance Sheet as at 6 April 2025

Current Assets	\$	\$	Current Liabilities	\$	\$
<i>Accounts Receivable</i>	5 600		<i>Bank</i>	300	
<i>Inventory</i>	22 500	28 100	<i>Accounts Payable</i>	6 000	
			<i>Loan – NAB</i>	12 000	18 300
Non-Current Assets					
<i>Fixtures and Fittings</i>	18 000		Non-Current Liabilities		
<i>Delivery Vans</i>	53 000		<i>Loan – NAB</i>		16 000
<i>Computer</i>	4 000	75 000			
			Owner's Equity		
			<i>Capital – Pete</i>	66 300	
			<i>Add Capital Contribution</i>	4 000	
			<i>Less Drawings</i>	(1 500)	68 800
Total Assets	\$	103 100	Total Equities	\$	103 100

Exercise 2.7 Transactions and the Balance Sheet

a

	Item	Classification (A/L/Oe)	Increase/ Decrease	Amount \$
Oct. 1	Accounts Payable	Liability	Decrease	2 000
	Bank	Asset	Decrease	2 000
2	Bank	Asset	Increase	5 000
	Capital – Sam	Owner's Equity	Increase	5 000
3	Loan – ANZ	Liability	Decrease	3 000
	Bank	Asset	Decrease	3 000
4	Inventory	Asset	Increase	10 000
	Accounts Payable	Liability	Increase	10 000
5	Drawings	- Owner's Equity	Increase	2 500
	Fridges	Asset	Decrease	2 500
6	Prepaid Rent Expense	Asset	Increase	1 200
	Bank	Asset	Decrease	1 200

b **SAM BOOKER LIQUOR**

Balance Sheet as at 6 October 2025

Current Assets	\$	\$	Current Liabilities	\$	\$
Accounts Receivable	3 000		Bank Overdraft	3 700	
Inventory	35 000		Accounts Payable	15 000	
Prepaid Rent Expense	1 200	39 200	Loan – ANZ	6 000	24 700
Non-Current Assets			Non-Current Liabilities		
Fixtures and Fittings	15 000		Loan – ANZ		27 000
Fridges	37 500	52 500	Owner's Equity		
			Capital – Sam	37 500	
			Add Capital Contribution	5 000	
			Less Drawings	(2 500)	40 000
Total Assets	\$	91 700	Total Equities	\$	91 700

c

Explanation *It is classified as a Current Asset as it is a present economic resource controlled by the entity, as a result of past events, which is reasonably expected to be consumed within the next 12 months*

Exercise 3.1 Recording in the General Ledger

a Analysing Chart

Date	Accounts affected	Classification (A/L/Oe/R/E)	Increase/Decrease	Debit \$	Credit \$
May 1	Bank	A	Inc.	40 000	
	Capital	Oe	Inc.		40 000
2	Prepaid Rent Expense	A	Inc.	500	
	Bank	A	Dec.		500
3	Inventory	A	Inc.	8 000	
	Accounts Payable	L	Inc.		8 000
4	Office Furniture	A	Inc.	3 000	
	Bank	A	Dec.		3 000
5	Advertising	E	Inc.	150	
	Bank	A	Dec.		150
6	Computer	A	Inc.	1 200	
	Capital	Oe	Inc.		1 200

b General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 1	Capital	40 000	May 2	Prepaid Rent Expense	500
			4	Office Furniture	3 000
			5	Advertising	150

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			May 1	Bank	40 000
			6	Computer	1 200

Chapter 3 *The General Ledger* – Solutions to exercises

Prepaid Rent Expense (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 2	Bank	500			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 3	Accounts Payable	8 000			

Accounts Payable (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			May 3	Inventory	8 000

Office furniture (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 4	Bank	3 000			

+

Advertising (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 5	Bank	150			

Computer (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 6	Capital	1 200			

c

Explanation

The business purchased inventory on credit. They now have a present obligation to transfer an economic resource (cash) to Lush Lawnseed within the next 12 months.

d

Explanation

The contribution of Jane's personal computer has increased her claim on the assets of her business. The transaction must be recorded as a Capital Contribution to reflect the transaction between the business and its owner, a separate Accounting Entity.

Exercise 3.2 Recording in the General Ledger

a Analysing Chart

Date	Accounts affected	Classification (A/L/Oe/R/E)	Increase/ Decrease	Debit \$	Credit \$
Nov. 1	Bank	A	Inc.	25 000	
	Capital	Oe	Inc.		25 000
2	Premises	A	Inc.	140 000	
	Mortgage	L	Inc.		140 000
3	Inventory	A	Inc.	50 000	
	Accounts Payable	L	Inc.		50 000
4	Wages	E	Inc.	1 900	
	Bank	A	Dec.		1 900
5	Drawings	–Oe	Inc.	1 000	
	Bank	A	Dec.		1 000
6	Prepaid Advertising	A	Inc.	4 000	
	Bank	A	Dec.		4 000
7	Accounts Payable	L	Dec.	1 500	
	Bank	A	Dec.		1 500

b General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Capital	25 000	Nov. 4	Wages	1 900
			5	Drawings	1 000
			6	Prepaid Advertising	4 000
			7	Accounts Payable	1 500

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Nov. 1	Bank	25 000

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Premises (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 2	Mortgage	140 000			

Mortgage (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Nov. 2	Premises	140 000

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 3	Accounts Payable	50 000			

Accounts Payable (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 7	Bank	1 500	Nov. 3	Inventory	50 000

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 4	Bank	1 900			

Drawings (–Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 5	Bank	1 000			

Prepaid Advertising (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 6	Bank	4 000			

c

Explanation *Going Concern assumes that the business will continue to operate indefinitely into the future, and its records are kept on that basis. The business now has a Non-Current Liability arising from the purchase of the Premises and is assumed to continue to operate long enough to settle this obligation.*

d

Explanation *The Prepaid Advertising is classified as a Current Asset as it is a present economic resource controlled by the entity, as a result of past events, which has been paid in advance and is reasonably expected to be consumed within the next 12 months (commencing December 2025).*

Exercise 3.3 Cash sales in the General Ledger

a

Explanation *Although Pete and the business are assumed to be separate entities, there is no 'sale' document (and no cash exchanged) when the asset is contributed. Therefore, the fair value (\$22 000) must be used as the cost price in the business' records.*

b Analysing Chart

Date	Accounts affected	Classification (A/L/Oe/R/E)	Increase/Decrease	Debit \$	Credit \$
Jan. 1	Bank	A	Inc.	15 000	
	Vehicle	A	Inc.	22 000	
	Capital	Oe	Inc.		37 000
2	Prepaid Rent Expense	A	Inc.	600	
	Bank	A	Dec.		600
3	Inventory	A	Inc.	45 000	
	Accounts Payable	L	Inc.		45 000
4	Bank	A	Inc.	700	
	Sales	R	Inc.		700
	Cost of Sales	E	Inc.	500	
	Inventory	A	Dec.		500
5	Wages	E	Inc.	150	
	Bank	A	Dec.		150
6	Bank	A	Inc.	1 400	
	Sales	R	Inc.		1 400
	Cost of Sales	E	Inc.	1 000	
	Inventory	A	Dec.		1 000
7	Accounts Payable	L	Dec.	2 500	
	Bank	A	Dec.		2 500

c General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 1	Capital	15 000	Jan. 2	Prepaid Rent Expense	600
4	Sales	700	5	Wages	150
6	Sales	1 400	7	Accounts Payable	2 500

Vehicle (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 1	Capital	22 000			

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Jan. 1	Bank / Vehicle	37 000

Prepaid Rent Expense (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 2	Bank	600			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 3	Accounts Payable	45 000	Jan. 4	Cost of Sales	500
			6	Cost of Sales	1 000

Accounts Payable (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 7	Bank	2 500	Jan. 3	Inventory	45 000

Chapter 3 *The General Ledger* – Solutions to exercises

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Jan. 4	Bank	700
			6	Bank	1 400

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 4	Inventory	500			
6	Inventory	1 000			

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 5	Bank	150			

d

	Increase/Decrease/No effect	Amount \$
Assets	Increase (Increase Bank \$700, decrease Inventory \$500)	200
Liabilities	No effect	0
Owner's Equity	Increase (Sales \$700 less Cost of Sales \$500 = Profit)	200

e

Explanation *The cost price of Inventory is verified by the source document used in the purchase transaction. This evidence ensures that the value of the asset is Faithfully represented, and thus free from bias or material error.*

f

Calculation

$$\begin{aligned}
 \text{Gross Profit} &= \text{Sales revenue} && \text{less} && \text{Cost of Sales} \\
 &= \$2\,100 && \text{less} && \$1\,500 \\
 &= \$600
 \end{aligned}$$

Gross Profit **\$ 600**

Exercise 3.4 Cash and credit sales in the General Ledger

a Analysing Chart

Date	Accounts affected	Classification (A/L/Oe/R/E)	Increase/Decrease	Debit \$	Credit \$
Aug. 1	Bank	A	Inc.	30 000	
	Inventory	A	Inc.	10 000	
	Capital	Oe	Inc.		40 000
2	Premises	A	Inc.	150 000	
	Bank	A	Dec.		10 000
	Mortgage – QV Bank	L	Inc.		140 000
3	Bank	A	Inc.	400	
	Sales	R	Inc.		400
	Cost of Sales	E	Inc.	200	
	Inventory	A	Dec.		200
4	Shelving	A	Inc.	2 500	
	Bank	A	Dec.		2 500
5	Inventory	A	Inc.	2 600	
	Accounts Payable	L	Inc.		2 600
6	Accounts Receivable	A	Inc.	900	
	Sales	R	Inc.		900
	Cost of Sales	E	Inc.	450	
	Inventory	A	Dec.		450
7	Wages	E	Inc.	600	
	Bank	A	Dec.		600
8	Drawings	–Oe	Inc.	1 500	
	Inventory	A	Dec.		1 500
9	Bank	A	Inc.	500	
	Accounts Receivable	A	Dec.		500

b General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 1	Capital	30 000	Aug. 2	Premises	10 000
3	Sales	400	4	Shelving	2 500
9	Accounts Receivable	500	7	Wages	600
	17 800				
		30 900			13 100

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 1	Capital	10 000	Aug. 3	Cost of Sales	200
5	Accounts Payable	2 600	6	Cost of Sales	450
			8	Drawings	1 500
	10 450				
		12 600			2 150

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Aug. 1	Bank / Inventory	40 000

Premises (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 2	Bank / Mortgage – QV Bank	150 000			

Mortgage – QV Bank (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Aug. 2	Premises	140 000

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Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Aug. 3	Bank	400
			6	Accounts Receivable	900
				1 300	

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 3	Inventory	200			
6	Inventory	450			
	650				

Shelving (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 4	Bank	2 500			

Accounts Payable (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Aug. 5	Inventory	2 600

Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 6	Sales	900	Aug. 9	Bank	500
	400				

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 7	Bank	600			

Drawings (–Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 8	Inventory	1 500			

c

Explanation *The transaction on 6 August is a credit sale. Even though the cash has not been received at the point of sale, the revenue has been earned and the expected economic benefit (being the receipt of cash from the Account Receivable) can be measured in a faithful and verifiable manner.*

d

Purpose *To ensure that total debits are equal to total credits, thus ensuring a balanced accounting equation.*

e MONARO MOTORS

Trial Balance as at 9 August 2025

Account	Debit \$	Credit \$
Bank	17 800	
Inventory	10 450	
Capital		40 000
Premises	150 000	
Mortgage – QV Bank		140 000
Sales		1 300
Cost of Sales	650	
Shelving	2 500	
Accounts Payable		2 600
Accounts Receivable	400	
Wages	600	
Drawings	1 500	
Total	\$183 900	\$183 900

Exercise 3.5 Opening balances in the General Ledger

a/b General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	1 500	June 4	Wages	900
1	Accounts Receivable	2 000	8	Shelving	3 200
6	Sales	120	10	Loan – CF Bank	700
7	Accounts Receivable	500	12	Wages	900
9	Sales	230			
				1 350	
		4 350			5 700

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	5 000	June 3	Cost of Sales	650
5	Accounts Payable	1 900	6	Cost of Sales	80
			9	Cost of Sales	150
			11	Cost of Sales	380
	5 640				
		6 900			1 260

Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	8 000	June 1	Bank	2 000
3	Sales	1 000	7	Bank	500
11	Sales	500			
	7 000				
		9 500			2 500

Shelving (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	16 000			
8	Bank	3 200			
	19 200				

Computer (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 2	Capital	2 500			

Accounts Payable (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			June 5	Inventory	1 900

Loan - CF Bank (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 10	Bank	700	June 1	Balance	6 000
				5 300	
		700			6 000

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			June 1	Balance	24 500
			2	Computer	2 500
				27 000	

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			June 3	Accounts Receivable	1 000
			6	Bank	120
			9	Bank	230
			11	Accounts Receivable	500
				1 850	

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 3	Inventory	650			
6	Inventory	80			
9	Inventory	150			
11	Inventory	380			
	1 260				

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 4	Bank	900			
12	Bank	900			
	1 800				

c

Explanation Under Accrual Accounting, revenue is to be recognised when it is earned, regardless of whether or not the cash has been received. The revenue has already been recognised at the point of sale and to do so again would be double-counting. The receipt from the Accounts Receivable simply swaps one asset (Accounts Receivable) for another asset (Bank).

d

Effect	<i>Assets would be understated by \$40 as Bank would be understated by \$120 but Inventory would be overstated by \$80.</i> <i>Liabilities would have no effect.</i> <i>Owner's Equity would be understated by \$40 as Sales revenues would be understated by \$120 and Cost of Sales expense would be understated by \$80, understating Net Profit.</i>
---------------	---

e HOT DOGGIES

Trial Balance as at 12 June 2025

Account	Debit \$	Credit \$
<i>Bank</i>		1 350
<i>Inventory</i>	5 640	
<i>Accounts Receivable</i>	7 000	
<i>Shelving</i>	19 200	
<i>Computer</i>	2 500	
<i>Accounts Payable</i>		1 900
<i>Loan – CF Bank</i>		5 300
<i>Capital</i>		27 000
<i>Sales</i>		1 850
<i>Cost of Sales</i>	1 260	
<i>Wages</i>	1 800	
Total	\$37 400	\$37 400

f

Error	<i>Two entries recorded on the same side</i> <i>Only one entry has been recorded</i> <i>Different amounts have been recorded on each side</i>
--------------	---

Exercise 3.6 Opening balances in the General Ledger

a/b General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 3	Accounts Receivable	8 000	Oct. 1	Balance	1 000
4	Sales	2 000	2	Shop Fittings	500
8	Accounts Receivable	4 000	7	Wages	700
			10	Accounts Payable	7 000
	4 800				
		14 000			9 200

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	Balance	70 000	Oct. 1	Cost of Sales	5 000
6	Accounts Payable	12 000	4	Cost of Sales	1 000
			9	Cost of Sales	1 750
	74 250				
		82 000			7 750

Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	Balance	34 000	Oct. 3	Bank	8 000
1	Sales	10 000	8	Bank	4 000
9	Sales	3 500			
	35 500				
		47 500			12 000

Shop Fittings (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	Balance	17 000			
2	Bank/Loan – Punkah CC	5 000			
	22 000				

Premises (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	Balance	100 000			

Loan – Highland Bank (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Oct. 1	Balance	90 000

Accounts Payable (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 10	Bank	7 000	Oct. 1	Balance	51 000
			6	Inventory	12 000
				56 000	
		7 000			63 000

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Oct. 1	Balance	79 000
			5	Advertising	130
				79 130	

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Oct. 1	<i>Accounts Receivable</i>	10 000
			4	<i>Bank</i>	2 000
			9	<i>Accounts Receivable</i>	3 500
				15 500	

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	<i>Inventory</i>	5 000			
4	<i>Inventory</i>	1 000			
9	<i>Inventory</i>	1 750			
	7 750				

Loan – Punkah CC (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Oct. 2	<i>Shop Fittings</i>	4 500

Advertising (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 5	<i>Capital</i>	130			

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 7	<i>Bank</i>	700			

c

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Explanation *It names the other ledger account affected as part of the double-entry of each transaction. This aids in tracking both effects of each transaction on the Accounting Equation, and ensures that a double-entry has been recorded.*

d

Explanation *Wages is an Expense because it is a decrease in assets (Bank) and a decrease in Owner's Equity, other than those relating to distributions to the owner.*

e BRIGHT CAMPING

Trial Balance as at 10 October 2025

Account	Debit \$	Credit \$
<i>Bank</i>	4 800	
<i>Inventory</i>	74 250	
<i>Accounts Receivable</i>	35 500	
<i>Shop Fittings</i>	22 000	
<i>Premises</i>	100 000	
<i>Loan – Highland Bank</i>		90 000
<i>Accounts Payable</i>		56 000
<i>Capital</i>		79 130
<i>Sales</i>		15 500
<i>Cost of Sales</i>	7 750	
<i>Loan – Punkah CC</i>		4 500
<i>Advertising</i>	130	
<i>Wages</i>	700	
Total	\$245 130	\$245 130

f

Error 1 *Debit and Credit reversed; transaction completely omitted*

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Error 2 *Wrong amount recorded on both sides; wrong accounts used; entry recorded twice*

Exercise 3.7 Identifying transactions

a

Date	Transaction
Dec. 1	<i>Opening balances</i>
2	<i>Cash sale of inventory for \$900 (Cost price \$600)</i>
3	<i>Paid \$100 cash for new office equipment</i>
4	<i>Owner withdrew \$250 worth of office equipment for personal use</i>
5	<i>Credit sale of inventory for \$600 (Cost price \$400)</i>
6	<i>Paid \$150 cash for repairs</i>
7	<i>Received \$300 cash from an account receivable</i>
8	<i>Purchased \$800 worth of inventory on credit</i>

b

Calculation	$SP = CP \times (1 + m/up^*)$ $\$900 = \$600 \times (1 + m/up^*)$ $1 + m/up^* = \frac{\$900}{\$600} \text{ (or 600)}$ $M/up^* = 1.5 - 1$	<i>* Measured as a decimal i.e. 0.5 = 50%</i>
	Mark-up	50 %

c PERFECT PHOTOGRAPHS

Trial Balance as at 8 December 2025

Account	Debit \$	Credit \$
<i>Bank</i>	1 950	
<i>Inventory</i>	4 800	
<i>Accounts Receivable</i>	2 000	
<i>Office Equipment</i>	3 850	
<i>Accounts Payable</i>		1 900
<i>Capital</i>		10 600

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<i>Sales</i>		1 500
<i>Drawings</i>	250	
<i>Cost of Sales</i>	1 000	
<i>Repairs</i>	150	
Total	\$14 000	\$14 000

d

Explanation *The Trial Balance would not identify this error as it has a matching double-entry, i.e. there is an entry on the debit side and a matching entry on the credit side.*

e

Explanation *Assets (Office Equipment) would be overstated by \$200 as the business would be recording an asset that it didn't actually have.*

There would be no effect on liabilities.

Owner's Equity would be overstated by \$200 as the expense, Office Expenses, would be understated by \$200, overstating Net Profit.

f

Account	Debit \$	Credit \$
<i>Office Expenses</i>	200	
<i>Office Equipment</i>		200

Exercise 3.8 Transactions to reports

a

Calculation

$$\begin{aligned}
 \text{Owner's Equity} &= \text{Assets} \quad \text{less} \quad \text{Liabilities} \\
 &= \$256\,100 \quad \text{less} \quad \$92\,500 \\
 &= \$163\,600
 \end{aligned}$$

Owner's Equity \$ 163 600

b/c General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	1 200	July 3	Electricity	450
1	Sales	800	9	Wages	500
14	Accounts Receivable	1 600	17	Accounts Payable	1 000
25	Sales	580	19	Mortgage – JH Finance/	500
27	Accounts Receivable	5 400		Interest Expense	200
			23	Wages	500
			31	Prepaid Advertising	6 000
				Balance	430
		\$9 580			\$9 580
Aug. 1	Balance	430			

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Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	52 000	July 1	Cost of Sales	400
7	Accounts Payable	4 000	6	Cost of Sales	2 700
			11	Cost of Sales	3 500
			20	Drawings	600
			25	Cost of Sales	290
			31	Balance	48 510
		\$56 000			\$56 000
Aug. 1	Balance	48 510			

Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	2 000	July 14	Bank	1 600
6	Sales	5 400	27	Bank	5 400
11	Sales	7 000	31	Balance	7 400
		\$14 400			\$14 400
Aug. 1	Balance	7 400			

Office Equipment (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	10 900			

Premises (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	190 000			

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Accounts Payable (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 17	Bank	1 000	July 1	Balance	7 500
31	Balance	10 500	7	Inventory	4 000
		\$11 500			\$11 500
			Aug. 1	Balance	10 500

Mortgage – JH Finance (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 19	Bank	500	July 1	Balance	85 000
31	Balance	84 500			
		\$85 000			\$85 000
			Aug. 1	Balance	84 500

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			July 1	Balance	163 600

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			July 1	Bank	800
			6	Accounts Receivable	5 400
			11	Accounts Receivable	7 000
			25	Bank	580
				13 780	

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Inventory	400			
6	Inventory	2 700			
11	Inventory	3 500			
25	Inventory	290			

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	6 890				
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Electricity (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 3	Bank	450			

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 9	Bank	500			
23	Bank	500			
	1 000				

Interest Expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 19	Bank	200			

Drawings (–Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 20	Inventory	600			

Prepaid advertising (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 31	Bank	6 000			

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d TURNING POINTS

Trial Balance as at 31 July 2025

Account	Debit \$	Credit \$
<i>Bank</i>	430	
<i>Inventory</i>	48 510	
<i>Accounts Receivable</i>	7 400	
<i>Office Equipment</i>	10 900	
<i>Premises</i>	190 000	
<i>Accounts Payable</i>		10 500
<i>Mortgage – JH Finance</i>		84 500
<i>Capital</i>		163 600
<i>Sales</i>		13 780
<i>Cost of Sales</i>	6 890	
<i>Electricity</i>	450	
<i>Wages</i>	1 000	
<i>Interest Expense</i>	200	
<i>Drawings</i>	600	
<i>Prepaid Advertising</i>	6 000	
Total	\$272 380	\$272 380

e

Accounting assumption	<i>Accrual basis</i>
Explanation	<i>The Accrual basis assumption requires that revenue is recorded when earned, not when the cash is received. The revenue was earned in the previous period (i.e. June 2025) when the goods were provided to the customer. To count it as revenue again in July would be double counting, overstating Net Profit.</i>

f

	Overstated/Understated/No effect	Amount \$
Assets	<i>Overstated (Bank overstated)</i>	<i>700</i>
Liabilities	<i>Overstated (Mortgage loan overstated)</i>	<i>500</i>
Owner's Equity	<i>Overstated (Interest expense understated → Net Profit overstated)</i>	<i>200</i>

g TURNING POINTS

Income Statement for July 2025

	\$	\$
Revenue		
<i>Sales</i>		13 780
less Cost of Goods Sold		
<i>Cost of Sales</i>		6 890
Gross Profit		6 890
less Other Expenses		
<i>Electricity</i>	450	
<i>Wages</i>	1 000	
<i>Interest Expense</i>	200	1 650
Net Profit	\$	5 240

h TURNING POINTS

Balance Sheet as at 31 July 2025

Current Assets	\$	\$	Current Liabilities	\$	\$
<i>Bank</i>	430		<i>Accounts Payable</i>	10 500	
<i>Inventory</i>	48 510		<i>Mortgage – JH Finance</i>	6 000	16 500
<i>Accounts Receivable</i>	7 400				
<i>Prepaid Advertising</i>	6 000	62 340	Non-Current Liabilities		
			<i>Mortgage – JH Finance</i>		78 500
Non-Current Assets					
<i>Office Equipment</i>	10 900		Owner's Equity		
<i>Premises</i>	190 000	200 900	<i>Capital – Belmore</i>	163 600	
			<i>Add Net Profit</i>	5 240	
			<i>Less Drawings</i>	600	168 240
Total Assets	\$	263 240	Total Equities	\$	263 240

i

Explanation

As at 31 July 2025 – when the Balance Sheet is prepared – the advertising is a Current Asset, and so must be included in the Balance Sheet to ensure that the report contains all information that may be useful for decision-making and/or forming predictions.

Exercise 4.1 Calculating GST

a

Explanation *A tax invoice is a source document used to verify any transaction that involves the GST. They provide specific information about transactions that is required by the ATO to substantiate GST amounts.*

b

Information 1 *The words 'Tax Invoice' stated clearly / name of the seller / ABN of the seller*

Information 2 *The date of the transaction / A description of the good/service provided*

Information 3 *The price of the transaction, including the GST /The amount of the GST*

c

	Selling price (excluding GST)	GST (10%)	Total price (including GST)
March 1	\$400	\$40	\$440
5	\$600	\$60	\$660
13	\$390	\$39	\$429
19	\$720	\$72	\$792
23	\$1 200	\$120	\$1 320
28	\$920	\$92	\$1 012

d

Calculation *Total GST received*
 $= \$40 + \$60 + \$39 + \$72 + \$120 + \$92 = \$423$

e

Explanation *A business will charge its customers the selling price, plus an additional 10% GST which is charged on behalf of the Government. The business is not entitled to keep any GST received, rather, they must forward any GST collected to the ATO, increasing their present obligation.*

f

Explanation *Ultimately it is the final consumer who is penalised by the GST system, not small businesses. If a business incurs any GST on purchases that it makes within the ordinary course of business operations, it is entitled to receive back this GST in the form of a decrease to an existing GST liability owed to the ATO.*

g

Calculation *Total GST at 31 March 2025:*
= GST received less GST paid
= \$423 - \$140 = \$283 owed to the ATO from the business

Exercise 4.2 Cash Receipt

a

Explanation Source documents provide evidence of the details of every transaction, ensuring that all transactions are Verifiable. In turn, this ensures that the accounting system provides a Faithful Representation of the firm's transactions, as they will be complete, free from bias or material error.

b

Document	Cash receipt: EFT
-----------------	-------------------

c

Transaction	The owner of Cal Q Later, Lenny, has deposited \$30 000 into his business' bank account via EFT to commence business operations
--------------------	---

d

General Journal

Date	Account	Debit \$	Credit \$
1 May	Bank	30 000	
	Capital		30 000
	Cash contribution by the owner to commence business operations (Rec. 001)		

e General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 1	Capital	30 000			

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			May 1	Bank	30 000

f

Explanation *The Accounting Entity assumption states that the records of assets, liabilities and business activities of the entity are to be kept completely separate from those of the owner. When Lenny commenced his business, a new bank account was required to be established that was separate from his account used for personal purposes.*

Exercise 4.3 Cash Sale

a

Document	<i>Receipt</i>
-----------------	----------------

b

Transaction	<i>Cash sale of 2 top hats for \$200 (plus GST) total</i>
--------------------	---

c

General Journal

Date	Account	Debit \$	Credit \$
2 Nov	<i>Bank</i>	220	
	<i>Sales</i>		200
	<i>GST Clearing</i>		20
	<i>Cost of Sales</i>	100	
	<i>Inventory</i>		100
	<i>Cash sale of 2 top hats (Rec. 60)</i>		

d General Ledger

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
2 Nov	<i>Sales / GST Clearing</i>	220			

Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			2 Nov	<i>Bank</i>	200

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			2 Nov	<i>Bank</i>	20

Cost of Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
2 Nov	Inventory	100			

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			2 Nov	Cost of Sales	100

e

Explanation *The GST is collected from the customer on behalf of the ATO, so Hats Off to Hats! has a present obligation to forward this GST to the ATO, and it is reasonably expected to be settled within 12 months.*

f

Effect *Assets will increase by \$120 as Bank will increase by \$220 but is offset by the decrease to Inventory of \$100*

Liabilities will increase by \$20 as the business now has a present obligation to forward this GST to the ATO

Owner's Equity will increase by \$100 as Sales revenues will increase by \$200 but is offset by the increase to Cost of Sales expense by \$100

g

Explanation *Accounting information is only useful if it available at the time that decisions need to be made. By recording transactions in a timely manner when they occur, all information that is required to influence and inform decisions at any specific point in time will be available.*

Exercise 4.4 Cash Transactions

Feature 1	<i>There is a Receipt number</i>
Feature 2	<i>The source document refers to 'Cash Sales'</i>

b

Explanation	<i>Document B is a credit card receipt. It would not be recognised by the ATO as a tax invoice because:</i> <i>It does not contain the words 'Tax Invoice' and</i> <i>It does not contain the ABN of the seller</i>
--------------------	--

Calculation	<i>Sales revenue</i> = \$319 <i>inclusive of GST</i> = \$319 / 1.1 = \$290
	Sales revenue \$ 290

Explanation	<i>A narration provides a short reference of the General Journal transaction, along with the source document reference. The user of the accounting information is able to Verify the specific evidence relating to the transaction, ensuring that it has been recorded correctly.</i>
--------------------	---

e

General Journal

Date	Account	Debit \$	Credit \$
1 Dec	Bank	5 280	
	Sales		4 800
	GST Clearing		480
	Cost of Sales	3 600	
	Inventory		3 600
2 Dec	Bank	319	
	Sales		290
	GST Clearing		29
	Cost of Sales	200	
	Inventory		200

f General Ledger

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
1 Dec	Balance	2 400			
1 Dec	Sales / GST Clearing	5 280			
2 Dec	Sales / GST Clearing	319			

Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			1 Dec	Bank	4 800
			2 Dec	Bank	290

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			1 Dec	Bank	480
			2 Dec	Bank	29

Cost of Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
1 Dec	Inventory	3 600			
2 Dec	Inventory	200			

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			1 Dec	Balance	20 000
			1 Dec	Cost of Sales	3 600
			2 Dec	Cost of Sales	200

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			1 Dec	Balance	22 400

9

Calculation	<i>Gross Profit = Sales Revenue less Cost of Goods Sold</i> <i>Sales Revenue = \$5 090</i> <i>Cost of Sales = \$3 800</i>
	Gross Profit \$ 1 290

h

Explanation

GST Clearing would be reported as a Current Liability of \$509 as it is a present obligation of the entity, as a result of past events, to transfer an economic resource within the next 12 months to the ATO.

Exercise 4.5 Cash Payment

a

Stage	Input
-------	-------

b

Document	<i>Cheque butt</i>
Transaction	<i>Cash payment to Bay Gazette for Advertising worth \$950 plus GST</i>

c

Advantage 1	<i>Secure – eliminate the need to carry large amounts of cash</i>
Advantage 1	<i>Traceable –can be traced / Verifiable – the cheque butt</i>

d

General Journal

Date	Account	Debit \$	Credit \$
2 May	<i>Advertising</i>	950	
	<i>GST Clearing</i>	95	
	<i>Bank</i>		1 045
	<i>Payment to Bay Gazette for Advertising (Chq. 663)</i>		

e

Effect	<i>Assets will decrease by \$1 045 as Bank will decrease by \$1 045 as the business is making a payment</i> <i>Liabilities will decrease by \$95 as the business is now entitled to receive the GST paid back from the ATO in the form of a decrease to an existing GST liability</i> <i>Owner's Equity will decrease by \$950 the business has now incurred an expense of \$950, decreasing Net Profit</i>
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f

Explanation

Given that the payment for Advertising incurred GST, additional information would need to be provided (for example, the original invoice from Bay Gazette) to ensure that the amounts recorded were verifiable by the source document evidence mandated by the ATO.

Exercise 4.6 Cash Payments

a

Calculation *GST paid = 10% of \$1 400 = \$140*

GST paid \$ 140

b

Explanation *There is no GST on drawings because this transaction is internal between a business and its owner and no purchase or sale of goods and/or services has taken place.*

c

Explanation *Document C would decrease the GST liability of Stipe, Buck and Mills by \$25 because the business is entitled to receive the GST paid back from the ATO in the form of a decrease to an existing GST liability.*

d

Explanation *The General Journal is an accounting record used to record each transaction, and identify its source document, before posting to the General Ledger. It provides the connection between the source document evidence and the recording that takes place in the General Ledger, ensuring that the financial reports which are generated provide information that is both Relevant and a Faithful Representation of the firm's financial situation and performance.*

e

General Journal

Date	Account	Debit \$	Credit \$
4 Jan	Inventory	1 400	
	GST Clearing	140	
	Bank		1 540
10 Jan	Drawings	400	
	Bank		400
15 Jan	Electricity	250	
	GST Clearing	25	
	Bank		275
20 Jan	Wages	600	
	Bank		600
26 Jan	Insurance	320	
	GST Clearing	32	
	Bank		352
31 Jan	Bank Fees	10	
	Bank		10

f General Ledger

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
1 Jan	Balance	4 200	4 Jan	Inventory / GST Clearing	1 540
			10 Jan	Drawings	400
			15 Jan	Electricity / GST Clearing	275
			20 Jan	Wages	600
			26 Jan	Insurance / GST Clearing	352
			31 Jan	Bank Fees	10

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
1 Jan	Balance	30 000			
4 Jan	Bank	1 400			

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
4 Jan	Bank	140	1 Jan	Balance	300
15 Jan	Bank	25			
26 Jan	Bank	32			

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			1 Jan	Balance	33 900

Drawings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
10 Jan	Bank	400			

Electricity

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
15 Jan	Bank	250			

Wages

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
20 Jan	Bank	600			

Insurance

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
26 Jan	Bank	320			

Bank Fees

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
31 Jan	Bank	10			

Exercise 4.7 GST Clearing Account

a

Transaction	<i>Cash sales</i>
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b

Transaction	<i>August 2</i>
Justification	<i>Given that selling prices are higher than cost prices, it is likely that the</i>
	<i>inventory purchased on 2 August was then sold on 5 August</i>

c **General Ledger**

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
2 Aug	Bank	35	5 Aug	Bank	240
8	Bank	12	11	Bank	320
16	Bank	500	23	Bank	250
22	Bank	21			
28	Bank	19			
31	<i>Balance</i>	223			
		810			810
			1 Sep	<i>Balance</i>	223

d

Explanation	<i>GST Clearing would be reported as a Current Liability of \$223 as it is a present obligation of the entity, as a result of past events, to transfer an economic resource within the next 12 months to the ATO.</i>
--------------------	---

e

General Journal

Date	Account	Debit \$	Credit \$
4 Sep	<i>GST Clearing</i>	223	
	<i>Bank</i>		223
	<i>GST settlement paid to ATO for balance owing as at</i>		
	<i>31 August 2025 (Chq. 658)</i>		

Exercise 4.8 GST Clearing Account

Explanation *Given that selling prices exceed cost prices, it is normal for the GST*

Given that selling prices exceed cost prices, it is normal for the GST Clearing ledger to be in credit at the end of the period. If, however, the ledger has a debit balance, this indicates that more GST was paid than received during the period. This is most likely due to the purchase of an expensive Non-Current Asset, or the bulk purchase of Inventory that has not yet been sold.

Calculation *Sales Revenue* = (63 + 85) x 10 = \$1 480

$$\text{Sales Revenue} = (63 + 85) \times 10 = \$1\,480$$

Sales revenue	\$ 1 480
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c General Ledger

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 1	Balance	240	Mar. 5	Bank	63
6	Bank	35	27	Bank	85
14	Bank	12	31	<i>Balance</i>	<i>179</i>
22	Bank	21			
28	Bank	19			
		327			327
<i>1 Apr</i>	<i>Balance</i>	<i>179</i>			

Explanation *GST Clearing would be reported as a Current Asset of \$179 as it is a*

GST Clearing would be reported as a Current Asset of \$179 as it is a present economic resource controlled by the entity, as a result of past events, which is reasonably expected to be converted to cash within the next 12 months (when it is received from the ATO).

e

General Journal

Date	Account	Debit \$	Credit \$
6 Apr	Bank	179	
	GST Clearing		179
	GST refund from the ATO for balance owing as at 31 March		
	2025 (EFT Ref.22101)		

Exercise 4.9 Cash Transactions

a

Calculation	<i>Capital = Assets less Liabilities</i>			
	<i>Total assets = \$23 000</i>			
	<i>Total liabilities = \$1 900 + 520 = \$2 420</i>			
	<i>Capital = \$20 580</i>			
		Capital	\$	20 580

b

General Journal

Date	Account	Debit \$	Credit \$
2 Feb	Bank	15 000	
	Loan – QPR Bank		15 000
5 Feb	Shop Fittings	3 500	
	GST Clearing	350	
	Bank		3 850
9 Feb	Wages	420	
	Bank		420
12 Feb	Inventory	800	
	GST Clearing	80	
	Bank		880
15 Feb	Bank	2 530	
	Sales		2 300
	GST Clearing		230
	Cost of Sales	1 150	
	Inventory		1 150
17 Feb	Drawings	300	
	Bank		300
21 Feb	Rent	820	
	GST Clearing	82	
	Bank		902

b (continued)

General Journal

26 Feb	Inventory	720	
	GST Clearing	72	
	Bank		792
29 Feb	Bank	2 200	
	Sales		2 000
	GST Clearing		200
	Cost of Sales	1 000	
	Inventory		1 000

c General Ledger

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
2 Feb	Loan – QPR Bank	15 000	1 Feb	Balance	1 900
15 Feb	Sales/GST Clearing	2 530	5 Feb	Fittings/GST Clearing	3 850
29 Feb	Sales/GST Clearing	2 200	9 Feb	Wages	420
			12 Feb	Inventory/GST Clearing	880
			17 Feb	Drawings	300
			21 Feb	Rent/GST Clearing	902
			26 Feb	Inventory/GST Clearing	792
	10 686				
		19 730			9 044

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
1 Feb	Balance	23 000	15 Feb	Cost of Sales	1 150
12 Feb	Bank	800	29 Feb	Cost of Sales	1 000
26 Feb	Bank	720			
	22 370				
		24 520			2 150

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
5 Feb	Bank	350	1 Feb	Balance	520
12 Feb	Bank	80	15 Feb	Bank	230
21 Feb	Bank	82	29 Feb	Bank	200
26 Feb	Bank	72			
				366	
		584			950

Loan – QPR Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			2 Feb	Bank	15 000

Shop Fittings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
5 Feb	Bank	3 500			

Wages

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
9 Feb	Bank	420			

Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			15 Feb	Bank	2 300
			29 Feb	Bank	2 000
				4 300	

Cost of Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
15 Feb	Inventory	1 150			
29 Feb	Inventory	1 000			
	2 150				

Drawings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
17 Feb	Bank	300			

Rent

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
21 Feb	Bank	820			

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			1 Feb	Balance	20 580

d PETA ANTHONY

Trial Balance as at 29 February 2025

Account	Debit \$	Credit \$
<i>Bank</i>	10 686	
<i>Inventory</i>	22 370	
<i>GST Clearing</i>		366
<i>Loan – QPR Bank</i>		15 000
<i>Shop Fittings</i>	3 500	
<i>Wages</i>	420	
<i>Sales</i>		4 300
<i>Cost of Sales</i>	2 150	
<i>Drawings</i>	300	
<i>Rent</i>	820	
<i>Capital</i>		20 580
Total	40 246	40 246

e PETA ANTHONY

Income Statement for February 2025

	\$	\$
REVENUES		
<i>Cash Sales</i>		4 300
LESS: COST OF GOODS SOLD		
<i>Cost of Sales</i>		2 150
GROSS PROFIT		2 150
LESS: OTHER EXPENSES		
<i>Wages</i>	420	
<i>Rent</i>	820	1 240
NET PROFIT		910

f

Discussion

Due to having a higher cost price of inventory, Peta Anthony will need to charge a higher selling price. This may put her business at a competitive disadvantage to her competitors who may be able to charge less. A decrease in volume of sales would lead to a reduced Net Profit.

The higher cost price of inventory will also lead to a higher Cost of Sales expense when the inventory is sold, decreasing Net Profit.

However, Peta is showing support of her own and other business' employees whose livelihoods are dependent on fair working conditions. This may lead to an increase in productivity from her own staff who view their employer as fair and equitable. An increased productivity may lead to increased sales volume and overall higher employee satisfaction.

In addition, customers may look favourably towards Peta's decision and may be willing to pay more for ethically sourced inventory.

g PETA ANTHONY

Balance Sheet as at 29 February 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
Bank	10 686		GST Clearing	366	
Inventory	22 370	33 056	Loan – QPR Bank	6 000	6 366
Non-Current Assets			Non-Current Liabilities		
Shop Fittings	3 500	3 500	Loan – QPR Bank		9 000
			Owner's Equity		
			Capital – P. Anthony	20 580	
			Add: Cap. Contribution	0	
			Less: Drawings	(300)	
			Add: Net Profit	910	21 190

Chapter 4 *Cash transactions: documents, the GST and the General Journal* – Solutions to exercises

Total Assets	\$	<u>36 556</u>	Total Equities	\$	<u>36 556</u>
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h

Explanation

The Shop Fittings are recorded at their original purchase price which is verifiable by the source document evidence on Chq. 613. By recording this Non-Current Asset at the price paid, it ensures that the value of Total Assets are accurate and free from bias or material error.

Exercise 4.10 Cash Transactions

a

Explanation	<i>The Accounting Entity assumption states that the records of assets, liabilities and business activities of the entity are to be kept completely separate from those of the owner. The drawings is an internal transaction between the business and its owner, and will reduce the owner's claim on the firm's assets.</i>
--------------------	--

b

General Journal

Date	Account	Debit \$	Credit \$
7 July	GST Clearing	1 700	
	Bank		1 700
	GST settlement paid to ATO for balance owing as at 30 June 2025 (Chq. 9001)		
12 July	Bank	1 760	
	Sales		1 600
	GST Clearing		160
	Cost of Sales	800	
	Inventory		800
	Cash sale of inventory for \$1 600 plus GST (Rec. 320)		
19 July	Electricity	630	
	GST Clearing	63	
	Bank		693
	Payment of Electricity bill (Chq. 9002)		

c

Explanation	<i>Assets will increase by \$650 as Bank will increase by \$1 650 but is offset by the decrease to Inventory of \$1 000</i> <i>Liabilities will increase by \$150 as the business now has a present obligation to forward this GST to the ATO</i> <i>Owner's Equity will increase by \$500 as Sales revenues will increase by \$1 500 but is offset by the increase to Cost of Sales expense by \$1 000</i>
--------------------	--

d General Ledger

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
1 July	Balance	4 700	3 July	Drawings	500
12 July	Sales/GST Clearing	1 760	7 July	GST Clearing	1 700
21 July	Sales/GST Clearing	1 650	14 July	Inventory/GST Clearing	715
			19 July	Electricity/GST Clearing	693
			27 July	Drawings	300
			30 July	Inventory/GST Clearing	572
			31 July	Balance	3 630
		8 110			8 110
1 Aug	Balance	3 630			

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
7 July	Bank	1 700	1 July	Balance	1 700
14 July	Bank	65	12 July	Bank	160
19 July	Bank	63	21 July	Bank	150
30 July	Bank	52			
31 July	Balance	130			
		2 010			2 010
			1 Aug	Balance	130

Chapter 4 Cash transactions: documents, the GST and the General Journal – Solutions to exercises

Inventory					
Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
1 July	Balance	25 000	12 July	Cost of Sales	800
14 July	Bank	650	19 July	Cost of Sales	1 000
30 July	Bank	520	31 July	Balance	24 370
		26 170			26 170
1 Aug	Balance	24 370			

e

Explanation

Inventory would be reported as a Current Asset of \$24 370 as it is a present economic resource controlled by the entity, as a result of past events, which is reasonably expected to be converted to cash within the next 12 months (when the Inventory is sold).

f

Discussion

The owner is incorrect in their assertion as GST does not simply equate to 10% of the bank balance.

In addition to applying to cash sales and purchases of inventory, GST will also apply to the transaction on 19 July – the payment of the business' electricity bill.

Furthermore, GST does not apply to all transactions that involve the bank account, in particular, the drawings that occurred on 3 July and 27 July.

The business has an obligation to record any information that is Relevant towards decision making and forming predictions about the outcomes of events. By recording this Current Liability in the Balance Sheet, the owner and other users of the financial reports have necessary information about their present obligations and can tailor their cash flow activities accordingly.

Failing to record this Current Liability would result in a Balance Sheet that is not Faithfully Represented nor free from bias or material error.

Exercise 5.1 Credit Purchase

a

Document	<i>Purchase invoice</i>
Transaction	<i>Credit purchase of 10 tea sets (from Fine Tea China)</i>

b

General Journal

Date	Details	Debit \$	Credit \$
<i>May 4</i>	<i>Inventory</i>	<i>1 200</i>	
	<i>GST Clearing</i>	<i>120</i>	
	<i>Account Payable – Fine Tea China</i>		<i>1 320</i>
	<i>Credit purchase of 10 tea sets from Fine Tea China</i>		
	<i>(Invoice S.90)</i>		

c

General Ledger

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>May 4</i>	<i>Account Payable – Fine Tea China</i>	<i>1 200</i>			

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>May 4</i>	<i>Account Payable – Fine Tea China</i>	<i>120</i>			

Account Payable – Fine Tea China (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>May 4</i>	<i>Inventory / GST Clearing</i>	<i>1 320</i>

d

Explanation	<i>It does not provide an economic benefit when the inventory is sold:</i>
	<i>it reduces the debt owed to the ATO (on the day the inventory is purchased).</i>
	<i>ie. the benefit is received when the GST refund / settlement occurs.</i>

e

	Increase / Decrease / No effect	Amount \$
Assets	Increase (Inventory)	1 200
Liabilities	Increase (Increase Accounts Payable \$1 320; decrease GST Clearing \$120)	2 250
Owner's Equity	No effect	

f

Explanation	<i>Purchasing inventory that is produced in a socially and/or environmentally responsible manner way may generate sales as customers may be more willing to purchase these items.</i>
	<i>(It could also mean higher cost prices and less Gross Profit per sale.)</i>

Exercise 5.2 Credit Purchases

a General Journal

Date	Details	Debit \$	Credit \$
Aug. 5	Inventory	12 000	
	GST Clearing	1 200	
	Account Payable – Yamaha		13 200
	Credit purchase of 3 grand pianos from Yamaha (Invoice Yh3764)		
Aug. 8	Inventory	3 000	
	GST Clearing	300	
	Account Payable – Yamaha		3 300
	Credit purchase of 3 upright pianos from Yamaha (Invoice Yh4801)		
Aug. 15	Bank	13 200	
	Sales		12 000
	GST Clearing		1 200
	Cost of Sales	8 000	
	Inventory		8 000
	Cash sale of 2 grand pianos (Receipt 301)		
Aug. 24	Inventory	2 000	
	GST Clearing	200	
	Bank		2 200
	Cash purchase of 1 special model piano (EFT trans. 430)		
Aug. 28	Inventory	15 600	
	GST Clearing	1 560	
	Account Payable – Yamaha		17 160
	Credit purchase of 4 grand pianos from Yamaha (Invoice Yh5132		

Chapter 5 *Special Journals 1: Credit Journals* – Solutions to exercises

b

Explanation	<i>Because they are issued by the suppliers of Phil's Pianos (eg. Yamaha)</i>
	<i>who will also issue them to their other customers (between transactions with</i>
	<i>Phil's Pianos).</i>

c

Explanation	<i>Assets will increase \$12 000 due to the inventory that has been bought;</i>
	<i>Liabilities will decrease \$12 000 overall as although</i>
	<i>GST Clearing will decrease \$1 200 as this will eventually be paid to the ATO</i>
	<i>by the supplier (Yamaha) on behalf of Phil's Pianos but</i>
	<i>the amount owed to Account Payable – Yamaha will increase by \$13 200 for</i>
	<i>the Inventory and the GST on the purchase.</i>

d

Explanation	<i>Going concern assumes that the business will continue to operate into the</i>
	<i>future, meaning:</i>
	<i>inventory can be recognised as an asset (that will produce economic benefits);</i>
	<i>and</i>
	<i>the Account Payable can be recognised as a liability (that will be settled)</i>
	<i>at some time in the future.</i>

e

Calculation			
Sales	\$12 000	(2 x \$6 000)	
less Cost of Sales	<u>\$8 000</u>	(2 x \$4 000)	
Gross Profit	\$4 000		
			Gross Profit
			\$ 4 000

f

Explanation *It is a cash purchase as it is verified by an EFT transaction receipt (430), so Inventory increases and GST Clearing decreases, but Bank decreases (instead of Accounts Payable).*

g

General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 1	Balance	3 800	Aug. 24	Inventory / GST Clearing	2 200
15	Sales / GST Clearing	13 200			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 1	Balance	76 000	Aug. 15	Cost of Sales	8 000
5	Account Payable – Yamaha	12 000			
8	Account Payable – Yamaha	3 000			
24	Bank	2 000			
28	Account Payable – Yamaha	15 600			

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
5	Account Payable – Yamaha	1 200	Aug. 1	Balance	1 500
8	Account Payable – Yamaha	300	15	Bank	1 200
24	Bank	200			
28	Account Payable – Yamaha	1 560			

Account Payable – Yamaha (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>Aug. 1</i>	<i>Balance</i>	<i>1 000</i>
			<i>5</i>	<i>Inventory / GST Clearing</i>	<i>13 200</i>
			<i>8</i>	<i>Inventory / GST Clearing</i>	<i>3 300</i>
			<i>28</i>	<i>Inventory / GST Clearing</i>	<i>17 160</i>

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>Aug. 15</i>	<i>Bank</i>	<i>12 000</i>

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Aug. 15</i>	<i>Inventory</i>	<i>8 000</i>			

Exercise 5.3 Credit Purchases and Payments to Accounts Payable

a

Feature 1	<i>It says 'For: Payment to Account Payable'</i>
Feature 2	<i>It notes 'Date of payment', and 'To: Shock Electrics'</i>

b

Explanation	<i>It is a payment to an Account Payable</i>
	<i>but GST is charged at the point of purchase ie. when the credit purchase is</i>
	<i>made.</i>
	<i>(This would be double-counting GST.)</i>

c

General Journal

Date	Details	Debit \$	Credit \$
<i>Nov. 2</i>	<i>Account Payable – Shock Electrics</i>	<i>800</i>	
	<i>Bank</i>		<i>800</i>
	<i>Payment to Shock Electrics (EFT rec. 563 099)</i>		
<i>13</i>	<i>Inventory</i>	<i>5 400</i>	
	<i>GST Clearing</i>	<i>540</i>	
	<i>Account Payable – Yamaha</i>		<i>5 940</i>
	<i>Credit purchase inventory from Shock Electrics</i>		
	<i>(Invoice 553)</i>		

Chapter 5 Special Journals 1: Credit Journals – Solutions to exercises

d General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Balance	1 000	Nov. 2	Account Payable – Shock Electrics	800

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Balance	80 000			
13	Account Payable – Shock Electrics	5 400			

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 13	Account Payable – Shock Electrics	540	Aug. 1	Balance	1 700

Account Payable – Shock Electrics (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 2	Bank	800	Nov. 1	Balance	1 320
			13	Inventory / GST Clearing	5 940

e

Explanation	<i>Inventory increases as more inventory has been purchased</i>
	<i>Accounts Payable increases as Glow Warm must pay for the Inventory and the GST owing</i>
	<i>GST Clearing decreases as Shock Electrics will forward this amount to the ATO.</i>

f

Explanation	<i>Information must be available to decision makers in time to influence their decision making, and generally the older the information the less useful it is. Ideally this information would become available in September while the poor quality inventory was still on hand so that Glow Warm could examine the items before they were sold. (Glow Warm could still check its existing inventory and hold any items delivered in September until it knows more.)</i>

g

Discussion	<i>Glow Warm has not received confirmation that the products are faulty and so could choose to continue selling those items as usual. However, this runs the risk of selling inventory which it knows could be faulty which could be argued to be unethical. Further, these items are electrical goods and could be dangerous and cause harm to the consumers. In the longer term this could cause reputational harm and jeopardise the firm's future. Alternatively, Glow Warm could remove from sale any remaining inventory and recall any of the items it has already sold (and replace them or issue a refund to the customer). However, this would decrease profit and could still harm the firm's reputation (and it is not yet confirmed that the products are faulty).</i>

Exercise 5.4 Purchase Return

a

Document	<i>Credit note</i>
Transaction	<i>Purchase return of 2 saxophones (to Musical Mayhem) due to damage</i>

b

General Journal

Date	Details	Debit \$	Credit \$
<i>Feb. 8</i>	Account Payable – Muscial Mayhem	1 100	
	<i>Inventory</i>		<i>1 000</i>
	<i>GST Clearing</i>		<i>100</i>
	<i>Purchase return of 2 saxophones to Musical Mayhem</i>		
	<i>due to damage (Credit note 480)</i>		

c

General Ledger

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Feb. 1</i>	<i>Balance</i>	<i>43 000</i>	<i>Feb. 2</i>	<i>Account Payable – Musical Mayhem</i>	<i>1 000</i>

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>Feb. 1</i>	<i>Balance</i>	<i>960</i>
			<i>2</i>	<i>Account Payable – Musical Mayhem</i>	<i>100</i>

Account Payable – Musical Mayhem (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Feb. 2</i>	<i>Inventory / GST Clearing</i>	<i>1 100</i>	<i>Feb. 1</i>	<i>Balance</i>	<i>23 000</i>

d

Explanation	<i>It increases</i>
	<i>as this GST will no longer be forwarded to the ATO by the supplier (Musical Mayhem)</i>
	<i>so it must be paid / is owed by Mentone Music Shop.</i>

e

Explanation	<i>Because it will generate trust from the supplier (Musical Mayhem)</i>
	<i>helping Mentone Music Shop to obtain good quality inventory at good prices,</i>
	<i>and allow them to return items when for legitimate reasons without having to</i>
	<i>resort to a (time consuming and costly) legal course of action.</i>

Exercise 5.5 Purchases, Payments and Returns

a

Document	<i>Cheque butt / EFT transfer receipt / ATM receipt / Bank Statement</i>
-----------------	--

b

General Journal

Date	Details	Debit \$	Credit \$
April 5	Inventory	1 600	
	GST Clearing	160	
	Account Payable – Freezing Fridges		1 760
April 11	Account Payable – Freezing Fridges	8 000	
	Bank		8 000
April 18	Bank	3 300	
	Sales		3 000
	GST Clearing		300
	Cost of Sales	1 200	
	Inventory		1 200
April 26	Inventory	2 100	
	GST Clearing	210	
	Account Payable – Freezing Fridges		2 310
April 26	Account Payable – Freezing Fridges	462	
	Inventory		420
	GST Clearing		42

Chapter 5 Special Journals 1: Credit Journals – Solutions to exercises

c

General Ledger

Account Payable – Freezing Fridges (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
April 11	Bank	8 000	April 1	Balance	8 000
29	Inventory / GST Clearing	462	6	Inventory / GST Clearing	1 760
			26	Inventory / GST Clearing	2 310

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
April 6	Account Payable – Freezing Fridges	160	April 1	Balance	350
26	Account Payable – Freezing Fridges	210	18	Bank	300
			29	Account Payable – Freezing Fridges	420

d

Explanation	Assets will decrease \$420 due to the inventory that has been returned to the supplier;
	Liabilities will decrease \$420 overall as although
	the amount owed to Account Payable – Freezing Fridges will decrease \$462
	for the Inventory which has been returned and the GST on the return,
	GST Clearing will increase \$42 as this amount is owed / must now be paid to
	the ATO by Benny Electricals.

e

Explanation	As a current liability
	because it is a present obligation to transfer an economic resource (cash),
	and this will be settled (when the cash is paid to the Account Payable)
	sometime in the next 12 months.

Exercise 5.6 Discount Revenue

a

Explanation	<i>To entice them to pay early</i>
	<i>therefore increasing the cash they have available to meet their own cash</i>
	<i>commitments (such as paying Accounts Payable or Wages).</i>

b

Explanation	<i>Because the terms of the purchase were 10/7, n/60, meaning a discount is available if they pay within 7 days of the purchase.</i>
	<i>The purchase occurred on 31 January 2025 and the payment is made less than 7 days later on 5 February 2025.</i>

C

Calculation	
<i>Amount owing</i>	<i>\$1 870</i>
- <i>Amount paid</i>	<u><i>1 683</i></u>
<i>Discount revenue</i>	<i>187</i>
Discount revenue	\$ 187

d

General Journal

Date	Details	Debit \$	Credit \$
Feb. 5	Account Payable – J&M Papermills	1 870	
	Bank		1 683
	Discount revenue		187
	Payment to Account Payable after discount of 10%		
	(Ch. 100 325)		

Chapter 5 Special Journals 1: Credit Journals – Solutions to exercises

e

General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Feb. 1	Balance	1 000	Feb. 5	Account Payable – J&M Papermills	1 683

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Feb. 15	Account Payable – J&M Papermills	250	Feb. 1	Balance	390

Account Payable – J&M Papermills (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Feb. 5	Bank / Discount revenue	1 870	Feb. 1	Balance	1 870
			15	Inventory / GST Clearing	2 750

Discount revenue (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Feb. 5	Account Payable – J&M Papermills	187

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Feb. 1	Balance	1 000			
15	Account Payable – J&M Papermills	2 500			

f

Explanation *It causes a decrease in liabilities (Accounts Payable) and an increase in Owner's equity, and is earned in February 2025 (when the payment is made).*

9

Explanation	<i>The GST is charged on the value of the inventory purchased (\$1 700)</i>
	<i>whereas the discount is charged on the amount owing (\$1 870)</i>
	<i>which includes the \$1 700 for the inventory plus the \$170 GST on the</i>
	<i>purchase.</i>

Exercise 5.7 Discount Revenue

a

Explanation	<i>This will breach Verifiability, meaning that the transactions cannot be checked against the source document to ensure that the information as recorded accurately.</i>
	<i>This means there is less confidence that the reports provide a Faithful representation of the firm's position, as it cannot be proven that the records are complete, free from error and neutral (without bias).</i>

b

General Journal

Date	Details	Debit \$	Credit \$
June 3	Account Payable – Freezing Fridges	15 950	
	Bank		14 674
	Discount revenue		1 276
12	Inventory	8 000	
	GST Clearing	800	
	Account Payable – Carter Diamonds		8 800
12	Display cabinets	5 500	
	GST Clearing	550	
	Bank		6 050
17	Account Payable – Carter Diamonds	1 650	
	Inventory		1 500
	GST Clearing		150
23	Bank	9 900	
	Sales		9 000
	GST Clearing		900
	Cost of Sales	6 000	
	Inventory		6 000

Chapter 5 *Special Journals 1: Credit Journals* – Solutions to exercises

c

	Increase / Decrease / No effect	Amount \$
Assets	Decrease (Bank)	14 674
Liabilities	Decrease (Accounts Payable)	15 950
Owner's Equity	Increase (Discount revenue)	1 276

d/e

General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	22 900	June 3	Account Payable – Carter Diamonds	14 674
5	Sales / GST Clearing	13 200	8	Wages	1 200
23	Sales / GST Clearing	9 900	12	Bank / GST Clearing	6 050
			14	Inventory / GST Clearing	4 950
			20	Account Payable – Carter Diamonds	6 578
			26	Drawings	1 000
			30	Electricity / GST Clearing	253
				Balance	11 295
		46 000			46 000
July 1	Balance	11 295			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	74 500	June 1	GST Clearing	1 700
12	Account Payable – Carter Diamonds	8 000	5	Cost of Sales	8 000
14	Bank	4 500	17	Account Payable – Carter Diamonds	1 500
29	Account Payable – Carter Diamonds	10 000	23	Cost of Sales	6 000
			30	Balance	79 800
		97 000			97 000
July 1	Balance	79 800			

Chapter 5 Special Journals 1: Credit Journals – Solutions to exercises

Display cabinets (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	35 000			
12	Bank	5 500			

Account Payable – Carter Diamonds (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 3	Bank / Discount revenue	15 950	June 1	Balance	15 950
17	Inventory / GST Clearing	1 650	12	Inventory / GST Clearing	8 800
20	Bank / Discount revenue	7 150	29	Inventory / GST Clearing	11 000

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Bank	1 700	June 1	Balance	1 700
12	Account Payable – Carter Diamonds	800	5	Bank	1 200
	Bank	550	17	Account Payable – Carter Diamonds	150
14	Bank	450	23	Bank	900
29	Account Payable – Carter Diamonds	1 000	30	Balance	573
30	Bank	23			
		4 523			4 523
July 1	Balance	573			

Discount revenue (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			June 3	Account Payable – Carter Diamonds	1 276
			20	Account Payable – Carter Diamonds	572

Chapter 5 *Special Journals 1: Credit Journals* – Solutions to exercises

Sales (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			June 5	Bank	12 000
			23	Bank	9 000

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 5	Inventory	8 000			
23	Inventory	6 000			

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 8	Bank	1 200			

Drawings (-OE)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 26	Bank	1 000			

Electricity (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Bank	230			

f

Explanation *As a Current asset because the Debit balance indicates a debt owed to the business by the ATO (as GST on purchases is greater than GST on sales) meaning it is a present economic resource controlled by the business which is expected to be received as cash within the next 12 months (as a GST refund).*

Exercise 5.8 Accounts Payable

a

Document	<i>Credit note (issued by the supplier)</i>
-----------------	---

b

Reason 1	<i>Wrong size / type / colour / quantity</i>
Reason 2	<i>Damaged</i>

c

General Ledger Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	<i>Balance</i>	42 000		<i>Cost of Sales</i>	60 000
	<i>Account Payable – Wilson Industries</i>	50 000		<i>Account Payable – Wilson Industries</i>	1 000
	<i>Bank</i>	3 000			

Account Payable – Wilson Industries (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
	<i>Bank / Discount revenue</i>	60 000	Oct. 1	<i>Balance</i>	34 000
	<i>Inventory / GST Clearing</i>	1 100		<i>Inventory / GST Clearing</i>	55 000

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
	<i>Account Payable – Wilson Industries</i>	5 000	Oct. 1	<i>Balance</i>	800
	<i>Bank</i>	300		<i>Bank</i>	9 000
	<i>Bank</i>	2 500		<i>Account Payable – Wilson Industries</i>	100

d

Calculation

$$\begin{array}{lcl} \text{Discount amount} & \frac{\$600}{\$60\,000} & \\ \text{Reduction in Accounts Payable} & * & = 0.01 \end{array} \quad * 59\,400 + 600$$

$$\begin{array}{lcl} \text{Discount rate} & 0.01 & \times 100 \\ & = & 1\% \end{array}$$

Discount rate	1 %
----------------------	-----

e

Explanation	<i>Because it gives the business time to sell the inventory and collect the cash before cash must be paid to the Account Payable.</i>
	<i>This means the business does not have to rely on cash reserves and is more likely to have cash available when needed.</i>

f

Discussion	<i>Paying early means Thommo's Toys earns Discount revenue, which reduces the amount of cash it has to pay and also increases Net Profit.</i>
	<i>However, the rate is so low (1%) that these benefits are small, and by paying early Thommo's Toys does not have the cash to use to make other payments.</i>
	<i>The benefits in this case may be too small to justify the costs.</i>

Exercise 5.9 Accounts Payable

a

Calculation			
Discount amount	<u>\$198</u>		
Reduction in Accounts Payable	\$3 300 *	= 0.06	* Balance owing
Discount rate	0.06	x 100	
=	6%		
Discount rate			6 %

b

General Journal

Date	Details	Debit \$	Credit \$
June 3	Account Payable – Look of the Irish	3 300	
	Bank		3 102
	Discount revenue		198
	Payment to Account Payable after discount of 6% (Cheque 143)		
12	Inventory	1 200	
	GST Clearing	120	
	Account Payable – Look of the Irish		1 320
	Credit purchase of inventory from Look of the Irish (Invoice MH 365)		

c

Explanation	Assets will decrease \$200 due to the inventory that has been returned to the supplier;
	Liabilities will decrease \$200 overall as although the amount owed to Account Payable – Look of the Irish will decrease \$220 for the Inventory which has been returned and the GST on the return,
	GST Clearing will increase \$20 as this amount is owed / must now be paid to the ATO by Celtic Sensations.

d General Ledger

Account Payable – Look of the Irish (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 3	Bank / Discount revenue	3 300	June 1	Balance	3 300
19	Inventory / GST Clearing	220	12	Inventory / GST Clearing	1 320
24	Bank	500	29	Inventory / GST Clearing	1 650
30	Balance	2 250			
		6 270			6 270
			July 1	Balance	2 250

e

Explanation	<i>As a current liability, Account Payable – Look of the Irish</i>
	<i>because it is a present obligation to transfer an economic resource (cash),</i>
	<i>and this will be settled (when the cash is paid to Look of the Irish)</i>
	<i>sometime in the next 12 months.</i>

f

Explanation	<i>As a Current asset, Account Receivable – Celtic Sensations</i>
	<i>because it is a present economic resource controlled by Look of the Irish</i>
	<i>which they expect to receive as cash within the next 12 months.</i>

g

Explanation	<i>It supports Verifiability as it can be checked against the ledger account for</i>
	<i>Account Payable – Look of the Irish in the General Ledger of Celtic Sensations</i>
	<i>as well as the original source documents for each transaction.</i>
	<i>This can ensure that the information is complete, free from error and neutral</i>
	<i>(without bias), and therefore provides a Faithful representation of the firm's</i>
	<i>financial events and position.</i>

Exercise 5.10 Accounts Payable Turnover

a

Measures	<i>average number of days taken to pay Accounts Payable (thereby indicating the effectiveness of the management of Accounts Payable).</i>
-----------------	---

b

Calculation		
$APTO$	$= \frac{\text{Average Accounts Payable}}{\text{Net Credit purchases (plus GST)}} \times 365$	
	$= \frac{(\$12\,000 + \$8\,000) / 2}{\$91\,300 - \$7\,150} \times 365$	
	$= \frac{\$10\,000}{\$84\,150} \times 365$	
	$= 44^* \text{ days (43.4 rounded up to the nearest day)}$	
Accounts Payable Turnover		44 days

c

Reason 1	<i>Greater than credit terms offered by suppliers (40 days)</i>
Reason 2	<i>Slower than previous year (2024 – 38 days)</i>

d

Explanation	<i>It could mean a loss of credit facilities, meaning the business would have to have cash on hand to purchase inventory.</i>
	<i>This could have negative effects on liquidity as the cash a) may not be available, leading to an inability to purchase or a bank overdraft, or</i>
	<i>b) the cash would not be available to use to make other payments such as</i>
	<i>Wages and other expenses, loan repayments or drawings.</i>

e

Action 1	<i>Increase cash sales / collections from Accounts Receivable so cash is available to pay Accounts Payable.</i>
Action 2	<i>Contact the Accounts Payable to negotiate an extended period to pay</i>

Exercise 5.11 Accounts Payable Turnover

a

Trend	<i>During 2024 Accounts Payable Turnover was marginally slower than 2023 but also slower than the 60 day credit terms offered by suppliers.</i>
	<i>This presents risks for the continuation of credit facilities.</i>
	<i>In 2025 Accounts Payable Turnover was not only faster than 2024 but also faster than the credit terms offered by suppliers, falling to around 45 days.</i>
	<i>It has therefore fluctuated across the three years, but the most recent trend is towards faster Accounts Payable Turnover</i>

b

Reason 1	<i>Less cash available to pay Accounts Payable on time, perhaps due to lower sales or receipts from Accounts Receivable, or higher other payments.</i>
Reason 2	<i>Deliberate decision by Sam to delay payments until well after the due date, perhaps because there is no follow up from the Accounts Payable.</i>

c

Explanation	<i>Action: reminder calls, letters; refusal to provide credit; threat of legal action which would have prompted Sam to pay on time (and even early).</i>
	<i>NB. Not discounts (see additional information).</i>

d

Explanation	<i>It is greater than the 60 day credit terms offered by the suppliers, meaning they may choose to withdraw credit facilities.</i>

e

Discussion	<i>Paying after the due date will mean Sam's Moulds retains cash for longer. This can then be used to make other payments (such as Wages and other expenses, loan repayments and drawings). In addition, there is no discount revenue to be earned from early payment.</i>
	<i>However, paying late could mean Accounts Payable refuse to supply on credit, meaning inventory must be purchased using cash. This would place greater pressure on cash flows, as cash would need to be paid before it had been generated from sales. Cash may not be available, leading to the need for a bank overdraft or a contribution by the owner, or it could mean cash is not available for other uses.</i>

f

Discussion	<i>Given there is no discount to be earned Sam should be delaying payments to Accounts Payable as long as possible, thereby retaining cash to be used for other purposes. This would be both financially and ethically responsible.</i>
	<i>Delaying payments beyond the credit terms may be both, or neither.</i>
	<i>At times it may be necessary to delay payments because cash is not available, or required for urgent purposes like paying employees. If this was only occasional it could be argued to be both financially and ethically responsible.</i>
	<i>However, regularly delaying payments beyond the credit terms is not adhering to the terms of the agreement and could be argued to be unethical.</i>
	<i>Further, the damage to the relationship with the Account Payable may have negative financial consequences especially if the supplier refuses further credit and the business is forced to use cash to purchase inventory, leading to a negative effect on liquidity.</i>

Exercise 6.1 Credit Sale

a

Document	<i>Sales invoice</i>
Transaction	<i>Credit sale of 12 sheet sets (to Country Inn)</i>

b

Explanation	<i>If the cash is received from the customer within 7 days a 6% discount is given but the full ('net') amount is due within 30 days.</i>

c

Calculation	
	$\text{Selling price} = CP \times (1 + M/up)$
	$720 = CP \times (1 + 1)$
	$CP = 720 / 2$
	Cost price \$ 360

d

General Journal

Date	Details	Debit \$	Credit \$
<i>May 4</i>	Account Receivable – Country Inn	792	
	<i>Sales</i>		<i>720</i>
	<i>GST Clearing</i>		<i>72</i>
	Cost of Sales	360	
	Inventory		360
	<i>Credit sale of 12 sheet sets to Country Inn</i>		
	<i>(Invoice 90)</i>		

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

e

General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 1	Balance	13 000			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 1	Balance	50 000	May 4	Cost of Sales	360

Account Receivable – Country Inn (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 1	Balance	400			
4	Sales / GST Clearing	792			

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			May 1	Balance	600
			4	Account Receivable – Country Inn	72

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			May 4	Account Receivable – Country Inn	720

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 4	Inventory	360			

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

f

	Increase / Decrease / No effect	Amount \$
Assets	<i>Increase (Increase Accounts Receivable \$792; decrease Inventory \$360)</i>	432
Liabilities	<i>Increase (GST Clearing)</i>	72
Owner's Equity	<i>Increase (Sales \$720 less Cost of Sales \$360 increases Net Profit)</i>	360

g

Explanation	<i>The GST is charged, and will be collected, on behalf of the ATO</i>
	<i>therefore Deco Décor has a present obligation to transfer an economic</i>
	<i>resource (cash) to the ATO by paying the GST settlement.</i>

Exercise 6.2 Credit Sales

a

Number	(Invoice) 76
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b

General Journal

Date	Details	Debit \$	Credit \$
Sept. 3	Account Receivable – Rydell PS	528	
	Sales		480
	GST Clearing		48
	Cost of Sales	320	
	Inventory		320
	Credit sale of 2 bookcases to Rydell PS		
	(Invoice 75)		
Sept. 11	Bank	1 980	
	Sales		1 800
	GST Clearing		180
	Cost of Sales	1 200	
	Inventory		1 200
	Cash sale of 3 beds (Receipt 55)		
Sept. 16	Inventory	900	
	GST Clearing	90	
	Account Payable – Pine Products		990
	Credit purchase of 5 desks from Pine Products		
	(Invoice A310)		
Sept. 23	Account Receivable – Rydell PS	2 640	
	Sales		2 400
	GST Clearing		240
	Cost of Sales	1 600	
	Inventory		1 600
	Credit sale of 4 beds to Rydell PS		
	(Invoice 76)		

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

b (continued)

General Journal

Date	Details	Debit \$	Credit \$
Sept. 29	Account Receivable – Rydell PS	297	
	Sales		270
	GST Clearing		27
	Cost of Sales	180	
	Inventory		180
	Credit sale of 1 desk to Rydell PS		
	(Invoice 77)		

c

Explanation	Assets increase \$208 because
	Accounts Receivable increases \$528 as Rydell PS owes Polly Junior for the
	Sale plus the GST, but Inventory decreases \$320 as the bookcases go out.
	Liabilities increase \$48 as Polly Junior has an obligation to pay the GT on the
	sale to the ATO.
	Owner's equity increases \$160 for the profit on the sale (Sales \$480 less Cost
	of Sales \$320).

d

Explanation	It is a cash sale as it is verified by Receipt 55
	so it is debited to Bank (rather than Accounts Receivable).
	The remaining entries are the same as for a credit sale.

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

e

General Ledger

Bank (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 11	Sales / GST Clearing	1 980	Sept. 1	Balance	2 000

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 1	Balance	43 000	Sept. 3	Cost of Sales	320
16	Accounts Payable – Pine Products	900	11	Cost of Sales	1 200
			23	Cost of Sales	1 600
			29	Cost of Sales	180

Account Receivable – Rydell PS (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 1	Balance	500			
3	Sales / GST Clearing	528			
23	Sales / GST Clearing	2 640			
29	Sales / GST Clearing	297			

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 16	Accounts Payable – Pine Products	90	Sept. 1	Balance	800
			3	Account Receivable – Rydell PS	48
			11	Bank	180
			23	Account Receivable – Rydell PS	240
			29	Account Receivable – Rydell PS	27

Account Payable – Pine Products (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Sept. 1	Balance	400
			16	Inventory / GST Clearing	990

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Sept. 3	Account Receivable – Rydell PS	480
			11	Bank	1 800
			23	Account Receivable – Rydell PS	240
			29	Account Receivable – Rydell PS	270

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 3	Inventory	320			
11	Inventory	1 200			
23	Inventory	1 600			
29	Inventory	180			

f

Explanation	<i>As a Current liability as it is a present obligation to transfer economic resources (cash) when the GST settlement is paid to the ATO in the next 12 months.</i>

Exercise 6.3 Credit Sales and Receipts from Accounts Receivable

a

Feature 1	<i>Settlement of account / Receipt number 83 / Received from V. Deo</i>
Feature 2	<i>Book Me Danno named at the top as the business receiving the cash</i>

b

Explanation	<i>It is a receipt from an Account Receivable</i>
	<i>GST is charged at the point of sale (when the credit sale is made)</i>
	<i>To recognise GST here would be double counting.</i>

c

Explanation	<i>This amount was owing on 1 October 2025 and has been received on 15 October 2025, more than the 10 days allowed by the credit terms.</i>

d

General Journal

Date	Details	Debit \$	Credit \$
Oct. 15	Bank	270	
	Accounts Receivable – V. Deo		270
	Received cash from V. Deo for amount owing (Receipt 83)		
23	Account Receivable – V. Deo	572	
	Sales		520
	GST Clearing		52
	Cost of Sales	350	
	Inventory		350
	Credit sale of books to V. Deo (Invoice 152)		
29	Bank	300	
	Accounts Receivable – V. Deo		300
	Received cash from V. Deo towards amount owing (EFT receipt 302)		

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

e

General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	Balance	3 000			
15	Account Receivable – V. Deo	270			
29	Account Receivable – V. Deo	300			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	Balance	26 000	Oct. 23	Cost of Sales	350

Account Receivable – V. Deo (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	Balance	270	Oct. 15	Bank	270
23	Sales / GST Clearing	572	29	Bank	300

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Oct. 1	Balance	500
			23	Account Receivable – V. Deo	52

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Oct. 23	Account Receivable – V. Deo	520

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 23	Inventory	350			

f

Explanation	<i>Under the Accrual basis assumption revenue is recognised when it is earned (ie. at the point of sale) because this is when the definition of revenue is met.</i>
	<i>On 15 October 2025 there is no revenue earned and therefore no effect on profit as no inventory has been provided.</i>
	<i>This receipt from an Account Receivable simply exchanges one asset (Accounts Receivable) for another (Bank): there is no overall change in assets.</i>

g

Explanation	<i>The reports would not be complete and the Accounts Receivable figure would be inaccurate, and they would not provide a Faithful representation of the firm's position.</i>
	<i>As a result, they would not include all Relevant information capable of making a difference to decision making.</i>

Exercise 6.4 Sales Return

a

Document	<i>Credit note</i>
Transaction	<i>Sales return of 5 children's bibles (by Grant Hugh) due to damage</i>

b

General Journal

Date	Details	Debit \$	Credit \$
<i>June 12</i>	<i>Sales returns</i>	<i>250</i>	
	<i>GST Clearing</i>	<i>25</i>	
	Account Receivable – Grant Hugh		792
	<i>Inventory</i>	<i>150</i>	
	<i>Cost of Sales</i>		<i>150</i>
	<i>Sales return of 5 children's bibles by Grant Hugh</i>		
	<i>(Credit note 46)</i>		

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

c

General Ledger

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	32 000			
12	Cost of Sales	150			

Account Receivable – Grant Hugh (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	990	June 12	Sales returns / GST Clearing	275

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 12	Account Receivable – Grant Hugh	25	June 1	Balance	450

Sales returns (-R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 12	Account Receivable – Grant Hugh	250			

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			June 12	Cost of Sales	150

d

	Increase / Decrease / No effect	Amount \$
Assets	Decrease (Decrease Accounts Receivable \$275; increase Inventory \$150)	125
Liabilities	Decrease (GST Clearing)	25
Owner's Equity	Decrease (Sales returns \$250 less decrease Cost of Sales \$150 decreases Net Profit)	100

e

Explanation	<i>Contact the postal company to determine how the damage occurred and whether compensation is possible / Repair the books so that they may be resold / Review handling and wrapping procedures in the store to prevent damage in future / Sell the books at a reduced price</i>
--------------------	--

f

Discussion	<i>From a financial perspective, accepting the Sales return will decrease profit. It is not clear when or how the damage was caused, so Pickwick Books Books could deny responsibility and refuse the return and advise the customer to complain to the the postal company. However, this could have legal, ethical and financial consequences. Legally, it could be claimed that Pickwick Books has an obligation to prepare (wrap) the books so that they are not damaged in the mail, and therefore they are legally obliged to accept the return. Ethically, if there is doubt as to whether this occurred then Pickwick Books should accept the return. This may be particularly the case given Grant Hugh has been a customer in the past and may continue to be into the future. Financially, there may be a benefit in the longer term from building a reputation as a business which looks after its customers (even if the damage was not the firm's fault). Pickwick Books could also take up the issue with the postal company to see if compensation is available, reducing the financial impact. Also, the amount of this return seems small meaning the cost of accepting it might be outweighed by the benefits.</i>
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Exercise 6.5 Sales, Receipts and Returns

a

Document	<i>Credit note</i>
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b

Reason	<i>Sales were made to other Accounts Receivable and invoices issued to them</i>
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c

General Journal

Date	Details	Debit \$	Credit \$
Sept. 2	<i>Account Receivable – L. Christopher</i>	1 716	
	<i>Sales</i>		1 560
	<i>GST Clearing</i>		156
	<i>Cost of Sales</i>	900	
	<i>Inventory</i>		900
9	<i>Bank</i>	1 000	
	<i>Account Receivable – L. Christopher</i>		1 000
15	<i>Inventory</i>	12 000	
	<i>GST Clearing</i>	1 200	
	<i>Account Payable – Delmonte Suits</i>		13 200
21	<i>Sales returns</i>	520	
	<i>GST Clearing</i>	52	
	<i>Account Receivable – L. Christopher</i>		572
	<i>Inventory</i>	300	
	<i>Cost of Sales</i>		300
29	<i>Account Receivable – L. Christopher</i>	176	
	<i>Sales</i>		160
	<i>GST Clearing</i>		16
	<i>Cost of Sales</i>	80	
	<i>Inventory</i>		80

Chapter 6 Special Journals 2: Cash Journals – Solutions to exercises

d **General Ledger**
Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 1	Balance	38 000	Sept. 2	Cost of Sales	900
15	Account Payable – Delmonte Suits	12 000	29	Cost of Sales	80
21	Cost of Sales	300			

Account Receivable – L. Christopher (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 1	Balance	1 100	Sept. 9	Bank	1 000
2	Sales / GST Clearing	1 716	21	Sales returns / GST Clearing	572
29	Sales / GST Clearing	176			

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 1	Balance	300	Sept. 2	Account Receivable – L. Christopher	156
21	Account Receivable – L. Christopher	52	29	Account Receivable – L. Christopher	16

e

Explanation	Asset decrease overall by \$220:
	Account Receivable – L. Christopher decreases \$572 because he no longer owes the business for the suit he has returned (and the GST on that suit);
	Inventory increases \$300 as the suit is put back into the shop; and
	GST Clearing increases \$52 as this amount is owed to the business by the ATO.

e

Strategy 1	Improve service at time of sale to ensure that the customer is fitted correctly and has the right size clothing.
Strategy 2	Improve signage and labelling to ensure customers are able to identify the size of the products they are buying.

Exercise 6.6 Discount Expense

a

Explanation	<i>Because the terms of the sale were 6/10, n/30, meaning a discount is available if cash is received within 10 days of the sale.</i>
	<i>The sale occurred on 24 April 2025 and the cash is received less than 10 days later on 3 May 2025.</i>

b

Calculation	
Amount owing	\$1 100
- Amount paid	<u>1 034</u>
Discount revenue	66
	Discount expense
	\$ 66

c

General Journal

Date	Details	Debit \$	Credit \$
May 3	Bank	1 034	
	Discount expense	66	
	Account Receivable – L. Christopher		1 100
	Cash received from M. Salah after discount of \$66		
	(EFT receipt 36524)		

d

Explanation	<i>It is a decrease in assets (Account Receivable – M. Salah) that results in a decrease in Owner's equity and is incurred when the cash is received and the discount is given on 3 May 2025.</i>
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Chapter 6 Special Journals 2: Cash Journals – Solutions to exercises

e General Ledger

Bank (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 3	Account Receivable – M. Salah	1 034	May 1	Balance	600

Account Receivable – M. Salah (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 1	Balance	1 100	May 3	Bank / Discount expense	1 100

Discount expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 3	Account Receivable – M. Salah	66			

f

Explanation	<i>Under the Accrual basis assumption, revenue is earned at the point of sale so the discount does not reduce the revenue earned on 24 April 2025.</i>
	<i>It increases expense incurred on 3 May 2025 when the discount is granted.</i>

g

Discussion	<i>Discounts offered to Accounts Receivable are expenses which reduce profit and also reduce the amount of cash received.</i>
	<i>However, they increase the speed at which cash is received from Accounts Receivable and this cash can then be used to meet other cash requirements such as paying Wages and other expenses or loans.</i>
	<i>This faster receipt of cash from Accounts Receivable can also reduce the possibility of bad debts.</i>
	<i>As a result, they can be beneficial for liquidity (but the owner must monitor the benefit in terms of receiving cash faster versus the costs of lower profit and smaller amounts of cash being received.</i>

Exercise 6.7 Accounts Receivable: Cash and Credit Transactions

a

Explanation	<i>The discount period of 25 days is almost as long as the 30 days given to pay so almost all Accounts Receivable will receive the discount.</i>
	<i>Sports Bonanza will thus incur Discount expense and receive less cash but without receiving the cash much faster from Accounts Receivable.</i>

b

General Journal

Date	Details	Debit \$	Credit \$
Dec. 5	Bank	1 188	
	Discount expense	132	
	Account Receivable – Emerald CC		1 320
9	Account Receivable – St. Carl's PS	1 430	
	Sales		1 300
	GST Clearing		130
	Cost of Sales	800	
	Inventory		800
13	Sales returns	200	
	GST Clearing	20	
	Account Receivable – St. Carl's PS		220
	Inventory	120	
	Cost of Sales		120
17	Account Payable – Apex Sports	12 000	
	Bank		10 230
	Discount revenue		770
21	Bank	1 089	
	Discount expense	121	
	Account Receivable – St. Carl's PS		1 210

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

c

Explanation *To receive the discount the customer must pay the full amount within the credit terms but this was only a partial payment of the \$825 owing from the sale on 16 December 2025.*

d/e

General Ledger

Bank (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 3	GST Clearing	700	Dec. 1	Balance	500
5	Account Receivable – Emerald CC	1 188		Drawings	500
21	Account Receivable – St. Carl's PS	1 089	12	Wages	780
24	Sales / GST Clearing	770	15	Inventory / GST Clearing	4 510
31	Account Receivable – Emerald CC	500	17	Account Payable – Apex Sports	10 230
	Balance	13 483	27	Electricity / GST Clearing	1 210
		17 730			17 730
			Jan. 1	Balance	13 483

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 1	Balance	14 000	Dec. 9	Cost of Sales	800
8	Account Payable – Apex Sports	10 000	16	Cost of Sales	450
13	Cost of Sales	120	24	Cost of Sales	400
15	Bank	4 100	31	Balance	26 570
		28 220			28 220
Jan. 1	Balance	26 570			

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

Account Receivable – Emerald CC (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 1	Balance	1 320	Dec. 5	Bank / Discount expense	1 320
16	Sales / GST Clearing	825	31	Bank	500

Account Receivable – St. Carl's PS (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 9	Sales / GST Clearing	1 430	Dec. 13	Sales returns / GST Clearing	220
			21	Bank / Discount expense	1 210

Shop fittings (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 1	Balance	25 000			

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 1	Balance	700	Dec. 3	Bank	700
8	Account Payable – Apex Sports	1 000	9	Account Receivable – St. Carl's PS	130
9	Account Receivable – St. Carl's PS	20	16	Account Receivable – Emerald CC	75
15	Bank	410	24	Bank	70
27	Bank	110	31	Balance	1 265
		2 240			2 240
Jan. 1	Balance	1 265			

Account Payable – Apex Sports (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 17	Bank / Discount revenue	11 000	Dec. 8	Inventory / GST Clearing	11 000

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

Loan – FinCo (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>Dec. 1</i>	<i>Balance</i>	<i>12 000</i>

Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>Dec. 1</i>	<i>Balance</i>	<i>28 520</i>

Drawings (-Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Dec. 1</i>	<i>Bank</i>	<i>500</i>			

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>Dec. 9</i>	<i>Account Receivable – St. Carl's PS</i>	<i>1 300</i>
			<i>16</i>	<i>Account Receivable – St. Carl's PS</i>	<i>750</i>
			<i>24</i>	<i>Bank</i>	<i>700</i>

Sales returns (-R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Dec. 13</i>	<i>Account Receivable – St. Carl's PS</i>	<i>200</i>			

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Dec. 9</i>	<i>Inventory</i>	<i>800</i>	<i>Dec. 13</i>	<i>Inventory</i>	<i>120</i>
<i>16</i>	<i>Inventory</i>	<i>450</i>			
<i>24</i>	<i>Inventory</i>	<i>400</i>			

Chapter 6 *Special Journals 2: Cash Journals* – Solutions to exercises

Discount expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 5	Account Receivable – Emerald CC	132			
21	Account Receivable – St. Carl's PS	121			

Discount revenue (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Dec. 17	Account Payable – Apex Sports	770

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 12	Bank	780			

Electricity (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 27	Bank	1 100			

f

Explanation	<i>As a Current liability, Bank overdraft as it has a credit balance meaning the business has a present obligation to transfer economic resources (cash) if the overdraft is called in in the next 12 months.</i>
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g

Explanation	<i>It decreases equities overall by \$470 because although the profit on the sale increases Owner's equity by \$300 liabilities (Bank overdraft) decrease by \$770. (GST Clearing is an asset)</i>
--------------------	--

h

Discussion	<i>The credit terms offered by Sports Bonanza require Accounts Receivable to pay within 30 days (or 25 days if they wish to receive the discount).</i>
	<i>This is well within the 60 days offered by Apex Sports and should have a positive effect on liquidity as cash should be received from Accounts</i>
	<i>Receivable faster than it is paid to Accounts Payable.</i>
	<i>However, in order to take advantage of the discount offered by Accounts</i>
	<i>Payable Sports Bonanza would need to pay within 10 days, well before it</i>
	<i>collects cash from its Accounts Receivable, and this would have a negative</i>
	<i>effect on liquidity as cash is paid before it is received.</i>
	<i>(This would be exacerbated if cash purchases of inventory were greater than</i>
	<i>cash sales.)</i>

Exercise 6.8 GST Clearing Account

a

Explanation	<i>Because it is not paid to suppliers on purchases,</i>
	<i>but to the ATO to settle the GST debt (from a previous Period)</i>
	<i>and this payment is only infrequent.</i>

b

	Increase / Decrease / No effect	Amount \$
Assets	<i>Decrease (Bank)</i>	<i>1 620</i>
Liabilities	<i>Decrease (GST Clearing)</i>	<i>1 620</i>
Owner's Equity	<i>No effect</i>	

d/e

General Ledger GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
	<i>Bank</i>	<i>1 620</i>	July 1	Balance	1 620
	<i>Bank</i>	<i>380</i>	<i>31</i>	<i>Bank</i>	<i>640</i>
	<i>Accounts Payable</i>	<i>630</i>		<i>Accounts Receivable</i>	<i>920</i>
	<i>Accounts Receivable</i>	<i>120</i>		<i>Accounts Payable</i>	<i>95</i>
<i>July 31</i>	<i>Balance</i>	<i>525</i>			
		<i>3 275</i>			<i>3 275</i>
			<i>Aug. 1</i>	<i>Balance</i>	<i>525</i>

d

Explanation	<i>As a current liability of \$550</i>
	<i>as it is a present obligation to transfer an economic resource (cash)</i>
	<i>when the GST is paid to the ATO sometime in the next 12 months</i>

e

Explanation	<i>Selling prices are usually higher than cost prices,</i>
	<i>so the GST on sales (which creates a liability) is likely to be greater than the</i>
	<i>GST on purchases (which decreases that liability).</i>

Exercise 6.9 Accounts Payable and Accounts Receivable

a

General Ledger

Bank (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Balance	5 000		<i>Inventory / GST Clearing</i>	8 800
	<i>Sales / GST Clearing</i>	22 000		<i>Expenses / GST Clearing</i>	1 650
	<i>Accounts Receivable</i>	39 000		<i>Accounts Payable</i>	28 500

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Balance	13 000		<i>Cost of Sales</i>	25 000
	<i>Bank</i>	8 000		<i>Cost of Sales</i>	12 500
	<i>Accounts Payable</i>	30 000		<i>Accounts Payable</i>	750
	<i>Cost of Sales</i>	750			

Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Balance	25 000		<i>Bank / Discount expense</i>	39 540
	<i>Sales / GST Clearing</i>	44 000		<i>Sales returns / GST Clearing</i>	1 320

Accounts Payable (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
	<i>Bank / Discount revenue</i>	28 870	Nov. 1	Balance	35 000
	<i>Inventory / GST Clearing</i>	825		<i>Inventory / GST Clearing</i>	33 000

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GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
	Bank		Nov. 1	Balance	950
	Bank	8 00		Bank	2 000
	Accounts Payable	3 000		Accounts Receivable	4 000
	Accounts Receivable	120		Accounts Payable	75
	Bank	150			

Cost of Sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
	Inventory	25 000		Inventory	750
	Inventory	12 500			

b

Explanation	<i>It is not possible to identify details relating to each individual Account Receivable such as balance owing, or the date of individual transactions.</i>
	<i>This makes it harder to manage these Accounts Receivable and ensure that they are paying on time.</i>

c

Explanation	<i>If there is only one Account Payable then the balance of the Accounts Payable account is the balance owed to that supplier.</i>
	<i>(Or the business may use additional subsidiary records for Accounts Payable.)</i>

d

Explanation	<i>By comparing it against the Statement of Account issued by the supplier to ensure that the General Ledger account was complete and free from material error.</i>

Exercise 6.10 Accounts Receivable Turnover

a

Measures	<i>average number of days taken to receive cash from Accounts Receivable</i>
	<i>(indicating the effectiveness of the management of Accounts Receivable).</i>

b

Calculation	
$ARTO = \frac{\text{Average Accounts Receivable}}{\text{Net Credit sales (plus GST)}} \times 365$	
$\frac{(\$6\,000 + \$8\,000) / 2}{\$56\,100 - \$1\,870} \times 365$	
$= \frac{\$7\,000}{\$54\,230} \times 365$	
$= 48^* \text{ days (47.1 rounded up to the nearest day)}$	
Accounts Receivable Turnover	47 days

c

Reason 1	<i>Slower than credit terms offered to customers (40 days)</i>
	<i>meaning credit checks / collection procedures are not working</i>
Reason 2	<i>Slower than previous year (2024 – 38 days)</i>
	<i>meaning cash is received more slowly and cannot be used to meet payments</i>

d

Explanation	<i>If cash is not collected quickly enough from Accounts Receivable</i>
	<i>Accounts Payable Turnover may slow</i>
	<i>and payments to Accounts Payable may not be made within the credit terms</i>
	<i>offered by suppliers.</i>

e

Strategy 1	<i>Credit checks before offering credit / Prompt invoicing /</i>
	<i>Offering settlement discounts /</i>
Strategy 2	<i>Reminder calls / Threats of legal action /</i>
	<i>Refusal to grant credit to slow payers</i>

f

Explanation	<i>If cash is not collected quickly enough from Accounts Receivable</i>
	<i>Accounts Payable Turnover may slow</i>
	<i>and payments to Accounts Payable may not be made within the credit terms</i>
	<i>offered by suppliers.</i>

Exercise 6.11 Accounts Receivable Turnover

a

Explanation	<i>Credit terms offered by suppliers are longer than those offered to customers.</i>
	<i>This should mean the business has time to make sales and collect cash from</i>
	<i>Accounts Receivable before cash must be paid to Accounts Payable,</i>
	<i>and short-term debts can be met as they fall due.</i>

b

Reason 1	<i>Lower sales</i>
	<i>Less effective credit checks</i>
Reason 2	<i>Less effective collection procedures</i>
	<i>eg. slow invoicing / failure to send reminders</i>

c

Explanation	<i>Slower collection of cash from Accounts Receivable may have meant less</i>
	<i>cash available to meet cash payments including payments to Accounts</i>
	<i>Payable therefore Accounts Payable Turnover slowed.</i>

d

Reason 1	<i>Faster than 2024 (fell from almost 40 days to under 30 days)</i>
	<i>meaning cash is received faster and can be used for cash requirements.</i>
Reason 2	<i>Faster than credit terms offered to customers (30 days)</i>
	<i>meaning an improvement in collection procedures</i>

e

Explanation	<i>It is more than 10 days slower than the 60 day credit terms offered by</i>
	<i>suppliers, who may decide to refuse to offer credit.</i>
	<i>This could mean Galvin Plastics needs to pay cash for inventory before it has</i>
	<i>time to generate the cash from sales, putting a strain on liquidity.</i>
Action 1	<i>Contact the Accounts Payable to negotiate repayment options</i>
Action 2	<i>Source extra cash (generate higher sales, make a capital contribution)</i>

f

Discussion	<i>Not offering credit to late payers should have the effect of increasing the speed of Accounts Receivable Turnover as only customers who pay on time will be offered credit. This would increase liquidity as cash is received faster from Accounts Receivable and can then be used to make cash payments.</i>
	<i>It could also lead to these customers paying cash for their inventory meaning cash is received much faster.</i>
	<i>However, it could also cost the business in lost sales as some customers decide to buy from other suppliers who do offer credit. This would negatively affect both profit (as the sales are lost) and liquidity as there would be less cash inflows from Accounts Receivable.</i>
	<i>This is particularly the case for a customer like McGregor Holdings which has been a loyal customer for more than 10 years, and usually only pays 3 or 4 days late.</i>
	<i>The business must consider the benefits in terms of faster cash against the costs generated by a potential loss of sales.</i>

Exercise 7.1 Non-cash transactions with the owner

a

Explanation	<i>As a non-current asset: a present economic resource (for displaying inventory for sale) controlled by the entity (Max's Smart Phones) as a result of past events (the contribution by the owner) which are expected to be used by the business for a number of years and are not held for resale.</i>
--------------------	--

b

General Journal

Date	Details	Debit \$	Credit \$
April 1	Shelving	12 500	
	Capital		12 500
	Contribution by owner of shelving valued at fair value		
	(Memo 63)		

c

Explanation	<i>The shelving is valued at its fair value – the value that would have been received if it had been sold at the time it was acquired by the business.</i>
	<i>This valuation is a Faithful representation of the real-world economic value of the shelving when it is acquired by the business.</i>

d

Explanation	<i>Assets will increase by \$12 500 due to the shelving providing economic benefit to the business. Liabilities are not affected.</i>
	<i>Owner's equity will increase by \$12 500 as the owner's contribution increases his claim on the assets of the business.</i>

e

Explanation	<i>Going concern assumes the business will continue operating into the future meaning its assets should continue to be valued by their future economic benefit. The asset is not expected to be liquidated now so should not be valued at its resale value.</i>
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Exercise 7.2 Non-cash transactions with the owner

a

Explanation	<i>To verify an internal transaction</i>
	<i>that does not involve cash and is not a sale, purchase or return of inventory.</i>

b

Explanation	<i>By identifying the current market valuation of other comparable assets</i>
	<i>(of a similar age and/or condition) which then provides a Faithful</i>
	<i>representation of the asset's real-world economic value which is neutral and</i>
	<i>free from bias.</i>

c

Explanation	<i>Under the Entity assumption, the business is an entity separate from the</i>
	<i>owner and its records must be kept on that basis.</i>
	<i>The amount paid by the owner relates to a different entity and cannot be used</i>
	<i>by the business.</i>

d

General Journal

Date	Details	Debit \$	Credit \$
Aug. 12	Laptop	1 100	
	Capital		1 100

e

Explanation	<i>Assets would be overstated by \$900 due to the laptop being over-valued.</i>
	<i>Liabilities would not be affected.</i>
	<i>Owner's equity would be overstated by \$900.</i>

f

Discussion	<i>Wendy is correct in arguing that using the \$2 000 valuation will make assets higher and this may make the business look better. It is also Verifiable by reference to the source document from when she made the purchase.</i>
	<i>However, this valuation is not Relevant from the point of view of the business as the business has not had access to economic benefits worth \$2 000. As a result, this valuation is detrimental to decision making.</i>
	<i>Further, it is not a Faithful representation of the value of the asset – a real world valuation of its economic benefit – at the time it is acquired by the business.</i>
	<i>The only valuation possible for the business is the fair value of \$1 100.</i>

Exercise 7.3 Non-cash drawings by the owner

a

Document	<i>Memo</i>
Transaction	<i>Drawings of inventory by the owner</i>
	<i>(for personal reasons ie. a birthday present for his son).</i>

b

Explanation	<i>Under the Entity assumption, the business is assumed to be an entity separate from the owner, so this transaction must be recorded as a reduction in the owner's claim on the assets of the firm.</i>

c

General Journal

Date	Details	Debit \$	Credit \$
<i>Sept. 16</i>	<i>Drawings</i>	<i>1 000</i>	
	<i>Inventory</i>		<i>1 000</i>
	<i>Drawings of inventory by the owner (Memo 73)</i>		

d

Explanation	<i>Assets decrease by \$1 000 due to the inventory that has been withdrawn and is no longer available to provide an economic benefit to the business.</i>
	<i>Liabilities are not affected.</i>
	<i>Owner's equity decreases by \$1 000 as the owner's claim on the assets of the business decreases.</i>

e Tool Town

Balance Sheet (extract) as at 30 September 2025

	\$	\$
Current Assets		
<i>Capital</i>	<i>23 000</i>	
<i>less Drawings</i>	<i>1 000</i>	<i>22 000</i>

f

Explanation	<i>Because he needs to consider the effect of these reports on society,</i>
	<i>meaning he is obliged to present reports which represent faithfully and</i>
	<i>accurately the true value of the firm's assets, as the reports may be relied</i>
	<i>upon (by Tom and others) to for decision making.</i>

Exercise 7.4 Non-cash transactions with the owner

a General Journal

Date	Details	Debit \$	Credit \$
July 2	Drawings	100	
	Office furniture		100
	Withdrawal of furniture by owner (Memo 24)		
July 10	Shelving	2 500	
	Capital		2 500
	Contribution of shelving by owner at fair value		
	(Memo 25)		

b

Explanation	<i>The shelving is valued at its fair value (excluding any GST) – the real-world economic value of the shelving / the potential economic benefits to the business at the time it was acquired by the business.</i>

c General Ledger Capital (Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			July 1	Balance	30 000
			10	Shelving	2 500

Drawings (-Oe)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 2	Office furniture	100			

d

Explanation	<i>No – drawings by the owner are expressly excluded from definition of an expense (as they are not the result of a business activity, but those of the owner).</i>

e

Explanation	<i>Assets would be understated by \$2 500 due to the shelving not being included in the non-current assets.</i>
	<i>Liabilities would not be affected.</i>
	<i>Owner's equity would be understated by \$2 500 due to the owner's contribution not being recorded.</i>

Exercise 7.5 Commencing entry

a

Calculation

$$\begin{aligned}\text{Owner's Equity} &= \text{Assets} \quad \text{less} \quad \text{Liabilities} \\ &= \$213\,340 \quad \text{less} \quad \$50\,700\end{aligned}$$

Owner's Equity \$ **162 640**

b

General Journal

Date	Details	Debit \$	Credit \$
March 1	Bank	3 400	
	Account Receivable – Sunset Pools	8 250	
	Account Receivable – Mickel Homes	8 690	
	Inventory	124 000	
	Delivery vehicles	69 000	
	Account Payable – Pool Gear		48 000
	GST Clearing		2 700
	Capital		162 640
	Commencement of double-entry records		
	(Memo 54)		

c

Explanation *It is recorded as a credit entry but to GST Clearing as it is a liability: present obligation of the entity (to pay the GST owing) as a result of past events.*

d

Explanation *It is not a transaction (like a deposit) but rather the recognition of a balance as the cash is already in the firm's account.*

e

Explanation	<i>To provide a mechanism for analysing the debit and credit entries and</i>
	<i>for identifying the source document (the memo) which verifies the transaction.</i>

Exercise 7.6 Commencing entry

a General Journal

Date	Details	Debit \$	Credit \$
May 1	Account Receivable – RACV	4 000	
	Account Receivable – Borders	6 800	
	GST Clearing	1 450	
	Inventory	117 000	
	Premises	500 000	
	Bank		2 500
	Account Payable – NZ Pile		26 000
	Account Payable – Woolmark		31 000
	Mortgage		475 000
	Capital		94 750
2	Office equipment	3 100	
	Bank		3 100

b

Explanation <i>The office equipment should be valued at \$3 100</i>	
<i>as this is its fair value and thus its real-world value / economic value to the</i>	
<i>business at the time of its acquisition (which is useful for decision making).</i>	
Qualitative characteristic	<i>Faithful representation (Relevance)</i>

c

Explanation <i>The difference in the two valuations should not be reported as an expense</i>	
<i>as it is not useful for decision making about the firm's activities as this value</i>	
<i>was not consumed by the business but by the owner.</i>	
Qualitative characteristic	<i>Relevance</i>

d Claire's Carpets

Balance Sheet as at 2 May 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Account Receivable – RACV</i>	4 000		<i>Bank</i>	5 600	
<i>Account Receivable – Borders</i>	6 800		<i>Account Payable – NZ Pile</i>	26 000	
<i>GST Clearing</i>	1 450		<i>Account Payable – Woolmark</i>	31 000	
<i>Inventory</i>	117 000	129 250	<i>Mortgage</i>	6 000	68 600
Non-Current Assets			Non-Current Liabilities		
<i>Office equipment</i>	3 100		<i>Mortgage</i>		469 000
<i>Premises</i>	500 000	503 100			
			Owner's equity		
			<i>Capital</i>		94 750
Total Assets		632 350	Total Equities		632 350

Exercise 7.7 Contribution of assets and liabilities

a General Journal

Date	Details	Debit \$	Credit \$
July 1	Bank	20 000	
	Van	13 000	
	Inventory	18 000	
	Loan		27 000
	Capital		24 000

b

Explanation	<i>The cash will be verified by a receipt (of some kind)</i>
	<i>The inventory will be verified by a memo (as it is the result of various purchases).</i>

c

Explanation	<i>The purchase of the van was not made by Danielle's Antiques</i>
	<i>(but rather by the owner – a separate entity)</i>
	<i>so the business cannot claim a reduction in GST owed to the ATO.</i>

d

Explanation	<i>It is assumed that business will continue operating into the future</i>
	<i>meaning the inventory should be valued at its original purchase price</i>
	<i>(as this is Verifiable). The asset is not expected to be liquidated now so</i>
	<i>should not be valued at its resale value.</i>
Accounting assumption	<i>Going concern</i>

e

Discussion	<i>Fair value is an estimate and thus can be said to be less Verifiable than the original purchase price.</i>
	<i>However, the purchase price was not paid by the business but by another Accounting entity, so this valuation is not Relevant to decision making by the business.</i>
	<i>It is also not a Faithful representation of the real-world value of the van at the time it is acquired by the business, meaning the fair value should be used.</i>

Exercise 7.8 Correcting entries

a General Journal

Date	Details	Debit \$	Credit \$
June 30	Telephone charges	50	
	Insurance		50
	Correcting entry: Telephone charges incorrectly debited to Insurance (Memo 16)		
30	Drawings	90	
	Interest expense		90
	Correcting entry: Drawings incorrectly recorded as Interest expense (Memo 17)		
30	Bank	198	
	Wages		198
	Correcting entry: Wrong amount recorded for Wages (Memo 18)		
30	Bank	1 600	
	Account Receivable – B. Billiten		800
	Account Payable – B. Bolton		800
	Correcting entry: receipt from Acc. Receivable recorded as payment to Acc. Payable (Memo 19)		

b

Explanation	<i>In both cases an expense was paid meaning both would result in an decrease to GST owing (and therefore a debit to the GST Clearing account).</i>

c

Explanation	<i>Interest expense decreases \$90 (as the expense was not actually incurred) meaning Net profit increases \$90.</i>

d

Method	<i>By comparing the amount recorded to the figure in the Bank Statement.</i>
	<i>By the employee notifying the business of the over-payment.</i>

e

Explanation	<i>Accounts Receivable would be overstated and Bank would be understated by \$800 because the receipt would not be shown, but Bank would be understated by a further \$800 due to incorrectly showing a payment meaning overall assets would be understated by \$800. No effect on liabilities.</i>
--------------------	---

f

Discussion	<i>Whether the transaction is recorded as Drawings or Interest expense (which decreases Net profit), Owner's equity will still decrease which might suggest it does not matter if the error is declared.</i>
	<i>However, Net profit as reported in the Income Statement will differ and this difference may affect decision making based on that report.</i>
	<i>As an result, Barry has a financial and ethical responsibility to report this error.</i>

Exercise 7.9 Correcting entries

a General Journal

Date	Details	Debit \$	Credit \$
June 30	Advertising	500	
	Drawings		500
	Equipment	120	
	GST Clearing	12	
	Cleaning expenses		132
	Loan – HBM	100	
	Interest expense		100
	Bank	45	
	Electricity	505	
	Account Payable – N. Smythe		550
	Sales returns	450	
	GST Clearing	90	
	Accounts Receivable – B. Quick		495
	Inventory	750	
	Cost of sales		300
	Accounts Payable – B. Quack		495

b

Explanation	<i>No effect – both will result in a decrease to Owner's equity (either directly or as a result of decreasing Net profit).</i>

c

Explanation	<i>Cleaning expenses will decrease by \$120 leading to an increase in Net profit.</i>

d

Explanation	<i>Liabilities will be understated by \$100 as as a result of incorrectly recording a decrease in the Loan – HBM.</i>
	<i>Owner's equity will be overstated by \$100 as a result of not recording the Interest expense. No effect on assets.</i>

e

Explanation	<i>The Statement of Account can be checked against the source documents which verified each transaction as well as against the Account Payable account in the General Ledger to ensure that the reports provide a Faithful representation of the real-world value of the amount owed.</i>
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f

	Increase / Decrease / No effect	Amount \$
Assets	<i>Increase (Increase Inventory \$750, decrease Acc Receivable \$495)</i>	<i>255</i>
Liabilities	<i>Increase (Decrease GST Clearing \$90, increase Acc Payable \$495)</i>	<i>405</i>
Owner's Equity	<i>Decrease (Sales returns 450 less decrease COS 300 = decrease Profit)</i>	<i>150</i>

Exercise 7.10 Order form

a

Explanation	<i>There is no transaction to record</i>
	<i>as no exchange of goods or services has taken place</i>
	<i>(and there are not dollar values).</i>

b

Explanation	<i>It is issued by Bev's Photo Shop as a request</i>
	<i>but Komak is responsible for setting the selling price.</i>

c

Explanation	<i>Because there is no exchange there is no 'past event',</i>
	<i>meaning Bev's Photo Shop does not have control of the inventory (as it has</i>
	<i>not yet been delivered) and it cannot therefore provide an economic benefit.</i>

d

Document	<i>Invoice</i>
-----------------	----------------

Exercise 7.11 Delivery docket

a

Document	<i>Delivery docket</i>
Purpose	<i>To verify the quantity of inventory delivered on a particular day</i>
	<i>(which can be checked against the invoice to verify the amount owing).</i>

b

Information 1	<i>The total amount of the transaction</i>
	<i>The GST on the purchase</i>
Information 2	<i>The invoice number</i>

c

Document 1	<i>Purchase order (Order form)</i>
Document 2	<i>Order confirmation / Shipping confirmation</i>

d

Number of Café sets	9
Justification	<i>10 were ordered but only 9 were 'Shipped' (with 1 remaining on back order)</i>

e

Explanation	<i>It can be checked against a physical count of the number of items delivered</i>
	<i>to ensure it is accurate and faithfully represents the quantity of inventory</i>
	<i>delivered.</i>
	<i>(It can also be checked against the invoice to verify the amount charged.)</i>

Exercise 8.1 Inventory cards: Constant cost prices

a

Explanation <i>No effect:</i>
<i>GST does not affect the economic benefit represented by the inventory, so</i>
<i>inventory cards only record the cost price of inventory that is bought and sold.</i>
<i>(GST on sales increases / GST on purchases decreases GST liability.)</i>

b

Inventory Item: Super Soft mattress					Location: C4, 114					
Inventory Code: SSM					Supplier: Foamworks					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Oct. 1	Balance							60	130	7 800
2	Invoice 4512	25	130	3 250				85	130	11 050
5	Invoice 52				20	130	2 600	65	130	8 450
7	Cr. Note 101				2	130	260	63	130	8 190
11	EFT rec. 2001	30	130	3 900				93	130	12 090
14	Rec. 64				40	130	5 200	53	130	6 890
17	Ch. 580	20	130	2 600				73	130	9 490
20	Cr. Note 16	1	130	130				74	130	9 620
26	Memo 43				2	130	260	72	130	9 360
29	Rec. 71				30	130	3 900	42	130	5 460
31	Memo 46				1	130	130	41	130	5 330

c

Explanation <i>It is a sale so it is</i>
<i>recorded in the OUT column</i>
<i>and decreases the Balance of inventory on hand.</i>

d

Calculation	<i>OUT column:</i>	
	Oct. 6	2 600
	18	5 200
	31	<u>3 900</u> 11 700
		Cost of Sales
		\$ 11 700

e

Reason	<i>It is only for one line of inventory.</i>
	<i>(The Balance Sheet will show the total value of all lines of inventory on hand.)</i>

f See next page

g

Explanation	<i>Thw owner is assumed to be an entity separate from the business</i>
	<i>so this is treated as Drawings by the owner (decreasing Owner's equity).</i>

Chapter 8 *Accounting for Inventory* – Solutions to exercises

f General Journal

Date	Details	Debit \$	Credit \$
Oct. 2	<i>Inventory</i>	3 250	
	<i>GST Clearing</i>	325	3 575
	<i>Account Payable – Supersoft</i>		
	<i>Credit purchase of 25 SuperSoft mattresses</i>		
	<i>(Invoice 4512)</i>		
Oct. 5	<i>Accounts Receivable – Bed World</i>	4 400	
	<i>Sales</i>		4 000
	<i>GST Clearing</i>		400
	<i>Cost of sales</i>		
	<i>Inventory</i>		
	<i>Credit sale of 20 mattresses to Bed World (Invoice 52)</i>		
Oct. 7	<i>Account Payable – Supersoft</i>		
	<i>Inventory</i>		
	<i>GST Clearing</i>		
	<i>Purchase return of 2 mattresses to SuperSoft due to</i>		
	<i>damage (Credit note 101)</i>		
Oct. 20	<i>Sales returns</i>		
	<i>GST Clearing</i>		
	<i>Accounts Receivable – Bed World</i>		
	<i>Inventory</i>		
	<i>Cost of sales</i>		
	<i>Sales return of one mattress from Bed World due to</i>		
	<i>change of mind (Credit note 16)</i>		
Oct. 26	<i>Advertising</i>	260	
	<i>Inventory</i>		260
	<i>Two mattresses donated to local school for sick bay</i>		
	<i>(Memo 43)</i>		

Exercise 8.2 Inventory cards: Identified cost

a

Inventory Item: Glass Front Cabinets					Location: Row 6, Bay 4					
Inventory Code: 900GF					Supplier: Pine Products					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
May 1	Balance							40	240	9 600
2	Invoice C745	20	250	5 000				40	240	9 600
								20	250	5 000
4	Invoice 76				23	240	5 520	17	240	4 080
					12	250	3 000	8	250	2 000
7	Memo 34				2	250	500	17	240	4 080
								6	250	1 500
12	Cr. Note 21	5	240	1 200				22	240	5 280
								6	250	1 500
15	Cr. Note A56				5	240	1 200	17	240	4 080
								6	250	1 500
19	Inv. C786	30	260	7 800				17	240	4 080
								6	250	1 500
								30	260	7 800
24	Rec. 98				8	240	1 920	9	240	2 160
					12	260	3 120	6	250	1 500
								18	260	4 680
28	Memo 37				4	240	960	5	240	1 200
								6	250	1 500
								18	260	4 680
31	Invoice 89				15	260	3 900	5	240	1 200
								6	250	1 500
								3	260	780

Chapter 8 *Accounting for Inventory* – Solutions to exercises

b **General Journal**

Date	Details	Debit \$	Credit \$
May 4	<i>Accounts Receivable – GQ Design</i>	19 250	
	<i>Sales</i>		17 500
	<i>GST Clearing</i>		1 750
	<i>Cost of sales</i>	8 520	
	<i>Inventory</i>		8 520
7	<i>Drawings</i>	500	
	<i>Inventory</i>		500
12	<i>Sales returns</i>	2 500	
	<i>GST Clearing</i>	250	
	<i>Accounts Receivable – GQ Design</i>		2 750
	<i>Inventory</i>	1 200	
	<i>Cost of sales</i>		1 200
15	<i>Account Payable – Fisher Furniture</i>	1 320	
	<i>Inventory</i>		1 200
	<i>GST Clearing</i>		120
24	<i>Bank</i>	11 000	
	<i>Sales</i>		10 000
	<i>GST Clearing</i>		1 000
	<i>Cost of sales</i>	5 040	
	<i>Inventory</i>		5 040

c

Explanation <i>Each item is marked ('identified') in some way</i>
<i>and its cost price noted.</i>

d

Explanation *The items are identical in the eyes of the customer
 and they are charged the same selling price.*

e

Calculation

<i>Sales (OUT column):</i>		<i>May 4</i>	5 520	
			3 000	
		<i>May 24</i>	1 920	
			3 120	
		<i>May 31</i>	3 900	17 460
<i>less Sales returns (IN column):</i>	<i>May 12</i>			(1 200)
Cost of Sales				\$ 16 260

f

Calculation

<i>Sales</i>	<i>May 4</i>	<i>35 cabinets x \$500 each</i>	<i>17 500</i>	
	<i>May 24</i>	<i>20 cabinets x \$500 each</i>	<i>10 000</i>	
	<i>May 31</i>	<i>15 cabinets x \$500 each</i>	<i>7 500</i>	<i>35 000</i>
<i>less Sales returns</i>	<i>May 12</i>	<i>5 cabinets x \$500 each</i>		<i>(2 500)</i>
				<i>32 500</i>
<i>less Cost of Sales</i>				<i>(16 260)</i>

9

Explanation	<i>Accounts receivable increases \$8 250 for the sale plus GST</i>
	<i>but Inventory decreases \$3 900 meaning assets increase overall \$4 350.</i>
	<i>Liabilities increase \$750 due to the increase in GST owing to the ATO from</i>
	<i>the sale.</i>
	<i>Owner's equity increases \$3 600 as a result of Sales \$7 500 less Cost of sales</i>
	<i>\$3 600 leading to profit of \$3 600.</i>

Exercise 8.3 Inventory loss: Identified cost

a

Qualitative Characteristic	<i>Faithful representation</i>
Explanation	<i>To check the accuracy of the inventory cards, in the process detecting any inventory losses / gains and ensuring that the records provide a valuation of inventory that reflects its real-world economic benefit and is accurate and complete.</i>

b

Reason 1	<i>Damage / breakages</i>
Reason 2	<i>Undersupply by supplier / Oversupply to customer</i>

c

Inventory Item: Executive 1000					Location: Aisle 3					
Inventory Code: EX1000					Supplier: Partner Desks					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Mar. 31	Balance							4	290	1 160
								15	300	4 500
								10	320	3 200
31	Memo 95				1	290	290	3	290	870
					1	320	320	15	300	4 500
								9	320	2 880

d

General Journal

Date	Details	Debit \$	Credit \$
March 31	Inventory loss	610	
	Inventory		610
	Inventory loss of 2 EX1000 desks revealed by physical count (Memo 95)		

e

Explanation	<i>It represents a decrease in assets (Inventory) and</i>
	<i>a decrease in Owner's equity</i>
	<i>that is not the result of Drawings.</i>

f

Explanation	<i>Assets (Inventory) decreases by \$610 due to the inventory lost and</i>
	<i>Liabilities are not affected.</i>
	<i>Owner's equity decreases by \$610 as Inventory loss expense decreases</i>
	<i>profit.</i>

Exercise 8.4 Inventory gain: Identified cost

a

Reason 1	<i>Oversupply by supplier</i>
Reason 2	<i>Undersupply to customer</i>

b

Inventory Item: Voss Headphones				Location: Back wall						
Inventory Code: MVH				Supplier: Voss Inc.						
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
De. 31	Balance							14	80	1 120
								7	90	630
31	Memo 115	1	80	80				15	80	1 200
		2	90	180				9	90	810

c

General Journal

Date	Details	Debit \$	Credit \$
March 31	Inventory	260	
	Inventory gain		260
	Inventory loss of 3 MVH headphones revealed by		
	physical count (Memo 115)		

d

Explanation	<i>It represents an increase in assets (Inventory) and</i>
	<i>an increase in Owner's equity</i>
	<i>that is not the result of a capital contribution.</i>

Chapter 8 *Accounting for Inventory* – Solutions to exercises

e

Explanation	<i>Assets (Inventory) increases by \$260 due to the inventory gained and</i>
	<i>Liabilities are not affected.</i>
	<i>Owner's equity increases by \$260 as Inventory gain revenue increases</i>
	<i>profit.</i>

f

Explanation	<i>It would reduce administrative expenses such as the cost of labels and the</i>
	<i>wages paid to staff for individually labelling each item of inventory and</i>
	<i>recording these cost prices.</i>

Exercise 8.5 Inventory cards: First in, First out

a

Inventory Item: Picture frames					Location: Back wall					
Inventory Code: 45B					Supplier: Priority Plastics					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Jan. 1	Balance							50	40	2 000
								60	50	3 000
3	Invoice 44				35	40	1 400	15	40	600
								60	50	3 000
5	Cheque 243	30	50	1 500				15	40	600
								90	50	4 500
10	EFT rec. 68				15	40	600			
					25	50	1 250	65	50	3 250
12	Invoice ZF390	40	60	2 400				65	50	3 250
								40	60	2 400
16	Memo 14				12	50	600	53	50	2 650
								40	60	2 400
19	Cr. Note 55	3	40	120				3	40	120
								53	50	2 650
								40	60	2 400
20	Rec. 114				3	40	120			
					53	50	2 650			
					4	60	240	36	60	2 160
22	Cr. Note ZF82				6	60	360	30	60	1 800
30	Inv. ZF402	25	70	1 750				30	60	1 800
								25	70	1 750

Chapter 8 Accounting for Inventory – Solutions to exercises

b

Explanation *The first items purchased are assumed to be the first to be sold / leave the store.*

Items are not physically marked to identify their cost price.

c

Explanation *Under FIFO, all of the units from the \$40 batch are assumed to be sold before any of the remaining units; all of the \$50 units are assumed to be sold next.*

Only when these units are all sold are the \$60 units assumed to be sold.

d

Calculation

Sales (OUT column):	Jan. 3	1 400	
	10	600	
		1 250	
	20	120	
		2 650	6 020
less Sales returns (IN column):	Jan. 19		(120)
Cost of Sales			\$ 5 900

Chapter 8 *Accounting for Inventory* – Solutions to exercises

e General Journal

Date	Details	Debit \$	Credit \$
Jan. 10	Bank	4 400	
	Sales		4 000
	GST Clearing		400
	Cost of sales	1 850	
	Inventory		1 850
16	Advertising	600	
	Inventory		600
19	Sales returns	300	
	GST Clearing	30	
	Accounts Receivable – Painters Inc.		330
	Inventory	120	
	Cost of sales		120
22	Account Payable – Zimmer Frames	396	
	Inventory		360
	GST Clearing		36
30	Inventory	1 750	
	GST Clearing	175	
	Account Payable – Zimmer Frames		1 925

f

Explanation *FIFO assumes that the older, cheaper items are sold first,
 leading to the lowest possible valuation of Cost of sales.*

Exercise 8.6 Inventory loss: FIFO

a

Inventory Item: FP 2000 dishwasher					Location: Row 16, Bay 3					
Inventory Code: FP 2000					Supplier: FP Dishwashers					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
June 30	Balance							6	600	3 600
								12	620	7 440
30	Memo 37				1	600	600	5	600	3 000
								12	620	7 440

b

Explanation <i>The first items purchased (the oldest ones in the Balance column) are assumed to be 'lost' first.</i>

c

General Journal

Date	Details	Debit \$	Credit \$
June 30	Inventory loss	600	
	Inventory		600
	Inventory loss of 1 FP 2000 dishwasher revealed by		
	physical count (Memo 37)		

d

Explanation <i>Assets (Inventory) would be overstated by \$600 as the records would show one more dishwasher than actually on hand. Liabilities would not be affected.</i>
<i>Owner's equity would be overstated by \$600 as Inventory loss would be understated and profit overstated.</i>

e

Explanation <i>The supplier has charged Esseb Electrical for more units than actually delivered (and this has not been detected).</i>	
Action	<i>Check the quantity delivered against the delivery docket</i>

Exercise 8.7 Inventory gain: FIFO

a

Explanation	<i>To provide a specific valuation of each item of inventory</i>
	<i>which can then be used to calculate an accurate selling price (to ensure an</i>
	<i>adequate mark-up).</i>

b

Inventory Item: Mohair wool, blue					Location: Aisle 7					
Inventory Code: MBL					Supplier: Aust. Wool Mills					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
April 1	Balance							23	10	230
7	Cheque 1002	30	11	330				23	10	230
								30	11	330
19	Receipt 56				8	10	80	15	10	150
								30	11	330
30	Memo 43	2	11	22				15	10	150
								32	11	352

c

Explanation	<i>The gain was valued using the most recent purchase price</i>
	<i>as this is the most up-to-date price and reflects the current real-world economic</i>
	<i>value of the inventory.</i>
Qualitative Characteristic	<i>Faithful representation</i>

Chapter 8 *Accounting for Inventory* – Solutions to exercises

d **General Journal**

Date	Details	Debit \$	Credit \$
April 30	Inventory	20	
	Inventory gain		20
	Inventory gain of 2 balls of MBL wool revealed by		
	physical count (Memo 43)		

e

Explanation <i>Under Comparability, accounting methods should be consistent</i>
<i>to ensure that reports can be compared between periods</i>
<i>to identify changes in performance.</i>

Exercise 8.8 Inventory cards: FIFO

a

Inventory Item: Glass Front Cabinets					Location: Row 6, Bay 4					
Inventory Code: 900GF					Supplier: Pine Products					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
May 1	Balance							40	240	9 600
2	Invoice C745	20	250	5 000				40	240	9 600
								20	250	5 000
4	Invoice 76				35	240	8 400	5	240	1 200
								20	250	5 000
7	Memo 34				2	240	480	3	240	720
								20	250	5 000
12	Cr. Note 21	5	240	1 200				8	240	1 920
								20	250	5 000
15	Cr. Note A56				5	240	1 200	3	240	720
								20	250	5 000
19	Inv. C786	30	260	7 800				3	240	720
								20	250	5 000
								30	260	7 800
24	Rec. 98				3	240	720			
					17	250	4 250	3	250	750
								30	260	7 800
28	Memo 37				3	250	750			
					1	260	260	29	260	7 540
31	Invoice 89				15	260	3 900	14	260	3 640

b

Number of cabinets on hand	14
Explanation Both methods of inventory valuation count the same number of items (but they assign a different valuation to those units).	

Chapter 8 *Accounting for Inventory* – Solutions to exercises

c

Calculation

Sales (OUT column):	May 4	8 400	
	May 24	720	
		4 250	
	May 31	3 900	17 270
less Sales returns (IN column):	May 12		(1 200)
Cost of Sales			\$ 16 070

d

Calculation

8.8 'c' (FIFO)	16 070	
8.2 'd' (Identified cost)	16 260	
Difference		\$ 190

e

Explanation *FIFO assumes that the latest, more expensive units of inventory remain on hand, meaning the highest possible valuation of Inventory.*

f

Discussion *Identified Cost might be administratively cheaper as the business does not have to pay for labelling and recording costs.*

However, given the relatively slow turnover, and the fact that the cost of each cabinet could be identified relatively easily, they may choose to use FIFO to ensure they calculate an accurate selling price which provides for an adequate mark-up.

Exercise 8.9 Reporting for inventory

a

Classification	<i>Expense</i>
Justification	<i>It is listed on the debit side of the Trial Balance.</i>

b WARREN'S WOKS

Income Statement for September 2025

	\$	\$
Revenue		
Sales	81 200	
less Sales returns	1 200	80 000
less Cost of Goods Sold		
Cost of sales	40 000	
Customs duty	2 200	42 200
Gross Profit		37 800
less Inventory loss		500
Adjusted Gross Profit		37 300
less Other Expenses		
Advertising	6 000	
Interest expense	600	
Wages	16 300	22 900
Net Profit		14 400

c

Justification	<i>Treated as part of Cost of Goods Sold</i>
	<i>as it is incurred to bring inventory into a location and condition ready for sale.</i>

d

Explanation	<i>It is necessary to provide information about the average mark-up, so that the owner can take corrective action (where necessary) to improve profit.</i>
	<i>(This could mean increasing the selling price to generate greater profit per sale, or decreasing the selling price to be more price competitive.)</i>

e WARREN'S WOKS

Balance Sheet as at 30 September 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Bank</i>	4 300		<i>Accounts Payable – Best Suppliers</i>	9 200	
<i>Account Receivable – KP Kitchens</i>	13 100		<i>GST Clearing</i>	3 400	
<i>Inventory</i>	19 000	37 500	<i>Mortgage – BH Bank</i>	12 000	24 600
Non-Current Assets			Non-Current Liabilities		
<i>Shelving</i>	17 000		<i>Mortgage – BH Bank</i>		78 000
<i>Premises</i>	120 000	137 000			
			Owner's Equity		
			<i>Capital – Warren</i>	59 400	
			<i>+ Net Profit</i>	15 500	
				74 900	
			<i>less Drawings</i>	3 000	71 900
Total Assets		174 500	Total Equities		174 500

Exercise 8.10 Reporting for inventory

a POTS 'N' PANS

Income Statement for June 2025

	\$	\$
Revenue		
Sales	96 800	
less Sales returns	6 800	90 000
less Cost of Goods Sold		
Cost of sales	60 000	
Cartage in	1 900	61 900
Gross Profit		28 100
add Inventory gain		700
Adjusted Gross Profit		28 800
less Other Expenses		
Delivery to customers	2 500	
Rent expense	14 000	
Wages	12 000	28 500
Net Profit	\$	300

b

Explanation <i>High Sales returns</i>
<i>indicates customers returning inventory</i>
<i>perhaps due to poor quality.</i>

c

Explanation <i>Insufficient</i> as it is
<i>barely high enough to cover Other expenses (and provide for Net Profit).</i>

Chapter 8 *Accounting for Inventory* – Solutions to exercises

d Pots 'n' Pans

Balance Sheet as at 30 June 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
Account Receivable – CS Cooking	2 500		Bank	1 500	
Account Receivable – Hotel Tyabb	2 100		Account Payable – Pansteel Co.	6 300	
Inventory Control	20 000	24 600	GST Clearing	500	8 300
Non-Current Assets			Non-Current Liabilities		
Shop Fittings		40 000	Loan – Quickfin		20 000
			Owner's Equity		
			Capital – Pamela	41 000	
			+ Net Profit	300	
				41 300	
			less Drawings	5 000	36 300
Total Assets	\$	64 600	Total Equities	\$	64 600

e

Discussion	<i>It is higher than the Net Profit figure (meaning Owner's Equity will decrease).</i>
	<i>However,</i>
	<i>it is only \$500 for the month:</i>
	<i>\$6 000 per year is not enough to live on if this is the owner's income.</i>

Exercise 8.11 Interpreting inventory cards

a

Valuation method	<i>FIFO (However, could be Identified cost!)</i>
Justification	<i>Nov. 22</i>
	<i>All \$40 units assumed to be sold before any \$40 units</i>

b

Transaction	<i>Credit sale (of 40 tins of oil, each with a cost price of \$30)</i>
--------------------	--

c

Relationship	<i>The items returned by customer as a sales return on 3 November 2025</i>
	<i>are the same items</i>
	<i>returned to the supplier as a purchase return on 4 November.</i>

d

Reason 1	<i>Advertising</i>
Reason 2	<i>Drawings</i>

e/f

General Journal

Date	Details	Debit \$	Credit \$
Nov. 22	<i>Bank</i>	1 710	
	<i>Sales</i>		1 710
	<i>GST Clearing</i>		
	<i>Cost of sales</i>	1 140	
	<i>Inventory</i>		1 140
	<i>Cash sale of 30 tins of VO-01 olive oil</i>		
	<i>(Receipt 19)</i>		
30	<i>Inventory loss</i>	120	
	<i>Inventory</i>		120
	<i>Inventory loss of 3 tins of VO-01 olive oil revealed by</i>		
	<i>physical count (Memo 64)</i>		

g

Calculation

<i>Sales (OUT column):</i>		Nov. 9	1 200	
		22	180	
			960	2 340
<i>less Sales returns (IN column):</i>		Nov. 3		(60)
Cost of Sales				\$ 2 280

h

Reason 1	<i>It is only for one line of inventory</i>
Reason 2	<i>It doesn't include other Cost of Goods Sold, such as buying expenses, freight in.</i>

i

Calculation

<i>Sales</i>	3 420	
<i>less Cost of sales</i>	2 280	
<i>Gross profit</i>	1 140	
<i>less Inventory loss</i>	120	
Adjusted Gross Profit		\$ 1 020

Exercise 8.12 Source documents and inventory cards

a

Qualitative characteristic	Timeliness
Explanation	<i>To detect any inventory loss / gain</i>
	<i>early enough so that corrective action may be taken.</i>

b

Inventory Item: Bedside lamps					Location: Row 5, Bay A					
Inventory Code: BL100					Supplier: Bright Lights					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Feb. 1	Balance							4	20	80
								7	25	175
2	Inv. 519	20	20	400				4	20	80
								7	25	175
								20	20	400
12	Inv. 70				4	20	80			
					6	25	150	1	25	25
								20	20	400
28	Memo 73				1	25	25			
					2	20	40	18	20	360

c

Explanation	<i>Not recorded as no transaction has occurred.</i>
	<i>– it is simply an order form</i>
	<i>(There is no exchange of goods, and no price is specified.)</i>

Chapter 8 *Accounting for Inventory* – Solutions to exercises

d General Journal

Date	Details	Debit \$	Credit \$
Feb. 2	Inventory	400	
	GST Clearing	40	
	Account Payable – Bright Lights		440
	Credit purchase of 20 BL 100 lights from Bright Lights (Invoice 519)		
12	Account Receivable – The Hilton Country Inn	660	
	Sales		600
	GST Clearing		60
	Cost of sales	230	
	Inventory		230
	Credit sale of 20 BL 100 lights to The Hilton Country Inn (Invoice 70)		
28	Inventory loss	65	
	Inventory		65
	Inventory loss of BL 100 lights revealed by physical count (Memo 73)		

e

Explanation	<i>It increases Inventory and Current Assets by \$1 000 as the firm has purchased more inventory.</i>
	<i>It increases liabilities overall by \$1 000: although Accounts Payable increases by \$1 100 as the business owes this,</i>
	<i>GST Clearing decreases by \$100 as the amount owed to the ATO decreases.</i>
	<i>Owner's equity is not affected.</i>

f

	Overstated / Understated / No effect	Amount \$
Assets	Overstated (Inventory)	65
Liabilities	No effect	
Owner's Equity	Overstated (Understated Inventory Loss overstates Net Profit)	65

Exercise 8.13 Inventory and the General Ledger

a

Explanation	<i>Inventory card only shows balance of this line (Plain welcome mats)</i>
	<i>Inventory account shows all lines of inventory</i>

b

Number of mats	105
-----------------------	-----

c

Explanation	<i>This is the most recent purchase price</i>	
	<i>and thus the price which reflects the real-world economic value of the inventory</i>	
	<i>at the time the gain is detected.</i>	
Qualitative Characteristic	<i>Faithful representation</i>	

Chapter 8 *Accounting for Inventory* – Solutions to exercises

d **General Journal**

Date	Details	Debit \$	Credit \$
April 2	Sales returns	120	
	GST Clearing	12	
	Account Receivable – Bullings		132
	Inventory	60	
	Cost of sales		60
	Sales return of 2 plain welcome mats by Bullings (Credit note 36))		
9	Drawings	90	
	Inventory		90
	Drawings of 3 plain welcome mats (Memo 71)		
25	Inventory	2 700	
	GST Clearing	270	
	Account Payable – Coir Industries		2 970
	Credit purchase of 60 PWM welcome mats from Coir Industries (Invoice B0003)		
30	Inventory	135	
	Inventory gain		135
	Inventory gain of 3 PWM welcome mats revealed by physical count (Memo 72)		

Chapter 8 *Accounting for Inventory* – Solutions to exercises

e

General Ledger

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 1	Balance	42 950	Apr. 9	Drawings	90
2	Cost of sales	60	17	Cost of sales	430
25	Account Payable – Coir Industries	2 700			
30	Inventory gain	135			

Account Receivable – Bullings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 1	Balance	2 000	Apr. 2	Sales returns / GST Clearing	132
17	Sales / GST Clearing	946			

f

Explanation <i>No effect:</i>
<i>lower drawings would be offset by a higher Inventory loss and lower profit.</i>
<i>(The missing inventory would be reported as Inventory loss.)</i>

Exercise 9.1 Cost of inventory

a

Explanation	<i>It does not affect the value of/economic benefit represented by the inventory;</i>
	<i>it reduces the GST liability owed to the ATO.</i>
	<i>(The benefit is received when the GST settlement is made, not when the</i>
	<i>inventory is sold.)</i>

b

Calculation
Supplier's price \$80 per barbecue + Cartage in <u>10</u> per barbecue \$90 Cost price of one barbecue \$ 90

c

Explanation	<i>It is included as a product cost,</i>
	<i>as it is a cost incurred to get the inventory ready for sale,</i>
	<i>and can be allocated to each individual barbecue on a logical basis</i>
	<i>(as it is charged per barbecue).</i>

d

Inventory Item: Barbecues					Location: Showroom, South west corner					
Inventory Code: El Fresco 90					Supplier: Mark Webber Industries					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Mar. 1	Balance							25	85	2 125
4	Ch. 102	40	90	3 600				25	85	2 125
								40	90	3 600

Chapter 14 *Inventory Valuation* – Solutions to exercises

e **General Journal**

Date	Details	Debit \$	Credit \$
Mar. 4	Inventory	3 900	
	GST Clearing	390	
	Bank		4 290
	Cash purchase of 40 El Fresco barbecues		
	(Cheque 102)		

Exercise 9.2 Cost of inventory

a

Explanation	<i>Selling price cannot be verified by a source document as the sale has not yet occurred.</i>
	<i>Therefore the selling price does not provide a real world valuation as it is not complete, free from error or neutral.</i>

b

Calculation	
Supplier's price	\$1 500 per couch
+ Anti-stain treatment	130 per couch
	<u>\$1 630</u>
Cost price of one couch	
	\$ 1 630

c

Explanation	<i>Not included</i>
	<i>as it is incurred after the goods are ready for sale</i>
	<i>so it will be reported as an Other Expense.</i>

d

Inventory Item: Couches					Location:					
Inventory Code:					Supplier: Wilson Products					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Jan. 1	Balance							8	1 590	12 720
3	Inv. 65	10	1 630	16 300				8	1 590	12 720
								10	1 630	16 300

Chapter 14 *Inventory Valuation* – Solutions to exercises

e **General Journal**

Date	Details	Debit \$	Credit \$
Jan. 3	Inventory	16 300	
	GST Clearing	1 630	
	Bank		17 930
	Credit purchase of 10 couches		
	(Invoice 65)		

Exercise 9.3 Product versus period costing

a

Explanation *Under Relevance, the cost price is capable of making a difference to decision making like setting selling prices / valuing inventory in the Balance Sheet.*
 or *Under Faithful representation the cost price represents the real world value of the inventory in a manner which is complete, free from bias and neutral.*

b

Explanation *As they are incurred to get the inventory ready for sale, and can be allocated to each individual washer/dryer on a logical basis because they are charged 'per unit'.*

c

Calculation

Invoice price	\$900	per washer/dryer
+ Freight in	90	per washer/dryer
+ Modification costs	25	per washer/dryer
	\$1 015	

Cost price of one washer/dryer \$ 1 015

d

Inventory Item: Washer / dryer					Location:					
Inventory Code:					Supplier: Young Bros.					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Nov. 6	Inv. 23	40	1 015	40 600				40	1 015	40 600

Chapter 14 *Inventory Valuation* – Solutions to exercises

e General Journal

Date	Details	Debit \$	Credit \$
Nov. 16	Inventory	40 600	
	GST Clearing	4 060	
	Account Payable – Young Bros.		17 930
	Credit purchase of 40 washer/dryers from Young Bros (Invoice 23)		
16	Insurance of inventory	400	
	GST Clearing	40	
	Bank		440
	Paid insurance of inventory for the month (Cheque 142)		

f

Calculation			
	Sales	(25 x \$2 500 each)	62 500
less	Cost of Goods Sold		
	Cost of Sales	(25 x \$1 015 each)	25 375
	Insurance of inventory	400	25 775
	Gross Profit		36 725
Gross Profit			\$ 36 725

g

Explanation	As although it is <i>incurred to get the inventory ready for sale</i> ,
	<i>it cannot be allocated to each individual washer/dryer on a logical basis</i>
	<i>because it is charged 'per month'.</i>

Exercise 9.4 Product versus period costs

a

Calculation

Supplier's price	\$140	per bike
+ Sign writing	17	per bike
	\$157	

Cost price of one bike \$ 157

b

Explanation *It is included as a **product cost**,*

*as it is a **cost incurred to get the inventory ready for sale**,*

*and **can be allocated to each individual bike on a logical basis***

*as it **relates (only) to the 10 new bikes**.*

c

Inventory Item: Mountain Bikes					Location: Storeroom, left hand side					
Inventory Code: MB120					Supplier: Wonder Cycles					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Feb. 1	Balance							4	155	620
12	Inv. A13 / Ch. 912	10	157	1 570				4	155	620
								10	157	1 570

d

General Journal

Date	Details	Debit \$	Credit \$
Feb. 12	Inventory	1 570	
	GST Clearing	157	
	Account Payable – Wonder Cycles		1 727
12	Inventory	170	
	GST Clearing	17	
	Bank		187

e

Calculation

8 bikes @ \$157 each

Value of mountain bikes on hand \$ 1 256

f

Calculation

8 bikes @ \$140 each

Value of mountain bikes on hand (Signwriting – period costing) \$ 1 120

g

	Higher / Lower / No effect	Amount \$
Inventory on hand	<i>Lower (than product costing)</i>	<i>136</i>
Explanation	<i>Under period costing, inventory on hand does not include any signwriting, so the 8 bikes on hand are valued at \$140 each rather than \$157 each</i>	
	<i>ie. 8 bikes on hand x \$17 per bike = \$136.</i>	
	<i>(Period costing does not allocate \$17 signwriting to each bike.)</i>	

Exercise 9.5 Product versus period costs

a General Journal

Date	Details	Debit \$	Credit \$
Apr. 1	Inventory	9 300	
	Freight in	300	
	GST Clearing	960	
	Account Payable – Wired Electrics		10 560
	Credit purchase of 12 TVs and 5 stereos from Wired Electrics (Invoice 201)		

b

Explanation It must be treated as a **period cost** and recorded in a separate ledger account.
 as it **cannot be allocated to individual units of inventory on a logical basis**
 because it is **incurred for both televisions and stereos**.

c STATIC SOUND AND VISION

Income Statement for April 2025

	\$	\$
Revenue		
Sales (3 TVs @ \$1 200 plus 2 stereos @ \$500)		4 600
less Cost of Goods Sold		
Cost of Sales (3 TVs @ \$650 plus 2 stereos @ \$300)	2 550	
Freight in	300	2 850
Gross Profit		1 750
less Inventory Loss (1 TV)		650
Adjusted Gross Profit		1 100

d

Explanation	<i>Period costing includes the entire cost as an expense</i>
	<i>in the period in which inventory is purchased.</i>
	<i>If not all inventory is sold, this will lead to a higher Cost of Goods Sold than</i>
	<i>product costing, and thus a lower profit</i>
	<i>(because an expense is recognised as incurred even though the inventory has</i>
	<i>not been sold).</i>

e

Discussion	<i>Given the TV is probably damaged</i>
	<i>it is unethical to sell it without disclosing this fact</i>
	<i>as to do so would be misleading the customer.</i>
	<i>However,</i>
	<i>if the customer was informed that the TV had been dropped and was given</i>
	<i>information about the nature of the damage</i>
	<i>it may be appropriate to sell the TV at a reduced price</i>
	<i>(provided the TV is still safe for use).</i>

Exercise 9.6 Product versus period costs

a

Discussion	<i>The cost of the brand badges could be treated as a product cost</i>
	<i>as it is incurred to get inventory ready for sale, and</i>
	<i>can be allocated to individual units of inventory on a logical basis</i>
	<i>(one badge per pair of goggles).</i>
	<i>However, Relevance allows this cost to be treated as a period cost as</i>
	<i>80c per pair of goggles is too small to affect decision-making.</i>

b

Calculation			
	Supplier's price	\$9 000 / 100 units	90
	+ Packaging and delivery	\$1 600 / 100 units	16
		Cost price of one pair of goggles	\$ 106

c

Explanation	<i>The insurance is a period cost as it</i>
	<i>cannot be allocated to individual units of inventory on a logical basis</i>
	<i>because it is incurred per annum,</i>
	<i>and there are likely to be other lines of inventory covered by the insurance.</i>

d

Calculation			
	Cost of sales	(30 pairs x \$106 each)	\$3 180
	+ Brand badges		80
	+ Acc. m'tment fee		150
		Cost of Goods Sold	\$ 3 410

e

Calculation

<i>Cost of sales</i>	<i>(30 pairs x \$90 each)</i>	\$2 700
+ <i>Brand badges</i>		80
+ <i>Packaging / delivery</i>		1 600
+ <i>Acc. m'ment fee</i>		150

Cost of Goods Sold (Packaging – period cost) \$ 4 530

f

Explanation *Assets (Inventory) would be \$1 120 lower*

because it would not include \$16 packaging per unit x 70 units

There would be no effect on liabilities.

Owner's equity would be \$1 120 lower

because COGS would include the full \$1 600 packaging cost

(compared to $30/100 \times \$1\,600 = \480 under product costing) and thus profit would be \$1 120 lower.

Exercise 9.7 Lower of cost and NRV

a

Calculation

40 plates @ \$20 each

Value of plates on hand \$ 800

b

Explanation The *Net Realisable Value of the plates has fallen below their Cost*

so their original purchase price no longer provides a Faithful representation of their value.

The cost price is no longer complete and free from error (accurate).

c

Calculation

Historical Cost	\$800	40 plates @ \$20 each
less Net Realisable Value	200	40 plates @ \$5 each
	600	40 plates @ \$15 each

Total Inventory Write-down \$ 600

d

Inventory Item: Plates (2006 World Cup)					Location: Storeroom, Shelf 8 (Top)					
Inventory Code: WC30					Supplier: Royal Dullard Plates					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
May 1	Balance							40	20	800
31	Memo 39				40	15	600	40	5	200

Chapter 14 *Inventory Valuation* – Solutions to exercises

e **General Journal**

Date	Details	Debit \$	Credit \$
May 31	Inventory write-down	600	
	Inventory		600
	40 plates written down to Net Realisable Value: out of		
	date (Memo 39)		

f

Explanation	<i>Assets (Inventory) will decrease by \$600</i>
	<i>because each plate is now worth less (\$5 instead of \$20).</i>
	<i>Liabilities are not affected.</i>
	<i>Inventory Write-down expense will decrease Net Profit</i>
	<i>and therefore Owner's Equity by \$600.</i>

Exercise 9.8 Lower of cost and NRV

a

Net Realisable Value	<i>Estimated selling price of inventory</i>
	<i>less any costs incurred in its selling, marketing or distribution</i>

b

Calculation	
<i>Estimated selling price</i>	\$500
<i>less Sales commission (15%)</i>	75
	\$425 x 8 cameras on hand
Total Net Realisable Value	
	\$ 3 400

c

Inventory Item: Security cameras					Location: Aisle 4					
Inventory Code: VM1000					Supplier: Viewmaster					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Sept. 1	Balance							14	450	6 300
21	Rec. 24				6	450	2 700	8	450	3 600
30	Memo 19				8	25	200	8	425	3 400

d

General Journal

Date	Details	Debit \$	Credit \$
Sept. 30	Inventory write-down	200	
	Inventory		200
	8 cameras written down to Net Realisable Value:		
	obsolete (Memo 19)		

e SIR VAYLANCE

Income Statement for September 2025

	\$	\$
Revenue		
<i>Sales (6 cameras @ \$800)</i>		4 800
less Cost of Goods Sold		
<i>Cost of Sales (6 cameras @ \$450 each)</i>		2 700
Gross Profit		2 100
<i>less Inventory Write-down</i>		200
Adjusted Gross Profit		1 900

Exercise 9.9 Lower of cost and NRV

a

Calculation

<i>Jeans</i>	<i>200 @ \$50</i>	<i>\$10 000</i>
<i>Shirts</i>	<i>50 @ \$35</i>	<i>1 750</i>
<i>Hats</i>	<i>400 @ \$20</i>	<i>8 000</i>

Value of inventory (Inventory card) \$ 19 750

b

Calculation

<i>Jeans</i>	<i>200 @ \$50</i>	<i>\$10 000</i>
<i>Shirts</i>	<i>50 @ \$32</i>	<i>1 600 (NRV = \$40 – \$8)</i>
<i>Hats</i>	<i>400 @ \$20</i>	<i>8 000</i>

Value of inventory (Lower of cost and NRV) \$ 19 600

c

Reason 1	<i>Damaged/shop soiled</i>
Reason 2	<i>Out of date/no longer fashionable/lack of demand</i>
Reason 3	<i>Marketing ploy</i>

d

Explanation *The Net Realisable Value of the shirts has fallen below their cost.*

This must be disclosed so that the reports are not misleading to users.

Reports must include all Relevant information

to provide a Faithful representation of the firm's position.

Chapter 14 *Inventory Valuation* – Solutions to exercises

e

Inventory Item: <u>Shirts</u>					Location:					
Inventory Code:					Supplier:					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Dec. 31	Balance							50	35	1 750
31	Memo 17				50	3	150	50	32	1 600

f

General Journal

Date	Details	Debit \$	Credit \$
May 31	Inventory write-down	150	
	Inventory		150

g

	Overstated / Understated / No effect	Amount \$
Assets	Overstated (Inventory)	150
Liabilities	No effect	
Owner's Equity	Overstated (Understated Inventory Write-down expense means overstated Net Profit)	150

Exercise 9.10 Lower of cost and NRV

a

Explanation	<i>The business is assumed to be a Going concern which will continue operating into the future</i>
	<i>so the jackets do not need to be valued at what they would realise today.</i>

b

Explanation	<i>The Net Realisable Value of the cameras has fallen below their Cost</i>
	<i>so their original purchase price no longer provides a Faithful representation of their value.</i>
	<i>The cost price is no longer complete and free from error (accurate).</i>

c

Calculation			
Historical cost:		less Net Realisable Value:	
50 @ \$70	\$3 500	Estimated selling price (70 @ \$80)	5 600
20 @ \$72	1 440	less Selling expenses	1 400
	<u>\$4 940</u>		<u>4 200</u>
Inventory Write-down			\$ 740

d

Inventory Item: Security cameras					Location: Aisle 4					
Inventory Code: VM1000					Supplier: Viewmaster					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Oct. 31	Balance							50	70	3 500
								20	72	1 440
31	Memo 73				50	10	500			
					20	12	240	70	60	4 200

Chapter 14 *Inventory Valuation* – Solutions to exercises

e **General Journal**

Date	Details	Debit \$	Credit \$
Oct. 31	<i>Inventory write-down</i>	740	
	<i>Inventory</i>		740
	<i>70 jackets written down to Net Realisable Value: end</i>		
	<i>of season (Memo 73)</i>		

Exercise 9.11 Inventory Turnover

a

Measures	<i>average number of days taken to sell inventory</i>
	<i>(indicating the effectiveness of the management of Inventory).</i>

b

Calculation	
ITO	$\frac{(\$68\,000 + \$78\,000) / 2}{\$300\,000} \times 365$
=	$\frac{\$73\,000}{\$300\,000} \times 365$
=	89* days (88.8 rounded up to the nearest day)
	Inventory Turnover 89 days

c

Reason 1	<i>Slower than credit terms offered by suppliers (60 days)</i>
	<i>meaning inventory is not sold fast enough to pay Accounts Payable</i>
Reason 2	<i>Slower than previous year (2024 – 72 days)</i>
	<i>inventory is not selling as fast (perhaps it is not in demand).</i>

d

Reason 1	<i>Increased chances of Inventory loss / Inventory write-down expenses</i>
	<i>(due to on hand for longer and damaged or out of date)</i>
Reason 2	<i>Lack of sales revenue</i>

e

Strategy 1	<i>Increase sales: lower selling prices / advertising / inventory mix /</i>
	<i>complementary products et al</i>
Strategy 2	<i>Decrease Inventory on hand</i>
	<i>eg. order less, more frequently (JIT), reduce range</i>

f

Discussion	<i>All purchases are made on credit and Accounts Payable allow 60 days to pay</i>
	<i>90% of sales are on cash so as soon as inventory is sold cash is received.</i>
	<i>However,</i>
	<i>Inventory Turnover of 89 days exceeds the credit terms offered by suppliers</i>
	<i>meaning the business needs to pay cash before it has sold the inventory</i>
	<i>and received the cash.</i>
	<i>Without a large bank balance or other sources of cash this will make it</i>
	<i>difficult to pay Accounts Payable on time.</i>

Exercise 9.12 Cash Cycle

a

Fastest Inventory Turnover	<i>Hair wax</i>
Reason	<i>Inexpensive / Consumed quickly (within days / weeks)</i>

b

Reason	<i>As customers grow beards sales of Beard trimmers increase</i>
	<i>and this decreases sales of Electric razors.</i>

c

Explanation	<i>Because the items are different and the demand for these items will differ</i>
	<i>so they will sell at different speeds.</i>

d

Explanation	<i>Reduce inventory of After shave on hand</i>
	<i>by ordering less, or more frequently (JIT).</i>

e

Information	<i>Previous year / Budget / Industry average</i>
	<i>Non-financial information: changes in number of men growing beards</i>

f

Discussion	<i>Lower selling prices may generate extra sales volume</i>
	<i>(provided customers respond positively to the change in prices)</i>
	<i>and this might be beneficial for profit.</i>
	<i>Higher sales would also make Inventory Turnover faster.</i>
	<i>However, lower selling prices would mean less revenue per sale</i>
	<i>which could mean lower Sales revenue overall and therefore lower profit.</i>
	<i>Also, the lower mark-up might mean Gross profit is not enough to cover</i>
	<i>Other expenses and provide for profit.</i>

Exercise 9.13 Product versus period costs

a

Calculation	
Invoice price (excl. GST)	\$3 200
16 suits	
Cost price of one suit	
	\$ 200

b

Explanation	<i>The tailoring is incurred to get the suits ready for sale</i>
	<i>and can be logically allocated to each suit.</i>
	<i>It is appropriate to include this in the valuation of inventory so users of the</i>
	<i>reports have all information Relevant to decision making.</i>

c

Inventory Item: Wool Suits, SB, Grey		Location: Row 7								
Inventory Code: SBG		Supplier: Woollen Mills Australia								
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
Aug. 31	Balance							10	195	1 950
3	Inv. 85	16	200	3 200				10	195	1 950
								16	200	3 200

d

Explanation	<i>The discount is excluded from the valuation of inventory in the inventory card</i>
	<i>as it does not affect the cost of the inventory purchased on 3 August 2025.</i>
	<i>(It decreases the amount paid to Accounts Payable on 9 August 2025.)</i>

Chapter 14 *Inventory Valuation* – Solutions to exercises

e **General Journal**

Date	Details	Debit \$	Credit \$
Aug. 3	Inventory	3 200	
	GST Clearing	320	
	Account Payable – Woollen Mills Australia		3 520
	Credit purchase of 16 suits from Wired		
	Electrics (Invoice 201)		

f

Explanation	<i>All tailoring costs would be reported as an expense</i>
	<i>when the suits were purchased, so</i>
	<i>Assets (Inventory) would be lower by \$120</i>
	<i>as the 4 suits on hand would not include \$30 tailoring per suit.</i>
	<i>Cost of Goods Sold would be \$120 higher</i>
	<i>as it would include \$480 of tailoring (rather than $12/16 \times \\$480 = \\360)</i>
	<i>meaning Net Profit and Owner's Equity would be lower by \$120.</i>
	<i>Liabilities are not affected.</i>

g

Explanation	<i>The GST is levied only on the selling price of \$3 200,</i>
	<i>whereas the discount is levied on the entire amount owing (\$3 520),</i>
	<i>including the GST.</i>

Exercise 9.14 Recording and reporting for inventory

a

Calculation

Supplier's price	\$1 400	per scooter
+ Freight in	400	(\$2 000 / 5 scooters)
+ Sports kit	100	per scooter

Cost price of one scooter \$ 1 900

b

Explanation Included as a *product cost*

as it is *incurred to get the scooters ready for sale,*

and *can be allocated to each scooter on a logical basis*

because it is *charged per bike/scooter.*

c

Explanation The *Net Realisable Value of the scooter has fallen below its Cost due to*

damage so its original purchase price no longer provides a Faithful representation of its value.

The cost price is no longer complete and free from error (accurate).

d

Inventory Item: Scooter, 125cc, Black					Location: Showroom					
Inventory Code: GT125					Supplier: BX Bikes					
Date	Details	IN			OUT			BALANCE		
		Qty	Cost	Total	Qty	Cost	Total	Qty	Cost	Total
July 1	Balance							16	1 800	28 800
5	Inv. V23				9	1 800	16 200	7	1 800	12 600
12	Inv.42/Ch.188	5	1 900	9 500				7	1 800	12 600
								5	1 900	9 500
14	Cr. note 17	1	1 800	1 800				8	1 800	14 400
								5	1 900	9 500
16	Cr. note 922				1	1 800	1 800	7	1 800	12 600
								5	1 900	9 500
26	Inv. V24				7	1 800	12 600			
					2	1 900	3 800	3	1 900	5 700
31	Memo 36				1	700	700	2	1 900	3 800
								1	1 200	1 200

e

Discussion	<i>The damaged scooter is the same model / line as the others</i>
	<i>and therefore could be recorded in the same Inventory card.</i>
	<i>However,</i>
	<i>the scratches / damage mean that it is identifiably different from the others:</i>
	<i>it is different in the eyes of the customer</i>
	<i>and will be sold for a different selling price.</i>
	<i>Because it is no longer the same line of inventory as the others</i>
	<i>it should therefore be removed from this Inventory card.</i>

Chapter 14 *Inventory Valuation* – Solutions to exercises

f **General Journal**

Date	Details	Debit \$	Credit \$
July 14	Sales returns	3 000	
	GST Clearing	300	
	Account Receivable – J. Fangio		3 300
	Inventory	1 800	
	Cost of sales		1 800
	Sales return of 1 scooter by J. Fangio – faulty engine (Credit note 17)		
16	Account Payable – BX Bikes	1 980	
	Inventory		1 800
	GST Clearing		180
	Purchase return of 1 scooter to BX Bikes – faulty engine (Credit note 922)		
31	Inventory write-down	700	
	Inventory		700
	1 scooter written down to Net Realisable Value: damage (Memo 36)		

g **General Ledger**
Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	28 800	July 5	Cost of sales	16 200
12	Account Payable – BX Bikes	9 000	16	Account Payable – BX Bikes	1 800
	Bank	500	26	Cost of sales	16 400
14	Cost of sales	1 800	31	Inventory write-down	700
				Balance	5 000
		40 100			40 100
Aug. 1	Balance	5 000			

h ZIPPY SCOOTERS

Income Statement for July 2025

	\$	\$
Revenue		
<i>Sales (18 scooters @ \$3 000 each)</i>	54 000	
<i>less Sales returns</i>	3 000	51 000
less Cost of Goods Sold		
<i>Cost of Sales (16 200 – 1 800 + 12 600 + 3 800)</i>		30 800
Gross Profit		20 200
<i>less Inventory Write-Down</i>		700
Adjusted Gross Profit		19 500

i

	Higher / Lower / /No effect	Amount \$
Assets	<i>Lower (Inventory: 3 scooters @ \$100 each)</i>	300
Liabilities	<i>No effect</i>	
Owner's Equity	<i>Lower (Higher COGS means lower Net Profit)</i>	300

j

Explanation	<i>Physically mark each individual item of inventory</i>
	<i>Record the cost price of each individual item of inventory</i>
	<i>at the time of purchase and sale.</i>

k

Explanation	<i>No need to allocate a cost price to the items sold because</i>
	<i>all items had the same cost price.</i>

l

Transaction	<i>July 26 – sale of 9 scooters</i>
Justification	<i>More of the scooters sold may have been those purchased later (at \$1 900 each).</i>

m

Discussion	<i>Using Identified cost would not have affected Sales revenue as it is used to determine the cost price only (and all scooters were sold for \$3000 each). However, It might have meant a higher Cost of sales as more of the later (\$1 900) items may have been sold on July 26. Also, higher costs of administering Identified cost – marking items and recording cost prices – may have also increased expenses. Together these might lead to higher expenses in the current Period and therefore lower Net profit for July 2025.</i>
-------------------	--

Exercise 10.1 Closing the ledger

a

Explanation	<i>To transfer revenues and expenses to the Profit and Loss Summary account so that profit can be calculated for the current period.</i>
	<i>To reset the revenue and expense accounts to zero in preparation for next period.</i>

b General Journal

Date	Details	Debit \$	Credit \$
Aug. 31	Cash Sales	34 000	
	Credit Sales	28 000	
	Interest Revenue	1 500	
	Sales Returns		1 300
	Profit and Loss Summary		62 200
	Closing revenue accounts to P&L Summary		
	(Memo 41)		
Aug. 31	Profit and Loss Summary	61 250	
	Cost of Sales		31 350
	Wages		12 000
	Rent Expense		9 000
	Advertising		8 400
	Inventory Loss		500
	Closing expense accounts to P&L Summary		
	(Memo 41)		
Aug. 31	Profit and Loss Summary	950	
	Capital		950
	Transfer of Net Profit to Capital account (Memo 41)		

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

c General Ledger

Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	<i>Profit and Loss Summary</i>	62 000	Aug. 5	<i>Bank</i>	34 000
			13	<i>Accounts receivable – CB Floors</i>	28 000
		<u>\$62 000</u>			<u>\$62 000</u>

Sales Returns

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 16	<i>Accounts receivable – CB Floors</i>	1 300	Aug. 31	<i>Profit and Loss Summary</i>	1 300
		<u>\$1 300</u>			<u>\$1 300</u>

Interest Revenue

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	<i>Profit and Loss Summary</i>	1 500	Aug. 4	<i>Bank</i>	1 500
		<u>\$1 500</u>			<u>\$1 500</u>

Cost of Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 5	<i>Inventory</i>	17 000	Aug. 16	<i>Inventory</i>	650
13	<i>Inventory</i>	15 000	31	<i>Profit and Loss Summary</i>	31 350
		<u>\$32 000</u>			<u>\$32 000</u>

Wages

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 24	<i>Bank</i>	12 000	Aug. 31	<i>Profit and Loss Summary</i>	12 000
		<u>\$12 000</u>			<u>\$12 000</u>

Rent Expense

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 12	<i>Bank</i>	9 000	Aug. 31	<i>Profit and Loss Summary</i>	9 000
		<u>\$9 000</u>			<u>\$9 000</u>

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

Advertising

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 3	Bank	8 000	Aug. 31	Profit and Loss Summary	8 400
21	Inventory	400			
		<u>\$8 400</u>			<u>\$8 400</u>

Inventory Loss

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	Inventory	500	Aug. 31	Profit and Loss Summary	500
		<u>\$500</u>			<u>\$500</u>

Profit and Loss Summary

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	Expenses	61 900	Aug. 31	Revenues	62 200
	Capital	300			
		<u>\$62 200</u>			<u>\$62 200</u>

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Aug. 1	Balance	40 000
			31	Profit and Loss Summary	300

d

Explanation	<i>Because as a current asset,</i>
	<i>it represents a future economic benefit,</i>
	<i>which will be carried forward into the next Reporting Period.</i>

e

Explanation	<i>The Profit and Loss Summary account is transferred to the capital account, as</i>
	<i>it is only a temporary account to assist in calculating profit. Therefore, would</i>
	<i>be reported as part of Owners Equity in the balance sheet as part of the net</i>
	<i>profit figure, being added to capital for the period.</i>

Exercise 10.2 Closing the ledger

a General Journal

Date	Details	Debit \$	Credit \$
Dec. 31	Cash Sales	30 000	
	Credit Sales	50 000	
	Inventory gain	1 200	
	Sales Returns		1 000
	Profit and Loss Summary		80 200
	Closing revenue accounts to P&L Summary		
	(Memo 13)		
Dec. 31	Profit and Loss Summary	81 400	
	Freight Inwards		1 600
	Cost of Sales		39 500
	Wages		30 500
	Rent Expense		8 500
	Discount Expense		1 300
	Closing expense accounts to P&L Summary		
	(Memo 13)		
Dec. 31	Capital	1 200	
	Profit and Loss Summary		1 200
	Transfer of Net Loss to Capital account (Memo 13)		

b General Ledger

Cash Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	<i>Profit and Loss Summary</i>	30 000	Dec. 3	<i>Bank</i>	18 000
			21	<i>Bank</i>	12 000
		<u>\$30 000</u>			<u>\$30 000</u>

Credit Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	<i>Profit and Loss Summary</i>	50 000	Dec. 19	<i>Accounts Receivable - Toyland</i>	30 000
			27	<i>Accounts Receivable – Big Q</i>	23 000
		<u>\$50 000</u>			<u>\$50 000</u>

Sales Returns

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec 26	<i>Accounts Receivable - Toyland</i>	1 300	Dec. 31	<i>Profit and Loss Summary</i>	1 300
		<u>\$1 300</u>			<u>\$1 300</u>

Inventory Gain

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	<i>Profit and Loss Summary</i>	1 200	Dec. 31	<i>Inventory</i>	1 200
		<u>\$1 600</u>			<u>\$1 600</u>

Freight Inwards

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 8	<i>Bank</i>	1 600	Dec. 31	<i>Profit and Loss Summary</i>	1 600
		<u>\$1 600</u>			<u>\$1 600</u>

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

Cost of Sales

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 3	Inventory	9 000	Dec. 26	Inventory	500
19	Inventory	13 500	31	Profit and Loss Summary	39 500
21	Inventory	6 000			
27	Inventory	11 500			
		40 000			40 000

Wages

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 12	Bank	16 000	Dec. 31	Profit and Loss Summary	30 500
26	Bank	14 500			
		\$30 500			\$30 500

Rent Expense

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 2	Bank	8 500	Dec. 31	Profit and Loss Summary	8 500
		\$8 500			\$8 500

Discount Expense

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 30	Account Receivable- Big Q	1 300	Dec. 31	Profit and Loss Summary	1 300
		\$1 300			\$1 300

Profit and Loss Summary

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	Expenses	81 400	Dec. 31	Revenues	80 200
				Capital	1 200
		\$81 400			\$81 400

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	Profit and Loss Summary	1 200	Jan. 1	Balance	36 000

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

c

Calculation

	<i>Sales revenue</i>	80 000	
	<i>Less Sales Returns</i>	1 000	79 000
<i>less</i>	<i>Cost of Goods Sold</i>		
	<i>Cost of Sales</i>	39 500	
	<i>Freight Inwards</i>	1 600	41 100
	<i>Gross Profit</i>		37 900
	<i>+ Inventory Gain</i>		1 200
	<i>Adjusted Gross Profit</i>		39 100

Adjusted Gross Profit \$ 39 100

d

Explanation *It ensures that only those revenues earned and expenses incurred in the current Reporting Period are used to calculate profit, as it is only this information that is useful for decision-making.*

Exercise 10.3 Closing the ledger and transferring drawings

a/b General Journal

Date	Details	Debit \$	Credit \$
June 30	Discount Revenue	500	
	Sales	82 500	
	Sales Returns		2 500
	Profit and Loss Summary		80 500
	Profit and Loss Summary	76 700	
	Cost of Sales		50 000
	Discount Expense		400
	Inventory Loss		300
	Water and Supplies Expense		15 000
	Wages		11 000
	Profit and Loss Summary	3 800	
	Capital		3 800
June 30	Capital	2 000	
	Drawings		2 000

c General Ledger

Profit and Loss Summary

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Expenses	76 700	June 30	Revenues	80 500
	Capital	3 800			
		<u>\$80 500</u>			<u>\$80 500</u>

Drawings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Bank	1 600	June 30	Capital	2 000
	Inventory	400			
		<u>\$2 000</u>			<u>\$2 000</u>

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Drawings	2 000	June 1	Balance	30 900
	Balance	32 700	June 30	Profit and Loss Summary	3 800
		\$34 700			\$34 700
			July 1	Balance	32 700

d

Explanation	<i>Because Drawings is not an expense</i>
	<i>– it is expressly excluded by the definition</i>
	<i>as it is not an action of the business, but of the owner.</i>

e **WOMBAT PLANTS**

Balance Sheet (extract) as at 30 June 2025

	\$	\$
Current Liabilities		
Accounts Payable	4 000	
GST Clearing	1 000	
Loan – ANZ	2 000	7 000
Non-Current Liabilities		
Loan – ANZ		14 000
Owner's Equity		
Capital – Withered	30 900	
add Net Profit	3 800	
	34 700	
less Drawings	2 000	32 700
Total Equities	\$	53 700

Exercise 10.4 Income Statement

a General Ledger

Profit and Loss Summary

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	<i>Expenses</i>	98 400	30/6/25	<i>Revenues</i>	122 400
	<i>Capital</i>	24 000			
		<u>\$121 800</u>			<u>\$121 800</u>

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	<i>Drawings</i>	5 600	1/7/24	Balance	28 000
	<i>Balance</i>	46 400	30/6/25	<i>Profit and Loss Summary</i>	24 000
		<u>\$52 000</u>			<u>\$52 000</u>
			1/7/25	<i>Balance</i>	46 400

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

b FROSTY FRIDGES

Income Statement for the year ended 30 June 2025

	\$	\$
Revenue		
<i>Sales</i>	122 600	
<i>Sales returns</i>	2 000	120 600
less Cost of Goods Sold		
<i>Cost of Sales</i>	60 000	
<i>Customs Duty</i>	2 500	62 500
Gross Profit		58 100
<i>less Inventory Loss</i>	500	
<i>less Inventory write-down</i>	600	1 100
Adjusted Gross Profit		57 000
add Other Revenue		
<i>Discount Revenue</i>		1 800
		58 800
less Other Expenses		
<i>Wages</i>	19 000	
<i>Advertising</i>	3 000	
<i>Discount Expense</i>	1 300	
<i>Rent Expense</i>	12 000	35 300
Net Profit		23 500

c

Explanation	<i>Customs duty would be reported as part of Cost of Goods Sold</i>
	<i>as it is incurred in order to get inventory into a position and location</i>
	<i>ready for sale.</i>

d

Explanation	<i>The Income Statement supports Relevance, assisting decision-making about the firm's trading operations by showing the individual revenues and expenses that have caused the Net Profit. The owner can examine Gross Profit to assess the adequacy of the mark-up, or assess control of particular expenses.</i>
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e

Reason	<i>Liabilities may have decreased.</i>
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f

Discussion	<i>In terms of total Owner's equity it does not matter whether the owner's Drawings is reported as part of Wages as both decrease the owner's claim on the assets of the business.</i>
	<i>However, Drawings are expressly excluded from the definition of an expense as they are not incurred to earn profit.</i>
	<i>To include Drawings as part of Wages would overstate expenses and understate profit, and this could distort decision making and lead to poor financial decisions (about trading operations).</i>
	<i>It would be unethical to knowingly present reports which do not provide an accurate and faithful representation of the firm's performance</i>
	<i>so Drawings must be reported separately in the Balance Sheet</i>
	<i>and not included as part of Wages in the Income Statement.</i>

Exercise 10.5 Income Statement

a General Journal

Date	Details	Debit \$	Credit \$
Oct 31	<i>Profit and Loss Summary</i>	16 030	
	<i>Advertising</i>		450
	<i>Inventory Loss</i>		400
	<i>Freight In</i>		610
	<i>Discount Expense</i>		70
	<i>Freight Out</i>		800
	<i>Cost of Sales</i>		9 600
	<i>Rent Expense</i>		1 800
	<i>Wages</i>		2 300

b General Ledger

Profit and Loss Summary

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct 31	<i>Expenses</i>	16 030	Oct 31	<i>Revenues</i>	17 550
	<i>Capital</i>	1 520			
		<u>\$17 550</u>			<u>\$17 550</u>

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct 31	<i>Drawings</i>	1 500	Oct 1	Balance	14 200
				<i>Profit and Loss Summary</i>	1 520
Oct 31	<i>Balance</i>	14 220			
		<u>\$15 720</u>			<u>\$15 720</u>
			Nov 1	<i>Balance</i>	14 220

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

c PRECIOUS PAINTINGS

Income Statement for October 2025

	\$	\$
Revenue		
Sales		17 500
less Cost of Goods Sold		
Cost of Sales	9 600	
Freight in	610	10 210
Gross Profit		7 290
less Inventory Loss		400
Adjusted Gross Profit		6 890
add Other Revenue		
Discount Revenue		50
		6 940
less Other Expenses		
Advertising	450	
Discount Expense	70	
Freight out	800	
Rent Expense	2 400	
Wages	2 300	6 020
Net Profit (Loss)	\$	920

d

Explanation	<i>Freight out is recorded as an expense as it will decrease assets and decrease owners' equity, however will need to be listed as 'Other expense' and not 'Cost of Goods sold' as it is not a cost associated with getting the inventory in a position and condition ready for sale.</i>
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e

Reason 1	<i>Less than the wages paid to the shop assistant</i>
Reason 2	<i>Not enough to cover Drawings</i>

f

Explanation	<i>Higher advertising could attract more customers leading to higher sales and Net Profit.</i>
	<i>or Higher Wages could improve customer service generating more sales.</i>
	<i>(Other answers possible, but not changing prices.)</i>

g PRECIOUS PAINTING

Balance Sheet as at 31 October 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Accounts Receivable</i>	2 800		<i>Accounts Payable</i>	6 350	
<i>Bank</i>	3 520		<i>Loan – Commonwealth</i>	5 000	
<i>Inventory</i>	14 000	20 320	<i>GST Clearing</i>	350	11 700
Non-Current Assets			Non-Current Liabilities		
<i>Delivery Vehicle</i>	20 000	20 000	<i>Loan – Commonwealth</i>		15 000
			Owner's Equity		
			<i>Capital – Love good</i>	14 200	
			<i>less Net Profit</i>	920	
				15 210	
			<i>less Drawings</i>	1 500	13 620
Total Assets		\$40 320	Total Equities		\$40 320

Exercise 10.6 Income Statement

a

Explanation	<i>The Gain and Write down may relate to different lines of inventory.</i>
	<i>It is possible that a business may have an Inventory gain in bed frames</i>
	<i>(more tiems) but an Inventory write down in mattresses (lower value).</i>

b

General Journal

Date	Details	Debit \$	Credit \$
May 31	Discount Revenue	250	
	Sales	12 000	
	Inventory Gain	300	
	Sales Returns		1 200
	Profit and Loss Summary		11 350

c REST EASY BEDS

Income Statement for May 2025

	\$	\$
Revenue		
Sales	12 000	
Less Sales Returns	1 200	10 800
less Cost of Goods Sold		
Cost of Sales	8 380	
Buying Expenses	900	9 280
Gross Profit		1 520
add Inventory Gain		300
Less Inventory Write Down		400
Adjusted Gross Profit		1 420
add Other Revenue		
Discount Revenue		250
		2 070
less Other Expenses		
Advertising	230	
Rent Expense	1 800	
Wages	2 120	4 150
Net Profit (Loss)		(2 480)

d

Explanation	<i>Discount revenue is recorded as 'Other revenue' (after Adjusted Gross Profit)</i>
	<i>as it not earned from the sale of inventory,</i>
	<i>and therefore will not have a direct impact on Gross Profit</i>
	<i>and should not be included in the measure for mark up.</i>

e

Explanation	<i>Sales returns (10%) – staff are providing incorrect advice to customers</i>
	<i>or Low Gross Profit (low mark-up) – sales staff not promoting sale of higher</i>
	<i>mark-up items</i>

f

- Action 1** *Increase selling prices (to increase m/up)*
 Find a cheaper supplier / Negotiate cheaper rent (or move!)
- Action 2** *Increase advertising (to generate sales)*
 Assess staff rostering

g REST EASY BEDS

Balance Sheet as at 31 May 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Accounts Receivable</i>	1 000		<i>Bank (overdraft)</i>	3 410	
<i>Inventory</i>	14 000	15 000	<i>Accounts Payable</i>	3 000	
			<i>GST Clearing</i>	350	
Non-Current Assets			<i>Loan – Bank of Hope</i>	5 000	11 760
<i>Office Furniture</i>	7 650				
<i>Shop Fittings</i>	21 920	29 570	Non-Current Liabilities		
			<i>Loan – Bank of Hope</i>		10 000
			Owner's Equity		
			<i>Capital – J. Snooze</i>	26 790	
			<i>less Net Loss</i>	(2 480)	
				24 310	
			<i>less Drawings</i>	1 500	22 810
Total Assets		44 570	Total Equities		44 570

Exercise 10.7 Income Statement

a

Explanation	<i>Revenues and expenses must be transferred to the P&L Summary account in order to determine profit for the current Period.</i>
<i>or</i>	<i>Revenue and expense accounts must be reset to zero in readiness for the next Period.</i>

b

General Journal

Date	Details	Debit \$	Credit \$
Dec 31	Profit and Loss Summary	2 600	
	Capital		2 600
	Drawings		4 000
	Capital	4 000	

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

c EDUTOYS

Income Statement for the year ended 31 December 2025

	\$	\$
Revenue		
Sales		99 000
less Cost of Goods Sold		
Cost of Sales	62 000	
Import Duties	1 200	63 200
Gross Profit		35 800
Inventory Write Down		900
Adjusted Gross Profit		34 900
add Other Revenue		
Discount Revenue		700
		35 600
less Other Expenses		
Advertising	8 000	
Discount Expense	600	
Electricity	3 400	
Wages	21 000	33 000
Net Profit (Loss)		2 600

d

Action 1	<i>Improve physical security measures (locking the storeroom / security cameras)</i> <i>Check purchase invoices against delivery dockets</i>
Action 2	<i>Change store layout to improve surveillance / protect inventory from damage</i> <i>More regular stocktakes / Change mark-up</i>

e

Explanation	<i>It may mean customers are less willing to buy from EduToys</i> <i>leading to lower Sales revenue and thus lower Net Profit.</i>
	<i>Customers may be slow to pay,</i> <i>leading to increased bad debts and thus lower Net profit.</i>

f

EDUTOYS
Balance Sheet as at 31 December 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
Bank	2 500		Accounts Payable	13 540	
Accounts Receivable	15 000		Loan – ANZ Bank	6 000	
Inventory	14 800				19 540
GST Clearing	270	32 570			
			Non-Current Liabilities		
Non-Current Assets			Loan – ANZ Bank		78 000
Premises	97 000				
Shop Fittings	36 000	133 000	Owner's Equity		
			Capital – A. Teacher	69 430	
			add Net profit	2 600	
				72 030	
			less Drawings	4 000	68 030
Total Assets		165 570	Total Equities		165 570

g

Discussion	<i>The fact that EduToys has no Sales returns in its Income Statement may indicate that its products are good quality and customers are happy with what they have purchased.</i>
	<i>However, it may not be ethical to make this claim if the Inventory write-down (which indicates that some inventory will sell below its cost) is due to poor quality inventory.</i>
	<i>(At the same time it is up to customers to check for themselves the accuracy of the claim due to caveat emptor – let the buyer beware.)</i>

Exercise 10.8 Net Profit Margin

a

Explanation	<i>Indicates the expense control of the business</i>
	<i>by calculating the percentage of net sales that is retained as net profit.</i>

b

Calculation	
<i>Net Profit / Net Sales</i>	
<i>90 000 / 892 000</i>	
<i>0.10089 * 100</i>	
Net Profit Margin (2024)	10.08 %
Calculation	
<i>Net Profit / Net Sales</i>	
<i>92 000 / 968 000</i>	
<i>0.0950 * 100</i>	
Net Profit Margin (2025)	9.50 %

c

Explanation	<i>The firm's ability to control its overall expenses has worsened</i>
	<i>as it is now only retaining 9.5 cents per sales dollar in net profit</i>
	<i>(compared to 2024 where it was retaining 10.05 cents per sales dollar).</i>

d

Evaluation	<i>Increasing advertising might lead to increased Sales and Net Profit in dollar terms as more customers are aware of the business, its products and prices.</i>
	<i>However, higher advertising will also increase expenses and this may lead to a decrease in the Net Profit Margin and worse profitability overall.</i>
	<i>The trend in Sales is increasing but Net Profit Margin is decreasing, suggesting revenue earning is not the problem but rather expense control, and higher advertising does not address this issue.</i>

e

Action 1	<i>Reduce wages by changing staffing</i>
	<i>Revert back to normal level of advertising</i>
Action 2	<i>Improve inventory management to avoid loss of inventory during the period.</i>

f

Explanation	<i>Graphical representations improve Understandability</i>
	<i>as the user (the owner) is able to comprehend the information without relying on accounting knowledge,</i>
	<i>leading to more informed and better decision making.</i>

Exercise 10.9 Gross Profit Margin

a

Explanation	<i>The Income Statement suggests that there are no early payments made to Accounts Payable, as there is no record of discount revenue.</i>
	<i>This would be the predominant reason for early payment of credit transactions.</i>

b

Explanation	<i>measures the average mark up of inventory</i>
	<i>by calculating the percentage of sales that is retained as Gross Profit.</i>

c

Calculation	
<i>Gross Profit / Net Sales</i>	
<i>218 400 / 476 800</i>	
<i>0.4580 * 100</i>	
Gross Profit Margin (2025)	45.80 %

d

Reason 1	<i>Increased selling price</i>
Reason 2	<i>Decreased cost price of inventory: cheaper supplier / lower buying expenses</i>

e

Evaluation	<i>From an financial perspective, cutting back on wages will not change the Gross Profit Margin as it will not change the average mark-up</i>
	<i>because it will not change the selling price or cost price of inventory.</i>
	<i>Further, it would unethical (and probably illegal) to simply reduce the hourly rate paid to employees.</i>
	<i>Reducing the hours employees work might be possible if they are casual</i>
	<i>but this runs the risk of reducing customers service and therefore sales and profit (but would still not improve the Gross Profit Margin).</i>

f **Use spreadsheet**

g

Explanation	<i>A Pie Chart presents the information in a more Understandable fashion</i>
	<i>showing a breakdown of how the Sales dollar is consumed.</i>
	<i>This can highlight problem areas so decisions can be made</i>
	<i>improving expense control within the business.</i>

Exercise 10.10 Income Statement

a

Explanation	<i>The premises is owned</i>
	<i>as 'Premises' is listed in Trial Balance</i>
	<i>(but 'Rent expense' is not).</i>

b/c General Journal

Date	Details	Debit \$	Credit \$
Apr 30	Wages expense	1 100	
	Advertising expense		1 000
	GST Clearing		100
Apr 30	Inventory Loss	390	
	Inventory		390
Apr 30	Sales	16 900	
	Commission Revenue	350	
	Sales Returns		400
	Profit and Loss Summary		16 850
Apr 30	Profit and Loss Summary	14 660	
	Cost of Sales		8 250
	Freight In		300
	Advertising		560
	Discount Expense		200
	Electricity Expense		620
	Interest Expense		50
	Telephone Charges		90
	Wages		4 200
	Inventory Loss		390
Apr 30	Profit and loss Summary	2 190	
	Capital		2 190

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

d ZARA & LUKE

Income Statement for the year ended 30 April 2025

	\$	\$
Revenue		
Sales	16 900	
Less Sales Returns	400	16 500
less Cost of Goods Sold		
Cost of Sales	8 250	
Freight in	300	8 550
Gross Profit		7 950
Inventory Loss		390
Adjusted Gross Profit		7 560
add Other Revenue		
Commission Revenue		350
		7 910
less Other Expenses		
Advertising	560	
Discount Expense	200	
Electricity	620	
Interest Expense	50	
Telephone Charges	90	
Wages	4 200	5 720
Net Profit (Loss)		2 190

e

Discussion	<i>Displaying the pottery generates commission revenue for Zara and Luke which increases Net Profit and this is an incentive to keep displaying the goods for sale.</i>
	<i>However, if the pottery business using dangerous chemicals it will be causing environmental damage meaning Zara and Luke should uphold its ethical responsibility to protect the environment and remove the items from display. (They might actually lose sales and profit if customers decide to not buy from them due to their lack of ethical and environmental responsibility.)</i>

f

Explanation	<i>Increase selling price to increase mark up (Gross Profit).</i>
	<i>Change the product mix towards higher mark-up items.</i>

g

ZARA & LUKE
Balance Sheet as at 30 April 2025

Current Assets	\$	\$	Current Liabilities	\$	\$
<i>Bank</i>	5 160		<i>Accounts Payable</i>	49 500	
<i>Inventory</i>	45 610		<i>GST Clearing</i>	4 800	
<i>Accounts Receivable</i>	2 300	53 070	<i>Mortgage – Melven</i>	6 000	60 300
Non-Current Assets			Non-Current Liabilities		
<i>Fixtures and Fittings</i>	35 000		<i>Mortgage – Melven</i>	484 000	484 000
<i>Premises</i>	520 000	555 000			
			Owner's Equity		
			<i>Capital</i>	63 080	
			<i>+ Net Profit</i>	2 190	
				65 270	
			<i>- Drawings</i>	(1 500)	63 770
Total Assets		608 070	Total Equities		608 070

g

Explanation	<i>By reporting the item at its original purchase price as shown on the source document, thereby ensuring the valuation is free from material error or bias.</i>

Exercise 10.11 Income Statement

a

Explanation	<i>They do sell on credit terms</i>
	<i>as Accounts Receivable and Discount Expense are both listed</i>
	<i>in the Trial Balance.</i>

b

General Ledger Profit and Loss Summary

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Expenses	414 750	June 30	Revenues	422 500
	Capital	7 750			
		<u>\$422 500</u>			<u>\$422 500</u>

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Drawings	31 700	June 1	Balance	255 070
	Balance	231 120	30	Profit and Loss Summary	7 750
		<u>262 820</u>			<u>262 820</u>
			July 1	Balance	231 120

Chapter 10 *Determining Profit or Loss* – Solutions to exercises

c PRIME WINDOWS

Income Statement for the year ended 30 June 2025

	\$	\$
Revenue		
Sales	420 000	
Less Sales Returns	1 500	418 500
less Cost of Goods Sold		
Cost of Sales	310 000	
Buying Expenses	4 300	314 300
Gross Profit		104 200
Inventory Write-Down		1 600
Adjusted Gross Profit		102 600
add Other Revenue		
Discount Revenue		4 000
		106 600
less Other Expenses		
Discount Expense	2 400	
Insurance	1 200	
Interest Expense	750	
Rent Expense	25 000	
Vehicle Expenses	16 400	
Wages	53 100	98 850
Net Profit (Loss)		7 750

d

Explanation	<i>There is no advertising expense for the year;</i>
	<i>the business only has two customers;</i>
	<i>and it is 500km from Melbourne.</i>

e

Discussion	<i>Changing suppliers would allow them to reduce the cost price of their windows increasing their mark-up as well as Gross and Net Profit.</i>
	<i>However,</i>
	<i>they would no longer be supporting local business;</i>
	<i>it could create job losses at the manufacturer JB Constructions;</i>
	<i>15/500 of town population is employed by main supplier;</i>
	<i>it would have a negative effect on the local economy (where they live).</i>

f

Action 1	<i>Increase selling price, while maintaining the same level of sales</i>
	<i>Advertise to attract new customers</i>
Action 2	<i>Decrease mark up of inventory to sell a larger quantity at a reduced level,</i>
	<i>therefore increasing overall gross profit</i>

g

PRIME WINDOWS

Balance Sheet as at 30 June 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Accounts Receivable:</i>			<i>Bank Overdraft</i>	680	
- <i>BuildWell</i>	48 000		<i>Accounts Payable – JB Construction</i>	140 000	
- <i>GQ Homes</i>	36 000		<i>Loan – QV Finance</i>	7 200	147 880
<i>GST Clearing</i>	3 800				
<i>Inventory</i>	146 000	233 800	Non-Current Liabilities		
			<i>Loan – QV Finance</i>	172 200	172 200
Non-Current Assets					
<i>Shelving</i>	145 000		Owner's Equity		
<i>Vehicles</i>	180 000	325 000	<i>Capital</i>	262 670	
			<i>+ Net Profit</i>	7 750	
				270 420	
			<i>- Drawings</i>	(31 700)	238 720
Total Assets		558 800	Total Equities		558 800

h

Explanation	<i>Because drawings (\$31700) were significantly higher than Net Profit (\$7750), therefore decreasing the owners' equity.</i>
	<i>This reduces the financial investment of the owner (increasing the level of risk) and the funds available to the firm.</i>

Exercise 11.1 Statement of Receipts and Payments

a General Ledger

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	8 600	July	Accounts Payable	70 000
	Sales / GST Clearing	110 000		Electricity / GST Clearing	2 640
	Accounts Receivable	50 000		Interest	600
	Capital	15 000		Office expenses / GST Clearing	5 500
				Wages	30 000
				Equipment / GST Clearing	6 160
				Drawings	40 000
				Loan	6 000
				Rent / GST Clearing	19 800
				Balance	2 900
		183 600			183 600
Aug. 1	Balance	2 900			

Chapter 11 *The Cash Flow Statement* – Solutions to exercises

b CRAFTY CABINETS

Statement of Receipts and Payments for July 2025

	\$	\$
Cash Receipts		
Cash Sales	100 000	
Receipts from Accounts Receivable	50 000	
GST Received	10 000	
Capital	15 000	175 000
less Cash Payments		
Payments to Accounts Payable	70 000	
Electricity	2 400	
Interest Expense	600	
Office Expenses	5 000	
Wages	30 000	
Equipment	5 600	
Drawings	40 000	
GST Paid	3 100	
Loan Repayment	6 000	
Rent Expense	18 000	180 700
Cash Surplus (Deficit)		(5 700)
add Bank Balance at Start		8 600
Bank Balance at End		2 900

c

Reason	<i>The business has suffered a Cash Deficit (of \$5 700), reducing its Bank balance</i>

d

Explanation	<i>By preparing a Cash Flow Statement,</i>
	<i>which shows sources and uses of funds by classifying cash flows as</i>
	<i>Operating, Investing or Financing activities,</i>
	<i>providing greater Understandability.</i>

Exercise 11.2 Cash Flow Statement

a

Calculation		
<i>Electricity</i>	150	
<i>Insurance</i>	180	
<i>Display cabinets</i>	600	
		GST paid \$ 930

b **BOOF HEAD**

Cash Flow Statement for the year ended 30 June 2025

	\$	\$
OPERATING ACTIVITIES		
<i>Cash Sales</i>	50 000	
<i>Receipts from Accounts Receivable</i>	25 000	
<i>GST Received</i>	5 000	80 000
<i>Payments to Accounts Payable</i>	(24 000)	
<i>Wages</i>	(28 000)	
<i>GST Paid</i>	(930)	
<i>Electricity</i>	(1 500)	
<i>Insurance</i>	(1 800)	(56 230)
Net Cash Flows from Operations		23 770
INVESTING ACTIVITIES		
<i>Display Cabinets</i>		(6 000)
Net Cash Flows from Investing Activities		(6 000)
FINANCING ACTIVITIES		
<i>Capital Contribution</i>		10 000
<i>Drawings</i>		(12 000)
Net Cash Flows from Financing Activities		(2 000)
Net Increase (Decrease) in Cash		15 770
Bank Balance at Start		(13 500)
Bank Balance at End		2 270

Chapter 11 *The Cash Flow Statement* – Solutions to exercises

c

Explanation	<i>Classified as a Financing Outflow</i>
	<i>as it is a cash flow related to a change in the firm's financial structure</i>
	<i>(i.e. it decreases Owner's Equity)</i>

d

Reason	<i>To keep the bank balance out of overdraft</i>
	<i>To help fund the purchase of the display cabinets</i>

e

Explanation	<i>It aids decision-making by classifying sources and uses of funds, allowing the owner to: identify whether Net Cash Flows from Operations is sufficient to cover other cash requirements / assess its performance in meeting its cash targets OR assists in planning for future cash activities by providing a basis for cash targets for the future (in the next Budgeted Cash Flow Statement).</i>

Exercise 11.3 Cash Flow Statement

a

Calculation

<i>Inventory</i>	<i>500</i>
<i>Electricity</i>	<i>50</i>
<i>Rent</i>	<i>240</i>
<i>Shelving</i>	<i>160</i>

GST paid	\$ 950
-----------------	---------------

b FLIP FLOPS

Cash Flow Statement for the quarter ended 30 September 2025

	\$	\$
OPERATING ACTIVITIES		
Cash Sales	10 000	
Receipts from Accounts Receivable	7 000	
GST Received	1 000	18 000
Payments to Accounts Payable	(14 000)	
Cash Purchases of Inventory	(5 000)	
Wages	(6 000)	
GST Paid	(950)	
Electricity	(500)	
Rent Expense	(2 400)	
Interest Expense	(550)	(29 400)
Net Cash Flows from Operations		(11 400)
INVESTING ACTIVITIES		
Cash Outflows		
Shelving		(1 600)
Net Cash Flows from Investing Activities		(1 600)
FINANCING ACTIVITIES		
Loan – Bodgey Bank		25 000
Loan Repayment	(1 000)	
Drawings	(2 000)	(3 000)
Net Cash Flows from Financing Activities		22 000
Net Increase (Decrease) in Cash		9 000
Bank Balance at Start		1 500
Bank Balance at End		10 500

c Use spreadsheet

d

Discussion	<i>The owner should be happy that there has been a Net increase in cash and therefore the Bank balance has increased.</i>
	<i>However, Net Cash Flows from Operations is negative meaning the business is not generating enough funds from its Operating activities to meet its other cash requirements.</i>
	<i>If not for the loan, the bank balance would have fallen into overdraft and the loan needs to be repaid at some point in the future which will mean a drain on cash resources.</i>

e

Action 1	<i>Reduce selling price to encourage more cash sales /</i>
	<i>Contact slow paying Accounts Receivable / Reduce payments on expenses</i>
Action 2	<i>Reduce / defer payments to Accounts Payable / drawings/ loan repayments</i>
	<i>Sell inefficient non-current assets</i>

Exercise 11.4 Operating activities

a

Calculation			
Cash Sales	60 000	less GST paid	380
GST Received	6 000	Electricity	1 200
	66 000	Wages	6 000
		GST Settlement	3 000
		Payments to Accounts Payable	45 000
		Interest	1 850
			57 430
Net Cash Flows from Operations			\$ 8 570

b

Explanation	<i>Not included in the cash flow statement</i>
	<i>as its currently a present obligation of the entity to be paid in a future period.</i>

c

Explanation	<i>Positive Net Cash Flows from Operations are necessary so the business has cash to meet its requirements without using other sources of finance, such as loans (which must be repaid, plus interest) or capital (which is limited to the funds of the owner).</i>

d

Action 1	<i>Capital Contribution / Loan</i>
Action 2	<i>Increase sales: new lines, change prices, more effective advertising</i>
	<i>NB. No receipts from Accounts Receivable</i>

Exercise 11.5 Operating activities

a

Calculation			
	<i>GST Refund</i>	300	<i>less Interest paid</i> 4 800
<i>Receipts from Accounts Receivable</i>	15 000		<i>GST paid</i> 1 900
	<i>Cash Sales</i>	16 000	<i>Rent paid</i> 15 000
	<i>GST Received</i>	1 600	21 700
		32 900	
Net Cash Flows from Operations			\$ 11 200

b

Explanation	<i>It is excluded from the Cash Flow Statement altogether</i>
	<i>as it is a non-cash expense.</i>
	<i>It involves a decrease to Accounts Receivable rather than Bank.</i>

c

Explanation	<i>The receipts are from different entities (customers v. ATO) and</i>
	<i>may relate to different reporting Periods (current v. previous).</i>

d

Action 1	<i>Reduce payments for expenses eg. Pay rent monthly</i>
	<i>Defer interest payments / Decrease drawings</i>
Action 2	<i>Extra GST paid indicates cash payment for NCA - defer payment?</i>
	<i>NB. No payments to Accounts Payable</i>

Exercise 11.6 Investing activities

a

Explanation	<i>Cash flows related to the purchase or sale of non-current assets</i>

b

Calculation	
<i>Fittings</i>	5 600
+ <i>Deposit paid on furniture</i>	<u>800</u> 6 400
Net Cash Flows from Investing Activities	\$ (6 400)

c

Explanation	<i>Excluded as it doesn't relate to non-current assets;</i>
	<i>inventory is a current asset, so cash purchases is an Operating outflow</i>
	<i>(as it relates to day-to-day trading activities).</i>

d

Explanation	<i>All GST cash flows are reported as Operating activities</i>
	<i>as dealing with the GST – whether for current or non-current assets – is a</i>
	<i>day-to-day trading activity.</i>

e

Discussion	<i>The owner may be concerned that Investing Cash flows are negative</i>
	<i>as this will reduce cash on hand.</i>
	<i>However, this means the business is purchasing non-current assets</i>
	<i>which should contribute to revenue earning capacity meaning greater cash</i>
	<i>inflows in future.</i>

Exercise 11.7 Investing activities

a

Calculation	
Vehicle	32 000
+ Shelving	10 000
Net Cash Flows from Investing Activities	
	\$ (42 000)

b

Reason	<i>It includes GST on (some) Operating outflows.</i>

c

Method 1	<i>Existing cash reserves/overdraft</i>
Method 2	<i>Net Cash Flows from Operations</i>
Method 3	<i>Loan / Capital contribution</i>

d

Explanation	<i>It indicates the purchase of non-current assets which should mean higher revenue and / or lower maintenance costs.</i>

Exercise 11.8 Financing activities

a

Explanation	<i>Cash flows related to changes in the firm's financial structure.</i>
	<i>Eg: Capital/Drawings & Loans/Loan Repayments</i>

b

Calculation	
<i>Receipt of Loan – NAB</i>	<i>12 000 less Drawings 25 000</i>
Net Cash Flows from Financing Activities	\$ (13 000)

c

Explanation	<i>Excluded as it is an Operating outflow –</i>
	<i>a cash flow related to the firm's day-to-day trading activities</i>

d **General Ledger**

Capital

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	<i>Drawings *</i>	25 700	1/7/24	Balance	48 000
	<i>Balance</i>	38 300	30/6/25	<i>Profit and Loss Summary</i>	16 000
		64 000			64 000
			1/7/15	<i>Balance</i>	38 300

Exercise 11.9 Financing activities

a

Explanation	<i>Upholding Relevance, it would be valued at its agreed value</i>
	<i>(the price that would apply in an arm's length transaction)</i>
	<i>as this is up to date and most useful for decision making.</i>

b

Calculation				
<i>Capital Contribution</i>	<i>30 000</i>	<i>less</i>	<i>Loan Repayment</i>	<i>15 000</i>
			<i>Cash Drawings</i>	<i>8 700</i>
	<i>30 000</i>			<i>23 700</i>
Net Cash Flows from Financing Activities				\$ 6 300

c

Explanation	<i>It is expressly excluded from the definition of revenue as it is</i>
	<i>not earned as a result of the activities of the business</i>
	<i>but rather those of the owner.</i>

d

Explanation	<i>If it involves the receipt of a Loan,</i>
	<i>interest expense may increase leading to a reduction in Net Profit.</i>

Exercise 11.10 Cash Flow Cover

a

Calculation

$$\begin{aligned}
 \text{Cash Flow Cover (CFC)} &= \frac{\text{Net Cash Flows from Operations}}{\text{Average Current Liabilities}} \times 100 \\
 &= \frac{\$120\,000}{(\$42\,000 + 38\,000) / 2} \times 100 \\
 &= 1.75 \text{ times}
 \end{aligned}$$

Cash Flow Cover **3 times**

b

Reason	<i>Greater Cash Flows from Operations</i>
	<i>Lower average current liabilities</i>

c

Explanation	<i>It is higher (better) than March's result of 2.4 times,</i>
	<i>meaning the business is more able to meet its current liabilities using its</i>
	<i>Operating cash.</i>

d

Explanation	<i>It has not met their budgeted target of 3.6 times meaning</i>
	<i>the business is not generating as much cash from Operating activities</i>
	<i>as expected / current liabilities are higher than expected.</i>

e

Discussion	<i>The business has positive Operating cash and</i>
	<i>its Cash Flow Cover is greater than 1 meaning it should be able to meet its</i>
	<i>short term debts as they fall due.</i>
	<i>However its cash flows from Investing and Financing activities are unknown</i>
	<i>and they affect the overall change in cash.</i>
	<i>Further the business does have a Bank overdraft</i>
	<i>(which may be approaching its limit?).</i>

Exercise 11.11 Cash versus profit

a

Calculation	
<i>Inventory</i>	300
<i>Computer</i>	100
GST paid	
	\$ 400

b

Calculation	
<i>Amount owing</i> $\times 10\% = 410$	
<i>so Amount owing</i> = 4 100	
<i>Receipt from Accounts Receivable</i> = 4 100 – 410	
Receipts from Accounts Receivable	
	\$ 3 690

c BUZZ WAX PRODUCTS

Cash Flow Statement for August 2025

	\$	\$
OPERATING ACTIVITIES		
Cash Sales	10 000	
Receipts from Accounts Receivable	3 690	
GST Received	1 000	14 690
Payments to Accounts Payable	(4 300)	
Cash Purchases of Inventory	(3 000)	
Wages	(5 000)	
Interest Expense	(750)	
GST Paid	(400)	(13 450)
Net Cash Flows from Operations		1 240
INVESTING ACTIVITIES		
Computer		(1 000)
Net Cash Flows from Investing Activities		(1 000)
FINANCING ACTIVITIES		
Capital Contribution		5 000
Drawings		(2 450)
Net Cash Flows from Financing Activities		2 550
Net Increase (Decrease) in Cash		2 690
Bank Balance at Start		(2 500)
Bank Balance at End	\$	190

d

Explanation	<i>The cash position is concerning because although the Bank Balance at End is positive it is only \$190 so there is little cash available to meet short-term debts as they fall due.</i>
	<i>However, there has been a Net Increase in Cash from last period,</i>
	<i>and Net Cash Flows from Operations are positive meaning the firm is</i>
	<i>generating enough cash.</i>

d

Example 1	<i>Capital Contribution/GST Received was greater than GST Paid.</i>
Example 2	<i>Receipts from Accounts receivable was greater than Credit Sales.</i>
Explanation	<i>Capital Contribution is a cash inflow, which will increase Net Cash Flows but is not a revenue and so will not affect the Net Loss.</i>
	<i>Receipts from Debtors (cash inflow) increased Net Cash Flows by more than</i>
	<i>Credit Sales (revenue) increased Net Profit (or decreased the loss).</i>

e

Explanation	<i>It allows the owner to identify sources and uses of cash</i>
	<i>to assess whether the business is generating sufficient Operating cash.</i>
	<i>This will help to identify problem areas so corrective action can be taken</i>
	<i>(particularly when it is compared against the Budgeted Cash Flow Statement).</i>

Exercise 11.12 Cash versus profit

a

Higher/Lower	<i>Lower</i>
Justification	<i>Receipts from Accounts receivable and Discount Expense of \$38 000</i>
	<i>decreases Accounts receivable more than</i>
	<i>Credit Sales plus GST of \$24 200 (which increases Accounts Receivable).</i>

b

Calculation	
Inventory	4070
Admin. expenses	300
Equipment	1 380
Insurance	600
GST paid \$ 6 350	

c SAW MILLER FURNITURE

Cash Flow Statement for the quarter ended 30 June 2025

	\$	\$
OPERATING ACTIVITIES		
<i>Receipts from Accounts Receivable</i>	36 500	
<i>Cash Sales</i>	25 000	
<i>GST Received</i>	2 500	64 000
<i>Cash Purchases of Inventory</i>	(40 700)	
<i>Administration Expenses</i>	(3 000)	
<i>Wages</i>	(11 900)	
<i>Insurance</i>	(6 000)	
<i>GST Paid</i>	(6 350)	(67 950)
Net Cash Flows from Operations		(3 950)
INVESTING ACTIVITIES		
<i>Equipment</i>		13 800
Net Cash Flows from Investing Activities		(13 800)
FINANCING ACTIVITIES		
<i>Loan – GIN Bank</i>	20 000	
<i>Capital Contribution</i>	6 000	26 000
<i>Drawings</i>	(13 500)	
<i>Loan Principal</i>	(1 100)	(14 600)
Net Cash Flows from Financing Activities		11 400
Net Increase (Decrease) in Cash		(6 350)
Bank Balance at Start		(1 600)
Bank Balance at End		(7 950)

d

Reason	<i>To purchase the Equipment</i>
	<i>without exceeding the overdraft limit of \$8 000</i>

Chapter 11 *The Cash Flow Statement* – Solutions to exercises

e

Example 1	<i>Equipment / Repayment of loan / GST paid > rec'd</i>
Example 2	<i>Payments for inventory are greater than Cost of Sales</i>
Explanation	<i>Cash outflows such as repaying a loan / purchasing equipment decrease Bank but are not expenses so do not affect Net Profit in that Period.</i>
	<i>Payments for inventory (\$40 700) are cash outflows that decrease Bank more than the Cost of Sales (\$23 500) expense decreases Net Profit.</i>

f

Calculation	
Cash Flow Cover (CFC)	$= \frac{\text{Net Cash Flows from Operations}}{\text{Average Current Liabilities}} \times 100$
	$= \frac{\$3\,950}{\$8\,000} \times 100$
	$= -0.49 \text{ times}$
Cash Flow Cover	
	-0.49 times

g

Explanation	<i>Improved from -4.3 last period to -0.49 this period</i>
	<i>indicating improved ability to meet Current liabilities from Operating cash.</i>
	<i>(However, still < 1 so unable to meet current liabilities using only</i>
	<i>Operating cash.)</i>

h

Action 1	<i>Purchase less inventory</i>
	<i>Purchase inventory on credit</i>
	<i>Use strategies to generate faster Accounts Receivable Turnover</i>
Action 2	<i>Strategies to increase cash sales</i>
	<i>Decrease Drawings</i>

Exercise 11.13 Cash versus profit

a

Calculation		
Rent	600	
Office equipment	700	
Cartage in	400	
		GST paid
		\$ 1 700

b FULL COLLECTION

Cash Flow Statement for January 2025

	\$	\$
OPERATING ACTIVITIES		
Receipts from Accounts Receivable		29 000
Rent expense	(6 000)	
GST Paid	(1 700)	
Cartage in	(4 000)	
Wages	(15 000)	(26 700)
Net Cash Flows from Operations		2 300
INVESTING ACTIVITIES		
Office Equipment		(7 000)
Net Cash Flows from Investing Activities		(7 000)
FINANCING ACTIVITIES		
Capital Contribution	20 000	
Loan – Kyneton Bank	50 000	70 000
Drawings		(7 500)
Net Cash Flows from Financing Activities		62 500
Net Increase (Decrease) in Cash		57 800
Bank Balance at Start		nil
Bank Balance at End		57 800

c FULL COLLECTION

Income Statement for January 2025

	\$	\$
Revenue		
Sales		40 000
less Cost of Goods Sold		
Cost of Sales		20 000
Gross Profit		20 000
less Other Expenses		
Interest Expense	250	
Rent Expense	1 000	
Wages	15 000	
Cartage Expenses	4 000	
Advertising	1 000	21 250
Net Profit (Loss)		(1 250)

d

Example 1	<i>Loan / Capital Contribution</i>
Example 2	<i>Inventory sold (COS) but unpaid / Interest Expense unpaid</i>
Explanation	<i>Loan / Capital Contribution are cash inflows that increase cash but are not revenue so do not affect Net Profit.</i>
	<i>Cost of sales / interest are expenses that decrease Net Profit but are not cash outflows so do not affect cash until the next period</i>

f

Discussion	<i>In terms of earning profit, the business has suffered a loss.</i>
	<i>Although it is only the first month of operations and the firm is still establishing</i>
	<i>itself and its customer base the owner should be concerned that Wages</i>
	<i>expense consumes such a large portion of Gross Profit as do Cartage</i>
	<i>expenses.</i>
	<i>In terms of cash there is a large increase which gives the business funds to</i>
	<i>use to finance its activities.</i>
	<i>Positive Operating cash means it is generating enough cash to meet its</i>
	<i>day-to-day activities but it is yet to pay for Inventory (which will be at least</i>
	<i>\$20 000 next month).</i>
	<i>The large bank balance is due mainly to a capital (which may not be possible</i>
	<i>every month) and the loan (which needs to be repaid starting next month).</i>

Exercise 11.14 Cash flows

a

Calculation

<i>Payment</i>	5 700
+ <i>Discount revenue</i>	300

Decrease in Accounts Payable \$ 6 000

b

Calculation

<i>Inventory</i>	290
<i>Shelving</i>	160

GST paid \$ 450

c THE GLASS HOUSE

Cash Flow Statement for October 2025

	\$	\$
OPERATING ACTIVITIES		
<i>Cash Sales</i>	6 700	
<i>Receipts from Account Receivable</i>	5 200	
<i>GST Refund</i>	500	
<i>GST Received</i>	670	13 070
<i>Payments to Accounts Payable</i>	(5 700)	
<i>Cash Purchases of Inventory</i>	(2 900)	
<i>Wages</i>	(1 000)	
<i>Interest</i>	(100)	
<i>GST Paid</i>	(450)	(10 150)
Net Cash Flows from Operations		2 920
INVESTING ACTIVITIES		
<i>Shelving</i>		(1 600)
Net Cash Flows from Investing Activities		(1 600)
FINANCING ACTIVITIES		
<i>Drawings</i>		(2 110)
Net Cash Flows from Financing Activities		(2 110)
Net Increase (Decrease) in Cash		(790)
Bank Balance at Start		230
Bank Balance at End	\$	(560)

d General Ledger

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 1	Balance	230	Oct.	Accounts Payable	5 700
	Sales / GST Clearing	7 370		Inventory / GST Clearing	3 190
	GST Clearing	500		Wages	1 000
	Accounts Receivable	5 200		Interest expense	100
31	Balance	560		Drawings	2 110
				Shelving / GST Clearing	1 760
		13 860			13 860
			Nov. 1	Balance	560

e

Example 1	<i>Cash Purchase of Shelving</i>
Example 2	<i>Cash Drawings</i>
Explanation	<i>Both these cash outflows increase the Bank overdraft, but are classified as Investing and Financing activities, respectively, and so have no effect on Net Cash Flows from Operations.</i>

f

Explanation	<i>Options:</i>
	<i>Reduce drawings / Defer purchasing the shelving until a future period</i>
	<i>Contribute capital / Take out a loan</i>

g

Increase or Decrease	<i>Decrease (by \$4000)</i>
Justification	<i>Negative Net Cash Flows from Operations (\$4 000) and Investing Activities (\$6 000) will outweigh positive Net Cash Flows from Financing Activities (\$6 000).</i>

h

Explanation	<i>Net Cash Flows from Operations is negative</i>
	<i>so the firm cannot meet its Investing and Financing cash requirements</i>
	<i>without additional loans (which must be repaid)</i>
	<i>or capital (which is limited to the funds of the owner).</i>

i

Action 1	<i>Purchase less inventory (JIT)</i>
	<i>Purchase inventory on credit . . .</i>
	<i>Defer payments to Accounts Payable . . .</i>
Action 2	<i>Collect cash from Accounts Receivable faster by . . .</i>

j

Discussion	<i>Net Cash Flows from Investing Activities is negative which will mean</i>
	<i>pressure on/a reduction in the firm's bank balance.</i>
	<i>However, it may be the result of purchasing new non-current assets</i>
	<i>(and this is supported by positive Financing cash flows, perhaps due to a loan</i>
	<i>or capital contribution) and more or better non-current assets may generate</i>
	<i>more sales.</i>
	<i>They may also be more efficient and cost less to maintain leading to better</i>
	<i>profit and liquidity.</i>

Exercise 11.15 Cash versus profit

a

Explanation	<i>The cash cycle will be longer</i>
	<i>as a result of the time it will take to collect the cash from Accounts Receivable.</i>
	<i>(depending on the credit terms and the strategies used by the business to</i>
	<i>collect this cash).</i>

b

Calculation	
	$\text{Discount rate} = \frac{\text{Discount}}{\text{Amount owing}}$
	$= \frac{\$1\,720}{\$170\,280 + \$1\,720}$
	Discount rate 10 %

c

Calculation	
Admin. Expenses	100
Rent	1 100
Insurance	420
Display cabinets	800
	GST paid \$ 2 420

a

Calculation	
Decrease	127 100
- Discount revenue	1 400
	Decrease in Accounts Payable \$ 125 700

e

General Ledger

Accounts Receivable

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
1/7/24	Balance	35 000		Bank/Discount Expense	172 000
	Sales/GST Clearing	198 000		Sales returns / GST Clearing	1 650
			30/6/25	Balance	59 350
		233 000			233 000
1/7/25	Balance	59 350			

f **BLING RINGS**

Cash Flow Statement for the year ended 30 June 2025

	\$	\$
OPERATING ACTIVITIES		
Receipts from Accounts Receivable		170 280
Payments to Accounts Payable	(125 700)	
Wages	(34 500)	
Administration Expenses	(1 000)	
Rent Expense	(11 000)	
Insurance	(4 200)	
Interest Expense	(3 000)	
GST Settlement	(1 100)	
GST Paid	(2 420)	(182 920)
Net Cash Flows from Operations		(12 640)
INVESTING ACTIVITIES		
Display Cabinets		(8 000)
Net Cash Flows from Investing Activities		(8 000)
FINANCING ACTIVITIES		
Loan – QZ FinCo.		15 000
Drawings		(13 500)
Net Cash Flows from Financing Activities		1 500
Net Increase (Decrease) in Cash		(19 140)
Bank Balance at Start		30 000
Bank Balance at End		10 860

g

Example 1	<i>Credit Sales is greater than Receipts from Accounts Receivable.</i>
Example 2	<i>Payments to Accounts Payable is greater than Cost of Sales.</i>
Explanation	<i>Credit Sales is revenue and so increases Net Profit by more than Receipts from Accounts Receivable increases Net Cash Flows from Operations.</i>
	<i>Payments to Accounts Payable is a cash outflow, which decreases Net Cash Flows from Operations more than Insurance expense decreases Net Profit.</i>

h

Action	<i>Issuing statement of accounts / reminder letters / threatening legal action etc</i>
	<i>This will result in Accounts Receivable paying at a faster rate.</i>

Exercise 12.1 Prepaid expense

a General Journal

Date	Details	Debit \$	Credit \$
March 1	Prepaid Rent Expense	6 600	
	GST Clearing	600	
	Bank		6 600
	Paid 6 months' rent in advance (Ch. 34)		

b

Accounting Assumption	Period / Accrual basis
Explanation	The business will have the use of the premises for March–June 2025, and will therefore consume / incur some of the rent in the Reporting Period ending 30 June 2015. The amount incurred will be reported as an expense. (The remaining rent for July and August will remain prepaid as at 30 June 2025.)

c

Calculation
$\frac{\$6\,000}{6\text{ months}} \times 4\text{ months' consumed (Mar.–June inclusive)}$ $= \$1\,000 \times 4$
Rent expense \$ 4 000

d General Journal

Date	Details	Debit \$	Credit \$
June 30	Rent Expense	4 000	
	Prepaid Rent Expense		4 000
	Adjustment for rent for year ended 30 June 2025		
	(Memo 51)		

e

Explanation	<i>Assets (Prepaid rent) decrease by \$4 000 because this amount has been consumed and will no longer provide an economic benefit.</i>
	<i>Liabilities are not affected.</i>
	<i>Owner's equity decreases as Rent expense increases \$4 000 leading to a decrease in Net profit as this amount has been incurred in the current Period.</i>

f **General Ledger**

Prepaid Rent Expense (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 1	Bank	6 000	June 30	Rent Expense	4 000
				Balance	2 000
		6 000			6 000
July 1	Balance	2 000			

Rent Expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Prepaid Rent Expense	4 000	June 30	Profit & Loss Summary	4 000
		4 000			4 000

Exercise 12.2 Prepaid expense

a General Journal

Date	Details	Debit \$	Credit \$
<i>Feb. 11</i>	<i>Prepaid Office Supplies</i>	<i>300</i>	
	<i>GST Clearing</i>	<i>30</i>	
	<i>Bank</i>		<i>330</i>
	<i>Paid for Office Supplies (Chq 153)</i>		

b

Calculation

$$\begin{array}{rcl}
 \$300 \text{ prepaid} & \text{less} & \$60 \text{ still on hand} \\
 = & & \$240
 \end{array}$$

Office supplies expense \$ 240

c General Journal

Date	Details	Debit \$	Credit \$
<i>Feb. 28</i>	<i>Office Supplies Expense</i>	<i>240</i>	
	<i>Prepaid Office Supplies</i>		<i>240</i>
	<i>Balance day adjustment to record office supplies</i>		
	<i>consumed (Memo 84)</i>		

d General Ledger

Prepaid Office Supplies (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Feb. 11</i>	<i>Bank</i>	<i>300</i>	<i>Feb. 28</i>	<i>Office Supplies Expense</i>	<i>240</i>
				<i>Balance</i>	<i>60</i>
		<i>300</i>			<i>300</i>
<i>Mar. 1</i>	<i>Balance</i>	<i>60</i>			

Office Supplies Expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Feb. 28</i>	<i>Prepaid Office Supplies</i>	<i>240</i>	<i>Feb. 28</i>	<i>Profit & Loss Summary</i>	<i>240</i>
		<i>240</i>			<i>240</i>

e RONNIE'S CAR PARTS

Balance Sheet (extract) as at 28 February 2025

Current Assets	\$	\$
<i>Prepaid Office Supplies</i>		<i>60</i>

Exercise 12.3 Prepaid expense

a

Qualitative characteristic	<i>Relevance</i>
Explanation	<i>Balance day adjustments ensure that profit is calculated accurately by comparing revenues earned against expenses incurred in the current Period. This ensures reports contain all information that is capable of making a difference to decision-making.</i>

b

Calculation	
$\frac{\$1\,800}{9 \text{ months remaining}}$ (i.e. Jan.–Mar. consumed already)	$\times 1 \text{ month consumed}$
Insurance expense	\$ 200

c **General Journal**

Date	Details	Debit \$	Credit \$
<i>April 30</i>	<i>Insurance Expense</i>	<i>200</i>	
	<i>Prepaid Insurance</i>		<i>200</i>

d

	Overstated/Understated/No effect	Amount \$
Assets	<i>Overstated (Prepaid Insurance)</i>	<i>200</i>
Liabilities	<i>No effect</i>	
Owner's Equity	<i>Overstated (Understated Insurance Expense means overstated Net Profit)</i>	<i>200</i>

e **MAXWELL'S SHOES**

Balance Sheet (extract) as at 31 July 2025

Current Assets	\$	\$
<i>Prepaid Insurance</i>		<i>1 000</i>

Exercise 12.4 Prepaid expense

a General Journal

Date	Details	Debit \$	Credit \$
June 27	Prepaid Advertising	2 000	
	GST Clearing	200	
	Bank		2 200
	Paid for 5 advertisements to appear July - November (EFT Trans. 307)		

b

Explanation	As a <i>Current Asset: Prepaid Advertising \$2 000</i> .
	<i>It is a present economic resource controlled by the entity as a result of past events that has the right to produce future economic benefit when the advertisements appear in the magazine within the next 12 months.</i>

c

Calculation
$\frac{\$2\,000}{5\text{ months}} \times 3\text{ months consumed (July, Aug., Sept.)}$ $= \$400 \times 3$
Advertising expense
\$ 1 200

d General Journal

Date	Details	Debit \$	Credit \$
Sept. 30	Advertising Expense	1 200	
	Prepaid Advertising		1 200
	Balance day adjustment to record 3 months' advertising consumed (Memo 82)		

e General Ledger

Prepaid Advertising (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	2 000	Sept. 30	Advertising Expense	1 200
				Balance	800
		2 000			2 000
Oct. 1	Balance	800			

Advertising expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 30	Prepaid Advertising	1 200	Sept. 30	Profit and Loss Summary	1 200
		1 200			1 200

f

Explanation	<i>Net Profit would be overstated by \$1 200 as</i>
	<i>Advertising Expense would be understated by \$1 200.</i>

Exercise 12.5 Prepaid expense

a

Calculation			
	<i>Rent paid 31 August</i>	<i>\$1 500</i>	
+	<i>Rent paid 28 February</i>	<u><i>1 800</i></u>	
	<i>Total rent paid</i>	<i>\$3 300</i>	
			Rent paid \$ 3 300

b

Calculation			
	<i>Sept.–Feb.:</i>	<i>= \$1 500</i>	
	<i>Mar–June:</i> <u><i>1 800</i></u> x <i>4 consumed</i>	<i>= <u>\$1 200</u></i>	
	<i>6 months</i>	<i>\$2 700</i>	
			Rent expense \$ 2 700

c

Explanation	<i>Of the \$3 300 rent paid, only the \$2 700 that will be consumed/incurred in the current Reporting Period is considered to be Rent expense. The remaining \$600 will not be incurred until the next Reporting Period: it is not part of the expense figure, but actually an asset – a future economic benefit.</i>
--------------------	--

d General Journal

Date	Details	Debit \$	Credit \$
June 30	Rent Expense	2 700	
	Prepaid Rent Expense		2 700

e General Ledger

Prepaid Rent Expense (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	Bank	1 500	June 30	Rent Expense	2 700
Feb. 28	Bank	1 800		Balance	600
		3 300			3 300
July 1	Balance	600			

Rent Expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Prepaid Rent Expense	2 700	June 30	Profit and Loss Summary	2 700
		2 700			2 700

f

Explanation	<i>Assets (Prepaid rent) would be overstated by \$2 700 as this amount would be showing as part of the economic benefit yet to be consumed.</i>
	<i>Liabilities would not be affected.</i>
	<i>Owner's equity would be overstated by \$2 700 as Rent expense would be understated and Net profit overstated by the amount of the expense not recognised as incurred in the current Period.</i>

Exercise 12.6 Accrued expense

a

Calculation			
	<i>Advertising paid</i>	<i>\$10 000</i>	
	<i>+ Advertising owing</i>	<i>3 000</i>	
	<i>Total advertising expense</i>	<i>\$13 000</i>	
Advertising expense			\$ 13 000

b

Qualitative characteristic	<i>Relevance</i>
Explanation	<i>The advertising has been incurred/consumed in the year ending 31 December 2025 and so should be included as an expense in the current Reporting Period to ensure that the reports include all information that is useful for decision-making.</i>

c **General Journal**

Date	Details	Debit \$	Credit \$
<i>Dec. 31</i>	<i>Advertising Expense</i>	<i>3 000</i>	
	<i>Accrued Advertising</i>		<i>3 000</i>
	<i>Balance day adjustment to record advertising owing</i>		
	<i>(Memo 44)</i>		

d

	Increase/Decrease/No effect	Amount \$
Assets	<i>No effect</i>	
Liabilities	<i>Increase (Accrued Advertising)</i>	<i>3 000</i>
Owner's Equity	<i>Decrease (Increase Advertising Expense means decrease Net Profit)</i>	<i>3 000</i>

e General Ledger

Advertising Expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	Bank	10 000	Dec. 31	Profit and Loss Summary	13 000
	Accrued Advertising	3 000			
		13 000			13 000

Accrued Advertising (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	Balance	3 000	Dec. 31	Advertising Expense	3 000
		3 000			3 000
			Jan. 1	Balance	3 000

f

Explanation	As a <i>Current Liability: Accrued Advertising \$3 000</i> , it is a <i>present obligation</i> of
	to transfer <i>an economic resource within the next 12 months</i> (<i>when the</i>
	<i>advertising owing is paid</i>).

Exercise 12.7 Accrued expense

a

Calculation

$$\frac{\$1\,260 \text{ per fortnight}}{14 \text{ days}} \times 5 \text{ days owing (26–30 June inclusive)} = \$90 \times 5$$

Accrued wages \$ 450

b General Journal

Date	Details	Debit \$	Credit \$
June 30	Wages	450	
	Accrued Wages		450
	Balance day adjustment to record 5 days wages owing		
	(Memo 17)		

c General Ledger

Wages (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 25	Bank	1 260	June 30	Profit and Loss Summary	1 710
June 30	Accrued Wages	450			
		1 710			1 710

Accrued Wages (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Balance	450	June 30	Wages	450
		450			450
			July 1	Balance	450

d General Journal

Date	Details	Debit \$	Credit \$
<i>July 9</i>	<i>Accrued Wages</i>	<i>450</i>	
	<i>Wages</i>	<i>810</i>	
	<i>Bank</i>		<i>1 260</i>
	<i>Paid wages to employee (EFT Trans. 236)</i>		

e

Accounting assumption	<i>Period</i>
Explanation	<i>Of the \$1 260 paid in July 2025 only \$810 will be incurred in the current</i>
	<i>Period (July 2025):</i>
	<i>\$450 was incurred (and accrued) in the previous Period (June 2025).</i>

Exercise 12.8 Accrued expense

a

Calculation

$$\begin{aligned}
 &(\$24\,000 \times 8\%) \times \frac{8}{12} \text{ months (Nov. – June inclusive)} \\
 = &\$1\,920 \times \frac{8}{12}
 \end{aligned}$$

Interest expense \$ 1 280

b General Journal

Date	Details	Debit \$	Credit \$
June 30	Interest Expense	320	
	Accrued Interest Expense		320

c General Ledger

Interest Expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 30	Bank	960	June 30	Profit and Loss Summary	1 280
June 30	Accrued Interest Exp.	320			
		1 280			1 280

Accrued Interest Expense (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Balance	320	June 30	Interest Expense	320
		320			320
			July 1	Balance	320

d

Explanation Net Profit would be overstated by \$320.

(Interest Expense would be understated by \$320.)

e General Journal

Date	Details	Debit \$	Credit \$
<i>Oct 31</i>	<i>Accrued Interest Expense</i>	<i>320</i>	
	<i>Interest Expense</i>	<i>640</i>	
	<i>Bank</i>		<i>960</i>
	<i>Paid interest (Chq 196)</i>		

f

	Increase/Decrease/No effect	Amount \$
Assets	<i>Decrease (Bank)</i>	<i>960</i>
Liabilities	<i>Decrease (Accrued Interest Expense)</i>	<i>320</i>
Owner's Equity	<i>Decrease (increased Interest Expense means decreased Net Profit)</i>	<i>640</i>

Exercise 12.9 Accrued expense

a

Calculation	
<i>Electricity incurred/expense</i>	<i>\$4 600</i>
– <i>Electricity paid</i>	<i>4 000</i>
<i>Electricity accrued/owing</i>	<i>\$600</i>
Accrued electricity	
	\$ 600

b General Journal

Date	Details	Debit \$	Credit \$
<i>Apr. 30</i>	<i>Electricity Expense</i>	<i>600</i>	
	<i>Accrued Electricity</i>		<i>600</i>
	<i>Balance day adjustment to record electricity owing</i>		
	<i>(Memo 31)</i>		

c General Ledger

Electricity Expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Apr. 30</i>	<i>Bank</i>	<i>4 000</i>	<i>Apr. 30</i>	<i>Profit and Loss Summary</i>	<i>4 600</i>
	<i>Accrued Electricity</i>	<i>600</i>			
		<i>4 600</i>			<i>4 600</i>

Accrued Electricity (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Apr. 30</i>	<i>Balance</i>	<i>600</i>	<i>Apr. 30</i>	<i>Electricity</i>	<i>600</i>
		<i>600</i>			<i>600</i>
			<i>May 1</i>	<i>Balance</i>	<i>600</i>

d

	Overstated/Understated/No effect	Amount \$
Assets	<i>No effect</i>	
Liabilities	<i>Understated (Accrued Electricity)</i>	<i>600</i>
Owner's Equity	<i>Overstated (Understated Electricity means overstated Net Profit)</i>	<i>600</i>

e General Journal

Date	Details	Debit \$	Credit \$
<i>Oct 31</i>	<i>Accrued Electricity</i>	<i>600</i>	
	<i>Electricity</i>	<i>1 900</i>	
	<i>GST Clearing</i>	<i>250</i>	
	<i>Bank</i>		<i>2 750</i>
	<i>Paid Electricity (Chq 196)</i>		

Exercise 12.10 Accrued expense

a General Journal

Date	Details	Debit \$	Credit \$
Aug. 5	Accrued Cleaning	450	
	Cleaning expense	1 250	
	GST Clearing	170	
	Bank		1 870
	Paid Cleaning expenses for July / August (Cheque 201)		

b

Calculation

Cleaning expenses paid	\$1 250
+ Accrued cleaning expenses	510
Cleaning expenses	\$1 760

Cleaning expense \$ 1 760

c General Journal

Date	Details	Debit \$	Credit \$
Aug. 31	Cleaning Expense	510	
	Accrued Cleaning Expenses		510
	Balance day adjustment to record cleaning expenses owing		
	(Memo 12)		

d General Ledger

Accrued Cleaning Expenses (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	Bank	450	Aug. 1	Balance	450
	Balance	510	31	Cleaning Expenses	510
		960			960
			Sept. 1	Balance	510

e

Explanation	<i>Assets would not be affected.</i>
	<i>Liabilities (Accrued Cleaning expenses) would be understated by \$510</i>
	<i>because the amount still owing to the supplier would not be shown.</i>
	<i>Owner's equity would be overstated by \$510 because Cleaning expenses</i>
	<i>would be understated because the amount incurred but yet to be paid would</i>
	<i>not be shown leading to Net profit overstated.</i>

f

Accounting assumption	<i>Period / Accrual basis</i>
Justification	<i>The expense must be recognised in the Period in which it was incurred</i>
	<i>(i.e. August 2025), regardless of when it is paid.</i>

Exercise 12.11 Reporting prepaid and accrued expenses

a/c General Journal

Date	Details	Debit \$	Credit \$
June 30	Inventory Loss	400	
	Inventory		400
June 30	Rent Expense	900	
	Prepaid Rent Expense		900
June 30	Wages	1 200	
	Accrued Wages		1 200
June 30	Sales	96 500	
	Discount Revenue	200	
	Sales returns		700
	Profit and Loss Summary		96 000
June 30	Profit and Loss Summary	94 020	
	Advertising		3 850
	Cost of Sales		57 000
	Discount Expense		250
	Freight In		600
	Interest Expense		220
	Wages		30 800
	Inventory Loss		400
	Rent Expense		900
June 30	Profit and Loss Summary	1 980	
	Capital		1 980
June 30	Capital	4 300	
	Drawings		4 300

b PICKFORD PAINTS

Post-adjustment Trial Balance as at 30 June 2025

Account	Debit \$	Credit \$
Accounts Payable		30 400
Accounts Receivable	23 100	
Advertising	3 850	
Bank	1 050	
Capital – Pickford		27 250
Cost of Sales	57 000	
Discount Expense	250	
Discount Revenue		200
Drawings	4 300	
Freight In	600	
GST Clearing		120
Interest Expense	220	
Inventory	45 200	
Loan – Bank of Wilco		40 000
Office Equipment	7 900	
Prepaid Rent Expense	3 600	
Sales		96 500
Sales returns	700	
Shop Fittings	15 800	
Wages	30 800	
<i>Inventory Loss</i>	400	
<i>Rent Expense</i>	900	
<i>Accrued Wages</i>		1 200
Total	195 670	195 670

d

Accounting assumption	<i>Period</i>
Explanation	To ensure that <i>profit is calculated accurately</i>
	by <i>comparing revenues earned against expenses incurred</i>
	in the <i>current Period</i> .

e **PICKFORD PAINTS**

Income Statement for June 2025

	\$	\$
Revenue		
Sales	96 500	
less Sales returns	700	95 800
less Cost of Goods Sold		
Cost of Sales	57 000	
Freight In	600	57 600
Gross Profit		38 200
less Inventory Loss		400
Adjusted Gross Profit		37 800
add Other Revenue		
Discount Revenue		200
		38 000
less Other Expenses		
Advertising	3 850	
Discount Expense	250	
Interest Expense	220	
Wages	30 800	
Rent Expense	900	36 020
Net Profit (Loss)		1 980

f

Explanation	<i>Change the format eg. radio to reach painters on the job</i>
	<i>Collect data on the location of its customers and advertise to their wants</i>

g **PICKFORD PAINTS**

Balance Sheet as at 30 June 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Bank</i>	1 050		<i>Accounts Payable</i>	30 400	
<i>Accounts Receivable</i>	23 100		<i>GST Clearing</i>	120	
<i>Prepaid Rent Expense</i>	3 600		<i>Loan – Bank of Wilco</i>	6 000	
<i>Inventory</i>	45 200	72 950	<i>Accrued Wages</i>	1 200	37 720
Non-Current Assets			Non-Current Liabilities		
<i>Office Equipment</i>	7 900		<i>Loan – Bank of Wilco</i>		34 000
<i>Shop Fittings</i>	15 800	23 700			
			Owner's Equity		
			<i>Capital – Pickford</i>	27 250	
			<i>add Net Profit</i>	1 980	
				29 230	
			<i>less Drawings</i>	4 300	24 930
Total Assets		96 650	Total Equities		96 650

h

Explanation	<i>It includes the effects of balance day adjustments,</i>
	<i>ensuring the reports contain all information that is capable of making a</i>
	<i>difference to decision making (such as expenses incurred but not paid, or</i>
	<i>incurred but paid earlier).</i>

Exercise 12.12 Reporting prepaid and accrued expenses

a/c General Journal

Date	Details	Debit \$	Credit \$
Dec. 31	Inventory Loss	300	
	Inventory		300
Dec. 31	Insurance Expense	900	
	Prepaid Insurance		900
Dec. 31	Interest Expense	3 600	
	Accrued Interest Expense		3 600
Dec. 31	Sales	191 600	
	Discount Revenue	580	
	Sales returns		1 200
	Profit and Loss Summary		190 980
Dec. 31	Profit and Loss Summary	138 430	
	Advertising		8 200
	Buying Expenses		3 000
	Cost of Sales		92 000
	Discount Expense		1 230
	Interest Expense		5 400
	Inventory write-down		400
	Wages		27 000
	Inventory Loss		300
	Insurance Expense		900
Dec. 31	Profit and Loss Summary	52 550	
	Capital		52 550
Dec. 31	Capital	31 000	
	Drawings		31 000

b MARANELLI SPORTS

Post-adjustment Trial Balance as at 31 December 2025

Account	Debit \$	Credit \$
Accounts Payable		18 300
Accounts Receivable	12 400	
Advertising	8 200	
Bank		2 300
Buying Expenses	3 000	
Capital – Maranelli		85 430
Cost of Sales	92 000	
Discount Expense	1 230	
Discount Revenue		580
Drawings	31 000	
Fittings and Fixtures	26 800	
GST Clearing		320
Interest Expense	5 400	
Inventory	31 700	
Inventory write-down	400	
Mortgage – HH Finance		180 000
Premises	240 000	
Prepaid Insurance	600	
Sales		191 600
Sales returns	1 200	
Wages	27 000	
<i>Inventory Loss</i>	300	
<i>Insurance Expense</i>	900	
<i>Accrued Interest Expense</i>		3 600
Total	482 130	482 130

d

Explanation	By <i>reporting revenues earned and expenses incurred in the current Period</i> ,
	<i>balance day adjustments ensure that the Income Statement includes</i>
	<i>all information that is useful for decision-making.</i>

e **MARANELLI SPORTS**

Income Statement for the 6 months ended 31 December 2025

	\$	\$
Revenue		
Sales	191 600	
less Sales returns	1 200	190 400
less Cost of Goods Sold		
Cost of Sales	92 000	
Buying Expenses	3 000	95 000
Gross Profit		95 400
less Inventory Loss	300	
Inventory write-down	400	700
Adjusted Gross Profit		94 700
add Other Revenue		
Discount Revenue		580
		95 280
less Other Expenses		
Advertising	8 200	
Discount Expense	1 230	
Interest Expense	5 400	
Wages	27 000	
Insurance Expense	900	42 730
Net Profit		52 550

f

Assessment	<i>Maranelli Sports has applied an average mark-up of 100%, which has been</i>
	<i>high enough to cover its Other Expenses and</i>
	<i>provide for a Net Profit of \$52 550 for just 6 months.</i>
	<i>Whether this is sufficient depends on the expectations of the owner</i>

g

Strategy 1	<i>Wages: review and change rosters to ensure the appropriate number of staff</i>
	<i>Cost of sales: change to a cheaper supplier</i>
	<i>Buying expenses: order in bulk to reduce delivery expenses</i>
Strategy 2	<i>Inventory loss / write down: rotate inventory / physical safeguards</i>
	<i>Interest expense: pay off loan balances</i>

h MARANELLI SPORTS

Balance Sheet as at 31 December 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Accounts Receivable</i>	12 400		<i>Bank (overdraft)</i>	2 300	
<i>Prepaid Insurance</i>	600		<i>Accounts Payable</i>	18 300	
<i>Inventory</i>	31 700	44 700	<i>GST Clearing</i>	320	
			<i>Mortgage – HH Finance</i>	12 000	
Non-Current Assets			<i>Accrued Interest Expense</i>	3 600	36 520
<i>Fixtures and Fittings</i>	26 800				
<i>Premises</i>	240 000	266 800	Non-Current Liabilities		
			<i>Mortgage – HH Finance</i>		168 000
			Owner's Equity		
			<i>Capital – Maranelli</i>	85 430	
			<i>add Net Profit</i>	52 550	
				137 980	
			<i>less Drawings</i>	31 000	106 980
Total Assets		311 500	Total Equities		311 500

i

Explanation	<i>It is unethical to present an incomplete / inaccurate picture of the firm's profit performance as users rely on this to make decisions.</i>

Exercise 12.13 Reporting for prepaid and accrued expenses

a/c General Journal

Date	Details	Debit \$	Credit \$
Mar. 31	Inventory	2 200	
	Inventory Gain		2 200
Mar. 31	Inventory write-down	800	
	Inventory		800
Mar. 31	Rent Expense	1 200	
	Prepaid Rent Expense		1 200
Mar. 31	Wages	360	
	Accrued Wages		360
Mar. 31	Office Supplies Expense	110	
	Prepaid Office Supplies		110
Mar. 31	Sales	62 400	
	Discount Revenue	310	
	Inventory Gain	2 200	
	Sales returns		400
	Profit and Loss Summary		64 510
Mar. 31	Profit and Loss Summary	38 250	
	Advertising		1 750
	Cost of Sales		24 800
	Discount Expense		140
	Interest Expense		90
	Wages		9 360
	Inventory write-down		800
	Rent Expense		1 200
	Office Supplies Expense		110
Mar. 31	Profit and Loss Summary	26 260	
	Capital		26 260
Mar. 31	Capital	21 000	
	Drawings		21 000

b ALANNAH FASHIONS

Post-adjustment Trial Balance as at 31 March 2025

Account	Debit \$	Credit \$
Accounts Payable		40 600
Accounts Receivable	21 700	
Advertising	1 750	
Bank		4 100
Capital – Alannah		48 350
Cost of Sales	24 800	
Discount Expense	140	
Discount Revenue		310
Drawings	21 000	
GST Clearing	400	
Interest Expense	90	
Inventory	40 400	
Loan – FinCo.		15 000
Office Equipment	6 300	
Prepaid Office Supplies	70	
Prepaid Rent Expense	4 800	
Sales		62 400
Sales returns	400	
Shop Fittings	40 000	
Wages	9 360	
<i>Inventory Gain</i>		2 200
<i>Inventory write-down</i>	800	
<i>Rent Expense</i>	1 200	
<i>Accrued Wages</i>		360
<i>Office Supplies Expense</i>	110	
Total	173 320	173 320

d General Ledger

Profit and Loss Summary

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 31	Expenses	38 250	Mar. 31	Revenues	64 510
	Capital	26 260			
		63 710			63 710

e ALANNAH FASHIONS

Income Statement for March 2025

	\$	\$
Revenue		
Sales	62 400	
less Sales returns	400	62 000
less Cost of Goods Sold		
Cost of Sales		24 800
Gross Profit		37 200
add Inventory Gain	2 200	
less Inventory write-down	(800)	1 400
Adjusted Gross Profit		38 600
add Other Revenue		
Discount Revenue		310
		38 910
less Other Expenses		
Advertising	1 750	
Discount Expense	140	
Interest Expense	90	
Wages	9 360	
Rent Expense	1 200	
Office Supplies Expense	110	12 650
Net Profit		26 260

f

Reason 1	<i>Out of fashion</i>
	<i>Damaged</i>
Reason 2	<i>Deliberate strategy to increase sales</i>

g

Calculation			
	<i>Wages expense (pre-adj.)</i>	\$9 000	
+	<i>Wages accrued at start</i>	310	\$9 310
Cash paid for wages			\$ 9 310

h ALANNAH FASHIONS

Balance Sheet as at 31 March 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Accounts Receivable</i>	21 700		<i>Bank Overdraft</i>	4 100	
<i>GST Clearing</i>	400		<i>Accounts Payable</i>	40 600	
<i>Prepaid Office Supplies</i>	70		<i>Accrued Wages</i>	360	45 060
<i>Prepaid Rent Expense</i>	4 800				
<i>Inventory</i>	40 400	67 370	Non-Current Liabilities		
			<i>Loan – FinCo</i>		15 000
Non-Current Assets					
<i>Office Equipment</i>	6 300		Owner's Equity		
<i>Shop Fittings</i>	40 000	46 300	<i>Capital – Alannah</i>	48 350	
			<i>add Net Profit</i>	26 260	
				74 610	
			<i>less Drawings</i>	21 000	53 610
Total Assets		113 670	Total Equities		113 670

i

Reason	<i>Decision to increase range of clothing (which has not yet sold)</i>
Justification	<i>GST on the purchase will be greater than the GST on sales meaning the business is owed GST by the ATO.</i>

j **General Journal**

Date	Details	Debit \$	Credit \$
<i>Apr. 2</i>	<i>Accrued Wages</i>	<i>360</i>	
	<i>Wages</i>	<i>1 240</i>	
	<i>Bank</i>		<i>1 600</i>

k

Explanation	<i>Assets (Bank) decrease by \$1 600 as cash is paid to the employees.</i>
	<i>Liabilities (Accrued wages) decrease by \$360 as the amount owing from last Period is 'paid off'.</i>
	<i>Owner's equity decreases \$1 260 as Wages expense of \$1 240 decreases Net profit by the amount incurred in the current Period.</i>

Exercise 13.1 Calculating Depreciation

a

Definition	<i>The process of allocating the cost of a non-current asset (as an expense) over its useful life</i>
-------------------	---

b

Calculation

$$\begin{aligned} \text{Depreciation} &= \frac{\$15\,000 - \$3\,000}{5} \\ &= \$2\,400 \text{ p.a.} \end{aligned}$$

Depreciation of office furniture	\$ 2 400
---	-----------------

c

Explanation	<i>The GST is not included in the cost of the asset</i>
	<i>as it does not affect the economic benefit provided by the office furniture /</i>
	<i>it will not provide an economic benefit for the life of the asset (5 years) but</i>
	<i>will reduce the GST liability only when the asset is purchased.</i>

d

Explanation	<i>Residual value represents the estimated value of the non-current asset at the end of its useful life or the cost of the asset that will not be consumed by</i>
	<i>Shovel and Shift. The residual value is not allocated as depreciation expense</i>
	<i>as it will not be incurred by Shovel and Shift.</i>

Exercise 13.2 Calculating Depreciation

a

Accounting principle	<i>The Period assumption</i>
Explanation	To ensure that the cost incurred in relation to a non-current asset is reported as an expense in each Period in which the asset earns revenue.
	<i>This ensures that profit is calculated accurately.</i>

b

Calculation
$\text{Depreciation} = \frac{\$30\,000 - \$6\,000}{8}$ $= \$3\,000 \text{ p.a.}$
Depreciation of shelving \$ 3 000

c

Calculation
$\text{Depreciation rate} = \frac{\$3\,000}{\$30\,000}$ $= 10\% \text{ pa.}$
Rate of depreciation 10 %

d

Discussion	<i>Faithful representation requires that information represent its real-world economic value and must be complete, neutral and free from error.</i>
	<i>Depreciation expense is based on estimate of useful life and residual value meaning it is not entirely neutral or free from bias.</i>
	<i>However, depreciation expense means the reports provide a more Faithful representation than if it was omitted entirely as it allocates the cost of a non-current asset over its useful life, thereby estimating how much of its value has been incurred in the current Period.</i>
	<i>Depreciation expense, although based on estimates, is more accurate than no expense at all.</i>

Exercise 13.3 Calculating Depreciation: Rate

a

Calculation

$$\begin{aligned}\text{Depreciation} &= \$40\,000 \times 10\% \\ &= \$4\,000 \text{ p.a.}\end{aligned}$$

Depreciation of van \$ **4 000**

b

Explanation *Relevance requires the inclusion of all information that is capable of making a difference to decision making.*

Depreciation represents the cost of the non-current asset incurred in the current period and thus assists in matching revenues earned against expenses incurred, which affects decisions about profit.

c

Explanation *No effect*

as it is a non-cash expense.

d

Calculation

$$\begin{aligned}\text{Acc. Depreciation} &= \$4\,000 \times 8 \text{ years} \\ \text{Residual value} &= \text{HC} - \text{Acc. Depreciation} \\ &= \$40\,000 - \$32\,000\end{aligned}$$

Residual value \$ **8 000**

Exercise 13.4 Calculating Depreciation: Less than a year

a

Explanation	<i>The Period assumption requires that reports are prepared for a particular period of time.</i>
	<i>The cabinets were only held for 5 months during the period ended 30 June 2025 they should only be depreciated for 5 months, rather than a full year.</i>

b

Calculation	
	$\begin{aligned}\text{Depreciation} &= \$1\,800 \times 20\% \times 5/12 \\ &= \$150\end{aligned}$
	Depreciation of cabinets \$ 150

c

Effect	<i>Net Profit would be understated by \$210</i>
	<i>due to depreciation being overstated by \$210.</i>

d

Calculation	
	$\begin{aligned}\text{Depreciation} &= \$1\,800 \times 20\% \\ &= \$360\end{aligned}$
	Depreciation of cabinets \$ 360

Exercise 13.5 Recording Depreciation

a

Calculation

$$\begin{aligned} \text{Depreciation} &= \frac{\$12\,000 - \$3\,000}{6} \\ &= \$1\,500 \text{ per year} \end{aligned}$$

Depreciation of equipment \$ 1 500

b General Journal

Date	Details	Debit \$	Credit \$
June 30	Depreciation of Equipment	1 500	
	Accumulated Depreciation of Equipment		1 500
	Depreciation of cabinets – s/line method at 20% pa		
	(Memo 44)		

c General Ledger

Depreciation of Equipment (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Acc. Dep. of Equipment	1 500	June 30	Profit and Loss Summary	1 500
		1 500			1 500

Accumulated Depreciation of Equipment (–A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Balance	1 500	June 30	Depreciation of Equipment	1 500
		1 500			1 500
			July 1	Balance	1 500

d ROAMIN' BLINDS

Balance Sheet (extract) as at 30 June 2025

Non-Current Assets	\$	\$
<i>Equipment</i>	<i>12 000</i>	
<i>less Accumulated Depreciation</i>	<i>1 500</i>	<i>10 500</i>

e

Explanation	<i>Relevance requires the inclusion of all information that is capable of making a difference to decision making. The carrying value is the most up-to-date valuation of the equipment as it reflects the unallocated cost / unused value at that point in time.</i>
--------------------	--

Exercise 13.6 Recording Depreciation

a

1. <i>Historical cost – the purchase price of the Office Furniture and all costs incurred to get the asset into condition and location ready for use</i>
2. <i>Accumulated depreciation – the cost of the Office Furniture that has been consumed / incurred over its life to date</i>
3. <i>Carrying value – the future economic benefit remaining; the value that has yet to be consumed by the firm (plus RV)</i>

b General Journal

Date	Details	Debit \$	Credit \$
June 30	Depreciation of Office Furniture	3 000	
	Accumulated Depreciation of Equipment		3 000

c

General Ledger

Depreciation of Office Furniture (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	Acc. Dep. of Equipment	3 000	30/6/15	Profit and Loss Summary	3 000
		3 000			3 000

Accumulated Depreciation of Office Furniture(–A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	Balance	12 000	1/7/24	Balance	9 000
			30/6/25	Depreciation of Equipment	3 000
		12 000			12 000
			1/7/25	Balance	12 000

d

JUNGLE JANE

Balance Sheet (extract) as at 30 June 2025

Non-Current Assets	\$	\$
<i>Office Furniture</i>	<i>29 000</i>	
<i>less Accumulated Depreciation</i>	<i>12 000</i>	<i>17 000</i>

e

Calculation

$$\begin{aligned}
 \text{Depreciation} &= \frac{HC - RV}{\text{Life}} \\
 \$3\,000 &= \frac{29\,000 - 2\,000}{\text{Life}} \\
 \text{Useful life} &= \frac{\$27\,000}{\$3\,000} \\
 &= 9 \text{ years}
 \end{aligned}$$

Useful life 9 years

Exercise 13.7 Recording Depreciation

a

Calculation

$$\text{Carrying value} = \text{Historical cost} - \text{Acc. dep.}$$

$$\$16\,000 = \$20\,000 - \text{Acc. dep.}$$

$$\text{Acc. dep.} = \$20\,000 - \$16\,000$$

Accumulated depreciation of shop fittings \$ **4 000**

b

Calculation

$$\text{Existing shop fittings} = \$20\,000 \times 10\%$$

$$= \$2\,000$$

$$\text{New shop fittings} = \$5\,000 \times 10\% \times \frac{3}{12}$$

$$= \$125$$

Depreciation of shop fittings \$ **2 125**

c

General Journal

Date	Details	Debit \$	Credit \$
June 30	Depreciation of Shop Fittings	2 125	
	Accumulated Depreciation of Shop Fittings		2 125
	Depreciation of shop fittings – s/line method		
	(Memo 23)		

D General Ledger

Depreciation of Shop Fittings (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	Acc. Dep. of Equipment	2 125	30/6/15	Profit and Loss Summary	2 125
		2 125			2 125

Accumulated Depreciation of Shop Fittings (–A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	Balance	6 125	1/7/24	Balance	4 000
			30/6/25	Depreciation of Equipment	2 125
		6 125			6 125
			1/7/25	Balance	6 125

e

Qualitative Characteristic	<i>Verifiability</i>
Explanation	The <i>original purchase price</i> of the asset is verifiable by reference to the source document.

f FROST FRIDGES

Balance Sheet (extract) as at 30 June 2025

Non-Current Assets	\$	\$
Office Furniture	25 000	
less Accumulated Depreciation	6 125	31 125

Exercise 13.8 Cash Purchase of a Non-Current Asset

a

Explanation	<i>It is not a transaction</i>
	<i>as no goods have been exchanged.</i>

b

Explanation	<i>Showcase World have not taken possession of the cabinets</i>
	<i>therefore they are not in control of the cabinets or the potential economic</i>
	<i>benefit they represent.</i>

c

General Journal

Date	Details	Debit \$	Credit \$
May 23	Cabinets	6 000	
	GST Clearing	600	
	Bank		6 600
	Cash purchase of new cabinets (Cheque 45)		

d

Explanation	<i>Tax invoice provided by Carl's cabinets to verify the GST.</i>
	<i>Delivery docket to verify number of cabinets received.</i>

Ex 13.9 Cost of a Non-Current Asset

a

Explanation	<i>The licence fee will not provide an economic benefit for the life of the asset</i>
	<i>– it only lasts for 12 months</i>
	<i>(so it is a current asset rather than a non-current asset).</i>

b

Date	Details	Debit \$	Credit \$
July 1	Cash Register	10 000	
	Prepaid Software License	4 800	
	GST Clearing	1 480	
	Bank		16 280
	Paid for new cash register (Chq 233)		

c

Calculation
$\text{Depreciation} = \frac{\$10\,000 - \$1\,000}{5}$ $= \$1\,800 \text{ p.a.}$
Depreciation of cash register
\$ 1 800

d

Calculation
$\text{Rate} = \frac{\$1\,800}{\$10\,000}$ $= 18\%$
Depreciation rate
18 %

e EILEEN'S LADDERS

Balance Sheet (extract) as at 30 June 2025

Non-Current Assets	\$	\$
<i>Cash Register System</i>	<i>10 000</i>	
<i>less Accumulated Depreciation</i>	<i>1 800</i>	<i>8 200</i>

f

Explanation	<i>Assets decrease \$1 800 as accumulate depreciation of Cash register system increases by the amount incurred in the current Period.</i>
	<i>There is no effect on liabilities.</i>
	<i>Owner's equity decreases \$1 800 as Depreciation of Cash register system expense decreases Net profit by the amount incurred in the current Period.</i>

Exercise 13.10 Cash Purchase of a Non-Current Asset

a

Date	Details	Debit \$	Credit \$
April 1	Bank	25 000	
	Loan		25 000
	Received loan (source document not given)		

b

Calculation	
Delivery van	\$21 000
Fitting of shelves	<u>1 500</u> \$22 500
Cost of delivery van	
	\$ 22 500

c

Explanation	Included in the cost of the van as it is
	necessary to bring the asset into a condition and location ready for use,
	and will bring a benefit for the life of the asset
	because the shelves are fitted in the van.

d

Date	Details	Debit \$	Credit \$
April 1	Delivery Van	22 500	
	Prepaid Service Contract	1 200	
	GST Clearing	2 370	
	Bank		26 070
	Purchase of new delivery van (EFT Trans 3201)		

Chapter 11 *Depreciation of Non-Current Assets* – Solutions to exercises

e MATT'S MATS

Cash Flow Statement (extract) for the year ended 30 June 2025

	\$	\$
OPERATING ACTIVITIES		
<i>Prepaid service contract</i>	(1 200)	
<i>GST Paid</i>	(2 370)	
INVESTING ACTIVITIES		
<i>Delivery van</i>		(22 500)

f

Calculation

$$\begin{aligned}
 \text{Depreciation} &= \frac{\$22\,500 - \$6\,500}{5} \times \frac{3}{12} \\
 &= \$3\,200 \text{ p.a.} \times \frac{3}{12}
 \end{aligned}$$

Depreciation of van \$ **800**

g MATT'S MATS

Balance Sheet (extract) as at 30 June 2025

Current Assets	\$	\$
<i>Prepaid Service Contract</i>		900

h MATT'S MATS

Balance Sheet (extract) as at 30 June 2026

Non-Current Assets	\$	\$
<i>Delivery Van</i>	22 500	
<i>less Accumulated Depreciation</i>	4 000	18 500

Ex 13.11 Depreciation for less than one year

a

Accounting assumption	Period / Accrual basis
Explanation	To ensure that the cost incurred in relation to a non-current asset is reported as an expense in each Period in which the asset earns revenue . This ensures that profit is calculated accurately .

b

Calculation	
Existing off. furniture =	\$8 000 x 10%
=	\$800
New off. Furniture =	\$1 200 x 10% x $\frac{5}{12}$
=	\$50
Depreciation of office furniture	
	\$ 850

c **General Journal**

Date	Details	Debit \$	Credit \$
June 30	Depreciation of Office Furniture	850	
	Acc. Depreciation of Office Furniture		850
	Depreciation of office furniture – s/line method		
	(Memo 35)		

Chapter 11 *Depreciation of Non-Current Assets* – Solutions to exercises

d General Ledger

Depreciation of Office Furniture (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	<i>Acc. Dep. of Office Furniture</i>	850	30/6/25	<i>Profit and Loss Summary</i>	850
		850			850

Accumulated Depreciation of Office Furniture (–A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	<i>Balance</i>	2 450	1/7/24	Balance	1 600
			30/6/25	<i>Dep. of Office Furniture</i>	850
		2 450			2 450
			1/7/25	<i>Balance</i>	2 450

e SCRATCH AND DENT DISCOUNTERS

Balance Sheet (extract) as at 30 June 2025

Non-Current Assets	\$	\$
<i>Office Furniture</i>	9 200	
<i>less Accumulated Depreciation</i>	2 450	6 750

Exercise 13.12 Reporting depreciation

a

Explanation	<i>To ensure profit is calculated accurately</i>
	<i>by comparing revenues earned and expenses incurred in the current Period.</i>

b/d General Journal

Date	Details	Debit \$	Credit \$
June 30	Inventory Loss	900	
	Inventory		900
June 30	Depreciation of Display Equipment	7 350	
	Acc. Depreciation of Display Equipment		7 350
June 30	Advertising	2 000	
	Prepaid Advertising		2 000
June 30	Administrative Expenses	1 500	
	Wages		1 500
June 30	Credit Sales	160 000	
	Profit and Loss Summary		160 000
June 30	Profit and Loss Summary	168 250	
	Administrative Expenses		12 000
	Cost of Sales		80 000
	Interest Expense		5 500
	Rent Expense		26 000
	Wages		34 500
	Inventory Loss		900
	Depreciation of Display Equipment		7 350
	Advertising		2 000
June 30	Capital	8 250	
	Profit and Loss Summary		8 250
June 30	Capital	16 000	
	Drawings		16 000

c HACK AND SAW

Post-adjustment Trial Balance as at 30 June 2025

Account	Debit \$	Credit \$
Accounts Receivable	17 000	
Accumulated Depreciation of Display Equipment		19 450
Administrative Expense	12 000	
Bank		5 300
Capital – Barr		68 000
Cost of Sales	80 000	
Display Equipment	49 000	
Drawings	16 000	
GST Clearing		400
Interest Expense	5 500	
Inventory	37 100	
Loan – DR Finance (repayable \$500 per month)		35 000
Prepaid Advertising	800	
Rent Expense	26 000	
Sales		160 000
Wages	34 500	
<i>Inventory Loss</i>	900	
<i>Depreciation of Display Equipment</i>	7 350	
<i>Advertising</i>	2 000	
Total	288 150	288 150

Chapter 11 *Depreciation of Non-Current Assets* – Solutions to exercises

e HACK AND SAW

Income Statement for the year ended 30 June 2015

	\$	\$
Revenue		
Sales		160 000
less Cost of Goods Sold		
Cost of Sales		80 000
Gross Profit		80 000
<i>less Inventory Loss</i>		<i>900</i>
Adjusted Gross Profit		79 100
less Other Expenses		
Administrative Expenses	<i>12 000</i>	
Interest Expense	5 500	
Rent Expense	26 000	
Wages	<i>34 500</i>	
<i>Depreciation of Display Equipment</i>	<i>7 350</i>	
<i>Advertising</i>	<i>2 000</i>	87 350
Net Profit (Loss)		(8 250)

f

Explanation	<i>Hack and Saw has applied an average mark-up of 100%.</i>
	<i>However, at this sales level Gross Profit is not high enough to cover Other</i>
	<i>Expenses. The sales level or the mark-up need to increase, or Other</i>
	<i>Expenses need to decrease.</i>

g

Action 1	<i>Reassess staff rostering to reduce Wages</i>
	<i>Renegotiate the lease/relocate to reduce Rent Expense</i>
Action 2	<i>Repay some of the loan principal to reduce Interest Expense</i>
	<i>Investigate what Administrative Expenses includes to find savings</i>

h HACK AND SAW

Balance Sheet as at 30 June 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Accounts Receivable</i>	17 000		<i>Bank (overdraft)</i>	5 300	
<i>Prepaid Advertising</i>	800		<i>GST Clearing</i>	400	
<i>Inventory</i>	37 100	54 900	<i>Loan – DR Finance</i>	6 000	11 700
Non-Current Assets			Non-Current Liabilities		
<i>Display Equipment</i>	49 000		<i>Loan – DR Finance</i>		29 000
<i>less Accumulated Depreciation</i>	19 450	29 550			
			Owner's Equity		
			<i>Capital – Barr</i>	68 000	
			<i>less Net Loss</i>	8 250	
				59 750	
			<i>less Drawings</i>	16 000	43 750
Total Assets		84 450	Total Equities		84 450

i

Discussion	<i>\$16 000 is very low for a year</i>
	<i>– the owner would need more than this to survive if it is their personal income.</i>
	However,
	<i>The business suffered a Net Loss (of \$8 250)</i>
	<i>so Drawings will cause Owner's Equity to decrease.</i>
	<i>The business has a Bank overdraft (of \$5 300),</i>
	<i>meaning the Drawings might make it difficult for the business to meet its cash.</i>
	<i>requirements</i>

Exercise 13.13 REPORTING DEPRECIATION

a/d **General Journal**

Date	Details	Debit \$	Credit \$
Dec. 31	Inventory	700	
	Inventory Gain		700
Dec. 31	Depreciation of Vehicle	2 000	
	Accumulated Depreciation of Vehicle		2 000
Dec. 31	Wages	900	
	Accrued Wages		900
Dec. 31	Rent Expense	12 000	
	Prepaid Rent Expense		12 000
Dec. 31	Sales	120 900	
	Discount Revenue	300	
	Inventory Gain	700	
	Sales returns		900
	Profit and Loss Summary		121 000
Dec. 31	Profit and Loss Summary	101 120	
	Cost of Sales		48 000
	Discount Expense		820
	Interest Expense		1 400
	Wages		36 900
	Depreciation of Vehicle		2 000
	Rent Expense		12 000
Dec. 31	Profit and Loss Summary	19 880	
	Capital		19 880
Dec. 31	Capital	14 000	
	Drawings		14 000

b NGUYEN SKI GEAR

Post-adjustment Trial Balance as at 31 December 2025

Account	Debit \$	Credit \$
Accounts Payable		18 000
Accounts Receivable	16 000	
Accumulated Depreciation of Vehicle		10 000
Bank	2 400	
Capital – Nguyen		32 620
Cost of Sales	48 000	
Discount Expense	820	
Discount Revenue		300
Drawings	14 000	
GST Clearing		700
Interest Expense	1 400	
Inventory	24 700	
Loan – NAB (repayable \$9 000 p.a.)		21 000
Prepaid Rent Expense	6 000	
Sales		120 900
Sales returns	900	
Vehicle	40 000	
Wages	36 900	
<i>Inventory Gain</i>		700
<i>Depreciation of Vehicle</i>	2 000	
<i>Accrued Wages</i>		900
<i>Rent Expense</i>	12 000	
Total	204 220	204 220

c

Accounting assumption	Period
Explanation	<i>To transfer revenue and expense amounts to the Profit and Loss</i>
	<i>OR Summary account in order to calculate profit for the current period.</i>
	<i>To reset revenue and expense accounts to zero</i>
	<i>in readiness for the next Period.</i>

e **NGUYEN SKI GEAR**

Income Statement for the six months ending 31 December 2025

	\$	\$
Revenue		
Sales	120 900	
less Sales returns	900	120 000
less Cost of Goods Sold		
Cost of Sales		48 000
Gross Profit		72 000
<i>add Inventory Gain</i>		<i>700</i>
Adjusted Gross Profit		72 700
add Other Revenue		
Discount Revenue		300
		73 000
less Other Expenses		
Discount Expense	820	
Interest Expense	1 400	
<i>Wages</i>	<i>36 900</i>	
<i>Depreciation of Vehicle</i>	<i>2 000</i>	
<i>Rent Expense</i>	<i>12 000</i>	53 120
Net Profit (Loss)		19 880

f

Explanation	<i>The firm's reputation must be strong</i>
	<i>because there is no Advertising expense listed under Other Expenses</i>
	<i>and yet it has still earned \$120 000 in Sales revenue.</i>

g NGUYEN SKI GEAR

Balance Sheet as at 31 December 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
Bank	2 400		Accounts Payable	18 000	
Accounts Receivable	16 000		GST Clearing	700	
Prepaid Rent Expense	6 000		Loan – NAB	9 000	
Inventory	24 700	49 100	Accrued Wages	900	28 600
Non-Current Assets			Non-Current Liabilities		
Vehicle	40 000		Loan – NAB		12 000
less Accumulated Depreciation	10 000	30 000			
			Owner's Equity		
			Capital – Nguyen	32 620	
			add Net Profit	19 880	
				52 500	
			less Drawings	14 000	38 500
Total Assets		79 100	Total Equities		79 100

h

Item	<i>Current assets / Owner's equity / Vehicle / Loan – NAB / Bank</i>
Justification	<i>There are enough current assets to cover current liabilities (and non-current liabilities) / Owner's equity has increased / Vehicle is relatively new /</i>
	<i>Bank is positive / Loan – NAB will be repaid in just over two years</i>

Exercise 13.14 Accounting for non-current assets

a/d

General Journal

Date	Details	Debit \$	Credit \$
March 1	Shop Fittings	9 400	
	Capital		9 400
	Contribution of shop fittings by owner at agreed value (Memo 6)		
June 30	Depreciation of Shop Fittings	700	
	Accumulated Depreciation of Shop Fittings		700

b

Qualitative characteristic	Relevance
Explanation	When acquired by the business, the shop fittings had an agreed value of \$9 400.
	This value is more useful for decision-making by the business.
	(\$12 000 was paid by the owner – a separate entity to the business).

c

Calculation

$$\begin{aligned}
 \text{Depreciation} &= \frac{\$9\,400 - \$1\,000}{4} \times \frac{4}{12} \\
 &= \$2\,100 \text{ p.a.} \times \frac{4}{12}
 \end{aligned}$$

Depreciation of shop fittings **\$ 700**

Chapter 11 *Depreciation of Non-Current Assets* – Solutions to exercises

e General Ledger

Shop Fittings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	<i>Capital</i>	9 400	30/6/25	<i>Balance</i>	9 400
		9 400			9 400
1/7/25	<i>Balance</i>	9 400			

Depreciation of Shop Fittings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	<i>Acc. Dep. of Shop Fittings</i>	700	30/6/25	<i>Profit and Loss Summary</i>	700
		700			700

Accumulated Depreciation of Shop Fittings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
30/6/25	<i>Balance</i>	700	30/6/25	<i>Dep. of Shop Fittings</i>	700
		700			700
			1/7/25	<i>Balance</i>	700

f FUNK FASHIONS

Balance Sheet (extract) as at 30 June 2026

Non-Current Assets	\$	\$
<i>Shop Fittings</i>	9 400	
<i>less Accumulated Depreciation</i>	2 800	6 600

FUNK FASHIONS

Balance Sheet (extract) as at 30 June 2027

Non-Current Assets	\$	\$
<i>Shop Fittings</i>	9 400	
<i>less Accumulated Depreciation</i>	4 900	4 500

Exercise 13.15 Accounting for non-current assets

a

Calculation

Van	\$22 000	
+Suspension	<u>900</u>	\$22 900

Cost of delivery van \$ 22 900

b

Suspension *Included in the cost of the van as it is*

*necessary to bring the asset into a condition and location ready for use,
 and will bring a benefit for the life of the asset.*

Insurance *Not included in the cost of the van,*

but treated as a current asset (Prepaid Insurance)

as it will provide a future economic benefit only for the next 12 months.

c

General Journal

Date	Details	Debit \$	Credit \$
Oct. 31	Bank	30 470	
	Loan		30 470
Oct. 31	Van	22 900	
	Prepaid Insurance	4 800	
	GST Clearing	2 770	
	Bank		30 470

Chapter 11 *Depreciation of Non-Current Assets* – Solutions to exercises

d

Accounting assumption	Period
Explanation	<i>Because it will provide a future economic benefit beyond 30 June 2025 / it will not be entirely incurred/consumed by 30 June 2025.</i>
	<i>Its cost must be allocated over its useful life</i>
	<i>to show the expense incurred in each period.</i>

e

Calculation	
<i>Depreciation =</i>	$\frac{\$22\,900 - \$4\,900}{5} \times \frac{8}{12}$
<i>=</i>	$\$3\,600 \text{ p.a.} \times \frac{8}{12}$
Depreciation of van	\$ 2 400

f

General Journal

Date	Details	Debit \$	Credit \$
30/6/25	<i>Depreciation of Van</i>	2 400	
	<i>Accumulated Depreciation of Van</i>		2 400

f

Discussion	<i>Depreciation is based on estimates of Useful life and residual value and therefore not Verifiable by reference to a source document</i>
	<i>which raises questions about whether it is ethical to include it in the reports.</i>
	<i>However,</i>
	<i>Depreciation represents the cost of the asset incurred in the current period</i>
	<i>which may affect decision making about profit.</i>
	<i>Relevance demands that this information is included so that the reports</i>
	<i>contain all information capable of making a difference to decision making.</i>
	<i>Further, the reports must provide a Faithful representation of the firm's</i>
	<i>position and this is only possible if the reports include the cost incurred in</i>
	<i>the current period. Otherwise the reports will not be complete or free from</i>
	<i>error.</i>

g

Explanation	<i>Yes: straight line depreciation allocates the cost according to time not usage,</i>
	<i>i.e. the life of the asset is measured in years, not units of use.</i>

Exercise 14.1 Purchase of a non-current asset

a General Journal

Date	Details	Debit \$	Credit \$
April 30	Computer	2 650	
	GST Clearing	265	
	Bank		2 915
	Purchase of new computer system		
	(Chq 196)		

b

Explanation	<i>It is included as part of the cost of the asset,</i>
	<i>as it is incurred to get the computer ready for use and</i>
	<i>has the potential to produce economic benefit over the life of the computer.</i>
	<i>Thus, it must be depreciated.</i>

c

Explanation	<i>Assets overall will decrease by \$265 as the Computer will increase assets by</i>
	<i>\$2 650 but Bank will decrease by \$2 915.</i>
	<i>Liabilities will decrease by \$265 as GST Clearing will decrease.</i>
	<i>There will be no effect on Owner's equity as there is no revenue earned or</i>
	<i>expense incurred.</i>

d

Explanation	<i>Does not meet the requirements of a Tax invoice:</i>
	<i>eg. ABN of supplier / amount of GST / words 'Tax invoice'</i>

e

Explanation	<i>Under the Accrual Basis assumption profit is calculated by</i>
	<i>comparing revenues earned to expenses incurred in the current period.</i>
	<i>The computer will provide economic benefit over a number of periods</i>
	<i>so the expense will need to be reported as it is incurred.</i>

Exercise 14.2 Purchase of a non-current asset

a

Explanation	<i>All costs incurred to get the asset into a condition and location ready for use</i>
	<i>which will bring a benefit for the life of the asset</i>
	<i>(and thus must be depreciated).</i>

b

General Journal

Date	Details	Debit \$	Credit \$
April 1	Photocopier	22 500	
	Prepaid technical assistance	1 200	
	GST Clearing	2 370	
	Bank		26 070

c

Explanation	<i>It is not included as part of the cost of the asset,</i>
	<i>as although it is incurred to get the photocopier ready for use</i>
	<i>it will not bring a benefit for the life of the asset</i>
	<i>because it only applies for 12 months. (It is in fact a current asset.)</i>

d

MATT'S MOWERS

Balance Sheet (extract) as at 30 April 2025

	\$	\$
Current Assets		
Prepaid Technical Assistance		1 100

Exercise 14.3 Depreciation methods

a General Journal

Date	Details	Debit \$	Credit \$
Sept. 30	<i>Shelving</i>	12 000	
	<i>Sewing machine</i>	500	
	<i>GST Clearing</i>	1 250	
	<i>Bank</i>		13 750
	Cash purchase of new shelving and sewing machine		
	(EFT trans. 3009)		

b

Explanation	<i>To ensure that profit is calculated accurately</i>
	<i>under the Accrual basis assumption</i>
	<i>by allocating the cost of a non-current asset as an expense incurred</i>
	<i>in Periods in which it earns revenue.</i>

c

Explanation	<i>It best reflects the revenue earning pattern of the shelving</i>
	<i>which will contribute evenly to revenue over its useful life</i>
	<i>(as it has no moving parts), and</i>
	<i>this method allocates depreciation expense evenly over the asset's life.</i>

d

Explanation	<i>It best reflects the revenue earning pattern of the sewing machine</i>
	<i>which will contribute more to revenue when it is new and less as it ages</i>
	<i>(as it has moving parts), and this method allocates</i>
	<i>more depreciation expense at the start of the asset's life and less as it ages.</i>

e

Explanation	<i>The assets will have different useful lives / residual values</i>
	<i>and will therefore have different depreciation rates.</i>
	<i>The depreciation expense for each asset needs to be reported separately</i>
	<i>to assist decision making (about replacement).</i>

Exercise 14.4 Reducing balance depreciation

a

Assumption	The asset will <i>contribute more to revenue when it is new and less as it ages.</i>

b

Calculation
$\begin{aligned} \text{Depreciation} &= \text{Carrying value} \times \text{Rate} \\ &= \$32\,000 \times 20\% \end{aligned}$
Depreciation of van – year ended 30 June 2025 \$ 6 400

c

General Journal

Date	Details	Debit \$	Credit \$
June 30	Depreciation of Van	6 400	
	Accumulated Depreciation of Van		6 400
	Depreciation of van – 20% reducing balance method		
	(Memo 12)		

d **BENANEE RUBBER**

Balance Sheet (extract) as at 30 June 2025

	\$	\$
Non-Current Assets		
Van	32 000	
less Accumulated Depreciation	6 400	25 600

e

Calculation
$\begin{aligned} \text{Depreciation} &= \text{Carrying value} \times \text{Rate} \\ &= \$25\,600 \times 20\% \end{aligned}$
Depreciation of van – year ended 30 June 2026 \$ 5 120

Exercise 14.5 Reducing balance depreciation

a

Calculation

$$\begin{aligned} \text{Depreciation} &= \text{Carrying value} \times \text{Rate} \\ &= \$8\,200 \times 18\% \end{aligned}$$

Depreciation of computers \$ **1 476**

b

General Journal

Date	Details	Debit \$	Credit \$
June 30	Depreciation of Computers	1 476	
	Accumulated Depreciation of Computers		1 476

c HEAVENLY DESIGNS

Balance Sheet (extract) as at 30 June 2026

	\$	\$
Non-Current Assets		
Computers	10 000	
less Accumulated Depreciation	3 276	6 724

d

Explanation The shop fittings will *earn revenue evenly over their useful life* so the straight-line method should be used to *allocate depreciation expense evenly*.
 Reducing balance is suited to assets that earn more revenue when new and allocates more expense at the start of the asset's life and less as it ages.

Chapter 15 Accounting for Non-Current Assets – Solutions to exercises

e

Qualitative Characteristic	<i>Comparability</i>
Explanation	<i>Changing accounting methods will mean that the reports will not be able to be compared from one period to another:</i>
	<i>it will be unclear whether changes in depreciation expense are the result of changes in financial performance or simply changes in accounting methods.</i>

f

Calculation			
Yr 1	Depreciation =	Carrying value	x Rate
	=	\$40 000	x 18%
	=	\$7 200	
	Acc. dep. =	\$7 200	
Yr 2	Depreciation =	Carrying value	x Rate
	=	\$32 800	x 18%
	=	\$5 904	
	Acc. dep. =	\$13 104	Balance Sheet as at 30 June 2025
Year of purchase			2023

Exercise 14.6 Comparing depreciation methods

a

Reason	<i>The depreciation expense will be the same every year.</i>
---------------	---

b

Reason	<i>Comparability only requires the use of the same depreciation method: the calculation of the same depreciation expense is not required.</i>
---------------	--

c

Information	<i>Type of asset / revenue earning pattern</i>
Justification	<i>This will determine how its cost should be allocated as an expense.</i>

d

Calculation				
<i>Depreciation</i>	<i>=</i>	<i>Historical Cost</i>	<i>x</i>	<i>Rate</i>
	<i>=</i>	<i>\$12 000</i>	<i>x</i>	<i>10%</i>
	<i>=</i>	<i>\$1 200</i>		
Depreciation of shop equipment – straight-line method				\$ 1 200

e

Calculation				
<i>Depreciation</i>	<i>=</i>	<i>Carrying value</i>	<i>x</i>	<i>Rate</i>
	<i>=</i>	<i>\$12 000</i>	<i>x</i>	<i>15%</i>
	<i>=</i>	<i>\$1 800</i>		
Depreciation of shop equipment – reducing balance method				\$ 1 800

f

Explanation	<i>Higher depreciation expense will mean Net Profit will be \$600 lower</i>
	<i>because the reducing balance method allocates more depreciation expense</i>
	<i>at the start of the asset's life when it is newer.</i>

9

Year	Historical Cost	Straight Line			Reducing Balance			Profit
		Acc. Dep.	Carrying Value	Dep. Expense	Acc. Dep.	Carrying Value	Dep. Expense	Higher (Lower)
2026	12 000	<i>Nil</i>	12 000	1 200	<i>Nil</i>	12 000	1 800	(600)
2027	12 000	1 200	10 800	1 200	<i>Nil</i>	10 200	1 530	(330)
2028	12 000	2 400	9 600	1 200	<i>Nil</i>	8 670	1 301	(101)
2029	12 000	3 600	8 400	1 200	<i>Nil</i>	7 369	1 105	95
2030	12 000	4 800	7 200	1 200	<i>Nil</i>	6 264	940	260

Exercise 14.7 Graphing depreciation

a

Photocopiers

Depreciation method	<i>Straight-line</i>
Justification	<i>both lines are straight lines indicating even allocation of depreciation over the life of the asset</i>

Office equipment

Depreciation method	<i>Reducing balance</i>
Justification	<i>both lines are curved indicating a change in allocation of depreciation over the life of the asset</i>

b

Line A

Represents	<i>Carrying Value (of Photocopiers)</i>
Justification	<i>It reduces (by the total of depreciation expense) each year.</i>

Line B

Represents	<i>Accumulated Depreciation (of Office Equipment)</i>
Justification	<i>It increases (by the total of depreciation expense) each year.</i>

c

Historical cost of Photocopiers	\$ 10 000
---------------------------------	------------------

d

Discussion	<i>Comparability requires that the same depreciation method be used</i>
	<i>so that reports can be compared from one Period to the next.</i>
	<i>However</i>
	<i>the reducing balance method allocates more depreciation expense at the start</i>
	<i>of the asset's life than at the end and this would</i>
	<i>would more closely match the revenue earning pattern of the photocopiers</i>
	<i>which are likely to earn more revenue when they are new and less as they age.</i>
	<i>This will ensure a more accurate expense and therefore profit in each period,</i>
	<i>and information which is more useful for decision making (Relevant).</i>

e

Explanation	<i>No effect:</i>
	<i>both methods will allocate the same total depreciation expense</i>
	<i>over the life of the asset.</i>

Exercise 14.8 Cash sale of a non-current asset

a General Journal

Date	Details	Debit \$	Credit \$
Aug. 1	Disposal of Van	24 000	
	Van		24 000
	Accumulated Depreciation – Van	19 000	
	Disposal of Van		19 000
	Bank	3 000	
	Disposal of Van		3 000
	Loss on Disposal of Van	2 000	
	Disposal of Van		2 000
	Cash sale of van (Rec. 31)		

b General Ledger Van (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 1	Balance	24 000	Aug. 1	Disposal of Van	24 000
		\$24 000			\$24 000

Accumulated Depreciation of Van (–A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 1	Disposal of Van	19 000	Aug. 1	Balance	19 000
		19 000			19 000

Disposal of Van

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 1	Van	24 000	Aug. 1	Acc. Depreciation of Van	19 000
				Bank	3 000
				Loss on Disposal of Van	2 000
		24 000			24 000

b (continued)

General Ledger

Loss on Disposal of Van (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	Disposal of Van	2 000			

c

Explanation	<i>Asset will decrease by \$2 000 because Bank will increase by \$3 000 but the carrying value of the van will decrease by \$5 000 as the van is sold.</i>
	<i>There will be no effect on Liabilities.</i>
	<i>Owner's equity will decrease by \$2 000 due to the Loss on Disposal of Van being reported as an expense and decreasing Net profit.</i>

d

Explanation	<i>As an Investing inflow of \$3 000 as it is a cash inflow from the sale of a non-current asset.</i>

Exercise 14.9 Cash sale of a non-current asset

a

Calculation

Depreciation (1/1 – 31/3/25)	$\$36\,000 \times 10\% \times \frac{3}{12}$	900	
+ Acc. depreciation (31/12/24)		32 800	
Acc. depreciation (31/3/25)		33 700	
Historical Cost	\$36 000		
less Acc. depreciation	33 700	2 300	
Carrying value			\$ 2 300

b

General Journal

Date	Details	Debit \$	Credit \$
Mar. 31	Disposal of Fittings	36 000	
	Fittings		36 000
	Accumulated Depreciation of Fittings	33 700	
	Disposal of Fittings		33 700
	Bank	2 700	
	Disposal of Fittings		2 700
	Disposal of Fittings	400	
	Profit on Disposal of Fittings		400
	Cash sale of fittings (Rec. 96)		

c

General Ledger

Fittings (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 1	Balance	36 000	Mar. 31	Disposal of Fittings	36 000
		36 000			36 000

Accumulated Depreciation of Fittings (–A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 31	Disposal of Fittings	33 700	Jan. 1	Balance	32 800
			Mar. 31	Depreciation of Fittings	900
		33 700			33 700

Disposal of Fittings

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 31	Fittings	36 000	Mar. 31	Acc. Depreciation of Fittings	33 700
	Profit on Disposal of Fittings	400		Bank	2 700
		36 400			36 400

Profit on Disposal of Fittings (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Mar. 31	Disposal of Fittings	400

d

Reason 1	Over-depreciated asset
	(due to understated residual value/useful life)
Reason 2	Asset was in high demand
	(due to rarity / better condition than expected)

e TRIFFIC TOYS

Income Statement (extract) for quarter ended 31 March 2025

	\$	\$
Other revenue		
Profit on Disposal of Fittings		400

f

30 April 2025

Calculation			
Depreciation (31/3 – 30/4/25)	$\$36\,000 \times 10\% \times \frac{1}{12}$	300	
Acc. depreciation (30/4/25)		33 700	
	Accumulated depreciation		\$ 34 000
Historical Cost	\$36 000		
less Acc. depreciation	34 000		
	Carrying value		\$ 2 000
Carrying value	\$2 000		
less Proceeds on Disposal	2 000		
	Profit (Loss) on Disposal		\$ nil

30 June 2025

Calculation			
Depreciation (30/4 – 30/6/25)	$\$36\,000 \times 10\% \times \frac{2}{12}$	600	
Acc. depreciation (30/4/25)		34 000	
	Accumulated depreciation		\$ 34 600
Historical Cost	\$36 000		
less Acc. depreciation	34 600		
	Carrying value		\$ 1 400
Carrying value	\$1 400		
less Proceeds on Disposal	1 200		
	Profit (Loss) on Disposal		\$ (200)

Exercise 14.10 Cash sale of a non-current asset

a

Explanation	<i>As an Investing Inflow,</i>
	<i>as it is a cash inflow as a result of the disposal of a non-current asset</i>

b

Calculation	
	<i>Proceeds on sale</i> \$1 900
	<i>less Carrying value</i> 3 000 (\$8 000 – \$5 000)
	Profit (Loss) on disposal of furniture \$ (1 100)

c

Explanation	<i>The carrying value was overstated, due to under-depreciation.</i>
	<i>This may have been caused by overstating the residual value or useful life,</i>
	<i>or because the asset was not in demand due to damage or obsolescence.</i>

d VICKI'S VINYL

Income Statement (extract) for October 2025

	\$	\$
Other Expenses		
<i>Loss on Disposal of Furniture</i>		1 100

Chapter 15 Accounting for Non-Current Assets – Solutions to exercises

e General Journal

Date	Details	Debit \$	Credit \$
Oct. 16	Disposal of Furniture	8 000	
	Furniture		8 000
	Accumulated Depreciation of Furniture	5 000	
	Disposal of Furniture		5 000
	Bank	1 900	
	Disposal of Furniture		1 900
	Loss on Disposal of Furniture	1 100	
	Disposal of Furniture		1 100
	Cash sale of furniture (Rec. 33)		

Exercise 14.11 Trade-in of a non-current asset

a

Definition	<i>When a firm uses the proceeds from the disposal of a non-current asset to</i>
	<i>reduce the amount payable for the purchase of a new non-current asset</i>

b

General Journal

Date	Details	Debit \$	Credit \$
May 1	Disposal of Van	30 000	
	Van		30 000
	Accumulated Depreciation of Van	20 000	
	Disposal of Van		20 000
	Van	7 000	
	Disposal of Van		7 000
	Loss on Disposal of Van	3 000	
	Disposal of Van		3 000
	Van	33 000	
	GST Clearing	4 000	
	Bank		37 000
	Trade-in of van on cash purchase of new van		
	(EFT trans. 2119)		

Chapter 15 Accounting for Non-Current Assets – Solutions to exercises

c General Ledger

Van (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May 1	Balance	30 000	<i>May 1</i>	<i>Disposal of Van</i>	<i>30 000</i>
	<i>Disposal of Van</i>	<i>7 000</i>			
	<i>Bank</i>	<i>37 000</i>			

Accumulated Depreciation of Van (–A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>May 1</i>	<i>Disposal of Van</i>	<i>20 000</i>	May 1	Balance	20 000

Disposal of Van

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>May 1</i>	<i>Van</i>	<i>30 000</i>	<i>May 1</i>	<i>Acc. Depreciation of Van</i>	<i>20 000</i>
				<i>Van</i>	<i>7 000</i>
				<i>Loss on Disposal of Van</i>	<i>3 000</i>
		<i>\$30 000</i>			<i>\$30 000</i>

Loss on Disposal of Van

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>May 1</i>	<i>Disposal of Van</i>	<i>3 000</i>			

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>May 1</i>	<i>Van / GST Clearing</i>	<i>37 000</i>

d

Definition	<i>When insufficient depreciation is allocated over the life of the asset</i>
	<i>(meaning its carrying value is overstated).</i>

e

Cause 1	<i>Overestimation of useful life</i>
Cause 2	<i>Overestimation of residual value</i>

Exercise 14.12 Trade-in of a non-current asset

a General Journal

Date	Details	Debit \$	Credit \$
<i>June 1</i>	<i>Disposal of Cash register</i>	<i>4 000</i>	
	<i>Cash register</i>		<i>4 000</i>
	<i>Accumulated Depreciation of Cash register</i>	<i>3 100</i>	
	<i>Disposal of Cash register</i>		<i>3 100</i>
	<i>Cash register</i>	<i>500</i>	
	<i>Disposal of Cash register</i>		<i>500</i>
	<i>Loss on Disposal of Cash register</i>	<i>400</i>	
	<i>Disposal of Cash register</i>		<i>400</i>
	<i>Cash register</i>	<i>5 500</i>	
	<i>GST Clearing</i>	<i>600</i>	
	<i>Bank</i>		<i>6 100</i>
	<i>Trade-in of cash register on cash purchase of new cash register (Cheque 113)</i>		

b **General Ledger**

Cash Register

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Balance	4 000	June 1	Disposal of Cash Register	4 000
	Disposal of Cash Register	500			
	Bank	5 500			

Disposal of Cash Register

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 1	Cash Register	4 000	June 1	Acc. Dep. of Cash register	3 100
				Cash register	500
				Loss on Disposal of Cash register	400
		\$4 000			\$4 000

Bank

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			June 1	Cash Register / GST Clearing	6 100

c

Explanation Not reported:
<i>only the overall Loss on Disposal of Cash Register is reported</i>
<i>in the Income Statement (under Other Expenses).</i>

d

Explanation As an Investing outflow of \$6 100
<i>as it is a cash outflow related to the purchase of a non-current asset.</i>

Exercise 14.13 Disposal of a non-current asset and financial reports

a General Journal

Date	Details	Debit \$	Credit \$
June 30	<i>Disposal of Fittings</i>	5 000	
	<i>Fittings</i>		5 000
	<i>Acc. Depreciation of Fittings</i>	3 000	
	<i>Disposal of Fittings</i>		3 000
	<i>Fittings</i>	1 200	
	<i>Disposal of Fittings</i>		1 200
	<i>Loss on Disposal of Fittings</i>	800	
	<i>Disposal of Fittings</i>		800
	<i>Fittings</i>	7 800	
	<i>GST Clearing</i>	900	
	<i>Bank</i>		8 700
June 30	<i>Depreciation of Fittings</i>	300	
	<i>Accumulated Depreciation of Fittings</i>		300
June 30	<i>Inventory Loss</i>	170	
	<i>Inventory</i>		170
June 30	<i>Interest Expense</i>	140	
	<i>Accrued Interest Expense</i>		140
June 30	<i>Rent Expense</i>	600	
	<i>Prepaid Rent Expense</i>		600
June 30	<i>Profit and Loss Summary</i>	23 590	
	<i>Advertising</i>		1 000
	<i>Cost of Sales</i>		14 820
	<i>Discount Expense</i>		280
	<i>Inventory Write-down</i>		230
	<i>Wages</i>		5 250
	<i>Depreciation of Fittings</i>		300
	<i>Loss on Disposal of Fittings</i>		800
	<i>Inventory Loss</i>		170
	<i>Interest Expense</i>		140
	<i>Rent Expense</i>		600

b KYABRAM KITES

Adjusted Trial Balance as at 30 June 2025

Account	Debit \$	Credit \$
Accounts Payable		8 600
Accounts Receivable	12 750	
Accumulated Depreciation of Fittings <i>(24 000 + 300 depⁿ – 3 000)</i>		<i>21 300</i>
Advertising	1 000	
Bank		9 090
Capital – Darling		34 720
Cost of sales	14 820	
Discount expense	280	
Discount revenue		130
Drawings	3 200	
Fittings <i>(60 000 – 5 000 disposal + 9 000 purchase)</i>	<i>64 000</i>	
GST Clearing <i>(1 060 – 900 on new fittings)</i>		<i>160</i>
Inventory	<i>26 500</i>	
Inventory write-down	230	
Loan – Northern Bank (repayable \$500 per month)		24 000
Prepaid Rent Expense	1 200	
Sales		33 400
Sales returns	<i>300</i>	
Wages	5 250	
<i>Depreciation of Fittings</i>	<i>300</i>	
<i>Loss on Disposal of Fittings</i>	<i>800</i>	
<i>Inventory loss</i>	<i>170</i>	
<i>Interest expense</i>	<i>140</i>	
<i>Accrued Interest Expense</i>		<i>140</i>
<i>Rent expense</i>	<i>600</i>	
Total	131 540	131 540

d KYABRAM KITES

Income Statement for June 2015

	\$	\$
Revenue		
Sales	33 400	
less Sales returns	300	33 100
less Cost of Goods Sold		
Cost of sales		14 820
Gross Profit		18 280
less Inventory loss	170	
less Inventory write-down	230	400
Adjusted Gross Profit		17 880
add Other Revenue		
Discount Revenue		130
		18 010
less Other Expenses		
Advertising	1 000	
Discount expense	280	
Wages	5 250	
Depreciation of Fittings	300	
Loss on Disposal of Fittings	800	
Interest expense	140	
Rent expense	600	8 370
Net Profit		9 640

e

Action 1	Physical security measures (e.g. locks/cameras)
	Rotation of inventory / Reduce level of inventory on hand
Action 2	More careful checking of deliveries
	Strategies to increase sales: advertising, inventory mix (not selling prices)

f

Straight-line method: 10%

Calculation

$$\begin{aligned}\text{Depreciation} &= \$60\,000 \times 10\% \times \frac{1}{12} \\ &= \$500\end{aligned}$$

Depreciation expense	\$ 500
-----------------------------	---------------

Profit: Higher (Lower)	Lower
-------------------------------	--------------

Straight-line method: 7%

Calculation

$$\begin{aligned}\text{Depreciation} &= \$60\,000 \times 7\% \times \frac{1}{12} \\ &= \$350\end{aligned}$$

Depreciation expense	\$ 350
-----------------------------	---------------

Profit: Higher (Lower)	Lower
-------------------------------	--------------

g

Explanation	<i>Because at both 7% and 10% Depreciation expense is higher using the straight line method so profit will be lower and the firm will not look more profitable.</i>
--------------------	---

h

Explanation	<i>Because he is suggesting choosing a depreciation method based on what makes the firm look profitable. This is misleading to users of the reports. (The depreciation method should be chosen based on the revenue earning pattern of the asset.)</i>
--------------------	--

i

KYABRAM KITES

Balance Sheet as at 30 June 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Accounts Receivable</i>	12 750		<i>Bank</i>	9 090	
<i>Prepaid Rent Expense</i>	1 200		<i>Accounts Payable</i>	8 600	
<i>Inventory</i>	26 500	40 450	<i>GST Clearing</i>	160	
			<i>Loan – Northern Bank</i>	6 000	
Non-Current Assets			<i>Accrued Interest Expense</i>	140	23 990
<i>Fittings</i>	64 000				
<i>– Accumulated Depreciation</i>	21 300	42 700	Non-Current Liabilities		
			<i>Loan – Northern Bank</i>		18 000
			Owner's Equity		
			<i>Capital – Darling</i>	34 720	
			<i>add Net Profit</i>	9 640	
				44 360	
			<i>less Drawings</i>	3 200	41 160
Total Assets		83 150	Total Equities		83 150

Exercise 15.1 Bad and doubtful debts

a

Definition	<i>a debt arising from credit sales in the current Period) that is estimated may not be collectable at some point in the future</i>
-------------------	---

b

Calculation
$D. \text{ debts} = \text{Estimated rate} \times \text{Net credit sales}$ $= 3\% \times \$130\,000$
Doubtful debts \$ 3 900

c

General Journal

Date	Details	Debit \$	Credit \$
Aug. 31	Bad debts	3 900	
	Allowance for doubtful debts		3 900
	Creation of allowance for doubtful debts – 3% of Net credit sales (Memo 27)		

d

Explanation	<i>It recognises in the current Period the (probable) expense incurred as a result of sales made in that Period.</i>
	<i>This means profit can be calculated accurately by matching revenue earned against expenses incurred in the current Period.</i>

e General Ledger

Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Aug. 1</i>	<i>Balance</i>	<i>42 000</i>			

Allowance for doubtful debts (-A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			<i>Aug. 31</i>	<i>Bad debts</i>	<i>3 900</i>

Bad debts (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Aug. 31</i>	<i>Allowance for doubtful debts</i>	<i>3 900</i>			

f Flicker Films

Balance Sheet (extract) as at 30 June 2025

	\$	\$
Current Assets		
<i>Accounts Receivable</i>	<i>42 000</i>	
<i>less Allowance for doubtful debts</i>	<i>3 900</i>	<i>38 100</i>

Exercise 15.2 Bad and doubtful debts

a

	Source document
March 8	Invoice
March 15	Credit note

b

Calculation	
$ \begin{aligned} D. \text{ debts} &= \text{Estimated rate} \times \text{Net credit sales} \\ &= 5\% \times (\$140\,000 - \$8\,000 + \$60\,000) \\ &= \$9\,600 \end{aligned} $	
Doubtful debts	\$ 9 600

c

General Journal

Date	Details	Debit \$	Credit \$
March 31	Bad debts	9 600	
	Allowance for doubtful debts		9 600
	Creation of allowance for doubtful debts – 5% of Net credit sales (Memo 96)		

d

General Ledger Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 1	Balance	85 000			

Allowance for doubtful debts (-A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Mar. 31	Bad debts	9 600

Bad debts (E)

Chapter 15 *Bad and doubtful debts* – Solutions to exercises

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Mar. 31</i>	<i>Allowance for doubtful debts</i>	<i>9 600</i>			

e

	Increase / Decrease / No effect	Amount \$
Assets	Decrease (<i>Increase Allowance for doubtful debts</i>)	9 600
Liabilities	No effect	
Owner's Equity	Decrease (<i>Bad debts expense decrease Net profit</i>)	9 600

f

Explanation	<i>Recognising Bad debts expense in the Income Statement and Allowance for doubtful debts in the Balance Sheet means the reports include all information capable of making a difference to decision making.</i>
	<i>It also means the Balance Sheet provides a Faithful representation of the real world value of Accounts Receivable as it the information is complete (although it is an estimate and thus not neutral).</i>

g

Reason 1	<i>There are no receipts from Accounts Receivable during March 2025</i>
	<i>Lack of cash received from Accounts Receivable will reduce liquidity</i>
Reason 2	<i>Doubtful debts is 5% of net credit sales</i>
	<i>Bad debts expense will reduce profit</i>

Exercise 15.3 Writing off a bad debt

a

Definition	<i>a debt that is deemed to be uncollectable / irrecoverable</i>
	<i>possibly because the Account Receivable has been declared bankrupt</i>

b

General Journal

Date	Details	Debit \$	Credit \$
Sept. 14	Allowance for doubtful debts	1 500	
	GST Clearing	150	
	Account Receivable – Chute		1 650
	Debt written off as uncollectable due to absence of		
	Account Receivable – Chute (Memo 43)		

c

Explanation	<i>It does not affect profit in the current Period</i>
	<i>as under the Accrual basis it was incurred in an earlier Period</i>
	<i>when the credit sale was made</i>
	<i>(but not confirmed until the current Period).</i>

d **General Ledger**

Account Receivable – Chute (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 1	Balance	1 650	Sept. 14	Allowance for doubtful debts /	1 650
				GST Clearing	

Allowance for doubtful debts (-A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 14	Account Receivable – Chute	1 500	Sept. 1	Balance	2 300

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Sept. 14	Account Receivable – Chute	150	Sept. 1	Balance	2 000

e

Action 1	<i>Credit checks</i>
	<i>Prompt invoicing / Offering settlement discounts</i>
Action 2	<i>Reminder calls</i>
	<i>Threats of legal action</i>

Exercise 15.4 Writing off a bad debt

a General Journal

Date	Details	Debit \$	Credit \$
March 25	Bank	440	
	Accounts Receivable		440
	Received cash from Account Receivable – Solvent (Receipt 31)		
March 25	Allowance for doubtful debts	1 600	
	GST Clearing	160	
	Accounts Receivable		1 760
	Debt written off as uncollectable due to bankruptcy of Account Receivable – Solvent (Memo 52)		

b General Ledger Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 1	Balance	19 500	Mar. 25	Bank	440
				Allowance for doubtful debts /	1 760
				GST Clearing	

c

Explanation	Assets decreases \$160 because Accounts Receivable decreases by \$2 200 (for the cash received and the amount written off), but Allowance for doubtful debts (-A) decreases by \$1 600 and Bank increases \$440 (for the cash received). Liabilities (GST Clearing) decreases \$160 as the GST will not be collected from the Accounts Receivable and thus is no longer owed to the ATO. There is no effect on Owner's equity (as there are no revenues earned or expenses incurred).
--------------------	--

d

Discussion	<i>The letter indicated the Account Receivable would be declaring bankruptcy,</i>
	<i>but this has not been confirmed meaning the amount written off may not be</i>
	<i>Verifiable yet.</i>
	<i>However, given the strong indication it is ethical to recognise this decrease in</i>
	<i>assets as being Relevant in that it is capable of affecting decision making</i>
	<i>(about the value of the firm's assets).</i>
	<i>Writing off the bad debt also ensures that the Balance Sheet provides a</i>
	<i>Faithful representation of the value of the firm's Accounts Receivable as it</i>
	<i>is complete.</i>

Exercise 15.5 Bad debt and doubtful debts: subsequent periods

a/c

General Journal

Date	Details	Debit \$	Credit \$
<i>Dec. 12</i>	<i>Allowance for doubtful debts</i>	<i>900</i>	
	<i>GST Clearing</i>	<i>90</i>	
	<i>Accounts Receivable</i>		<i>990</i>
	<i>Debt written off as uncollectable due to bankruptcy</i>		
	<i>of Account Receivable – Springs (Memo 201)</i>		
<i>Dec. 31</i>	<i>Bad debts</i>	<i>6 200</i>	
	<i>Allowance for doubtful debts</i>		<i>6 200</i>

b

Calculation

$$\begin{aligned}
 D. \text{ debts} &= \text{Estimated rate} \times \text{Net credit sales} \\
 &= 5\% \times (\$150\,000 - \$12\,000) \\
 &= \$6\,900
 \end{aligned}$$

Doubtful debts \$ **6 900**

d

Explanation *The Allowance for doubtful debts account had an existing balance of \$700 meaning less had to be recorded as Bad debts expense.*

e

General Ledger

Accounts Receivable (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 1	Balance	60 000	Dec.	Bank	145 000
	Sales / GST Clearing	165 000		Sales returns / GST Clearing	13 200
			12	Accounts Receivable /	990
				GST Clearing	
			31	Balance	65 810
		225 000			225 000
Jan. 1	Balance	65 810			

Allowance for doubtful debts (-A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 12	Accounts Receivable	900	Dec. 1	Balance	1 600
31	Balance	6 900	31	Bad debts	6 200
		7 800			7 800
			Jan. 1	Balance	6 900

Bad debts (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	Allowance for doubtful debts	6 200	Dec. 31	Profit and Loss Summary	6 200
		6 200			6 200

f Wishart Wells

Balance Sheet (extract) as at 31 December 2025

	\$	\$
Current Assets		
Accounts Receivable	65 810	
less Allowance for doubtful debts	6 900	58 910

Exercise 15.6 Bad debt and doubtful debts

a General Journal

Date	Details	Debit \$	Credit \$
Mar. 2	Account Receivable – Tusche	880	
	Sales		800
	GST Clearing		80
	Cost of sales	500	
	Inventory		500
Mar. 29	Bank	605	
	Account Receivable – Tusche		605
Mar. 29	Allowance for doubtful debts	1 650	
	GST Clearing	165	
	Account Receivable – Tusche		1 815
Mar. 31	Bad debts	2 450	
	Allowance for doubtful debts		2 450

b

	Overstated / Understated / No effect	Amount \$
Assets	Understated (U/s Accounts Receivable \$880, O/s Inventory \$500)	380
Liabilities	Understated (GST Clearing)	80
Owner's Equity	Understated (Net profit)	300

c

Explanation	<i>Relevance requires that all information that is capable of affecting decision making be included in the reports.</i>
	<i>This information may affect decisions based on the valuation of assets (Accounts Receivable).</i>

d General Ledger

Account Receivable – Elsa Tours (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 1	Balance	32 000	Mar.	Bank / discount revenue	58 000
	Sales / GST Clearing	69 520		Sales returns / GST Clearing	4 400
			31	Balance	39 120
		101 520			101 520
Apr. 1	Balance	39 120			

Account Receivable – Tusche (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 1	Balance	1 540	Mar. 29	Bank	605
2	Sales / GST Clearing	880		Allowance for doubtful debts / GST Clearing	1 815
		2 420			2 420

Allowance for doubtful debts (-A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 29	Accounts Receivable	1 650	Mar. 1	Balance	1 600
31	Balance	2 400	31	Bad debts	2 450
		4 050			4 050
			Apr. 1	Balance	2 400

Bad debts (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	Allowance for doubtful debts	2 450	Dec. 31	Profit and Loss Summary	2 450
		2 450			2 450

e Nordic Supplies

Balance Sheet (extract) as at 31 March 2025

	\$	\$
Current Assets		
<i>Account Receivable – Elsa Tours</i>	39 120	
<i>less Allowance for doubtful debts</i>	2 400	36 720

f

Correct statement	<i>Bad debts are leaving him with less cash</i>
Justification	<i>Bad debts mean less cash is collected from Accounts Receivable</i>

g

Incorrect statement	<i>Bad debts are reducing his revenue</i>
Justification	<i>Bad debts are not incurred at point of sale (when revenue is earned)</i>
	<i>but sometime later when the Account Receivable cannot pay</i>

h

Discussion	<i>Continuing to sell to Tusche could mean further sales and therefore more profit.</i>
	<i>However, the insolvency firm representing Tusche has indicated that the current remaining debt is irrecoverable.</i>
	<i>To continue making sales would be to risk further bad debts which will decrease profit and also reduce cash received.</i>

Exercise 15.7 Accounting reports

a

Explanation	<i>To calculate profit accurately according to the Accrual basis assumption by comparing revenues earned against expenses incurred in the current Period.</i>

b

General Journal

Date	Details	Debit \$	Credit \$
Oct. 31	Inventory loss	900	
	Inventory		900
31	Rent expense	1 500	
	Prepaid rent expense		1 500
31	Advertising expense	410	
	Accrued advertising		410
31	Depreciation of van	300	
	Accumulated Depreciation of Van		300
31	Depreciation of Fixtures and fittings	625	
	Accumulated Depreciation of Fixtures and fittings		625
31	Allowance for doubtful debts	1 200	
	GST Clearing	120	
	Account Receivable – Eagles SC		1 320
31	Bad debts	1 045	
	Allowance for doubtful debts		1 045
31	Insurance	1 500	
	GST Clearing	150	
	Wages		1 650

c

Omni Sports

Post-adjustment Trial Balance as at 31 October 2025

Account	Debit \$	Credit \$
Account Receivable – Eagles SC	1 320	
Account Receivable – Western FC	27 500	
Accounts Payable		46 000
Accumulated depreciation of Fixtures and fittings		9 625
Accumulated depreciation of Van		25 300
Advertising	2 910	
Allowance for doubtful debts		2 145
Bank		5 100
Buying expenses	1 600	
Capital		33 830
Cost of sales	35 000	
Discount expense	3 100	
Discount revenue		1 790
Drawings	4 500	
Fixtures and fittings	59 000	
GST Clearing		3 630
Insurance	1 600	
Interest expense	400	
Inventory	64 100	
Loan – QZ Bank (repayable \$1 200 per month)		55 000
Prepaid rent expense	10 500	
Sales		75 000
Sales returns	3 500	
Van	36 000	
Wages	3 750	
<i>Inventory loss</i>	900	
<i>Rent expense</i>	1 500	
<i>Accrued advertising</i>		410
<i>Depreciation of Van</i>	300	
<i>Depreciation of Fixtures and fittings</i>	625	

Chapter 15 *Bad and doubtful debts* – Solutions to exercises

<i>Bad debts</i>	<i>1 045</i>	
<i>Totals</i>	<i>257 830</i>	<i>257 830</i>

d

OMNI SPORTS

Income Statement for September 2025

	\$	\$
<i>Sales</i>	75 000	
<i>Sales returns</i>	3 500	71 500
<i>less Cost of Goods Sold</i>		
<i>Cost of sales</i>	35 000	
<i>Buying expenses</i>	1 600	36 600
<i>Gross Profit</i>		34 900
<i>less Inventory loss</i>		900
<i>Adjusted Gross Profit</i>		34 000
<i>add Other revenue</i>		
<i>Discount revenue</i>		1 790
		35 790
<i>less Other expenses</i>		
<i>Advertising</i>	2 910	
<i>Discount expense</i>	3 100	
<i>Insurance</i>	1 600	
<i>Interest expense</i>	400	
<i>Wages</i>	3 750	
<i>Rent expense</i>	1 500	
<i>Depreciation of Van</i>	300	
<i>Depreciation of Fixtures and fittings</i>	625	
<i>Bad debts</i>	1 045	15 230
<i>Net profit (loss)</i>		20 560

e

Expense 1	<i>Rent expense / Depreciation (of Van or F&F) / Bad debts /</i>
Expense 2	<i>Advertising</i>
Explanation	<i>Balance day adjustments for expenses like rent / bad debts</i>
	<i>increase expenses and decrease profit,</i>

Chapter 15 *Bad and doubtful debts* – Solutions to exercises

It is ethical to disclose these expenses as users rely on this information to make decisions.

f

Action 1	<i>Lower CP of inventory by . . .</i>
	<i>cheaper supplier, cheaper buying expenses</i>
Action 2	<i>Decrease Inventory loss by . . .</i>
	<i>physical safeguards, rotating inventory</i>

g

Discussion	<i>Wages expense for October 2025 (\$3 750) equates to \$45 000 per year which is below average earnings and might indicate a need for a pay rise for ethical (social) reasons.</i>
	<i>Financially, the business is on track to make a yearly profit of more than \$240 000 indicating it can be afforded</i>
	<i>This would be even more so if there is more than one employee.</i>
	<i>However, there is no information about the number of hours worked by the employees so it is hard to determine their hourly rate.</i>
	<i>Further, the business would need to consider the wages paid by similar businesses and the quality of the work performed by its staff: it may wish to pay more to retain loyal and competent staff (or not!).</i>
	<i>The business would also need to consider its previous financial performance to see if this result is 'normal'</i>
	<i>and its budgeted performance to see if this level of profit is expected to continue into the future.</i>

h

OMNI SPORTS

Balance Sheet as at 31 October 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Account Receivable – Western FC</i>	27 500		<i>Bank</i>	5 100	
<i>less Allowance for doubtful debts</i>	(2 145)		<i>GST Clearing</i>	3 630	
<i>Inventory</i>	64 100		<i>Accounts Payable</i>	46 000	
<i>Prepaid rent expense</i>	10 500	99 955	<i>Accrued Advertising</i>	410	
			<i>Loan – QZ Bank</i>	1 200	56 340
Non-Current Assets					
<i>Fixtures and fittings</i>	59 000		Non-Current Liabilities		
<i>– Accumulated Depreciation</i>	(9 625)		<i>Loan – QZ Bank</i>		53 800
<i>Van</i>	36 000				
<i>– Accumulated Depreciation</i>	(25 300)	60 075	Owner's Equity		
			<i>Capital</i>	33 830	
			<i>add Net Profit</i>	20 560	
				54 390	
			<i>less Drawings</i>	4 500	49 890
Total Assets		160 030	Total Equities		160 030

i

Discussion	<i>Bank is in overdraft which means debt owed to bank</i>
	<i>Allowance for doubtful debts almost 10% of Accounts Receivable balance</i>
	<i>However,</i>
	<i>Increase in Owner's equity: healthy profit (> Drawings)</i>
	<i>Current asset > Current liability (good Working Capital Ratio / liquidity)</i>
	<i>Safe - 66% of assets financed by debt</i>
	<i>Non-current assets have plenty of useful life left</i>
	<i>Accounts Payable < Inventory on hand</i>

Exercise 16.1 Unearned revenue

a General Journal

Date	Details	Debit \$	Credit \$
Mar. 1	Bank	9 900	
	Unearned Rent revenue		9000
	GST Clearing		900
	6 months' rent revenue received in advance		
	(Receipt 54)		

b

Explanation	Only part ($\frac{4}{6}$ months) of the rent received is earned in the year ended 30 June 2025 and under the Accrual basis assumption only this amount should be recognised as revenue for the Period.
	(The remaining 2 months remain unearned at the end of the Period).

c

Calculation	
	$\frac{\$9\,000}{6\text{ months}} \times 4\text{ months' earned (March–June inclusive)}$
	$= \$1\,500 \times 4$
	Rent revenue \$ 6 000

d General Journal

Date	Details	Debit \$	Credit \$
June 30	Unearned Rent revenue	6 000	
	Rent revenue		6 000
	4 months' (March – June 2025) rent revenue earned		
	(Memo 44)		

e

Explanation	<i>There is no effect on assets (the cash was received on 1 March 2025).</i>
	<i>Liabilities (Unearned Rent revenue) decreases \$6 000</i>
	<i>as the obligation is settled by the provision of the premises.</i>
	<i>Owner's equity increases (\$ 6000)</i>
	<i>as the Rent revenue earned increases profit.</i>

f

General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Mar. 1	Balance	6 000			
	<i>Unearned Rent revenue /</i>	<i>9 900</i>			
	<i>GST Clearing</i>				

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Mar. 1	Balance	1 500
				<i>Bank</i>	<i>900</i>

Unearned Rent revenue (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>June 30</i>	<i>Rent revenue</i>	<i>6 000</i>	<i>Mar. 1</i>	<i>Bank</i>	<i>9 000</i>
		6 000			6 000

Rent revenue (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>June 30</i>	<i>Profit and Loss Summary</i>	<i>6 000</i>	<i>June 30</i>	<i>Unearned Rent revenue</i>	<i>6 000</i>
		6 000			6 000

Exercise 16.2 Cash sale involving a deposit

a General Journal

Date	Details	Debit \$	Credit \$
Jan. 16	Bank	400	
	Unearned Sales		400
	Deposit received in advance on bulk order		
	(Receipt 84)		

b

Explanation	Under <i>Current Liabilities as Unearned Sales \$400</i> ,
	as it is a <i>present obligation (to provide the goods to the customer)</i>
	that is <i>expected to be settled sometime in the next 12 months</i>
	<i>when the goods are provided / as the goods are owed to the customer.</i>

c General Journal

Date	Details	Debit \$	Credit \$
Feb. 27	Bank	5 100	
	Unearned Sales	400	
	Sales		5 000
	GST Clearing		500
	Cost of sales	2 300	
	Inventory		2 300
	Cash sale of inventory following deposit		
	(Receipt 92)		

d

Reason 1	The amount in the Bank account includes the GST received on the sale
Reason 2	The amount in the Bank account (on Feb. 27) does not include the deposit

Chapter 16 *Balance Day Adjustments: Revenues* – Solutions to exercises

e

General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Feb. 1	Balance	* 1 700			
<i>Feb. 27</i>	<i>Sales / GST Clearing</i>	<i>5 100</i>			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Feb. 1	Balance	57 800	<i>Feb. 27</i>	<i>Cost of sales</i>	<i>2 300</i>

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Feb. 1	Balance	750
			<i>Feb. 27</i>	<i>Bank</i>	<i>500</i>

Unearned Sales (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Feb. 27</i>	<i>Sales</i>	<i>400</i>	Feb. 1	Balance	400

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>June 30</i>	<i>Profit and Loss Summary</i>	<i>5 000</i>	<i>Feb. 27</i>	<i>Bank / Unearned Sales</i>	<i>5 000</i>
		<i>5 000</i>			<i>5 000</i>

Cost of sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Feb. 27</i>	<i>Inventory</i>	<i>2 300</i>	<i>June 30</i>	<i>Profit and Loss Summary</i>	<i>2 300</i>
		<i>2 300</i>			<i>2 300</i>

Chapter 16 *Balance Day Adjustments: Revenues* – Solutions to exercises

* *Includes the \$400 deposit received on 16 January 2025 (the previous Period).*

Exercise 16.3 Credit Sale involving a deposit

a

Explanation	<i>Assets (Bank) increases by \$350 because the cash deposit has been received.</i>
	<i>Liabilities (Unearned Sales) increases by \$350 because there is a present obligation to provide the goods to the customer at some point in the future.</i>
	<i>There is no effect on Owner's equity as no revenue has been earned yet.</i>

b

Qualitative Characteristic	Relevance
Explanation	<i>As at 31 December 2024 the goods have not been provided to the customer so the revenue has not been earned in December 2024.</i>
	<i>It adversely affects decision making – about profit for December 2024 – if this deposit is recognised as revenue in the wrong Period.</i>

c

General Journal

Date	Details	Debit \$	Credit \$
Jan. 4	Account Receivable – Hartwells	1 190	
	Unearned Sales	350	
	Sales		1 400
	GST Clearing		140
	Cost of sales	920	
	Inventory		920
	Credit sale of washing machine to Hartwells		
	following deposit (Invoice 44)		

d

	Increase / Decrease / No effect	Amount \$
Assets	<i>Increase</i> (<i>Increase Accounts Receivable \$1 190, decrease Inventory \$920</i>)	<i>270</i>
Liabilities	<i>Decrease</i> (<i>Decrease Unearned Sales \$350, increase GST Clearing \$140</i>)	<i>210</i>
Owner's Equity	<i>Increase</i> (<i>Sales \$1 400 less Cost of Sales \$920 = Net Profit</i>)	<i>480</i>

e

General Ledger

Account Receivable – Hartwells (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 1	Balance	25 600			
4	<i>Sales / GST Clearing</i>	1 190			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 1	Balance	75 900	Jan. 4	<i>Cost of sales</i>	920

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Jan. 1	Balance	1 900
			4	<i>Account Receivable – Hartwells</i>	140

Unearned Sales (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 4	<i>Sales</i>	350	Jan. 1	Balance	350

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Jan. 4	<i>Account Receivable – Hartwells</i>	1 400
				<i>/ Unearned Sales</i>	

Cost of sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 4	<i>Inventory</i>	920			

Exercise 16.4 Credit sale involving a deposit

a

Calculation

$$\begin{aligned}
 \text{Deposit} &= 30 \text{ consoles @ } \$275 \text{ each} && \times 20\% \text{ deposit} \\
 &= \$8\,250 && \times 20\% \\
 &= \$1\,650
 \end{aligned}$$

Cash received \$ 1 650

b

Explanation *The revenue has not yet been earned*

so it would be misleading the users of the report to include it as revenue

and might distort their decision making.

c

Explanation *Because this is simply a **deposit** (to guarantee the sale);*

GST is recognised at point of sale

when the goods are provided to the customer

d

General Journal

Date	Details	Debit \$	Credit \$
Nov. 13	Bank	1 650	
	Unearned Sales		1 650
Nov. 26	Account Receivable – Spot On	6 600	
	Unearned Sales	1 650	
	Sales		7 500
	GST Clearing		750
	Cost of sales	3 600	
	Inventory		3 600

e

General Ledger

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Balance	8 500			
13	Unearned Sales	1 650			

Account Receivable – Spot On (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Balance	16 000			
26	Sales / GST Clearing	6 600			

Inventory (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 1	Balance	30 500	Nov. 26	Cost of sales	3 600

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Nov. 1	Balance	2 300
			13	Account Receivable – Spot On	750

Unearned Sales (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 26	Sales	1 650	Nov. 13	Bank	1 650

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Nov. 26	Account Receivable – Spot On /	7 500
				Unearned Sales	

Cost of sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 26	Inventory	3 600			

Chapter 16 *Balance Day Adjustments: Revenues* – Solutions to exercises

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f

	Overstated / Understated / No effect	Amount \$
Assets	<i>Understated (u/s Accounts Receivable \$6 600, o/s Inventory \$3 600)</i>	3 000
Liabilities	<i>Overstated (o/s Unearned Sales \$1 650, u/s GST Clearing \$750)</i>	900
Owner's Equity	<i>Understated (u/s Sales \$7 500 less Cost of Sales \$3 600 = Net profit)</i>	3 900

Exercise 16.5 **Accrued revenue**

a

Justification *The \$700 interest was **earned in the current Period** (August 2025).*

b

General Journal

Date	Details	Debit \$	Credit \$
<i>Aug. 31</i>	<i>Accrued Interest Revenue</i>	<i>700</i>	
	<i>Interest Revenue</i>		<i>700</i>
	<i>Interest revenue earned but not yet received</i>		
	<i>(Memo 95)</i>		

c

Explanation *Assets increase by \$700 as Accrued Interest revenue will be received at some point in the future.*

There is no effect on liabilities.

Owner's equity increases by \$700 as the revenue is earned and thus increases profit.

d General Ledger

Interest revenue (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	Profit and Loss Summary	6 700	Aug. 31	Bank	6 000
				Accrued Interest revenue	700
		6 700			6 700

Accrued Interest revenue (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Aug. 31	Interest revenue	700	Aug. 31	Balance	700
		700			700
Sept. 1	Balance				

e

Explanation	As a current asset worth \$7 00
	as it is an economic resource controlled by the entity
	and has the potential to produce future economic benefits
	sometime in the next 12 months when the interest is received.

Exercise 16.6 Accrued revenue

a

Calculation

$$\begin{aligned}
 \text{Interest} &= \$50\,000 \times 12\% \times \frac{3}{12} \text{ instalments received (May)} \\
 &= \$6\,000 \times \frac{3}{12} \\
 &= \$1\,500
 \end{aligned}$$

Interest revenue received \$ 1 500

b

Calculation

$$\begin{aligned}
 \text{Accrued interest} &= \$6\,000 \times \frac{1}{12} \text{ months owing (June)} \\
 &= \$500
 \end{aligned}$$

Accrued interest revenue \$ 500

c

General Journal

Date	Details	Debit \$	Credit \$
Aug. 31	Accrued Interest Revenue	500	
	Interest Revenue		700

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d **General Ledger**

Interest revenue (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Profit and Loss Summary	2 000	May 31	Bank	1 500
			June 30	Accrued Interest revenue	500
		2 000			2 000

Accrued Interest revenue (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
June 30	Interest Revenue	500	June 30	Balance	500
		500			500
July 1	Balance	500			

e **General Journal**

Date	Details	Debit \$	Credit \$
Aug. 31	Bank	1 500	
	Accrued Interest Revenue		500
	Interest Revenue		1 000
	Received interest for June – August 2025		
	(Bank Statement)		

f

Explanation	<i>\$500 was earned in the previous Period (June) and represents a decrease in the current asset – Accrued Interest revenue.</i>
	<i>Only \$1 000 is earned in the current Period (August).</i>

Exercise 16.7 Accrued revenue

a

Calculation

Commission revenue <i>received</i>	\$8 000
+ <i>Accrued commission revenue</i>	<u>4 000</u>
Commission revenue <i>earned</i>	\$12 000

Commission revenue earned \$ 12 000

b

General Journal

Date	Details	Debit \$	Credit \$
<i>Apr. 30</i>	<i>Accrued Commission revenue</i>	<i>4 000</i>	
	<i>Commission revenue</i>		<i>4 000</i>
	<i>Commission revenue for April 2025 earned but not yet received (Memo 54)</i>		

c

Explanation *Commission revenue would be understated by \$700 because it would not include the revenue earned but not yet received so Net profit would also be understated*

d

General Journal

Date	Details	Debit \$	Credit \$
<i>May 3</i>	<i>Bank</i>	<i>6 600</i>	
	<i>Accrued Commission revenue</i>		<i>4 000</i>
	<i>Commission revenue</i>		<i>2 000</i>
	<i>GST Clearing</i>		<i>600</i>
	<i>Received Commission revenue for April and May 2025 (Receipt 31)</i>		

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e

	Increase/Decrease/No effect	Amount \$
Assets	<i>Increase</i> (Increase Bank \$6 600, decrease Accrued Comm. Rev. \$4 000)	2 600
Liabilities	<i>Increase</i> (GST Clearing)	600
Owner's Equity	<i>Increase</i> (Commission Revenue increases Net Profit)	2 000

f

General Ledger
Commission revenue (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Apr. 30</i>	<i>Profit and Loss Summary</i>	<i>12 000</i>	<i>Apr. 30</i>	<i>Bank</i>	<i>8 000</i>
				<i>Accrued Commission revenue</i>	<i>4 000</i>
		12 000			12 000
			<i>May 3</i>	<i>Bank</i>	<i>2 000</i>

Accrued Commission revenue (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
<i>Apr. 30</i>	<i>Commission Revenue</i>	<i>4 000</i>	<i>Apr. 30</i>	<i>Balance</i>	<i>4 000</i>
		4 000			4 000
<i>May 1</i>	<i>Balance</i>	<i>4 000</i>	<i>May 3</i>	<i>Bank</i>	<i>4 000</i>

Exercise 16.8 Accrued revenue

a/b

General Journal

Date	Details	Debit \$	Credit \$
<i>Dec. 31</i>	<i>Accrued Interest revenue</i>	<i>100</i>	
	<i>Interest revenue</i>		<i>100</i>
<i>May 3</i>	<i>Bank</i>	<i>5 150</i>	
	<i>Term deposit</i>		<i>5 000</i>
	<i>Accrued Interest revenue</i>		<i>100</i>
	<i>Interest revenue</i>		<i>50</i>
	<i>Received cash on maturity of Term Deposit plus</i>		
	<i>interest (EFT trans. 619)</i>		

c

Discussion	<i>The interest of \$150 would be reported as an Operating inflow as it is a cash inflow as a result of day-to-day trading activities.</i>
	<i>The cash received from the Term Deposit not fit neatly into any classification: it is not Operating as it is not a day-to-day trading activity;</i>
	<i>it is not Financing as it is not changing the firm's financial structure; and</i>
	<i>it is not Investing as it is not a non-current asset (as it was for 6 months).</i>
	<i>Given that it was taken out as an investment (to generate interest revenue), it could be reported as an Investing inflow and this seems useful for decision-making.</i>
	<i>However, It could also be included as part of the cash balance on hand.</i>

Exercise 16.9 Reporting for unearned and accrued revenues

a

Explanation	To ensure that <i>profit is calculated accurately</i> under the Accrual basis
	by matching/comparing <i>revenues earned against expenses incurred</i>
	<i>in the current Period</i>

b

General Journal

Date	Details	Debit \$	Credit \$
Dec. 31	Accrued Interest Revenue	15	
	Interest Revenue		15
Dec. 31	Bank	1 620	
	Unearned Sales	1 680	
	Sales		3 000
	GST Clearing		300
	Cost of Sales	2 000	
	Stock Control		2 000

c RAWSON RUGS

Post-adjustment Trial Balance as at 31 December 2025

Account	Debit \$	Credit \$
Accounts Payable		31 070
Accounts Receivable	29 600	
Accumulated Depreciation of Premises		19 500
Advertising	340	
Allowance for doubtful debts		500
Bank (2 100 + 1 620)	3 720	
Capital – Parker		51 040
Cartage in	990	
Cost of Sales (20 420 + 2 000)	22 620	
Depreciation of Premises	3 900	
Discount expense	690	
Drawings	8 610	
GST Clearing (390 + 300)		690
Interest expense	400	
Inventory (38 750 – 2 000)	36 750	
Inventory gain		130
Inventory write-down	240	
Mortgage – Bank of Erica (Repayable \$12 000 p.a.)		100 000
Premises	130 000	
Prepaid Advertising	1 360	
Profit on disposal of vehicle		650
Sales (43 000 + 3 000)		46 000
Sales returns	860	
Term Deposit (Matures 15 April 2030)	3 600	
Unearned Sales		nil
Wages	5 900	
Accrued Interest revenue	15	
Interest revenue		15
Total	249 595	249 595

d RAWSON RUGS

Income Statement for 2025

	\$	\$
Revenue		
Sales	46 000	
less Sales returns	860	45 140
less Cost of Goods Sold		
Cost of sales	22 620	
Cartage in	990	23 610
Gross Profit		21 530
add Inventory gain	130	
less Inventory write-down	240	110
Adjusted Gross Profit		21 420
add Other Revenue		
Profit on disposal of vehicle	650	
Interest revenue	15	665
		22 085
less Other Expenses		
Advertising	340	
Depreciation of Premises	3 900	
Discount expense	690	
Interest expense	400	
Wages	5 900	11 230
Net Profit (Loss)		10 855

e

Item 1	<i>Sales returns / Cost of sales / Gross, Adjusted Gross, Net Profit</i>
Item 2	<i>Inventory gain (reduce by Inventory loss – not Inventory write-down)</i>

f RAWSON RUGS

Balance Sheet as at 31 December 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Bank</i>	3 720		<i>Accounts Payable</i>	31 070	
<i>Accounts Receivable</i>	29 600		<i>GST Clearing</i>	690	
<i>Prepaid Advertising</i>	1 360		<i>Mortgage – Bank of Erica</i>	12 000	43 760
<i>Inventory</i>	36 750				
<i>Accrued Interest revenue</i>	15	71 445	Non-Current Liabilities		
			<i>Mortgage – Bank of Erica</i>		88 000
Non-Current Assets					
<i>Premises</i>	130 000		Owner's equity		
<i>– Accumulated Depreciation</i>	19 500	110 500	<i>Capital – Parker</i>	51 540	
<i>Term Deposit</i>		3 600	<i>add Net Profit</i>	10 855	
		114 100		62 305	
			<i>less Drawings</i>	8 610	53 695
Total Assets		185 545	Total Equities		185 455

Exercise 16.10 Revenues, records and reports

a

Reason 1	<i>Technical obsolescence / Lack of demand</i>
Reason 2	<i>Deliberate strategy to sell below cost</i>

b/e

General Journal

Date	Details	Debit \$	Credit \$
June 30	<i>Disposal of Vehicle</i>	20 000	
	Vehicle		20 000
	<i>Accumulated Depreciation of Vehicle</i>	16 500	
	<i>Disposal of Vehicle</i>		16 500
	Vehicle	3 100	
	<i>Disposal of Vehicle</i>		3 100
	<i>Loss on Disposal of Vehicle</i>	400	
	<i>Disposal of Vehicle</i>		400
	Vehicle	19 900	
	<i>GST Clearing</i>	2 300	
	Bank		22 200
June 30	<i>Unearned Sales Revenue</i>	500	
	<i>Accounts Receivable</i>	3 900	
	Sales		4 000
	<i>GST Clearing</i>		400
	<i>Cost of Sales</i>	2 500	
	<i>Stock Control</i>		2 500
June 30	<i>Accrued Interest Revenue</i>	350	
	<i>Interest Revenue</i>		350
June 30	<i>Discount Revenue</i>	410	
	Sales	164 000	
	<i>Interest Revenue</i>	350	
	Sales returns		3 000
	<i>Profit and Loss Summary</i>		161 760

Chapter 16 *Balance Day Adjustments: Revenues* – Solutions to exercises

c

Reason 1	<i>Under-depreciation due to overstated useful life/residual value</i>
Reason 2	<i>Lack of demand due to damage or superseded by new model</i>

d

Qualitative characteristic	<i>Relevance</i>
Explanation	<i>Resetting revenue and expense accounts to zero</i>
	<i>in readiness for the next Period</i>
	<i>ensures that the Income Statement includes only information that is</i>
	<i>useful for decision-making about the current Period.</i>

f MM'S MUSIC

Balance Sheet (extract) as at 30 June 2025

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Bank</i>			<i>Accounts Payable</i>		44 900
<i>Accounts Receivable</i>	16 200		<i>Accrued Wages</i>		1 900
<i>less Allowance for doubtful debts</i>	1 650	14 550	<i>Bank</i>		1 800
<i>Accrued Interest revenue</i>		350	<i>Loan – QuickFin</i>		7 200
<i>GST Clearing</i>		1 270	<i>Unearned Sales</i>		15 500
<i>Inventory</i>		80 960			
<i>Prepaid Advertising</i>		10 400			
Total Current Assets		107 530	Total Current Liabilities		71 300

g

Explanation	<i>As a current asset,</i>
	<i>as it is a resource controlled by the entity</i>
	<i>that has the potential to produce economic benefits</i>
	<i>sometime in the next 12 months when the GST refund is received</i>

Exercise 17.1 Budgeted Cash Flow Statement

a

Calculation

<i>GST on:</i>	<i>Inventory</i>	400	
	<i>Advertising</i>	210	
	<i>Rent</i>	840	
	<i>Shop fittings</i>	<u>350</u>	1 800

Budgeted GST paid \$ 1 800

b TOP HATS

Budgeted Cash Flow Statement for July 2026

	\$	\$
OPERATING ACTIVITIES		
<i>Cash sales</i>	12 000	
<i>Receipts from Accounts Receivable</i>	3 300	
<i>GST Received</i>	1 200	16 500
<i>GST Paid</i>	(1 800)	
<i>Cash Purchase of Inventory</i>	(4 000)	
<i>Advertising</i>	(2 100)	
<i>Wages</i>	(3 600)	
<i>Interest Expense</i>	(230)	
<i>Prepaid Rent Expense</i>	(8 400)	20 130
<i>Net Cash Flows from Operations</i>		(3 630)
INVESTING ACTIVITIES		
<i>Shop Fittings</i>		3 500
<i>Net Cash Flows from Investing Activities</i>		(3 500)
FINANCING ACTIVITIES		
<i>Loan Repayment</i>	(1 600)	
<i>Drawings</i>	(1 200)	2 800
<i>Net Cash Flows from Financing Activities</i>		(2 800)
Net Increase (Decrease) in Cash		(9 930)
Bank Balance at Start		2 700
Bank Balance at End		(7 230)

c

Action 1	Reduce outflows such as drawings / reduce or defer the loan repayment /
	pay only 6 months' rent in advance / defer the purchase of the shop fittings
Action 2	Increase inflows: capital contribution / use a loan to purchase the fittings /
	organise a bank overdraft / offer discounts to Accounts Receivable

d TOP HATS

Budgeted Cash Flow Statement (extract) for July 2026

	Cash sales: \$15 000		Credit sales: \$10 000	
	\$	\$	\$	\$
OPERATING ACTIVITIES				
<i>Cash Sales</i>	15 000		12 000	
<i>Receipts from Accounts Receivable</i>	3 300		6 600	
<i>GST Received</i>	1 500	19 800	1 200	19 800
<i>GST Paid</i>	(1 800)		(1 800)	
<i>Cash Purchase of Inventory</i>	(4 000)		(4 000)	
<i>Advertising</i>	(2 100)		(2 100)	
<i>Wages</i>	(3 600)		(3 600)	
<i>Interest Expense</i>	(230)		(230)	
<i>Prepaid Rent Expense</i>	(8 400)	20 130	(8 400)	20 130
Net Cash Flows from Operations		(330)		(330)

e

Explanation	<i>They should aim to increase Cash sales as a smaller increase (\$3 000)</i>
	<i>brings the same cash inflows as a larger increase in Credit sales (\$5 000)</i>
	<i>because not all of the Accounts Receivable will pay in the month of sale.</i>

Exercise 17.2 Cash budget: consecutive periods

a January 2026

Calculation		
GST on: Advertising	130	
Prepaid Rent	<u>900</u>	
Budgeted GST paid		\$ 1 030

February 2026

Calculation		
GST on: Advertising	130	
Vehicle	<u>2 100</u>	
Budgeted GST paid		\$ 2 230

March 2026

Calculation		
GST on: Advertising	130	
Budgeted GST paid		\$ 130

b See next page

c

Action 1	<i>Defer the purchase of the vehicle until March 2026</i>
	<i>Bring the capital contribution forward to February 2026</i>
Action 2	<i>Use a loan to purchase the vehicle</i>
	<i>Organise a bank overdraft (with a limit of at least \$15 160!)</i>

d

Explanation	<i>Monthly trends can be identified allowing the owner to plan</i>
	<i>the best time to undertake a cash activity (such as the purchase of an NCA).</i>
	<i>or Allows for the earlier detection of problems, so that</i>
	<i>corrective action can be taken in a more timely fashion.</i>

b LOCKHARDT LOCKS

Budgeted Cash Flow Statement for January – March 2026

	January	February	March
OPERATING ACTIVITIES			
<i>Cash Sales</i>	26 000	27 000	25 000
<i>GST Received</i>	2 600	2 700	2 500
<i>Total Operating Inflows</i>	28 600	29 700	27 500
<i>GST Paid</i>	(1 030)	(2 230)	(130)
<i>Payments to Accounts Payable</i>	(13 200)	(14 300)	(14 850)
<i>Wages</i>	(4 000)	(4 000)	(4 000)
<i>Advertising</i>	(1 300)	(1 300)	(1 300)
<i>Interest Expense</i>	(150)	(150)	(150)
<i>Prepaid Rent Expense</i>	(9 000)		
<i>GST Settlement</i>	(1 600)		
<i>Total Operating Outflows</i>	(30 280)	(21 980)	(20 430)
Net Cash Flows from Operations	(1 680)	7 720	7 070
INVESTING ACTIVITIES			
<i>Cash Sale of Vehicle</i>	1 900		
<i>Vehicle</i>		(21 000)	
Net Cash Flows from Investing Activities	1 900	(21 000)	nil
FINANCING ACTIVITIES			
<i>Capital Contribution</i>			15 000
<i>Drawings</i>	(2 000)	(2 000)	(2 000)
<i>Loan Repayment</i>	(1 500)		
Net Cash Flows from Financing Activities	(3 500)	(2 000)	13 000
Net Increase (Decrease) in Cash	(3 280)	(15 280)	20 070
Bank Balance at Start	3 400	120	(15 160)
Bank Balance at End	120	(15 160)	4 910

Exercise 17.3 Schedule of Receipts from Accounts Receivable

a

Reason	<i>Start of summer sports (such as cricket, tennis)</i>
	<i>Christmas / Increased advertising / More established customer base</i>

b

Month	Credit sales (incl. GST)	October 2026	November 2026	December 2026
August	8 800	2 640		
September	9 900	6 930	2 970	
October	11 000		7 700	3 300
November	12 100			8 470
December	13 200			
Budgeted Receipts from Accounts Receivable		\$9 570	\$10 670	\$11 770

c

Explanation	<i>Credit sales (\$12 000) is budgeted to be higher than</i>
	<i>Receipts from Accounts Receivable (\$11 770),</i>
	<i>meaning revenues and budgeted Net Profit will increase.</i>
	<i>by more than cash inflows and budgeted Net Cash Flows from Operations</i>

d

Explanation	<i>The owner can prepare in advance for a budgeted increase / decrease in cash.</i>
	<i>A budgeted decrease: organise an overdraft, other finance / defer payments</i>
	<i>A budgeted increase: repay loans, purchase assets, increase drawings</i>

Exercise 17.4 Schedule of Receipts from Accounts Receivable

a

Month	Credit sales (incl. GST)	April 2026	May 2026	June 2026
<i>February</i>	44 000	8 800		
<i>March</i>	49 500	14 850	9 900	
<i>April</i>	38 500	19 250	11 550	7 700
<i>May</i>	33 000		16 500	9 900
<i>June</i>	22 000			11 000
Budgeted Receipts from Accounts Receivable		42 900	37 950	28 600

b **JAZZY JACKETS**

Budgeted Cash Flow Statement (extract) for April – June 2026

	April	May	June
OPERATING ACTIVITIES			
<i>Cash Sales</i>	27 000	32 000	26 000
<i>GST Received</i>	2 700	3 200	2 600
<i>Receipts from Accounts Receivable</i>	42 900	37 950	28 600
Total Operating Inflows	72 600	73 150	57 200

c

Explanation	<i>Sets a benchmark to compare actual performance against,</i>
	<i>to identify / highlight problems</i>
	<i>so corrective action can be taken.</i>

Exercise 17.5 Schedules and the Budgeted Cash Flow Statement

a

Month	Credit sales (incl. GST)	January 2026	February 2026	March 2026
<i>January</i>	22 000	8 360	7 700	4 400
<i>February</i>	27 500		10 450	9 625
<i>March</i>	30 800			11 704
Budgeted Receipts from Accounts Receivable		8 360	18 150	25 729

b

Month	Credit purchases (incl. GST)	January 2026	February 2026	March 2026
<i>January</i>	13 200	6 600	6 600	
<i>February</i>	14 300		7 150	7 150
<i>March</i>	15 400			7 700
Budgeted Payments to Accounts Payable		6 600	13 750	14 850

c **BETTY'S BAGS**

Budgeted Cash Flow Statement (extract) for January – March 2026

	January	February	March
OPERATING ACTIVITIES			
<i>Cash Sales</i>	30 000	34 000	36 000
<i>GST Received</i>	3 000	3 400	3 600
<i>Receipts from Accounts Receivable</i>	8 360	18 150	25 729
<i>Total Operating Inflows</i>	41 360	55 550	65 329
<i>Payments to Accounts Payable</i>	(6 600)	(13 750)	(14 850)
<i>Advertising</i>	(2 500)	(2 500)	(2 500)
<i>GST Paid</i>	(250)	(250)	(250)
<i>Wages</i>	(1 800)	(1 800)	(1 800)
<i>Total Operating Outflows</i>	(11 150)	(18 300)	(19 400)
Net Cash Flows from Operations	30 210	37 250	45 929

d

Explanation	<i>Excluded as it is does not involve a cash flow:</i>
	<i>it is a non-cash expense</i>
	<i>involving the allocation of the cost of a non-current asset over its useful life</i>

e

Explanation	<i>As a Financing Outflow,</i>
	<i>as it is a cash outflow related to a change in the firm's financial structure</i>

f BETTY'S BAGS

Budgeted Cash Flow Statement (extract) for July 2026

	Wages: 10% of Sales		Wages: 20% of Sales	
	\$	\$	\$	\$
OPERATING ACTIVITIES				
<i>Cash Sales</i>	36 000		36 000	
<i>GST Received</i>	3 600		3 600	
<i>Receipts from Accounts Receivable</i>	25 729	65 329	25 729	65 329
<i>Payments to Accounts Payable</i>	(14 850)		(14 850)	
<i>Advertising</i>	(2 500)		(2 500)	
<i>GST Paid</i>	(250)		(250)	
<i>Wages</i>	(3 600)	(21 200)	(7 200)	(24 800)
Net Cash Flows from Operations		44 129		40 529

g

Explanation	<i>Betty's Bags can afford an increase in staff.</i>
	<i>Even with an increase to 20% of sales (which is 4 times as much as budgeted)</i>
	<i>there is still likely to be an Operating Cash surplus,</i>

Exercise 17.6 Budgeted reports

a DAN'S DETERGENTS

Budgeted Cash Flow Statement for May 2026

	\$	\$
OPERATING ACTIVITIES		
Cash Sales	15 000	
GST Received	1 500	
Receipts from Accounts Receivable (13 200 – 3 500)	9 700	26 200
Payments to Accounts Payable (40 000 + GST – 12 000)	(32 000)	
Prepaid Advertising	(1 200)	
GST Paid (120 + 100 + 600)	(820)	
Wages	(2 000)	
Rent expense	(1 000)	(37 020)
Net Cash Flows from Operations		(10 820)
INVESTING ACTIVITIES		
Shelving		(6 000)
Net Cash Flows from Investing Activities		(6 000)
FINANCING ACTIVITIES		
Capital	20 000	
Loan – ZNA	35 000	55 000
Drawings		(1 900)
Net Cash Flows from Financing Activities		53 100
Net Increase (Decrease) in Cash Position		36 280
Bank Balance at Start		nil
Bank Balance at End		36 280

b DAN'S DETERGENTS

Budgeted Income Statement for May 2026

	\$	\$
Revenue		
Cash Sales	15 000	
Credit Sales	12 000	27 000
less Cost of Goods Sold		
Cost of Sales		18 000
Gross Profit		9 000
less Inventory Loss		500
Adjusted Gross Profit		8 500
less Other Expenses		
Advertising	200	
Wages	2 000	
Depreciation of Shelving	50	
Rent expense	1 000	3 250
Net Profit		5 250

c

Reason 1	<i>Capital contribution / Loan – ZNA are both cash inflows which increase cash but are not revenues and so have no effect on Net Profit.</i>
Reason 2	<i>Depreciation / Inventory loss are both expenses which decrease Net Profit but are not cash flows and so do not affect the Net Increase in Cash Position</i>

Also:

Credit sales (\$12 000) is greater than Receipts from Accounts Receivable (\$9 700) increasing profit more than cash.

d

General Ledger

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May	Accounts Payable	40 000	May	Cost of Sales	18 000
				Inventory Loss	500
				Drawings	300
			May 31	Balance	21 200
		40 000			40 000
June 1	Balance	21 200			

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
May	Bank	600	May	Bank	1 500
	Accounts Payable	4 000		Accounts Receivable	1 200
	Bank	120	May 31	Balance	2 120
	Bank	100			
		4 820			4 820
June 1	Balance	2 120			

e DAN'S DETERGENTS

Budgeted Balance Sheet as at 31 May 2026

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Bank</i>	36 280		<i>Accounts Payable</i>	12 000	
<i>Inventory</i>	21 200		<i>Loan – ZNA</i>	6 000	18 000
<i>Accounts Receivable</i>	3 500				
<i>Prepaid Advertising</i>	1 000		Non-Current Liabilities		
<i>GST Clearing</i>	2 120	64 100	<i>Loan – ZNA</i>		29 000
Non-Current Assets			Owner's Equity		
<i>Shelving</i>	6 000		<i>Capital – Dan</i>	20 000	
<i>less Accumulated depreciation</i>	50	5 950	<i>add Net Profit</i>	5 250	
				25 250	
			<i>less Drawings</i>	2 200	23 050
Total Assets		70 050	Total Equities		70 050

f Dana's Detergents

Budgeted Income Statement for May 2026

	Sales: 100% mark-up		Sales: 150% mark-up	
	\$	\$	\$	\$
Revenue				
Cash Sales	15 000		15 000	
Credit Sales	12 000	27 000	12 000	27 000
less Cost of Goods Sold				
Cost of Sales		13 500		10 800
Gross Profit		13 500		17 800
less Inventory Loss		500		500
Adjusted Gross Profit		13 000		17 300
less Other Expenses				
Advertising	200		200	
Wages	2 000		2 000	
Depreciation of Shelving	50		50	
Rent expense	1 000	3 250	1 000	3 250
Net Profit		9 750		14 050

g

Explanation	<i>It assumes that customers will pay more for the same products</i>
	<i>or that cheaper products will be able to be sourced to maintain the same sales volume</i>
	<i>(and that Wages and advertising will not need to change).</i>

Exercise 17.7 Budgeted reports

a

Calculation

$$\text{June } \$18\,700 \times 40\% = \$7\,480$$

$$\text{July } \$19\,800 \times 60\% = 11\,880$$

Budgeted Receipts from Accounts Receivable	\$ 19 360
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b

Calculation

$$\text{June } \$9\,900 \times 95\% = \$9\,405$$

Budgeted Payments to Accounts Payable	\$ 9 405
--	-----------------

c JACUZZI JOINT

Budgeted Cash Flow Statement for July 2026

	\$	\$
OPERATING ACTIVITIES		
Cash Sales	22 000	
GST Received	2 200	
Receipts from Accounts Receivable	19 360	43 560
Payments to Accounts Payable	(9 405)	
Wages	(7 500)	
Electricity	(200)	
GST Paid (20 + 1 200)	(1 220)	
Accrued Interest Expense	(300)	
Interest Expense	(150)	(18 775)
Net Cash Flows from Operations		24 785
INVESTING ACTIVITIES		
Office equipment		(12 000)
Net Cash Flows from Investing Activities		(12 000)
FINANCING ACTIVITIES		
Capital		10 000
Drawings		(3 100)
Net Cash Flows from Financing Activities		6 900
Net Increase (Decrease) in Cash		19 685
Bank Balance at Start		4 000
Bank Balance at End		23 685

b

Calculation

$$\begin{aligned}
 D. \text{ debts} &= \text{Estimated rate} \times \text{Net credit sales} \\
 &= 4\% \times \$18\,000 \\
 &= \$720 \\
 \text{less Existing balance} &= \$720 - \$500
 \end{aligned}$$

Budgeted Bad debts expense \$ **220**

Chapter 17 Budgets – Solutions to exercises

e JACUZZI JOINT

Budgeted Income Statement for July 2026

	\$	\$
Revenue		
Cash Sales	22 000	
Credit Sales	18 000	40 000
less Cost of Goods Sold		
Cost of Sales		20 000
Gross Profit		20 000
less Inventory Loss		300
Adjusted Gross Profit		19 700
add Other Revenue		
Discount Revenue		495
		20 195
less Other Expenses		
Rent Expense	1 500	
Wages	8 300	
Depreciation of Office Equipment	300	
Electricity	200	
Interest Expense	150	
Bad debts	220	10 670
Net Profit		9 525

f

Reason 1	<i>Receipts from Accounts Receivable (\$19 360) is will increase cash</i>
	more than Credit Sales (\$18 000) revenue will increase Net Profit.
	Cost of Sales (\$20 000) is an expense, which will decrease Net Profit
	more than cash P'ments to Accounts Payable (\$9 405) will decrease cash.
Reason 2	Others:
	GST received > GST paid
	Expenses not cash flows: Dep / Bad debts / Inventory loss
	Wages / Rent expense > paid, Rent ex

g

General Ledger

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	28 000	July 31	Cost of Sales	20 000
31	Accounts Payable	11 000		Inventory Loss	300
				Balance	18 700
		39 000			39 000
Aug. 1	Balance	18 700			

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July	Bank	20	July 1	Balance	950
	Accounts Payable	1 100	31	Bank	2 200
	Bank	1 200		Accounts Receivable	1 800
	Balance	2 630			
		4 950			4 950
			Aug. 1	Balance	2 630

h JACUZZI JOINT

Budgeted Balance Sheet as at 31 July 2026

	\$	\$		\$	\$
Current Assets			Current Liabilities		
<i>Bank</i>		23 685	<i>GST Clearing</i>	2 630	
<i>Inventory</i>		18 700	<i>Accounts Payable</i>	12 100	
<i>Accounts Receivable</i>	7 920		<i>Accrued Wages</i>	800	15 530
<i>less Allowance for doubtful debts</i>	(720)	7 200			
<i>Prepaid Rent expense</i>		4 500	Non-Current Liabilities		
		54 085	<i>Loan – APS Finance</i>		30 000
Non-Current Assets					
<i>Office equipment</i>	36 000		Owner's Equity		
<i>less Accumulated Depreciation</i>	7 500	28 500	<i>Capital – Jacqui</i>	53 630	
<i>Vehicle</i>		23 000	<i>add Net Profit</i>	9 525	
		51 500		63 155	
			<i>less Drawings</i>	3 100	60 055
Total Assets		105 585	Total Equities		105 585

Exercise 17.8 Account reconstruction

a

Item	Budgeted Report
Accounts Receivable balance – 1 July 2025	<i>Only in Balance Sheet (30 June 2025)</i>
Accounts Receivable balance – 30 June 2026	<i>Budgeted Balance Sheet (30 June 2026)</i>
Credit Sales	<i>Budgeted Income Statement (2026)</i>
Discount Expense	<i>Budgeted Income Statement (2026)</i>

b

General Ledger Accounts Receivable

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	50 000		Bank /	115 500
	Sales/GST Clearing	110 000		Discount Expense	4 500
			June 30	Balance	40 000
		160 000			160 000
1/7/16	Balance	40 000			

Budgeted receipts from Accounts Receivable	\$ 115 500
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c

Explanation	<i>Budgeted Sales is a key revenue (in the Budgeted Income Statement) and cash inflow (in the Budgeted Cash Flow Statement).</i>
	<i>It also determines a number of other items which vary directly with the level of sales such as Wages, purchases of inventory.</i>

Exercise 17.9 Account reconstruction

a

General Ledger Accounts Receivable

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 1	Balance	35 000		Bank /	46 400
	Sales / GST Clearing	66 000		Discount Expense	2 300
				Sales Returns / GST Clearing	3 300
				Bad Debts	4 000
			Dec. 31	Balance	45 000
		101 000			101 000
Jan. 1	Balance	45 000			

Budgeted receipts from Accounts Receivable	\$ 46 400
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b **BULLY HIDES**

Budgeted Cash Flow Statement (extract) for 2026

	\$	\$
OPERATING ACTIVITIES		
Cash Sales	70 000	
GST Received	7 000	
Receipts from Accounts Receivable	46 400	123 400

c

General Ledger Accounts Payable

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Dec. 31	Bank /	50 500	Jan. 1	Balance	13 000
	Discount Revenue	1 500		Inventory / GST Clearing	49 500
Dec. 31	Balance	10 500			
		62 500			62 500
			Jan. 1	Balance	10 500

Budgeted payments to Accounts Payable	\$ 50 500
--	------------------

Exercise 17.10 Account reconstruction

a

General Ledger

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	31 000		Cost of Sales	35 000
	Bank	10 000		Drawings	3 000
	Accounts Payable	18 400	June 30	Balance	26 000
	Cost of Sales	600			
	Inventory Gain	4 000			
		64 000			64 000
July 1	Balance	26 000			

Budgeted credit purchases	\$ 19 240
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b

General Ledger

Accounts Payable

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
	Bank /	19 240	July 1	Balance	16 000
	Discount Revenue	2 000		Inventory / GST Clearing	20 240
June 30	Balance	15 000			
		36 240			36 240
			July 1	Balance	15 000

Budgeted payments to Accounts Payable	\$ 19 240
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Exercise 17.11 Cash Flow Statement Variance Report

a

Explanation *It aids decision-making by allowing for a comparison between the budget benchmark and actual cash performance so that problems can be identified and corrective action taken.*

OR *It aids planning by providing a basis for the formulation of the next Budgeted Cash Flow Statement.*

b **SIMPLY STUNNING**

Cash Flow Variance Report for the year ended 30 June 2026

	Budgeted	Actual	Variance	Fav./Unfav.
OPERATING ACTIVITIES				
Receipts from Accounts Receivable	99 200	89 200	10 000	U
Cash Sales	85 000	94 000	9 000	F
GST Received	8 500	9 400	900	F
Payments to Accounts Payable	(115 000)	(136 000)	21 000	U
Prepaid Rent Expense	(12 000)	(15 000)	3 000	U
GST Paid	(1 440)	(1 590)	150	U
Wages	(30 000)	(26 000)	4 000	F
Advertising	(2 400)	(900)	1 500	F
Interest Expense	(2 700)	(3 100)	400	U
GST Settlement	(3 700)	(4 600)	900	U
Net Cash Flows from Operations	25 460	5 410	20 050	U
INVESTING ACTIVITIES				
Cash Sale of Equipment	5 000	3 000	2 000	U
Shelving	–	(12 000)	12 000	U
Net Cash Flows from Investing Activities	5 000	(9 000)	14 000	U
FINANCING ACTIVITIES				
Capital Contribution	–	20 000	20 000	F
Loan	(5 000)	–	5 000	F
Drawings	(36 000)	(40 000)	4 000	U
Net Cash Flows from Financing Activities	(41 000)	(20 000)	21 000	F
Net Increase (Decrease) In Cash Position	(10 540)	(23 590)	13 050	U
Bank Balance at Start	8 500	8 500	–	–
Bank Balance at End	(2 040)	(15 090)	13 050	U

c

Favourable / Unfavourable	<i>Unfavourable</i>
Justification	<i>Actual payments to Accounts Payable is greater than budgeted, meaning the cash balance will decrease by more than expected.</i>

d

Reason	<i>Because the business had exceeded its overdraft limit To fund the unexpected purchase of the shelving</i>
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e

Explanation	<i>The cash balance will be \$14 000 lower than expected, because the equipment was sold for \$2 000 less than budgeted, and the purchase of the shelving for \$12 000 was not expected at all.</i>
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e

Assessment	<i>Operating Cash Flows is much worse than expected. Despite higher than expected cash sales, receipts from Accounts Receivable was lower than budgeted which may indicate problems with collection procedures. Much higher payments to Accounts Payable and for rent (perhaps due to a new lease?) more than offset lower spending on Advertising and Wages. The firm didn't realise as much from the sale of its equipment and had to make an unexpected payment for new shelving which caused a \$14 000 variance in Investing activities. Financing activities was \$19 000 higher than expected but this was because the owner had to make a capital contribution and the business still exceeded its overdraft limit by more than \$9 000.</i>
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g

Asset 1	<i>Bank</i>
Justification	<i>The sum of the variances means Bank will be \$11 050 lower than budgeted.</i>
Asset 2	<i>Accounts Receivable / Prepaid Rent Expense / Shelving</i>
Justification	<i>Less Receipts from Accounts Receivable</i>

Exercise 17.12 Cash Flow Statement Variance Report

a

Calculation

Budgeted rent paid	\$12 000
– Prepaid rent at start	300 (Paid last period)
+ Prepaid rent at end	500 (Paid this period)
	<u>500</u>
	\$12 200

Actual rent paid \$ 12 200

b **BRIGHT LIGHTS**

Cash Variance Report (extract) for the year ended 30 June 2026

	Budgeted	Actual	Variance	Fav./Unfav
Operating Activities				
Receipts from Accounts Receivable	100 000	105 000	5 000	F
Payments to Accounts Payable	(45 000)	(40 000)	5 000	F
Interest expense	(500)	(800)	300	U
GST Paid	(6 000)	(4 500)	1 500	F
Prepaid Rent expense	(12 000)	(12 200)	200	U
Investing Activities				
Sale of Shelving	4 000	5 000	1 000	U
Van	(17 000)	(23 000)	6 000	U
Financing Activities				
Loan	7 500	10 000	2 500	F
Drawings	(25 000)	(15 000)	10 000	F

c

Explanation The *actual* amount *received* for the loan was \$2 500 *higher than expected*, meaning the *cash balance will be higher than budgeted*.

Chapter 17 *Budgets* – Solutions to exercises

d

Reason	<i>Decreased bad debts written off</i>
	<i>Faster paying Accounts Receivable / better debtor management</i>

e

Explanation	<i>The higher than expected loan</i>
	<i>could mean higher interest charges, and thus a lower budgeted Net Profit.</i>

Exercise 17.13 Income Statement Variance Report

a

Explanation	<i>It is a means of checking the performance of the business,</i>
	<i>and the accuracy of the budgets,</i>
	<i>before decisions are made and budgets are prepared for the next period.</i>

b TOOT AND TWANG

Income Statement Variance Report (extract) for the year ended 30 June 2026

	Budgeted	Actual	Variance	Fav./Unfav.
Revenue				
Sales	120 000	110 000	10 000	U
less Cost of Goods Sold				
Cost of sales	70 000	55 000	15 000	F
Gross Profit	50 000	55 000	5 000	F
add/less Inventory gain (loss)	1 500	(4 200)	5 700	U
Adjusted Gross Profit	51 500	50 800	700	U
add Other Revenue				
Profit on Disposal of Vehicle	1 500	6 500	5 000	F
	53 000	57 300	4 300	F
less Other Expenses				
Wages	18 000	19 000	1 000	U
Rent	12 000	14 000	2 000	U
Depreciation of Vehicles	2 300	1 600	700	F
Interest expense	1 400	1 800	400	U
Net Profit (Loss)	19 300	20 900	1 600	F

c

Explanation	<i>Favourable as actual Cost of Sales is lower than budgeted,</i>
	<i>meaning Net Profit will be higher than budgeted.</i>

Chapter 17 *Budgets* – Solutions to exercises

d

Reason	<i>Sold a vehicle (which was not replaced) earlier than expected</i>
	<i>Changed depreciation methods</i>

e

Explanation	<i>The profit variance is only favourable due to the higher than expected</i>
	<i>profit on sale of vehicle which is unlikely to happen every period.</i>
	<i>Sales is lower than expected</i>
	<i>Inventory loss / Wages increased despite a fall in Sales</i>

Exercise 17.14 Income Statement Variance Report

a BLADES

Income Statement Variance Report (extract) for the year ended 30 June 2026

	Budgeted	Actual	Variance	Fav./Unfav.
Revenue				
Sales	105 000	90 000	15 000	U
less Sales Returns	8 500	4 000	4 500	F
Net Sales	96 500	86 000	10 500	U
less Cost of Goods Sold				
Cost of Sales	48 000	54 000	6 000	U
Cartage Inwards	3 000	1 000	2 000	F
Total Cost of Goods Sold	51 000	55 000	4 000	U
Gross Profit	45 500	31 000	14 500	U
less Inventory Loss	1 800	2 300	500	U
Adjusted Gross Profit	43 700	28 700	15 000	U
less Other Expenses				
Wages	28 000	33 000	5 000	U
Rent	15 000	18 000	3 000	U
Depreciation of Equipment	1 400	2 200	800	U
Interest Expense	1 100	800	300	F
Net Profit (Loss)	(1 800)	(25 300)	(23 500)	U

b

Reason 1	<i>Lower sales</i>
Reason 2	<i>Better quality / more suitable inventory</i>

c

Reason	<i>Lower interest rate /</i>
	<i>Repaid more of the loan principal than expected</i>

d

Explanation	<i>Unfavourable variance means less able to cover Other Expenses and provide for Net Profit.</i>

e

Assessment	<i>The profit performance is much worse than expected, due to both lower than expected Sales revenue and higher than expected expenses.</i>
	<i>Actual Sales is lower than budgeted indicating revenue earning has fallen expectation. At the same time, Cost of sales has actually increased.</i>
	<i>This could mean higher prices charged by suppliers were passed on to customers who chose to not buy.</i>
	<i>There is also an increase in Inventory loss which – particularly considering sales was lower than expected – could mean problems with handling techniques or security.</i>
	<i>The unfavourable variance in Wages is concerning given the lower than expected Sales and might indicate over-staffing (or a lack of utilisation given lower sales.</i>
	<i>Higher Rent indicates a new lease which has not been covered as well by Sales.</i>

Exercise 17.15 Account reconstruction and budgeted reports

a

Calculation	
Carrying value	\$400 (\$4 800 – \$4 400)
+ Profit on disposal	<u>300</u>
	\$700
Budgeted proceeds on sale of shop fittings	
	\$ 700

b

Calculation		<i>Accounts Receivable</i>	
<i>Balance</i>	17 600	<i>Bank/</i>	319 088
<i>Credit Sales/GST</i>	330 000	<i>Disc. Expense (2%)</i>	6 512
		<i>Balance</i>	22 000
	347 600		347 600
<i>Balance</i>			
Budgeted Receipts from Accounts Receivable			\$ 319 088

c

Calculation		<i>Accounts Payable</i>	
<i>Bank</i>	158 400	<i>Balance</i>	41 800
<i>Balance</i>	37 400	<i>Inventory/GST</i>	154 000
	195 800		195 800
		<i>Balance</i>	37 400
Budgeted Payments to Accounts Payable			\$ 158 400

d

Calculation	
GST on: Occ. expenses	4 700
Office expenses	3 900
Advertising	<u>180</u>
Budgeted GST paid	
	\$ 8 780

e BAYES SURFBOARDS

Budgeted Cash Flow Statement for 2026

	\$	\$
OPERATING ACTIVITIES		
<i>Receipts from Accounts Receivable</i>	319 088	
<i>GST Refund</i>	3 000	322 088
<i>Payments to Accounts Payable</i>	(158 400)	
<i>Occupancy Expenses</i>	(47 000)	
<i>Office Expenses</i>	(39 000)	
<i>Wages</i>	(35 000)	
<i>Accrued Wages</i>	(700)	
<i>GST Paid</i>	(8 780)	
<i>Prepaid Advertising</i>	(1 800)	(290 680)
Net Cash Flows from Operations		31 408
INVESTING ACTIVITIES		
<i>Cash Sale of Shop Fittings</i>		700
Net Cash Flows from Investing Activities		700
FINANCING ACTIVITIES		
<i>Loan – AX Bank</i>		10 000
<i>Drawings</i>		(12 000)
Net Cash Flows from Financing Activities		(2 000)
Net Increase (Decrease) in Cash		30 108
Bank Balance at Start		(5 000)
Bank Balance at End		25 108

f

Explanation	<i>Variance reports can be prepared more frequently, allowing problems to be identified earlier so that more timely corrective action can be taken.</i>
	<i>or More frequent budgets are likely to be more accurate,</i>
	<i>and thus more useful as a benchmark for comparison with actual figures.</i>

g General Ledger

Inventory

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 1	Balance	62 400		Cost of Sales	150 000
	Accounts Payable	140 000		Inventory Loss	2 500
			Dec. 31	Balance	49 900
		202 400			202 400
Jan. 1	Balance	49 900			

GST Clearing

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Jan. 1	Balance	3 000		Bank	3 000
	Accounts Payable	14 000		Accounts Receivable	30 000
	Bank	8 780			
Dec. 31	Balance	7 220			
		33 000			33 000
			Jan. 1	Balance	7 220

h BAYES SURFBOARDS

Budgeted Balance Sheet (extract) as at 31 December 2026

	\$		\$
Current Assets		Current Liabilities	
Bank	25 108	Accounts Payable	37 400
Accounts Receivable	22 000	GST Clearing	7 220
less Allowance for doubtful debts	(3 000)	Loan – AX Bank	10 000
Inventory	49 900	Accrued Interest Expense	600
Prepaid Advertising	1 350		
Total Current Assets	95 358	Total Current Liabilities	55 220

i

Explanation	<i>It details the expected carrying value of non-current assets</i>
	<i>so the owner can prepare for their replacement</i>
	<i>It can be used to plan for the repayment of loans / to set a level for Drawings</i>
	<i>(must be done in conjunction with the Budgeted Cash Flow Statement).</i>

Exercise 17.16 Account reconstruction and budgeted reports

a

Calculation

<i>Existing prepaid rent (2 months x \$500)</i>	\$1 000
+ <i>New contract (10 months x \$600)</i>	<u>6 000</u>
	\$7 000

Budgeted Photocopier rent expense \$ 7 000

b

Calculation

$$\begin{aligned} \text{Interest revenue} &= \$6\,000 \times 8\% \times \frac{3}{12} \\ &= \$120 \end{aligned}$$

Budgeted Interest revenue \$ 120

c

Calculation

$$\begin{aligned} \text{Doubtful debts} &= [\$180\,000 - (\$180\,000 \times 5\%)] \times 1\% \\ &= (\$180\,000 - \$9\,000) \times 1\% \\ &= \$1\,710 \end{aligned}$$

$$\begin{aligned} \text{Bad debts} &= \text{Doubtful debts} - \text{Allowance for doubtful debts} \\ &= \$1\,710 - 800 \end{aligned}$$

Budgeted Bad debts expense \$ 910

d DIGITAL MASTERS

Budgeted Income Statement for the year ended 30 June 2026

	\$	\$
Revenue		
<i>Cash sales</i>	42 000	
<i>Credit sales</i>	180 000	
	222 000	
<i>less Sales returns</i>	9 000	213 000
less Cost of Goods Sold		
<i>Cost of sales</i>		142 000
Gross Profit		71 000
<i>less Inventory loss</i>		2 220
Adjusted Gross Profit		68 780
add Other revenue		
<i>Interest revenue</i>		120
		70 220
less Other expenses		
<i>Bad debts expense</i>	910	
<i>Discount expense</i>	3 600	
<i>Wages</i>	29 000	
<i>Depreciation of Shop Fittings</i>	5 300	
<i>Photocopier rent</i>	7 000	45 810
Net Profit (Loss)		24 410

e

Explanation	<i>It allows the owner to assess the adequacy of the firm's expected mark-up,</i>
	<i>so that preparations can be made to . . .</i>
	<i>access a cheaper supplier / raise or lower selling prices.</i>

f DIGITAL MASTERS

Budgeted Balance Sheet (extract) as at 30 June 2026

Current Assets	\$	\$	\$
<i>Prepaid photocopier rent</i>		1 200	
<i>Accounts Receivable</i>	31 600		
<i>less Allowance for doubtful debts</i>	1 710	29 890	
<i>Inventory</i>		106 780	
<i>Accrued interest revenue</i>		120	137 990
Non-Current Assets			
<i>Shop fittings</i>	48 000		
<i>less Accumulated depreciation</i>	26 900	21 100	
<i>Term deposit</i>		6 000	27 100
Total Assets			165 090

g DIGITAL MASTERS

Budgeted Income Statement for the year ended 30 June 2026

	\$	\$
Revenue		
<i>Cash sales</i>	44 100	
<i>Credit sales</i>	189 000	
	233 100	
<i>less Sales returns</i>	9 450	223 650
less Cost of Goods Sold		
<i>Cost of sales</i>		149 100
Gross Profit		74 550
<i>less Inventory loss</i>		2 331
Adjusted Gross Profit		72 219
add Other revenue		
<i>Interest revenue</i>		120
		72 339
less Other expenses		
<i>Advertising</i>	3 000	
<i>Bad debts expense</i>	996	
<i>Discount expense</i>	3 780	
<i>Wages</i>	29 000	
<i>Depreciation of Shop Fittings</i>	5 300	
<i>Photocopier rent</i>	7 000	49 076
Net Profit (Loss)		23 263

Exercise 18.1 Profitability

a

Explanation	<i>Profitability measures a firm's ability to earn profit,</i>
	<i>not just its profit in dollar terms.</i>
	<i>Profitability expresses profit in relation to another measure (e.g. assets)</i>
	<i>to provide a common base for comparison between periods or between firms.</i>

b

Base 1	<i>Level of assets</i>
Base 2	<i>Owner's investment / Sales</i>

Exercise 18.2 Return on Owner's Investment

a

Calculation

$$\begin{aligned} \text{ROI} &= \frac{\text{Net Profit}}{\text{Average Owner's Equity}} \times 100 \\ &= \frac{\$15\,000}{\$150\,000} \times 100 \end{aligned}$$

Return on Owner's Investment – 2024	10	%
--	----	---

Calculation

$$\begin{aligned} \text{ROI} &= \frac{\text{Net Profit}}{\text{Average Owner's Equity}} \times 100 \\ &= \frac{\$14\,400}{\$120\,000} \times 100 \end{aligned}$$

Return on Owner's Investment – 2025	12	%
--	----	---

b

Explanation	Although Net Profit decreased (from \$15 000 to \$14 400, or 4%),
	Owner's Equity decreased by proportionately more
	(\$150 000 to \$120 000, or 20%),
	meaning the owner is earning a greater return on a smaller investment.

c

Reason 1	ROI has increased (from 10% to 12%).
Reason 2	ROI is higher than the return 8% on the alternative investment (property trust).

d

Reason	Net Profit has decreased (from \$15 000 to \$14 400):
	the only reason for the increase in ROI is the (larger) reduction in Owner's Equity.

Exercise 18.3 Return on Owner's Investment and Debt Ratio

a

Improved / Worsened	<i>Improved (Worsened)</i>
Justification	<i>ROI increased (ROA decreased)</i>

b

Calculation	
$\text{Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}} \times 100$	
$= \frac{\$180\,000}{\$400\,000} \times 100$	
Debt Ratio – 2024	45 %

Calculation	
$\text{Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}} \times 100$	
$= \frac{\$320\,000}{\$400\,000} \times 100$	
Debt Ratio – 2025	80 %

c

Explanation	<i>Higher Debt Ratio means a decrease in the firm's long-term stability</i>
	<i>because there is a greater reliance on borrowed funds,</i>
	<i>and thus a greater risk that the business will be unable to repay</i>
	<i>both its debts and any interest charges (especially if interest rates rise).</i>

d

Explanation	<i>The increase in the Debt Ratio has led to an increase in the Return on Owner's</i>
	<i>Investment and an increase in profitability from an investor's perspective</i>
	<i>as the business is using borrowed funds to finance its operations,</i>
	<i>but the owner still receives any profits.</i>

e

Discussion	<i>The owner may be pleased with the higher Return on Owner's Investment</i>
	<i>as it indicates that she is earning more profit per dollar she has invested.</i>
	<i>However, Net Profit has actually fallen, so</i>
	<i>the increase in the ROI is at the cost of a higher Debt Ratio and less stability,</i>
	<i>which means a greater risk that the business will be unable to meet its debts;</i>
	<i>and assets have remained the same, so Return on Assets has actually fallen,</i>
	<i>indicating less profitable use of assets – none of which is pleasing.</i>

Exercise 18.4 Return on Owner's Investment and Return on Assets

a

ROA measures	<i>profit generated per dollar of assets controlled by the business /</i>
	<i>how profitably the firm's assets have been used to earn profit</i>

b

Calculation	
$ROA = \frac{\text{Net Profit}}{\text{Average Total Assets}} \times 100$	
$= \frac{\$12\,000}{\$120\,000} \times 100$	
Return on Assets – Legends Guitars	10 %

Calculation	
$ROA = \frac{\text{Net Profit}}{\text{Average Total Assets}} \times 100$	
$= \frac{\$12\,000}{\$150\,000} \times 100$	
Return on Assets – Axeman’s Heaven	8 %

c

Explanation	<i>Axeman's Heaven has a higher Debt Ratio/Owner's Equity is lower</i>
	<i>so the owner is earning the same profit on a smaller investment</i>
	<i>(as the funds to finance the firm's operations are being provided by liabilities).</i>

d

More profitable firm	<i>Legends Guitars</i>
Justification	<i>Return on Assets is higher.</i>
	<i>(The business has earned the same profit using less assets.)</i>

e

Explanation	<i>Its Owner's Equity will always be lower than its assets</i>
	<i>due to its liabilities.</i>
	<i>(The extent of this difference will depend on the level of liabilities</i>
	<i>ie the Debt Ratio.)</i>

f

Indicator	<i>Asset Turnover / Net Profit Margin</i>
Explanation	<i>To assess how effectively the firm is using its assets to generate Sales /</i>
	<i>To assess how much of each dollar of Sales revenue is retained as Net Profit.</i>
	<i>Both will allow the owner to identify whether the owner should focus on</i>
	<i>revenue generation or expense control.</i>

Exercise 18.5 Return on Assets and Asset Turnover

a

ATO measures	<i>Sales revenue generated per dollar of assets controlled by the firm /</i>
	<i>how effectively the firm's assets have been used to generate Sales</i>

b

Calculation	
ATO =	$\frac{\text{Sales revenue}}{\text{Average Total Assets}}$
=	$\frac{\$300\,000}{\$200\,000}$
Asset Turnover – 2023	
	1.5 times

Calculation	
ATO =	$\frac{\text{Sales revenue}}{\text{Average Total Assets}}$
=	$\frac{\$448\,000}{\$280\,000}$
Asset Turnover – 2024	
	1.6 times

c

Explanation	<i>Sales revenue increased (by \$148 000 – almost 50%)</i>
	<i>proportionately more than the increase in Average Total Assets</i>
	<i>(which increased by \$80 000, or 40%),</i>
	<i>indicating an improved ability to use assets to earn Sales revenue.</i>

d

Explanation	<i>Asset Turnover increased (indicating an improved ability to generate revenue),</i>
	<i>but Return on Assets actually decreased (indicating worsening profitability).</i>
	<i>Given that revenue increased,</i>
	<i>the only reason for a lower Return on Assets is poorer expense control.</i>

e

Strategy 1	<i>Cheaper supplier – cheaper Cost of Sales</i>
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Chapter 18 *Evaluating Profitability* – Solutions to exercises

Strategy 2	<i>Reduce inventory loss/Better control over advertising; wages</i>
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Exercise 18.6 Asset Turnover and Net Profit Margin

a

Reason 1	<i>Asset Turnover is lower than the industry average</i>
	<i>(indicating it is not using its assets as effectively to earn Sales revenue).</i>
Reason 2	<i>Net Profit Margin is lower than the industry average</i>
	<i>(indicating it is retaining less of every dollar of Sales revenue as Net Profit).</i>

b

Benchmark 1	<i>The Return on Assets from a previous period</i>
Benchmark 2	<i>The budgeted Return on Assets</i>

c

Strategy 1	<i>Increase advertising</i>
Strategy 2	<i>Reduce selling prices (provided Qty sold increases to offset the lower SP)</i>

d

Explanation	<i>Some expenses (such as Cost of Sales and possibly Wages) are variable,</i>
	<i>and must increase in line with Sales volume.</i>
	<i>If these expenses increase in proportion to (or less than) Sales</i>
	<i>it indicates satisfactory expense control.</i>

e

	Higher / Lower / Same / Unable to be determined
Debt Ratio	<i>Higher</i>
Justification	<i>Return on Owner's Investment is higher than the industry average</i>
	<i>(in spite of Net Profit being lower).</i>

Exercise 18.7 Net Profit Margin

a

Indicator	<i>Asset Turnover has decreased.</i>
------------------	--------------------------------------

b

Reason	<i>Average total assets increased by (proportionately) more than the increase in Sales.</i>
---------------	---

c

Net Profit Margin	<i>Net Profit earned per dollar of Sales revenue</i>
	<i>the percentage of every dollar of Sales revenue retained as Net Profit.</i>

d

Calculation	
	$NPM = \frac{\text{Net Profit}}{\text{Sales revenue}}$ $= \frac{\$8\,500}{\$153\,000}$
	Net Profit Margin – 2024 5.56 %

Calculation	
	$NPM = \frac{\text{Net Profit}}{\text{Sales revenue}}$ $= \frac{\$11\,000}{\$175\,000}$
	Net Profit Margin – 2025 6.29 %

e

Explanation	<i>The Net Profit Margin has increased proportionately more than the decrease in the Asset Turnover*: although the firm has been less effective at earning Sales revenue, its expense control has improved,</i>
	<i>meaning more of every dollar of Sales revenue is retained as Net Profit.</i>

* Alternative first point:
 Net Profit has increased proportionately more than the increase in average Total Assets.

Exercise 18.8 Gross Profit Margin

Gross Profit Margin	<i>Gross Profit earned per dollar of Sales revenue /</i>
	<i>percentage of every dollar of Sales revenue retained as Gross profit</i>

Calculation

$$GPM = \frac{\text{Gross Profit}}{\text{Sales revenue}}$$

$$= \frac{\$75\,000}{\$120\,000}$$

Gross Profit Margin	62.5 %
----------------------------	--------

Strategy 1	<i>Decrease cost prices by finding a cheaper supplier / cheaper delivery company</i>
Strategy 2	<i>Increase selling prices (any strategy that would increase the average mark-up)</i>

Explanation	<i>It will increase the average mark-up and Gross Profit Margin.</i>
	<i>However, customers may be unwilling to pay the higher prices,</i>
	<i>leading to a decrease in the volume/quantity of sales,</i>
	<i>i.e. more profit per sale may be offset by fewer sales.</i>

Strategy 1	<i>Use of security measures to reduce theft / Staff training to reduce damage</i>
Strategy 2	<i>Careful checking of sales / purchases against invoice</i>

* Any strategy to reduce Inventory loss

Exercise 18.9 Gross Profit Margin

a

Reason 1	<i>Increase in cost prices, higher period costs</i>
Reason 2	<i>Decrease in selling prices (any reason causing a decrease in average mark-up)</i>

b

Explanation	<i>Increasing advertising will not change the average mark-up as it does not affect selling prices or cost prices.</i>
	<i>It may generate greater sales volume (and thus greater Sales revenue), but will not affect the gross profit per dollar of Sales revenue.</i>

c

Strategy	<i>Decrease cost prices by finding a cheaper supplier * /</i>
	<i>Decrease period costs (by finding a cheaper delivery company)</i>

d

Explanation	<i>Higher advertising will increase expenses, but should mean more Sales revenue (as more customers know about the business and its products).</i>
	<i>If the increase in Sales revenue is proportionately more than the increase in Advertising, the Net Profit Margin will increase. If not, it will decrease.</i>

e

Information 1	<i>The number of sales returns / The number of purchase returns</i>
Information 2	<i>The number of customer complaints / Number of items written off</i>

f

Limitation	<i>It only reflects the average mark-up / It relies on historical data</i>
	<i>It doesn't assess revenue earning ability; control of Other Expenses</i>

Exercise 18.10 Vertical analysis of the Income Statement

a

Reason 1	<i>Increase in advertising ie more people know about the business / its products</i>
Reason 2	<i>Decrease in Gross Profit Margin indicating decrease in selling prices</i>
Reason 3	<i>Higher wages meaning better service / Higher rent meaning better location</i>

b

Improved / Worsened	<i>Worsened</i>
Justification	<i>The Net Profit Margin has decreased (from 15% to 14%), indicating less of every dollar of Sales revenue is retained as Net Profit.</i>

c

Explanation	<i>A lower Gross Profit Margin (possibly due to lower selling prices) has generated greater Sales volume, leading to higher Sales revenue and higher Net Profit (in dollar terms).</i>
--------------------	--

d

Reason 1	<i>Adjusted Gross Profit has increased in dollar terms.</i>
Reason 2	<i>Smaller gap between Gross Profit Margin and Adjusted Gross Profit Margin indicating better management of inventory loss.</i>

e

Strategy 1	<i>Better assessment of number of staff required</i>
Strategy 2	<i>Better training to improve staff productivity / service levels</i>

f

Reason	<i>Signed a new lease at a higher rate / Moved to more expensive premises</i>
---------------	---

g

Discussion	<i>Increased Advertising expense has a negative effect on Net Profit.</i>
	<i>However,</i>
	<i>because more potential customers know about the business and its products,</i>
	<i>Sales revenue has increased,</i>
	<i>and by proportionately more than Advertising expense.</i>
	<i>As a result, Advertising expense decreased as a percentage of sales,</i>
	<i>leading to a positive effect on the Net Profit Margin.</i>
	<i>(Net Profit Margin has decreased mainly due to higher Cost of Goods Sold.)</i>
	<i>Overall, higher advertising has been beneficial for profitability.</i>

h

Information 1	<i>Staff turnover / Average length of employment</i>
Information 2	<i>Number of days lost due to sick leave/industrial action</i>

Exercise 18.11 Graphical representation of vertical analysis

a

Asset Turnover

Improved / Worsened	<i>Improved</i>
Explanation	<i>Sales increased but Total assets stayed the same,</i>
	<i>indicating an improved ability to use the same assets to earn more Sales</i>
	<i>revenue.</i>

Gross Profit Margin

Improved / Worsened	<i>Worsened</i>
Explanation	<i>Sales increased but Gross Profit didn't increase at the same rate</i>
	<i>(as shown by the lower gradient in the line graph,</i>
	<i>indicating a lesser ability to retain Sales revenue as Gross Profit</i>
	<i>(and a lower average mark-up).</i>

b

Explanation	<i>Higher Sales revenue, possibly due to</i>
	<i>lower selling prices / an effective advertising campaign / complementary</i>
	<i>products / rotation of inventory et al</i>

c

Explanation	<i>Lower average mark-up,</i>
	<i>due to lower selling prices (possibly due to a deliberate strategy to generate</i>
	<i>sales volume – which is consistent with the increase in Sales revenue)</i>
	<i>or higher cost prices charged by suppliers.</i>

d

Discussion	<i>Given that Sales revenue increased, the fall in the Gross Profit is concerning as it indicates a lower average mark-up.</i>
	<i>This means expense control as it relates to Cost of Goods Sold has worsened and strategies must be considered to improve retain more Gross Profit.</i>
	<i>However, the overall expense control has actually improved because the Net Profit Margin has stayed the same.</i>
	<i>Given the Gross Profit Margin fell, this must mean the percentage of Sales revenue consumed by Other Expenses must have actually fallen,</i>
	<i>meaning improved control of expenses like Wages, Advertising, Bad debts, and others.</i>

e

Action	<i>Find a cheaper supplier</i>
	<i>Reduce buying expenses (eg. freight in, modifications)</i>

f

Discussion	<i>In the short-term, Quick-a-Count could improve the financial performance of Clarke Doors as it would mean expenses would be 15% lower.</i>
	<i>However, the possibility that Quick-a-Count exploits overseas employees is both an ethical and long-term financial problem.</i>
	<i>Clarke Doors has an ethical responsibility to avoid trade with businesses whose activities are socially damaging, and exploiting employees is just such an activity.</i>
	<i>In the long-term, using this unethical organisation could have negative consequences for Clarke Doors as customers choose to buy from other firms who are more ethical and sales – and profits – suffer.</i>
	<i>Clarke Doors also has an ethical responsibility to consider its own employee, particularly as he has been with them for such a long time.</i>
	<i>Clarke Doors needs to weigh the short-term financial benefits against the ethical and long-term financial consequences.</i>

Exercise 18.12 Graphical representation of vertical analysis

a

Reason	<i>Increase in advertising (in dollar terms and as a percentage of Sales revenue)</i>
---------------	---

b

Explanation	<i>Rent was fixed (possibly due to a lease) at \$18 000 per year,</i>
	<i>so as Sales revenue increased it consumed less as a percentage of Sales.</i>

c

Strategy 1	<i>Better inventory management eg. rotation / physical security (e.g. cameras) /</i>
	<i>staff training / more careful checking of purchases, sales</i>
Strategy 2	<i>Reduction in inventory on hand</i>

d

	Higher / Lower / Same
Wages	<i>Higher</i>
Justification	<i>Wages is consuming the same percentage of each dollar of Sales revenue</i>
	<i>but Sales revenue has increased in 2016.</i>

e

Explanation	<i>Cost of Goods Sold has increased as a percentage of Sales revenue,</i>
	<i>meaning a lower average mark-up</i>
	<i>and less of every dollar of Sales revenue retained as Gross Profit.</i>

f

Discussion	<i>+ higher Sales revenue</i>
	<i>+ higher Asset Turnover indicates ability to earn revenue increased</i>
	<i>– lower Gross Profit Margin indicates a lower average mark-up</i>
	<i>+ constant Net Profit Margin indicates control of Other Expenses improved</i>
	<i>+ higher Sales revenue and constant Net Profit Margin means higher Net Profit</i>
	<i>+ higher Net Profit and constant assets means higher Return on Assets</i>
	<i>+/- higher Net Profit and higher Owner's Equity</i>
	<i>may mean higher or lower Return on Owner's Investment</i>

+ *Improved profitability*

– *Worsened profitability*

Exercise 19.1 Liquidity

a

Reason 1	<i>There are likely to be sources of liquid funds other than just cash in the bank, such as Accounts Receivable, inventory, and GST (refund).</i>
Reason 2	<i>The owner must also consider the level of current liabilities – the obligations that are due to be met (Accounts Payable/loans/GST payable).</i>

b

Indicator 1	<i>Working Capital Ratio</i>
Indicator 2	<i>Quick Asset Ratio</i>

c

Indicator 1	<i>Inventory Turnover /</i>
Indicator 2	<i>Accounts Receivable Turnover / Accounts Payable Turnover</i>

Exercise 19.2 Working Capital Ratio

a

Measures	<i>liquidity,</i>
	<i>ie. a firm's ability to meet its current liabilities using its current assets.</i>

b

Calculation	
	$WCR = \frac{\text{Current assets}}{\text{Current liabilities}}$ $= \frac{\$34\,000}{\$42\,500}$
	Working Capital Ratio 0.8 :1

c

Assessment	<i>The Working Capital Ratio is less than 1:1.</i>
	<i>Thus, the firm has insufficient current assets to meet its current liabilities,</i>
	<i>and may be unable to meet its short-term debts as they fall due</i>
	<i>without the aid of additional finance (such as loans or capital).</i>

d

Action 1	<i>Make a capital contribution / Reduce drawings / Organise a bank overdraft</i>
Action 2	<i>Defer the purchase of assets / Use credit facilities / Defer the repayment of loans</i>

Exercise 19.3 Working Capital Ratio

a

Explanation	<i>It has reduced, indicating less current assets for every dollar of current liabilities meaning the firm is less able to meet its short-term debts as they fall due, and may require the owner to organise or extend a bank overdraft / make a capital contribution / arrange alternative finance.</i>
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b

Explanation	<i>It is a static measure, and does not indicate the timing of cash flows (eg. when current assets will be turned into cash/current liabilities are due to be paid)</i>
or	<i>It relies on historical data, which may not result in cash flows (eg. bad debts)</i>
or	<i>It includes assets that might be difficult to liquidate quickly (eg. inventory)</i>

c

Explanation	<i>It predicts/forecasts expected cash inflows and outflows,</i>
	<i>indicating whether the business will generate sufficient cash flows</i>
	<i>to meet its obligations.</i>

Exercise 19.4 Working Capital Ratio and Quick Asset Ratio

a

Measures *immediate liquidity*

ie. a firm's ability to meet its quick liabilities using its quick assets

b

Explanation *The business will already be selling its inventory as fast as it can, so there is no guarantee that inventory can be liquidated immediately to meet immediate debts. Therefore, it cannot be counted as a source of immediate liquid funds.*

c

Calculation

$$\begin{aligned} \text{QAR} &= \frac{\text{Current assets (excl. Inventory and Prepaid exp.)}}{\text{Current liabilities}} \\ &= \frac{\$34\,400}{\$33\,500} \end{aligned}$$

Quick Asset Ratio 1.03 :1

d

Assessment *The Quick Asset Ratio is greater than 1:1.*

Thus, the firm has sufficient quick assets to meet its quick liabilities, and should be able to meet its short-term debts as they fall due.

e

Explanation *The main component of the quick assets is Accounts Receivable.*

If the business can collect its cash fast enough from its Accounts Receivable it should be able to meet its quick liabilities (the main one of which is Accounts Payable).

Exercise 19.5 Working Capital Ratio and Quick Asset Ratio

a

Explanation	<i>Large purchases of inventory on credit would</i>
	<i>increase Inventory and thus current assets and the Working Capital Ratio</i>
	<i>but not quick assets and thus not the Quick Asset Ratio.</i>

b

Explanation	<i>This means assets are idle, and not earning as much as they could:</i>
	<i>Bank (interest is relatively low) / Accounts Receivable (are not paying) /</i>
	<i>Inventory (is not selling).</i>
	<i>The funds tied up in these assets could be employed more usefully elsewhere.</i>

c

Explanation	<i>Working Capital Ratio > 1:1 means if inventory is sold fast enough to meet the</i>
	<i>Accounts Payable' terms, the business should not have liquidity problems.</i>
	<i>Quick Asset Ratio < 1:1 means if inventory is not sold fast enough to meet</i>
	<i>Accounts Payable' terms, liquidity problems could ensue.</i>

Exercise 19.6 Cash Flow Cover (CFC)

a

Calculation

$$\begin{aligned} \text{CFC} &= \frac{\text{Net Cash Flows from Operations}}{\text{Average Current Liabilities}} \\ &= \frac{\$39\,000}{\$13\,000} \end{aligned}$$

Cash Flow Cover – 2024 **3 times**

Calculation

$$\begin{aligned} \text{CFC} &= \frac{\text{Net Cash Flows from Operations}}{\text{Average Current Liabilities}} \\ &= \frac{\$35\,000}{\$10\,000} \end{aligned}$$

Cash Flow Cover – 2025 **3.5 times**

b

Explanation *Improved:*

the business has more Net Cash Flows from Operations available to meet less average current liabilities. It is more able to meet its average current liabilities using Net Cash Flows from Operations.

c

Explanation *Although Net Cash Flows from Operations has decreased (by just over 10%), average current liabilities has decreased by proportionately more (23%). There is less Operating Cash but even less current liabilities to meet with that cash.*

d

Information 1	<i>Net Cash Flows from Investing Activities/</i>
Information 2	<i>Net Cash Flows from Financing Activities / Bank Balance at start/end</i>

e

Explanation	<i>The business must be able to generate enough cash from its day-to-day trading operations otherwise it will be unable to meet its obligations</i>
	<i>without contributions from the owner, loans, or the sale of non-current assets,</i>
	<i>none of which can occur indefinitely.</i>

Exercise 19.7 Level of liquidity

a

Explanation	<i>The Working Capital Ratio includes Inventory and Prepaid Expenses that will increase the value of current assets and can be counted as sources of liquid funds in order to meet current liabilities.</i>
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b

Explanation	<i>The Working Capital Ratio is too high, which means it may have current assets that are idle / unproductive such as Bank that is earning only a low rate of interest. Inventory that is not selling / Accounts Receivable that are not paying /</i>
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c

Explanation	<i>The owner can assess individual current assets and current liabilities, to inform decision making. For example whether Bank o/draft is actually a source of cash / how much cash can be generated from inventory / Receipts from Accounts Receivable</i>
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d

Discussion	<i>With Quick Asset Ratio < 1:1, it may be difficult to meet immediate debts as quick assets are insufficient to meet quick liabilities. However, Working Capital Ratio > 1:1 indicates that there may be inventory on hand: if this can be sold (and the cash collected from Accounts Receivable) quickly enough to meet Accounts Payable' terms, it may be able to generate cash in time to meet its short-term debts as they fall due. CFC is high enough to pay CL.</i>
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e

Information	<i>Inventory on hand / Bank overdraft limit / ITO / ARTO</i>
Justification	<i>Can be used to assess possible cash from sales / Indicates extra cash available / Indicates speed of sales/ collections from Accounts Receivable</i>

Exercise 19.8 Orlando's Blooms

a

Measures	<i>the average number of days a firm takes to sell its inventory /</i>
	<i>convert its inventory into sales.</i>

b

Calculation
$ITO = \frac{\text{Average Inventory}}{\text{Cost of Goods Sold}} \times 365$ $= \frac{\$8\,000}{\$195\,000} \times 365$
Inventory Turnover
15 days

c

Reason 1	<i>It is slower than the budgeted Inventory Turnover (of 4 days).</i>
Reason 2	<i>The nature of the inventory – flowers would wilt and die in 15 days.</i>

d

Explanation	<i>The business is not generating sales fast enough, so:</i>
	<i>profit will be reduced as revenue is not earned</i>
	<i>liquidity will be reduced as cash is not generated</i>
	<i>from Sales or Receipts from Accounts Receivable.</i>

e

Action	<i>Reduce the level of inventory on hand</i>
	<i>(by reducing orders, purchasing less more often, Just in Time ordering).</i>

Exercise 19.9 Inventory Turnover

a

Explanation	<i>ITO is faster: on average it takes fewer days to turn inventory into sales.</i>
	<i>This should be beneficial for both profitability in terms of higher Sales revenue</i>
	<i>and liquidity in terms of higher cash inflows from Cash Sales</i>
	<i>and Receipts from Accounts Receivable.</i>

b

Explanation	<i>Inventory will have to be ordered very frequently, meaning higher delivery</i>
	<i>charges and/or the loss of discounts for bulk purchases.</i>
	<i>Inventory may run out, meaning sales (and profits) are lost as customers go</i>
	<i>elsewhere / It may indicate SP is too low, meaning less Gross Profit</i>

c

Explanation	<i>Higher selling prices are likely to lead to a slower Inventory Turnover</i>
	<i>as customers may be unwilling to pay higher prices, so sales may decrease.</i>
	<i>Lower selling prices are likely to lead to a faster Inventory Turnover as</i>
	<i>customers may be more willing to purchase inventory, so sales may increase.</i>

d

Limitation	<i>Inventory Turnover relies on averages</i>
	<i>– the actual turnover of individual lines may be very different to the average.</i>

e

Explanation	<i>Inventory cards can be used to identify fast-moving and slow-moving lines,</i>
	<i>so that steps can be taken to increase the speed at which they sell,</i>
	<i>or shift to faster moving items.</i>

Exercise 19.10 Accounts Receivable Turnover

a

Measures	<i>the average number of days a firm takes to receive cash from its Accounts Receivable.</i>
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b

Calculation
$ \begin{aligned} \text{DTO} &= \frac{\text{Average Accounts Receivable}}{\text{Credit Sales}} \times 365 \\ &= \frac{\$6\,000}{\$45\,000} \times 365 \end{aligned} $
Accounts Receivable Turnover 49 days

c

Satisfactory / Unsatisfactory	<i>Unsatisfactory</i>
Justification	<i>It is greater than the credit terms offered to customers (40 days), i.e. Accounts Receivable are taking too long to pay.</i>

d

Strategy 1	<i>Conduct extensive credit checks before granting credit</i>
	<i>Offer discounts for early payment</i>
Strategy 2	<i>Contact slow-paying Accounts Receivable by phone or letter</i>
	<i>Threaten legal action</i>

e

Explanation	<i>The majority of its sales are for cash,</i>
	<i>and its Inventory Turnover is 21 days,</i>
	<i>which means it should be able to generate cash in time</i>
	<i>to meet its Accounts Payable and other obligations.</i>

Exercise 19.11 Accounts Receivable Turnover and Inventory Turnover

a

Explanation	<i>It takes 46 days to sell inventory, and a further 25 days to collect cash from Accounts Receivable, meaning it takes 71 days to generate cash, but Accounts Payable (suppliers) only allow 60 days. I.e. the firm is not generating cash quickly enough to meet its Accounts Payable on time.</i>
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b

Fact 1	<i>Inventory Turnover is worse than it was in 2024.</i>
Fact 2	<i>AR TO is lower than the credit terms offered to customers (40 days).</i>

c

Explanation	<i>Purchasing inventory means either a decrease in cash (for cash purchases) or an increase in Accounts Payable (for credit purchases);</i>
	<i>it must therefore be sold quickly in order generate cash</i>
	<i>to meet obligations to Accounts Payable and other suppliers.</i>

d

Strategy 1	<i>Increase advertising</i>
Strategy 2	<i>Reduce selling prices</i>
Strategy 3	<i>Reduce the level of inventory on hand / change ordering practices</i>

e

Benefit	<i>May generate greater sales</i>
	<i>Receive cash faster from Accounts Receivable</i>
Cost	<i>Receive less cash</i>
	<i>Discount expense decreases Net profit</i>

f

Explanation	<i>Slow-paying Accounts Receivable will be refused credit;</i>
	<i>meaning only reliable Accounts Receivable – who are likely to pay on time –</i>
	<i>will be extended credit.</i>

Exercise 19.12 Accounts Payable Turnover

a

Measures	<i>the average number of days a firm takes to pay cash to its Accounts Payable.</i>

b

Calculation	
$APTO = \frac{\text{Average Accounts Payable}}{\text{Credit Purchases}} \times 365$	
$= \frac{\$10\,000}{\$91\,250} \times 365$	
Accounts Payable Turnover	40 days

c

Reason 1	<i>It is greater than the credit terms offered by suppliers (30 days).</i>
Reason 2	<i>It has increased (from 34 days in 2024).</i>

d

Consequence 1	<i>Loss of discount for early payment / Reduction in credit rating</i>
Consequence 2	<i>Loss of credit facilities</i>

e

Discussion	<i>Retaining cash longer – can be used for other purposes</i>
	<i>Can leave time to sell inventory and collect cash from Accounts Receivable</i>
	<i>before payments are made</i>
	<i>However</i>
	<i>loss of potential discounts</i>
	<i>negative effect on reputation and credit rating – loss of credit facilities provided</i>
	<i>by suppliers</i>
	<i>Ethically, suppliers cannot make payment as have not received cash</i>
	<i>Financial pressure on supplier and rest of economy.</i>

Exercise 19.13 Inventory Turnover, Accounts Receivable Turnover and

Accounts Payable Turnover

a

Reason 1	<i>Greater advertising / lower selling prices / inventory that is in high demand</i>
Reason 2	<i>Lower inventory on hand (JIT ordering / smaller, more frequent purchases</i>

b

Strategy 1	<i>Contact by phone or letter to remind Accounts Receivable to pay</i>
Strategy 2	<i>Threat of loss of credit facilities / Legal action</i>

c

Explanation	<i>Much slower Accounts Receivable Turnover</i>
	<i>means more days to collect cash from Accounts Receivable, so the business</i>
	<i>does not have cash fast enough to meet Payments to Accounts Payable on</i>
	<i>time, leading to an increase in Accounts Payable Turnover</i>

d

Indicator	<i>Working Capital Ratio / Quick Asset Ratio</i>
Explanation	<i>If it has sufficient liquid reserves –</i>
	<i>particularly in the form of cash in the bank or an overdraft –</i>
	<i>it will be able to meet its short-term obligations as they fall due.</i>

Exercise 19.14 Analysing liquidity

a

Information 1	<i>Previous years' ITO / Budgeted ITO / Industry averages for ITO</i>
Information 2	<i>Level of Inventory on hand</i>

b

Discussion	<i>Working Capital Ratio is greater than 1:1 indicating that current assets are sufficient to meet current liabilities and that liquidity is satisfactory.</i>
	<i>However it could be argued that it is too high</i>
	<i>meaning current assets could be idle: Bank could be earning low interest;</i>
	<i>Accounts Receivable may not be paying; and Inventory may not be selling.</i>
	<i>Quick Asset Ratio is actually below 1:1 indicating that if I cannot be sold fast enough the business has insufficient quick assets to meet its quick liabilities.</i>
	<i>Inventory Turnover indicates that inventory is selling more slowly and</i>
	<i>this has negative consequences for liquidity as cash is generated more slowly.</i>
	<i>Even though most sales are on credit, the speed of Inventory Turnover is still</i>
	<i>barely fast enough to meet the terms offered by Accounts Payable.</i>
	<i>Accounts Receivable Turnover is faster (than previous years and the credit terms offered to customers) and this may indicate improved management</i>
	<i>and collection techniques.</i>
	<i>However, the time taken to sell inventory and collect cash has increased to</i>
	<i>more than 80 days,</i>
	<i>much longer than the 60 day credit terms offered by suppliers.</i>
	<i>This explains why the Accounts Payable Turnover has slowed over the period,</i>
	<i>but could result in a lower credit rating and even a loss of credit facilities.</i>

c

Action 1	<i>Increase sales – change prices / advertise / rotate, change inventory mix</i>
	<i>Decrease inventory on hand – change ordering</i>
Action 2	<i>Negotiate with Accounts Payable</i>
	<i>Contribute cash</i>

Exercise 19.15 Analysing profitability and liquidity

a

Indicator 1	<i>Asset Turnover / Net Profit Margin</i>
Indicator 2	<i>Return on Assets (given both ATO and NPM have increased)</i>

b

	Higher / Lower
Return on Assets	<i>Higher</i>
Justification	<i>Both Asset Turnover and Net Profit Margin have increased</i>

c

Discussion	<i>Lower selling prices helped generate increase sales volume,</i>
	<i>resulting in higher Sales revenue and a higher Asset Turnover.</i>
	<i>It also meant faster Inventory Turnover which improved by 11 days.</i>
	<i>However, the lower mark-up did mean Gross Profit Margin fell</i>
	<i>meaning less of each dollar of sales is retained as Gross Profit.</i>
	<i>Having said that, the increase in Net Profit Margin indicates that the increase</i>
	<i>in Sales was enough to cover Other Expenses.</i>
	<i>(It is also possible that expense control improved.)</i>

d

Discussion	<i>Faster Inventory Turnover is beneficial for liquidity as cash is generated faster and this might explain why the Working Capital Ratio has fallen.</i>
	<i>Working Capital Ratio is still satisfactory as it is above 1:1 which means the business can meet its short-term debts as they fall due, but Quick Asset Ratio of less than 1:1 indicates this is only true if Inventory is sold quickly enough.</i>
	<i>Accounts Receivable Turnover has slowed and cash is still collected after the credit terms offered to customers meaning collection techniques need to improve. Taken together with the Inventory Turnover, the cash cycle is 157 days – too slow to meet the credit terms offered by suppliers and this could mean a loss of credit facilities.</i>
	<i>The fact that Accounts Payable Turnover has actually decreased means the business has used other funds, maybe by running down a large cash balance or by making a cash contribution.</i>
	<i>However, neither of these strategies is sustainable over time.</i>

e

Action 1	<i>Improve ARTO – credit checks // offer discounts / reminder calls</i>
	<i>Capital contribution / Loans to purchase non-current assets</i>
Action 2	<i>Reduce drawings / defer loan payments</i>